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# Domestic Resource Mobilization in Sub-Saharan Africa: The Case of Cameroon#

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## I. INTRODUCTION

Starting from 1986, Cameroon experienced negative economic growth averaging almost 4 percent per annum. Growth turned positive following the 1994 CFA franc devaluation agreed upon by Cameroon, its Franc Zone partners and France. The economy witnessed positive economic growth averaging almost 5 percent per annum in the years following the devaluation, but started slowing down after 2001 and by 2005, GDP growth was only 2.3 percent, though IMF projections indicate a growth rate of 4.1 percent in 2009 and 4 percent in 2010 (IMF, 2009b). According to ECA (2001) and the World Bank (2001), poor countries in Sub-Saharan Africa require GDP to grow annually at 7 percent if they are to attain the MDGs by 2015; and to achieve this growth rate, domestic investment will have to increase by 50 percent and aid by 20 percent. Cameroon's growth rate, though expected to be higher in the coming years, will be much lower than that required to have any significant impact on poverty. Any hope therefore, of raising growth and meeting the MDGs requires raising the level of investment (both public and private) which should stimulate growth. Increased investment requires the mobilisation of additional resources, both domestic and foreign.

Scaling up ODA has been the focus of the international development community as far as financing the MDG is concerned. Enhancing the potentials for mobilising domestic revenue has been neglected in international development, as donors are pessimistic about the capacity of developing countries to raise revenue locally. This study argues that a greater share of resources for development should be mobilised within the country than from external sources. Unlike resources mobilised domestically, foreign resources may not reflect local development objectives and priorities<sup>1</sup>, but driven by profit motives of foreign private investors or political objectives of donors and creditors. According to Culpeper and Bhushan (2008, p.3), the quantity of foreign resources might not only be insufficient, unpredictable and unsustainable, but they will not "fit" the needs of many sectors. UNCTAD (2007: p.1) adds that "reducing dependence on donor funds and associated conditionalities would increase "ownership" of the development process whereby these resources could be used to fund countries' own priorities rather than those of the donors". There is also both theoretical and empirical evidence that resources mobilised domestically will enhance investment, productivity and growth in poor countries (Culpeper and Bhushan, 2008), relative to foreign aid. A political economy argument for increased DRM relates to the fact that governments reliant on external resources are not accountable to their citizens, but instead answerable to suppliers of these resources. Such dependence on non-citizens erodes the quality of governance (Knack, 2001). Furthermore, the recent international financial crisis affected many donor countries, shifting their attention away from international development issues to a domestic agenda. Such a situation poses some risks for countries that are highly dependent on international assistance.

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<sup>1</sup> These arguments are well articulated in Culpeper and Bhushan (2008).

How therefore can Cameroon increase the level of resources mobilised locally for its development? An attempt to answer this question must first recognise the restricted policy space at the disposal of the government. Cameroon is constrained because it cannot unilaterally adjust monetary, fiscal and even trade policies because of its membership of the sub-regional economic and monetary union – CEMAC. Membership of the BEAC Zone virtually deprives Cameroon of an independent monetary and exchange rate policy stance. Cameroon's participation in the CEMAC fiscal convergence initiative<sup>2</sup> also restricts its macroeconomic policy instruments. CEMAC member countries practice free trade and impose a common external tariff on its trading partners, implying that Cameroon cannot unilaterally alter its tariff rates. Donor conditionalities, add to narrow policy ownership, even though Cameroon is not an aid-dependent<sup>3</sup> country. Although membership of CEMAC constraints policy space, it also provides others benefits<sup>4</sup> to the economy that go beyond DRM. For example, CEMAC membership imposes some policy discipline with likely positive effects on macroeconomic stability, debt sustainability, policy predictability and credibility through peg with euro, risk sharing and possibility to cope with negative external shocks through pooled reserves. CEMAC arrangements also allow for sub-regional DRM institutions, which could be more effective than similar institutions at the individual country level, like the bank supervisory authority - COBAC. Our intention in this study is not to individually evaluate the effect of the various components of the reduced policy space on DRM, but to view them as signpost as we examine the opportunities of improving DRM in Cameroon. Such constraints should, however, not be seen as insurmountable hurdles. The question is therefore how Cameroon, given such constraints and its potentials, can increase its level of DRM in both public and private sectors. This project defines 'domestic resources' as "fiscal and financial resources accruing within the domestic economy". This includes private-corporate and household savings; corporate profits and retained earnings; and public sector revenue (Culpeper and Bhushan, 2008, p.6).

The need to improve the rate of domestic resource mobilization is not, however, a new concern in Cameroon. It has been one of the policy goals of adjustment programmes, starting with the World Bank's financial-sector adjustment loans and continued with IMF's PRGF arrangements. These initiatives have aimed at removing restrictions on financial intermediation and enhancing non-oil revenue mobilisation with specified DRM targets. The attainment of such targets has influenced the scope of cooperation with these IFIs and the disbursement of funds. Letters of Intent and Memorandums of Economic and Financial Policies from the government to the IMF always indicated how far Cameroon is meeting these targets or asking for waivers when they are not met. In the Letter of Intent before the sixth and last review of PRGF, the Prime Minister requested a waiver. The Prime

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<sup>2</sup> The four convergence criteria established by these countries are as follows: the primary budget balance as a ratio of GDP to be positive or nil; an annual inflation rate of less than 3 percent; a debt/GDP ratio (both internal and external) of 70 percent (or less); and the non-accumulation of internal and external arrears (CEMAC, 2004).

<sup>3</sup> A country is usually said to be aid-dependent when the ODA/GNI ratio exceeds 10 percent

<sup>4</sup> Iossifove et al. (2009, p.11) note that "The revealed preference of the political establishments in member countries for monetary union suggests that the advantages of CEMAC membership exceed its opportunity costs". The authors regret that CEMAC members have yet to reap the potentially large benefits of closer intraregional integration. Others studies compare various aspects of Franc Zone membership with non-members: Elbadawi and Majd (1992), Devarajan (1997), Devarajan and Hinkle (1994), Khan and Baye (2005), etc.

Minister noted that<sup>5</sup> “the government is requesting a waiver for non-compliance of the performance criterion related to the non-oil primary balance, owing to the poor performance of non-oil revenue in the first half of 2008, in particular, lower than expected non-tax revenue” (IMF, 2009b, p.24). Therefore, despite the targets set by Cameroon and its multilateral partners, there are still difficulties raising enough resources domestically.

Table A4 in the appendix indicates how Cameroon’s fiscal variables are less dependent on international assistance. Between 2003 and 2005, grants to government averaged, only 0.5 percent of GDP compared with 16.3 percent to government revenue i.e. grants averaged just a tiny fraction of total government revenue. On the contrary, the share of foreign assistance in government capital expenditure is substantial. Foreign-financed investment averaged 0.6 percent of GDP between 2003 and 2006, to which we can add 0.3 percent financed from debt relief. Capital expenditure from government-own resources was 1.2 percent within the same period. This implies that about 38 percent of government capital expenditure within this period was financed with foreign assistance. However, as a share of total government expenditure, grants (including debt relief) represented only 6 percent. This indicates that government relies more on foreign assistance for capital expenditure than current expenditure, but that total government expenditure is not dependent on foreign aid.

Cameroon is relatively well endowed with both natural and human resources, but seems unable to use such resources to build the institutions and capacity required to raise substantial resources locally. The oil sector has been contributing significantly to state revenue, but production has been declining over the years. From a peak of 186,000 barrels/day in 1985, oil output in 2005 was only 82,337 barrels/day<sup>6</sup>. Cameroon has not seen any significant discoveries as production from the old oilfields depletes and government continues with efforts to attract oil companies to develop marginal and deep-water offshore fields. In the wake of the financial/economic crisis, oil prices<sup>7</sup> fell by more than 60 percent from their August 2008 levels when it was selling for almost US\$150/barrel. Timber exports also plummeted as the housing sector dipped into crisis in timber importing countries. This is an indication of how reliance on export income from primary commodities may not be a sustainable long run option. Seeking for ways to increase DRM and reduce dependence on aid and volatile export income should be the ambition of the Cameroon government.

Cameroon’s DRM indicators are below expectations as tax revenue averaging about 16 percent of GDP is lower than the African average of almost 22 percent in 2002 (World Bank, 2005). Similarly, Cameroon

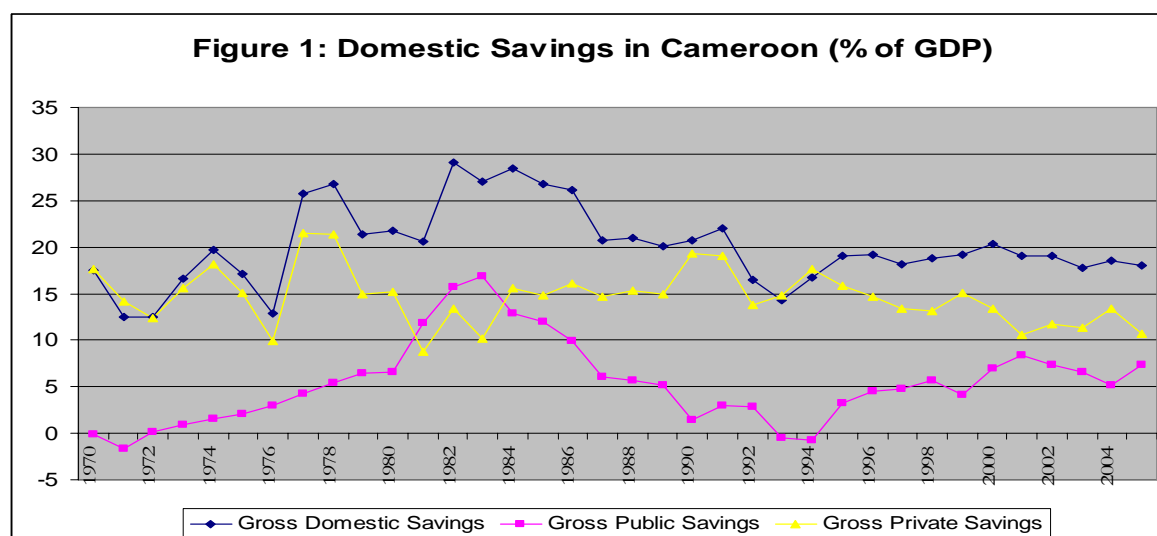
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<sup>5</sup> From Cameroon’s letter of intent addressed to the Managing Director of the IMF on December 11, 2008

<sup>6</sup> AfDB/OECD (2007) “African Economic Outlook”.

<sup>7</sup> If prices were to stay at their present levels or especially fall below US\$50/barrel as predicted, then Cameroon will face some tough liquidity problems in the near future

performs poorly in terms of savings rates (see Figure 1<sup>8</sup>). After rising above 25 percent in the early 1980s due to the oil boom, the rate of gross domestic savings in Cameroon has remained below 20 percent since 1992 to date. It stood at 18.8 percent in 2006, compared with 26.0 percent in South Asia, 24.0 percent in Latin America and the Caribbean, and nearly 42.9 percent in East Asia and Pacific countries, though higher than the Sub-Saharan African average of 17.6 percent (Aryeetey, 2009). The private savings rate which rose to more than 20 percent in the late 1980s, has fallen below 15 percent since 1996 and was only 10.7 percent of GDP in 2005. Public savings have performed worse following the peak of almost 17 percent in 1983. Public savings followed a declining trend from 1983 to hit a trough of -0.8 percent in 1994, then to rise gradually and fluctuate below 10 percent of GDP.



The overall objective of this study is to assess the potentials and constraints of Cameroon mobilising resources locally to finance its development and consequently reduce its dependence on foreign resources. The specific objectives are:

- a. To examine the policy environment and performance of DRM in Cameroon;
- b. To identify the binding constraints to public and private sector resource mobilisation;
- c. To examine the opportunities of enhancing DRM in both the public and private sectors in the context of tight policy space due to membership of an economic and monetary union.

The rest of this report is organised as follows: Section II puts the work in context with a brief overview of the Cameroonian economy, while Section III examines DRM policy, performance, constraints and

<sup>8</sup> Figure 1 is drawn with data from WDI (government final consumption expenditure, gross domestic savings, current GDP and exchange rate), IMF (WEO) (central government total revenue and grants) and OECD-DAC (ODA grants disbursements). Public savings have been computed as government revenue (excluding grants) less general government consumption expenditure. Private savings then derived as total savings less public savings.

opportunities in the public sector. Section IV carries out a similar exercise as Section III, but now in the private sector. The results are summarised and the strategies for enhancing DRM are outlined in the conclusion in Section V.

## **II. Brief Presentation of the Cameroonian Economy**

Cameroon is located in Central Africa with a total surface area of 475 650 km<sup>2</sup> and population estimated at 19.4 million inhabitants in January 2010. It is bordered to the west by Nigeria, to the northeast by Chad, to the east by the Central African Republic, to the south by Congo, Gabon and Equatorial Guinea. Germany colonized Cameroon and after the First World War, it was placed by the League of Nations under the trusteeship of France (for East Cameroon) and Britain (for West Cameroon). Both West and East Cameroon came together after independence to form what is today the Republic of Cameroon. After a long period of one-party rule in the wake of independence, multiparty politics was reintroduced in 1990. Current President, Paul Biya, has been in power since 6<sup>th</sup> November 1982.

In the years following independence (1960s and 1970s), the economy of Cameroon performed fairly well with GDP growth averaging 5.7 percent per year. This growth was essentially from the agricultural sector with cash crops such as cocoa, coffee and cotton, and other subsistence crops. Agriculture accounted for almost 40 percent of GDP. With the discovery and exploitation of crude oil as from 1978, the rate of GDP growth moved up rapidly to about 10.1 percent per year (World Bank, 1995). Oil became a major source of government revenue as oil prices surged in 1979-80, accounting for two-thirds of export earnings and nearly half of government revenues. Growth remained strong until 1985 when the fortunes of the country started changing.

After 1985, Cameroon's terms of trade deteriorated sharply because of plummeting prices of its exports (crude oil, cocoa and coffee). Terms of trade declined consequently by nearly 40 percent (Ghura, 1997). This was aggravated by the overvaluation of the CFA franc, which was pegged to the French franc. Growth averaged -4.0 percent between 1986/87 and 1992/93. Incomes and consumption declined by nearly one-half within the same period. This led to widespread poverty and large unmet social needs. The country's education and health systems, civil service and infrastructure deteriorated rapidly. Poor farmers suffered the brunt of the fall in producer prices. The huge external debt contracted to fund the large balance of payment deficit, became unserviceable and arrears mounted. Cameroon reluctantly signed the structural adjustment programme with the Bretton Woods institutions in 1988 when its foreign exchange reserves were almost depleted and it had accumulated massive domestic and external arrears.

Cameroon signed its first standby arrangement with the IMF in 1988 and the World Bank's first structural adjustment loan followed in 1989. However, both programs ran into immediate implementation problems, and a significant share of commitments was cancelled. This pattern was repeated for three subsequent standby arrangements with the IMF as reform efforts failed numerous times during the crisis period. Implementation of structural reforms was plagued by political turmoil and social disturbances. During this period, Cameroon developed a reputation of a reluctant reformer. In light of a poor track record with reforms, most creditors curtailed their lending programs, and by 1993, France remained as the key creditor, accounting for 78 percent of net ODA disbursements.

Given the magnitude of the macroeconomic imbalances, it became clear by the end of 1993 that internal adjustment alone has not been sufficient to put the economy back on its rails. To remedy this situation, the CFAF, pegged to the French franc in 1948 was reluctantly devalued by 50 percent in January 1994. Terms of trade recovered and GDP growth became positive. The donor community reacted promptly. By March 1994, Cameroon signed a third standby with the IMF and her debt with Paris Club was rescheduled a few days later. Despite these positive developments, the burden of the external debt remained significant. By end of June 1999, the total debt stock stood at US\$7802 million in nominal terms<sup>9</sup> and was unsustainable as the present value of debt to export ratio exceeded 150 percent, and the present value of debt to budget revenue exceeded 250 percent. Cameroon was consequently admitted into the HIPC initiative in June 2000. After satisfactorily meeting a number of triggers, she attained the HIPC decision point in October 2000. This opened new prospects for the country, thanks to resources from the HIPC decision point debt relief that were dedicated to fight poverty.

The satisfactory implementation of the three-year economic and financial program 1997-2000 and other reforms outlined in the interim-PRSP improved macroeconomic stability and laid the basis for sustained economic growth. From 1996/1997 to 2003, annual real GDP growth averaged about 4 percent. Inflation was held below 2 percent and the current account deficit excluding official transfers declined and terms of trade improved. The major target now was to attain the enhanced HIPC completion point, which was expected to give way to significant debt relief, thus providing the government with huge financial resources to finance its growth and poverty alleviation programmes. The completion point was initially expected for 2003, but due to difficulties in implementing required reforms, Cameroon had to wait until April 2006. Among the hurdles to HIPC completion point were governance related issues and the preparation and satisfactory implementation of the final PRSP for at least one year.

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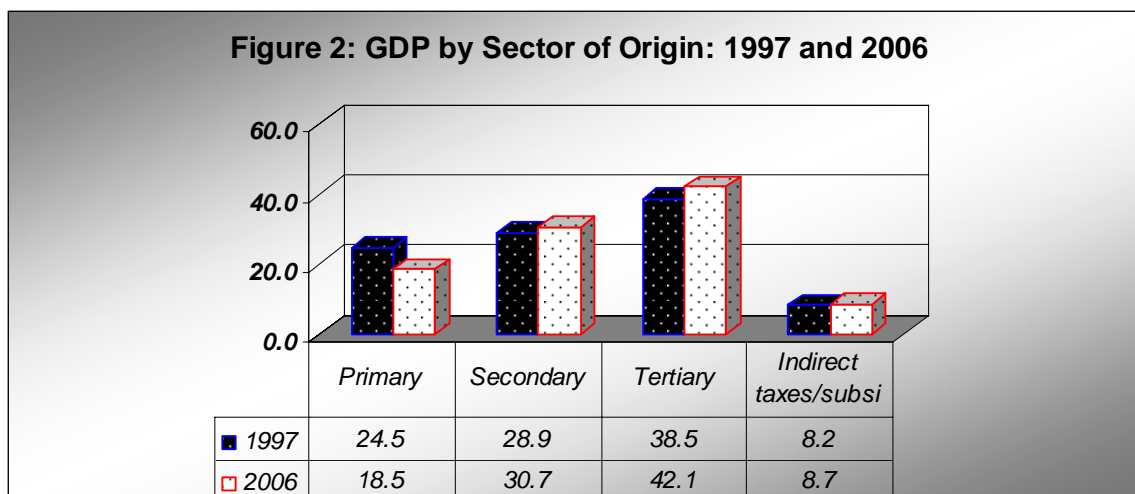
<sup>9</sup> See "Decision Point Document for the EHIPC Initiative", Table 3

On reaching the completion point of the enhanced HIPC Initiative, Cameroon also qualified for the Multilateral Debt Relief Initiative (MDRI), and also benefited from the *Contrat de Désendettement et de Développement* (C2D – France’s debt relief initiative) which implied additional resources to finance development. The population was very expectant of the fallouts of the Completion Point in terms of increased salaries for public sector employees, employment opportunities, increased investment, etc. These have been slow to come and in late February 2008, street demonstrations were organised against rising commodity prices and cost of living. The government was forced to take measures including increase in public sector salaries and the reduction of tariffs on some essential commodities.

Cameroon completed its second Poverty Reduction and Growth Facility (PRGF) (2006-2008) programme with the IMF early 2009 (initially slated to end in 2008). The aim of the programme was to strengthen Cameroon’s fiscal position, preserve macroeconomic stability, promote investment and boost poverty reduction. Efforts are also being made to improve execution of capital spending through a medium-term expenditure framework (MTEF), especially in health, education and rural development. This is in view of achieving the MDGs by 2015. Preliminary results of the 2007 Household consumption survey indicate that 39.9 percent of the population is below the poverty line, slightly below 40.2 percent recorded from the 2001 survey. This result indicates that Cameroon is still far away from halving poverty by 2015 and it will require a miracle for this to happen. The average national poverty incidence conceals important disparities between the regions (urban Vs rural and the Southern Vs the Northern part of the country) and the various social categories (gender, level of education, household size, occupation, etc.).

Cameroon’s GDP is estimated at US\$18.3 billions in 2006. The sectoral distribution of GDP in Cameroon (see Table A1 in the Appendix) has been shifting over the years in favour of the tertiary sector and against the primary sector. Agriculture that contributed almost 40 percent of GDP after independence is now accounting for less than 15 percent, with the entire primary sector contributing only 18.5 percent in 2006, as against 24.5 percent in 1996. Livestock, fishing and forestry now account for less than 5 percent of GDP in Cameroon.





The contribution of the secondary sector has been fluctuating between 26 and 31 percent over the past ten years. From 28.9 percent in 1996, it dropped to 26.6 percent in 2000 and then started rising again to attain 30.7 percent in 2006. Manufacturing and mining (especially crude oil) activities have been the main drivers of the secondary sector, contributing respectively 16.8 and 10 percent of GDP in 2006. The tertiary sector has been the principal source of GDP growth in Cameroon for several years now. Its contribution has increased from 38.5 in 1996 to almost 49 percent in 2001, and then declined again to 42 percent in 2006. Non-marketable government services, telecommunication and financial services contribute significantly to activities in the tertiary sector. Over the 10-year period (1997 to 2006), the contribution of the primary sector has decreased by 6 percent, while the secondary and tertiary sectors have gained about 2 and 4 percent respectively (Figure 2).

Cameroon generally enjoys a low inflation rate thanks to monetary union arrangements and the macroeconomic convergence initiative requiring inflation to be less than 3 percent. The fuel and food crisis significantly raised inflation, forcing government to freeze fuel prices and lower taxation of some basic commodities. Inflation peaked at almost 5 percent by December 2008. It is on a downward trend and projected to remain under 3 percent (IMF, 2009b).

### III. The Public Sector and DRM in Cameroon

#### 1) Tax Reforms and Performance in Cameroon

##### a) An Overview of Tax Policy in Cameroon

On January 24, 1994, the government undertook a major reform of its tax and trade policy; following on the heels of the 50 percent currency devaluation. The reforms were initiated in the phase of declining government revenue, rising fiscal deficit, rising inequalities and distortions, and corruption among administrators. Government total revenue had fallen by 51 percent between 1985 and 1991. These reforms were not only motivated by the need to restore fiscal balance, but were largely in compliance with the conditionality of the IFIs and the need to foster regional integration between fellow UDEAC members. Before these reforms<sup>10</sup>, the government of Cameroon relied on a tax regime that bore the traits of its colonial past and its UDEAC membership through the Treaty of Brazzaville<sup>11</sup>.

Apart from UDEAC arrangements, Cameroon instituted a series of selective taxes and tariff exemptions which made the whole system very cumbersome. It comprised several special tax plans and a system of negotiating tax rates on a case-by-case basis between individual enterprises and the tax authorities. This gave rise to administrative discretion and corruption and firms invested significantly in lobbying in order to receive and maintain the special status. Firms not benefiting from the special status or exemptions were taxed heavily through a variety of direct and indirect taxes (Fambon, 2006). Gauthier et al. (2002, p.468) list five different tax arrangements that gave rise to different payments, and firms involved in international trade faced other fiscal obligations. For example, importers of intermediate goods paid four additional taxes (three due to the UDEAC arrangement and one imposed unilaterally by Cameroon). The tax regime became what Gauthier et al (p.451), describe as “one of the most complex and unfair system of taxes and duties in Sub-Saharan Africa”. The different investment codes provided other tax exemptions, including the establishment of the free trade zone/point in 1990 covered by special legislation. The result was a regime with a highly diversified structure that encouraged evasion, administrative discretion and corruption. The tax base was highly narrowed by the exemptions and the government relied more on tariffs for its revenue than on domestic direct and indirect taxes resulting from local productive activities (Fambon, 2006, p.4).

The major innovations of the 1994 reforms were among others, to reduce the number of taxes, eliminate special treatments and exemptions, reduce evasion, introduce a quasi-value-added tax<sup>12</sup> and reduce tariff rates. The reforms can be divided into its foreign trade and indirect tax revenue components<sup>13</sup>. As concerns foreign trade taxes, a common external tariff (CET<sup>14</sup>) replaced the four tariff

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<sup>10</sup> Gauthier et al. (2002) and Fambon (2006) also discuss the tax system before the 1994 reforms.

<sup>11</sup> The Treaty of Brazzaville was signed by UDEAC member countries in 1964 requiring their tax systems and trade regimes to conform to regional standards (Fambon, 2006; p.2). UDEAC was transformed in 1994 to CEMAC. The objective of the transformation was to give a new impulse to regional integration in Central Africa through increased harmonisation of the policies and legislations of the various countries.

<sup>12</sup> Gauthier et al (2002, p.471) describe it as a quasi-VAT because firms initially paid taxes on their purchases, and then periodically applied to the government for reimbursements. The complete VAT went operational in Cameroon on January 1, 1999 following another fiscal reform

<sup>13</sup> See Fambon (2006, pp.4-5) and Gauthier et al. (2002, p.470-1):

types that were applied to imports from countries outside the UDEAC. Also, all privileges related to foreign trade under the Investment Code and special production regimes (*tax unique* - TU, *tax intérieure à la production* - TIP) were eliminated. A generalised preferential tariff was introduced on trade between UDEAC countries, with an initial rate fixed at 20 percent of the CET, but scheduled to be eliminated by January 1, 1998. Tariff rates were reduced and imports classified into four categories with rates ranging between 5 and 30 percent, as compared to 0 and 500 percent in the former system. Each country was allowed to freely define additional protection in the form of a temporary surcharge, at a rate not exceeding 30 percent, and an excise duty.

The following changes were introduced as regards indirect taxation: elimination of all indirect tax privileges; introduction of a turnover tax (a prelude to the implementation of a VAT) applicable to domestic production, imported inputs, and intermediary products, replacing sales and production taxes; and the creation of a mechanism for levying excise taxes on certain products.

Another major step in tax reforms in Cameroon was the introduction of the value-added tax in January 1999, replacing the turnover tax. It was imposed at the unique rate of 18.7 percent on economic activities such as production, imports, provision of services, distribution, construction, mining, agriculture, agro-industry, forestry, arts and craft, and the liberal professions. The VAT is accompanied by an *ad valorem* excise tax of 25 percent meant to discriminate against some particular goods. Products subject to excise duties are tobacco/cigarettes, alcoholic beverages, perfumes and colognes, cosmetic and make-up products, hair lotions, precious stones and metals, jewellery, etc. In 2005, the VAT rate was increased from 18.7 to 19.25 percent in response to stagnating fiscal revenue.

The personal income tax has also undergone reforms starting in 2004. The thrusts of the reform were: to relief low-income taxpayers; harmonise tax rules and other retirement benefits; reinforce control of incomes declared by taxpayers eligible under the income tax regimes applying to handicrafts, commercial and industrial profits; and creation of specialised tax centres with a view to improving the monitoring of tax declarations by professionals (*professions libérales*). Personal income tax rates are progressive and range from 10 percent to 35 percent. The government also introduced a property tax, starting in the two major cities of Douala and Yaoundé

Reforms were also implemented to improve the organisation and functioning of the tax administration. One of the major innovations was the creation of a special unit responsible for managing major taxpayers and big enterprises. The large taxpayers' unit is expected to improve tax revenue mobilisation

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<sup>14</sup> Before the introduction of CET, there was a unique external tariff (Tarif Extérieur Unique – TEU) adopted in December 1965 within UDEAC. The TEU existed alongside other complementary taxes on many imported goods, at rates independently fixed by each member country.

effort, thanks to the enhanced control and collection of arrears owed by the companies concerned. Other reforms included the establishment of a taxpayer registration system; an initiative to educate taxpayers; and the upgrading of the data processing capabilities of tax administration to facilitate tax management. As concerns customs administration, a number of measures have been taken: implementation of the electronic one-stop shop at the port of Douala to facilitate foreign trade (GUCE<sup>15</sup>); strengthening of the joint tax-custom unit computer links to facilitate data exchange between the information systems of the tax and custom departments; and improving physical and documentary inspections for the release of goods.

Even after the different reforms, there are still some exemptions in the tax system in Cameroon. The principal source of tax exemptions has been the Investment Codes<sup>16</sup>, though the Investment Charter adopted in 2002 (but still to be fully operational as some of its institutions have not been created) lays more emphasis on creating a conducive business environment for private sector activities.

In the phase of the failure of previous reforms to have a significant impact on tax revenue, the government created a Fiscal Reform Commission in April 2007 to review domestic and foreign taxation and draw up a medium-term tax reform plan. The commission comprised government departments, private sector stakeholders and civil society. In a forward to the Commission Report (République du Cameroun, 2007), the Minister of Finance justifies the need for fiscal reform to meet up with declining oil revenue and eventual signing of EPA (and the resulting decline in tariff revenue) by looking for avenues to improve internal non-oil revenue. The commission had ten sub-commissions, which covered issues related to personal income and company tax, consumption tax, tariffs and regional integration, local and real estate tax, informal sector taxation, some specific taxes, tax administration, incentive fiscal regimes, tax control, recovery and dispute settlement and the organisation/modernisation of services and simplification of procedures.

## **b) Public Sector DRM Performance in Cameroon**

Le et al. (2008) classify Cameroon as a low effort, low collection country in terms of tax revenue. Table 1 presents some components of government revenue, which indicate that for the period 2002-06, the oil sector's contribution to government revenue (including taxes and royalties) averaged less than 5 percent of GDP, much lower than 20 percent during the oil boom era. Oil revenue represented, on average less than 30 percent of all government revenue during this period, as against more than 40 percent in the 1980s. The trend in oil revenue is undoubtedly downward as oil wells dry out and no major new discoveries are made. This reemphasises the need for increasing the share of non-oil

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<sup>15</sup> GUCE is a French acronym for Guichet Unique des opérations de Commerce Extérieurs

<sup>16</sup> Khan and Bamou (2007) showed that the generous incentives through tax holidays and tariff exonerations granted by the Investment Codes did not have expected effect of attracting FDI into the country

revenue in total government revenue. However, recent data does not indicate any clear increasing trend in non-oil revenue. As a share of total revenue, it stood at only 64.5 percent in 2006, down from 73.6 percent in 2002, averaging about 73 percent over the 5-year period on Table 1. Non-oil revenue averaged less than 13 percent of GDP over the period.

The bulk of total government revenue in Cameroon comes from taxes. Tax revenue represent on average more than 90 percent of total government revenue (excluding grants), though averaging only 16 percent of GDP during the period under consideration. This indicates a remarkable increase from the tax-GDP ratio of less than 10 percent in the late 1980s, but is far lower than the ratio of 38 percent in Algeria and Angola or the African average of 22 percent in 2002 (World Bank, 2005). Compared with similar countries, we can conclude that there is still room for improving tax performance in Cameroon. This is even more important given the declining importance of the oil sector in government revenue. After declining to 14 percent of GDP in 2004, tax revenue shows signs of an increasing trend as it stood at 17.8 percent of GDP in 2006.

**Table 1:** Components of Government Revenue

	2002	2003	2004	2005	2006
	<b>Percentage of GDP</b>				
<b>Total revenue</b>	17.5	17.7	15.2	17.3	18.9
Oil revenue	4.6	4.1	3.9	4.9	6.7
Non-oil revenue	12.9	14.2	11.3	12.4	12.2
Tax revenue	16.5	16.8	14.0	15.9	17.8
Taxes on income and profits	3.4	3.5	2.7	2.9	2.8
Taxes on goods and services	5.0	5.5	5.1	5.2	5.4
Taxes on international trade	2.2	2.2	2.1	2.1	2.2
Non-tax revenue	0.9	0.9	1.2	1.4	1.0
	<b>Percent of total revenue</b>				
<b>Total revenue</b>	100.0	100.0	100.0	100.0	100.0
Oil revenue	26.4	23.2	25.7	28.5	35.5
Non-oil revenue	73.6	79.8	74.3	71.5	64.5

Tax revenue	94.6	94.8	92.4	91.9	94.5
Taxes on income and profits	19.6	19.6	18.0	17.0	14.6
Taxes on goods and services	28.8	30.9	33.3	29.9	28.9
Taxes on international trade	12.4	12.5	14.1	12.3	11.4
Non-tax revenue	5.4	5.2	7.6	8.1	5.5

Source: IMF (2008, Table 5, p.21), IMF (2007a, Table 11, p.12) and IMF (2006, Table 6, p.31)

Taxes on goods and services (indirect taxes) are the main source of tax revenue in Cameroon (averaging 30.4 percent of total revenue), followed by taxes from income and profits (direct taxes – averaging 17.8 percent), and then taxes on international trade (12.5 percent) as indicated on Table 1. Over the period 2002-06, these components of tax revenue all stagnated at best. Direct taxes declined from 3.4 percent of GDP in 2002 to only 2.8 percent in 2006, while international trade taxes stagnated at 2.2 percent of GDP, much lower than the period before trade liberalisation. Indirect taxes increased slightly from 5 to 5.4 percent between 2002 and 2006.

## 2) Constraints to Public Sector DRM in Cameroon

Why are public sector revenues in Cameroon less than in comparator countries? Le et al. (2008, p.16) include Cameroon among countries having “their tax policies riddled with overly complex structures and multiple - largely ad-hoc - incentives that narrow the already limited tax base, create more loopholes for tax avoidance and evasion, intensify the public perception of unfairness of taxes, and generate opportunity for corruption”. This section identifies some of the constraints responsible for the poor performance of Cameroon as far as public sector DRM is concerned.

### a) A large informal sector

A survey by the National Institute of Statistics in 2005 on employment and the informal sector<sup>17</sup> in Cameroon (INS, 2006) revealed that the informal sector provides 90.4 percent of employment and

<sup>17</sup> For this survey, The National Institute of Statistics (NIS) defined the informal sector as all those production units which are not registered (and consequently do not have a tax number) and/or do not record their activities using formal accounting procedures. The NIS does not distinguish between the genuine informal sector and the illegal informal sector as we do in this report.

produces more than 50 percent of national output. The average monthly wage of US\$56.12<sup>18</sup> earned by those in the informal sector exceeds the minimum wage. However, only 24.8 percent will accept to register their business and only 38.9 percent are ready to pay any tax on their activities. These informal sector participants pay a limited amount of direct taxes and a significant share of the informal sector output does not pay the VAT.

It is important at this level to distinguish between those who genuinely carry out informal subsistence activities and whose earnings might not qualify them to pay formal sector taxes or any taxes at all, from those who remain in the informal sector simply to escape their civic obligation of paying taxes. The second group are the tax cheats and constitute the 'illegal' informal sector, not because they are involved in any criminal business activities, but simply because they are qualified to be pay formal taxes but are not doing so. The size of this 'illegal' informal sector therefore constitutes an important constraint to public sector DRM in Cameroon. Informal sector firms pay only a local tax known as the 'impôt libérateur'<sup>19</sup>.

The growth of this sector is attributable to the desire to cheat, but also to the complex procedure and costs for setting up and registering an enterprise, inefficiency of the public administration, and other bottlenecks in Cameroon. The Doing Business 2010 report (World Bank, 2009) ranks Cameroon 174<sup>th</sup> and 170<sup>th</sup> out of 183 countries, in terms of the *ease of starting a business*, and the *challenges of paying taxes* respectively. For example, to launch a business in Cameroon, it requires 12 procedures, 34 days and cost 121.1 percent of per capita income (World Bank, 2009; p.6). Moreover, these figures have only slightly improved since the Doing Business 2008 report. With all these obstacles, some entrepreneurs prefer to operate in the informal sector, consequently paying less or no taxes for their activities. Others continue to pay informal taxes through the connivance of tax administrators who enable them to scale down the size of their businesses artificially.

## **b) The high level of corruption**

Corruption in a country is widely acknowledged as an obstacle to raising more tax revenue. Transparency International generally rates Cameroon as highly corrupt and the need to fight corruption (and good governance in general) has featured prominently in discussions with the Bretton Woods institutions since the adoption of SAP in 1988. In 2004, Cameroon lost US\$575 million because of fiscal fraud (Essama, 2008). Fiscal fraud in Cameroon is attributable to both the taxpayers and tax collectors. Some taxpayers defraud the state by refusing to register, thereby paying some lower taxes meant for the informal sector and others by lowering their turnover during tax declarations. Tax collectors also

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<sup>18</sup> We have used an exchange rate (for 2005 from WDI –World Bank) of CFAF527.47 per dollar to convert average wage of CFAF29600

<sup>19</sup> The Impôt libérateur implies that the entity concerned is freed from paying other taxes.

assist in the corruption as they encourage or condone such illegal activities in return for kickbacks. Tax and custom officials are known to be a well-off class of civil servants in Cameroon, not from their normal salaries, but from bribery and corruption. Essama (2008) reports that 53 percent of the taxpayers use fraudulent methods to escape from fines and penalties resulting from fiscal fraud, and that 32 percent declare only about 25 percent of their turnover to tax officials. He concludes that the very corrupt tax system in Cameroon is largely due to the deviant behaviour of tax administrators and less to taxpayers. He finally submits that corruption is so endemic and systematic that it becomes very difficult and unfair to punish a few individuals severely, knowing well that many others (including many in authority) are also guilty.

Another aspect through which corruption constrains tax revenue is through the illicit import of goods into Cameroon. Some of these goods do not pay the required tariffs due to customs fraud, while others are smuggled through the long border with Nigeria. Once in the country, most of these goods are sold in the informal sector without paying the required taxes and therefore compete unfairly with local producers or with those who import through the legal channels. The state loses taxes from import duties, but more especially from local firms (VAT and profit taxes) losing market share from illicit goods. One of the major associations of entrepreneurs (GICAM) has recently published a report complaining about the impact of illicit imports on their activities and on state revenue. According to GICAM (2009), the local sugar company (SOSUCAM) lost 65 percent of its turnover in February 2005 because of fraudulently imported sugar in the northern part of the country. The illegal import of petroleum products (especially from Nigeria) costs the tax authorities about US\$1.8 million annually in the form of diverse taxes not paid. Finally, corruption increases the tax burden on honest tax compliers in Cameroon, and leaves the impression of a very heavy tax burden.

### **c) Low real estate and real estate income taxes**

Real estate tax and tax on income from such property, is one of the most underutilised forms of taxation in Cameroon. All owners of real estate in the headquarters of administrative units or other agglomerations benefiting from urban infrastructure or services are supposed to pay 0.1 percent of the value of the property (declared by the owner) as taxes annually. Equally, tax is supposed to be paid on any income arising from owning property, such as rents. The real estate income tax of 5 percent is supposed to be paid directly by the tenant to the tax authorities (DGI, 2008; p.47). Over the years, we have not seen any concerted effort from tax officials to collect property tax despite the fact that revenue has increased substantially over the years. Property tax revenue increased from US\$2.55 million in 2005 to more than US\$5.7 million<sup>20</sup> in 2006, despite the timid enforcement of the legislation.

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<sup>20</sup> We have used exchange rates from the various years to convert the amounts from CFAF to US dollars (sourced from WDI- World Bank)



According to the legislation, land is not supposed to serve as mortgage unless the land tax is paid regularly, and land registration is conditioned on the presentation of proof of payment of real estate tax. Equally, no litigation can be heard on a piece of land in a law court if taxes are not paid on it - for example, a landlord can only pursue a tenant legally for non-payment of rents if he pays taxes regularly on his property. None of this is strictly enforced today as people continue to acquire titles for property on which no land tax has ever been paid – paying only some small tax at the moment the title is drawn. The non-enforcement of the legislation regarding property tax, and especially that related to land ownership and income accruing thereof, constitutes a constraint to mobilising more tax revenue. One of the reasons advanced for the narrow land tax base is that, most of the land in the big agglomerations belongs to wealthy and politically well-connected people who use their political influence and wealth to avoid taxes. Another reason is that a good share of urban land belongs to the indigenous people. In addition to its commercial value, such ancestral/communal lands play an important cultural role. Taxing such land is a political hot potato to the ruling elite, given the political influence of indigenous populations and risk of social unrest.

#### **d) Tax exemptions and reductions**

The government of Cameroon has relied for a long time on generous tax incentive in the form of tax exemptions and tax holidays to promote both domestic and foreign investment. Tax exemptions can possibly erode the tax base, encourage evasion and increase the burden on tax compliers. Exemptions and reductions are evident in the three Investment Codes promulgated since independence: in 1960, 1984 and 1990, and the Investment Charter in 2002 (Khan and Bamou, 2007). For example, the 1990 Investment Code created an Export Processing Zone/Point with the following exonerations as incentives for firms to locate in the zone/point (Khan and Bamou, p.84):

- Freedom from exchange rate and price controls,
- All indirect and direct taxes were waived for the first 10 years of operation. From then on, a 15 percent tax was levied on profits. Profits were to be netted of 25 percent of the salaries paid to nationals and of 25 percent of investment expenses before tax is applied.
- Enterprises in the zone were exempt from import and export tariffs, but had to pay for services used in the process of importing or exporting.
- Enterprises were allowed to set their wage and did not have to pay dues to the National Social Security Fund if they provided parallel arrangements for their employees.
- Electricity and water were subsidized for export processing firms and telephone connection was facilitated and provided at a promotional rate for the first five years of operation.

An evaluation of the export processing zone by Nanfah (2002, p.69) indicated that the lost in government revenue from the incentives amounted to more than US\$169<sup>21</sup> million between 1993/94 and 1999/00. Gauthier and Gersovitz (1997) demonstrate that the tax base in Cameroon is eroded through exemptions and evasion.

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<sup>21</sup> Converted from CFAF to US dollars using exchange rate of 2002, since Nanfah did his evaluation in 2002

The level of tax exemptions and exonerations has since been reduced, but remains a constraint to mobilising more tax revenue. The General Tax Code for 2008 (DGI, 2008) carries 25 exemptions from the payment of the 'Patente' (or business licence tax) (Article 162). Article 162bis adds, "New enterprises are exonerated from paying any 'Patente' for the first 2 years of operations" (DGI, 2008; p.77). Some of these exemptions are justified but certainly not all. Also important to note is the tax privileges granted firms that enlist on the Douala Stock Exchange (DSX) and to interests/dividends from owning securities on the DSX (we discuss this in more details in the next section).

#### **e) Unattractive business climate**

It has been argued that a favourable business climate in Cameroon will attract more investment than incentives through tax exemptions, which constitute lost revenue to the state. An attractive business climate would increase investment, production, trade, employment opportunities, wages, and profits from which government can tap direct, indirect and even trade taxes. The business climate in Cameroon is, rated, however, as unattractive. In its last review of the PRGF, the IMF (2009, p.25) noted that "measures to improve the business climate have not all been completed". This is not even the case today as one of the issues emphasized in the IMF review is not yet carried out after the deadline: the government "... has undertaken to submit the draft law on e-commerce to Parliament by June 2009 at the latest" (p.25). The need to improve the poor reputation of the business environment has featured prominently in all IMF reviews of the Cameroon economy. The main concerns of recent have been the financial sector, trade liberalisation, strengthening physical infrastructure, and improving transparency and governance.

The World Bank's Doing Business 2010 Indicators rank Cameroon at the 171<sup>st</sup> position out of 183 countries. Cameroon's ranking has worsened compared to Doing Business 2009 when she ranked 164<sup>th</sup> out of 181 countries. Table 2 compares Cameroon with the average Sub-Saharan African country, using OECD countries as the benchmark. Cameroon performs worse than the average Sub-Saharan African country in all but one of the selected indicators, and obviously worst than the average OECD country. The taxation system in Cameroon has a very bad reputation as Cameroon is ranked 170<sup>th</sup> of 183 countries. The worst indicator is the 1400 hours required to prepare, file and pay taxes, while only 306 and 194.1 hours are sufficient in the average Sub-Saharan African and OECD countries respectively. Cameroon however performs better than most Sub-Saharan African countries as its enterprises pay only an average of 50.5 percent of their profits as taxes, as against 67.5 percent for the other Sub-Saharan African countries. Such a difference questions the persistent cry of the business community in Cameroon about the heavy burden of taxes. This might be pointing to the fact that a reduction in business taxes might not attract private investment, though it will substantially hurt government tax revenue. It is important to note that the government in collaboration with the private sector and the World Bank are in the process of drafting a plan to improve the business climate.

Table 2: Doing Business Indicators for Cameroon, 2010 (Overall Rank: 171/183)

Indicators		Cameroon	Sub-Saharan Africa	OECD
No. of procedures for starting a business		12	9.4	5.7
Cost of registry of property (% of property value)		17.8	9.9	4.6
No. of days of enforcing contract		800	643.9	30.6
Paying taxes (Rank: 170/183)	No of payments per year	41	37.7	12.8
	Hours of payment per year	1400	306	194.1
	Total tax rate (% of profits)	50.5	67.5	44.5

Source: Doing Business Database (World Bank,2009)

#### f) Trade liberalisation

Reforms carried out within SAP have had significant effects on international trade taxes. CEMAC's Common External Tariff (CET) also curtails Cameroon's ability to raise more revenue through tariffs and there is more pressure for further trade liberalisation, including the reduction of the CET rate from 30 to 20 percent. On 15 January 2009, Cameroon signed an interim economic partnership agreement (EPA) with the EU (Cameroon's main trading partner); undertaking to reduce tariffs on 80 percent of its EU imports over 15 years in exchange for tariff-free exports to the EU. This will constitute another constraint to raising international trade taxes, as it will not only grant free access to EU goods, but might also divert trade away from other tariff-paying trading partners like China and the USA. A study carried out at the United Nations Economic Commission for Africa (Karingi et al., 2004; p.51) on the likely impact of EPA on CEMAC countries indicates that EU imports to Cameroon will increase by 29 percent, consequently reducing revenue by almost 70 percent (more than US\$149 million)<sup>22</sup>.

#### g) Low economic growth and high prevalence of poverty

Growth has fallen below 3 percent in recent years (and population is growing at 2.6 percent) which has translated into lower incomes, unemployment and underemployment and increased poverty. Many who work earn incomes that are too low to be taxed and are largely in the informal sector. 7.1 million

<sup>22</sup> The study carried simulations using a partial equilibrium model and evaluated the impact of total trade liberalization with the EU. It accounts only for the direct effects; ignoring feed-back effects i.e. inter-sectoral interactions are not taken into consideration.

Cameroonians (representing 39.9 percent of the population) live on less than US\$2<sup>23</sup> per day (INS, 2009). The low economic growth and low income per capita in recent years constitutes a constraint on raising taxes by the government.

### **3) Avenues for Increasing DRM in the Public Sector in Cameroon**

It is important to note from the start that government has recognised the importance of mobilising more non-oil revenue for the development of the country and has plans to implement a series of measures. The government's Letter of Intent to the IMF (IMF, 2009b; p.24) clearly state its intention to step up efforts at strengthening tax and customs administration. The proposals we outline below are therefore complementary to the initiative of the government.

#### **Reducing the size of the “illegal” informal sector**

A number of issues, if addressed can facilitate or coerce firms to move from the ‘illegal’ informal to the formal sector where they should meet their normal tax obligations. The first is to facilitate the process and cost of launching and registering a business. There is an ongoing process of business registration but the process is slow and not broad enough. Firms can also be encouraged and eventually coerced to keep proper records of their transactions using accepted accounting procedures so that their activities are transparent, thereby, easing the work of tax officials. One of the definitions of informal firms in Cameroon is that they do not keep records of their business activities. Taxpayer education (using an appropriate medium) on the risk of not paying the appropriate taxes and their civic responsibility might also increase taxes, even from those rightly in the informal sector – informal sector business associations can play an important role in such an initiative<sup>24</sup>. Curbing illegal business activities (some resulting from illicit imports and counterfeit products) mostly carried out by informal sector actors might force some of them out of the market or into the formal sector where such activities are taxable. Accelerating the process of registering all informal sector businesses (already begun by the tax authorities) should be an important prelude to formalisation.

#### **Intensifying the fight against corruption**

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<sup>23</sup> The poverty line in Cameroon following the survey was established at CFAF738

<sup>24</sup> The government inaugurated three Licensed Management Centres (Centres de Gestions Agréés - CGA) on March 3, 2010, to assist SMEs in management, accounting, and the handling of financial and tax documents. It's an initiative to help firms out of the informal sector and consequently pay appropriate taxes. Firms enrolled in an CGA, benefit from a 25% deduction of taxable profits. The Permanent Secretary in the ministry of SMEs declared during the inauguration that “we can not help somebody who is in the informal sector” (Cameroon Tribune of March 3, 2010, p. 11)

Tackling corruption within the tax and customs administrations should be a priority if fiscal revenue is to increase substantially. Suspected officials (and especially high-ranking) should undergo trial and if found guilty, sanctioned severely, and large publicity made of such decisions. Guilty taxpayers can be subjected to similar sanctions because it takes more than one for corruption to happen. This requires a strong political will, as some of those involved in customs fraud and tax evasion are politically well connected. It is tempting here to think that granting more autonomy to the revenue collecting authority will stem corruption. The experience of Uganda reported by Fjeldstad (2005) indicates that autonomous tax authorities are no guarantee for transparency, even when tax collectors are motivated with handsome salaries.

Another proposal on curbing corruption is to break networks between tax officials and taxpayers by introducing rotation systems, where revenue collectors remain only for short periods in the same station or post (Fjeldstad, 2005). There is also need for increased policing of the long Cameroon-Nigeria border to curb the flow of smuggled goods into the country.

### **Improving the investment climate<sup>25</sup>**

A good investment climate should stimulate private sector-led productive investment, increase production and trade, create jobs, increase tax revenue and subsequently promote growth and poverty reduction. Reforms should target those areas in which Cameroon lags behind, relative to the average Sub-Saharan African country. This could address issues related to corruption, public service efficiency, the judicial system (that can control tax evasion), infrastructure, and streamlining tax rules. The government is conscious of the poor investment climate, and is reportedly working with the private sector and the World Bank to improve conditions, with priority given to addressing corruption, the lack of infrastructure, and complex and conflicting tax rules (IMF, 2009b).

Curtailing business taxes as requested by the business community might not significantly improve the business climate, as the tax burden in Cameroon is substantially less than the Sub-Saharan African average – according to a World Bank Doing Business 2010 indicator. Incentives to private investors in the form of tax exemptions might not be as efficient as enhancing the business climate and they are costly in terms of tax revenue. Exemptions, if necessary should be clearly justifiable in terms of social or public interest needs, and not as an incentive to attract investment. Even when exemptions are justifiable on social grounds, supplementary information is needed to show that there are more

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<sup>25</sup> The main objective of the first meeting of the Cameroon Business Forum (CBF) held on February 18, 2010, under the chairmanship of the Prime Minister was to improve the business climate in Cameroon. Issues related to creating of enterprises, simplifying the tax procedures, settling commercial disputes were high on the agenda, among others. CBF is a public-private platform aimed at identifying the obstacles to investment and designing reforms to improve the business climate in Cameroon (Cameroon Tribune of February 22, 2010, p.2).

efficient than direct subvention to targeted groups. This is important as some might exploit such opportunities to evade taxes. If intended to promote investment, their costs should be compared with expected benefits to the economy.

### **Liberalise trade progressively, sequencing it with increase in other forms of government revenue**

Trade liberalisation in itself might not be a bad initiative, but its impact on tariff revenue for a developing country like Cameroon cannot be underestimated. The envisaged reduction of the CET from 30 to 20 percent, the signing of EPA with the EU (and the likely diversion of trade with other partners), among others may significantly reduce tariff revenue. Donors and especially the EU can assist Cameroon in developing other avenues for mobilising tax revenue, whereas tariff reductions/exemptions can be introduced progressively to allow a gradual substitution of other means of taxation for tariffs. This calls for policy cohesion i.e. trade policy decisions, need to be taken with due consideration of their fiscal implications.

### **Enforce existing property tax legislation and broaden the base of real estate tax**

Urban real estate tax constitutes a potential area for raising more tax revenue in Cameroon, especially for municipal governments, who have been receiving increasing responsibilities in the delivery of services but so far have been unable to generate sufficient local revenue. Real estate is very often concentrated in the hands of the rich and powerful, giving real estate tax a positive distributional effect and likely to be broadly pro-poor. Heady (2001) argues, "Land is in fixed supply and so the incidence of the tax will be on the landowner and the tax will not generate an excess burden". A broadening of the base of this tax and/or a more stringent enforcement of the existing legislation can substantially increase tax revenue from this source. However, its implementation is constrained by the difficulty in determining the value of the property, especially as the real estate market is under-developed in Cameroon. For the moment, authorities rely quite often on the valuation of the property owner, and might have to continue relying on the honesty of property owners as it is logistically difficult and costly for tax officials to value all land property. Article 156bis of the General Tax code (DGI, 2008) stipulates that the government can order its own valuation when it believes that the property has been undervalued.

To increase real estate tax base, the government could oblige real estate owners in designated administrative units and neighbourhoods to register their land say within 5 years or more. It is important to underscore that in Cameroon, land registries cover less than 1 percent of the country's territory and their integrity cannot be assured (IMF, 2009a, p.11). It however requires a strong political will to implement such a land registration policy. The influence of wealthy and politically well-connected has to be dealt with by the ruling elite, else the process will be undermined. It also requires some political courage to tackle the thorny issue of ancestral lands in urban areas. Indigenous populations constitute a

very strong political constituency and issues related to land remain very controversial. Perhaps, the government could exempt all unexploited ancestral lands from taxation. The government may also provide incentives such as social amenities (water, electricity, roads) which will increase the value of land and encourage owners to title it.

Increased titling of real estate property should enable the government to create a database on real estate ownership and consequently facilitate the taxing of such property, thus increasing its efficiency and equity. This can also increase financial intermediation as land titles are a common credit guarantee requested by lending institutions. Despite the recent measures taken to facilitate land registration, the process is still time-consuming and costly in Cameroon. According to Doing Business 2010, to register property in Cameroon, you need 17.8 percent of the value of the property, while in the average Sub-Saharan African country, the figure is 9.9 percent and 4.6 percent in OECD countries (Table 2).

### **Continue to promote economic growth**

Enhancing economic growth will have a positive impact on government revenue. The government should continue with the policy of macroeconomic stability, promotion of private sector activities and improving public infrastructure investment to enhance firm productivity.

### **Create a viable bond market in Cameroon**

Another avenue through which government can raise non-tax revenue is by issuing treasury bonds. Regularly, the government raises money through the Central Bank (BEAC) to finance its budget. This is susceptible to crowd out private sector activities and is costly to the state. In July 2008, BEAC raised the interest rate for credit to governments from 5.25 to 5.50 percent. The bond market in Cameroon is virtually inexistent apart from those issued to settle the internal debt from time to time. Issuing bonds could be a more efficient method of raising non-tax revenue and equally developing the bond market in the country<sup>26</sup>. This idea has been around for quite a while and was supposed to go operational in the first quarter of 2008, but is still to take off at the beginning of 2010.

## **IV. The Private Sector and DRM**

### **1) Financial sector Policy and Performance in Cameroon**

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<sup>26</sup> The quality of the expenditure of revenue from bonds is an important issue, though not dealt with in this study. i.e. whether such resources are spent for investment or for consumption expenditure.

### **a) An overview of developments in the financial sector**

The financial sector is highly influenced by Cameroon's membership of the franc zone and its participation in sub-regional economic and monetary union – CEMAC. Cameroon shares a common currency, a supranational central bank (BEAC), a bank supervisory authority (COBAC), and other regional decision-making bodies with fellow CEMAC members.

In this section, we distinguish between three categories of financial institutions in the financial sector in Cameroon: the formal, semi-formal and informal financial institutions. The formal financial sector comprises commercial banks, and other non-bank financial institutions that are fully regulated like insurance companies and the stock exchange. Semi-formal financial institutions are those that also have a regulatory framework and supervised by COBAC, but are not subject to the same stringent prudential norms as commercial banks. For example, regulations on the minimum capital adequacy ratio, large exposures are less stringent for MFIs than for commercial banks. The third category is the informal financial institutions, which according to Nissanke and Aryeetey (2008, p.119) can be grouped into non-commercial and commercial informal sector financial institutions. Non-commercial institutions are those whose transactions are between relatives, friends or small-scale group arrangements; while commercially based institutions are those whose transactions are conducted by saving collectors, estate-owners, traders and moneylenders. Most of them are unknown to the authorities but tend to mobilise substantial amounts of resources and play some intermediation role in the country.

The financial sector in Cameroon experienced a severe crisis in the late 1980s attributed largely to the difficult economic environment, poor management, government interference in banks' lending policies, weak judicial system and supervisory frameworks. These factors led to liquidity and solvency problems in the sector. The crisis was not limited to the commercial banks, but also affected microfinance institutions, development banks (and other public sector credit institutions) and non-bank financial institutions, as insurance companies were also in a critical position (IMF, 2007a).

The adoption of SAP in 1988 signalled important reforms in almost all the sectors of the economy. The financial sector component of these reforms laid more emphasis on the formal financial sector, especially commercial banks. The reform that started in 1989 and continued in the 1990s focused essentially on the liquidation, restructuring and privatization of nonperforming institutions. These initial measures did not sanitise the banking sector as some of the banks were still undercapitalised and about half of their private sector loans were nonperforming. The second phase of reforms (1995-1997), comprised further liquidations, recapitalisations, and the issuance of government securities on its debt to commercial banks. The development banks that were created to finance long term development projects were all shut down. These included Cameroon Development Bank (La Banque Camerounaise de



Développement - BCD), The National Fund for Rural Development (Fonds National de Développement Rural - FONADER), and The Fund for Small and Medium Enterprise financing (Fonds de Garantie aux Petites et Moyennes Entreprises - FOGAPE). Other government financial institutions that have undergone some reforms, though still under stress are the Postal Savings Bank (Caisse d'Épargne Postale) and the Housing Credit Bank (Crédit Foncier du Cameroun).

An important step in the financial sector reform process was the creation of the Central African Banking Commission (COBAC) in 1990 entrusted with the task of enforcing the respect of the legislative and regulatory dispositions put in place. The signing of a convention harmonising banking regulations in the sub-region in 1992 allowed COBAC to go operational in 1993.

One recent and significant change in the banking sector in the CEMAC sub-region has been the July 2008 suppression of the maximum lending rate, which was hitherto fixed at 15 percent. Many banks considered the maximum rate insufficient to cover the perceived risk of lending, especially to SMEs. The abolition of the rate now gives banks more latitude to manage risk themselves. The minimum deposit rate was reduced from 4.25 to 3.25 percent. One might question the maintenance of a minimum deposit rate in a country in which commercial banks are grappling with excess liquidity, even though this can help to prevent saving rates from falling.

Still in the formal financial sector, we have non-bank financial institutions. These institutions have also been subjected to the financial sector reforms. Five insurance companies lost their operating licences during the reform process and some of the 24 companies in existence are still facing solvency problems. The government created The Douala Stock Exchange (DSX) through Law No. 99/015 of 22 December 1999 with the aim of facilitating the mobilisation of long-term savings for long-term investment. It went operational in 2002. Despite an agreement with its CEMAC partners to create a regional stock exchange with headquarters in Libreville (Gabon) Cameroon created the DSX. The DSX is supposed to compete in the small CEMAC market with the regional stock exchange created in 2003.

In the semi-formal financial sector, the rapid and uncontrolled expansion of MFIs and the lack of professionalism of their managers led inevitably to a crisis. The government reacted by transferring the supervisory role of MFIs from the Ministry of Agriculture to the Ministry of Finance. Today, MFIs in Cameroon follow sub-regional (CEMAC) regulations. The sub-regional bank control commission (COBAC) also supervises MFIs, and has come out with 21 rules or prudential norms (La Microfinance,

2008)<sup>27</sup>. Three categories of MFIs are envisaged: i) those that deal only with their members (associations and cooperatives); ii) those providing financial services to the public (obliged to have the status of a public limited company); and iii) those restricted only to lending. Most of the MFIs in Cameroon fall under the first category, i.e. savings and lending associations or cooperatives that constitute about 80 percent of all the institutions in the country (Creusot, 2006). Each MFI is required to apply and obtain a license before going operational.

The government of Cameroon believes that the Microfinance sector can contribute effectively in fighting poverty in the country. In April 2001, the government published a National Microfinance Policy Declaration, in which it outlined its intention to create a favourable environment for microfinance activities, improve professionalism and transparency in the management of MFIs, consolidate and extend the harmonious development of MFIs throughout the country, etc (Creusot, 2006). The poverty reduction strategy paper (PRSP) envisages actions by government that should facilitate access to appropriate financial services by the marginalised sections of the population. The government has equally created a National Microfinance Committee (CNMF), charged with coordinating microfinance institutional stakeholders - notable the state, microfinance professionals and donors. Its role is to concert and chart a course for the microfinance sector in Cameroon.

Since informal financial institutions operate largely without the knowledge of the authorities, there has been no meaningful attempt to regulate their activities. However, a recent development has been their voluntary registration with local administrative authorities. This has been in a bid to facilitate the prosecution of members who default on their agreements, for example, fail to repay funds borrowed from the association. Once constituted as a recognised group, informal financial institution can easily seek legal redress when need arises. It should however be noted that such registration for legal protection is not limited to informal financial institutions, but to any type of grouping of individuals largely referred to in Cameroon as 'Common Initiative Groups' or simply as 'Associations'.

## **b) Private sector DRM performance**

While the government is responsible for public revenue generation, the financial sector mobilises domestic savings from households and firms and equally facilitates the allocation of savings to households and firms for investment purposes. The process of savings and investment lies at the heart of development and their volumes determine the pace of growth. As indicated in Figure 1, the rate of

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<sup>27</sup> The IMF (2009a, p.9) reports that corporate governance within the MFIs remain weak, as the regulatory framework, is yet to be fully implemented. The limited resources COBAC means only a partial supervision of this sector, which the IMF considers a matter of concern.

private sector savings in Cameroon was below 11 percent in 2005 and compares very unfavourably with some low income countries where the private savings rate is very high, like in Asia.

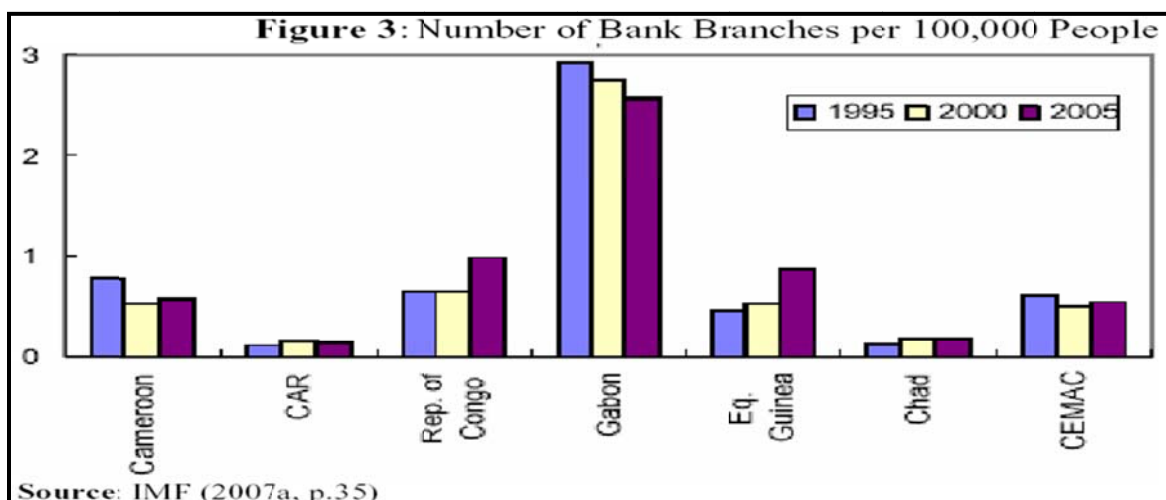
The 2001 household consumption survey – ECAM II (MINEFI, 2002), indicated that only 38 percent of the population declared possessing some savings. When disaggregated, the results indicate that poor households save less than non-poor households do; 25 percent of poor households compared with 41 percent of non-poor households declare being in possession of savings. In the urban areas, about one out of every two households declared having some savings, as against a little less than one out of three households in the rural areas. Household savings amongst the poor and rural dwellers is largely precautionary and not meant for investment. Such savings are in formal, semi-formal and informal financial institutions, without ignoring savings in physical form.

The financial sector in Cameroon<sup>28</sup> is dominated by commercial banks holding about 85 percent of the system's assets, representing almost 20 percent of GDP. Foreign banks tend to dominate the banking sub-sector with more than 2/3<sup>rd</sup> of total commercial bank assets. The landscape of commercial banking has recently undergone some changes with the arrival of new banks. Union Bank of Africa from Nigeria has entered the Cameroonian market, while another Nigerian bank, Oceanic Bank International now owns 75 percent shares in Union Bank of Cameroon. Banque Atlantique from Côte d'Ivoire has taken over Amity Bank. Out of the 12 banks in Cameroon at moment, only three are largely or entirely domestic-owned: Commercial Bank of Cameroon, Afriland First Bank and National Financial Credit Bank.

The rate of bank penetration (in terms of number of branches) fell after the restructuring of the sector begun in 1989. Most of the banks closed several branches and are now present only in major cities. Some of them like CITI Bank and Standard Chartered Bank are located only in the cities of Douala and Yaoundé (with one branch each) and only one bank has branches in all the ten regions of the country (i.e. BICEC - Banque Internationale du Cameroun pour l'Épargne et le Crédit). According to the IMF (2009a), the number of bank branches actually declined from 105 for eight banks in 1995, to 98 for 10 banks in 2005. Figure 3 compares bank outreach in Cameroon with the other CEMAC member countries in 1995, 2000 and 2005. Bank penetration in Cameroon was far less than one bank per 100,000 people in 2005, while in Gabon it was more than 2.5 banks per 100,000 people. It is only Chad and the Central African Republic that bank penetration is lower than in Cameroon. However, in 2005, Cameroon owned 30.3 percent of the banking institutions and 55.6 percent of total bank assets in the CEMAC region (IMF, 2007a). One of the consequences of the limited penetration of financial institutions in Cameroon is the limited number of Cameroonians with bank accounts

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<sup>28</sup> Table A3 in the Appendix presents the structure of the financial system in Cameroon in 2005. We do not have information about the structure at present moment, which has evolved with the number of banks increasing from 10 to 12



Among the non-bank financial institutions (NBFIs) in Cameroon include many insurance companies, the Douala Stock Exchange (DSX), and some specialised non-bank financial institutions. As of 2005, insurance companies in Cameroon possessed almost 5 percent of total financial system assets and numbered about 24 institutions. Specialised non-bank financial institutions like the postal savings bank (CAMPOST), the housing bank (Crédit Foncier) and the public pension fund (CNPS) also participate in the mobilisation of domestic savings. Since its creation in 2002, the DSX has been virtually dormant, despite the numerous incentives to attract firms. So far, it has failed to mobilise savings to finance long-term investments as envisaged.

The financial sector also includes a large number of semi-formal financial institutions, and especially microfinance institutions (MFIs). The rapid growth in these institutions is attributable to the banking sector crisis of the late 1980s and the restructuring that followed with a number of banks liquidated and many bankers retrenched. The remaining banks retreated to the cities leaving the rural areas and small towns with no banking institutions. This offered an opportunity to mostly retrenched bankers to set up small savings and credit institutions throughout the country. In 2006, there were 490 MFIs in Cameroon, down from about 714 in 2005. The reduction followed a crisis in the sector and the implementation of a tougher regional (CEMAC) regulatory framework for MFIs in April 2005, which led to the closure of some 300 unlicensed institutions at end-2005.

Despite their numbers, MFIs accounted for less than 5 percent of the total assets of the financial system in 2005. However, their deposits and credits are rising rapidly in both absolute and relative terms and they are playing an important intermediation role in Cameroon. Overall, the share of deposits with MFIs represented 12 percent of total deposits in 2006, up from 6 percent in 2000. The share of MFI

credits also increased from 4.3 percent to 10.4 percent of total credits (La Microfinance, 2008). MFIs tend to respond adequately to the financial needs of small and medium size enterprises (SMEs) and households than the commercial banks. They are, generally handicapped by their incapacity to finance long-term investment, but represent a budding source of mobilising domestic resources in the private sector in future. There is however concern that corporate governance in the semi-formal financial sector remains weak and the regulatory framework is not fully implemented, largely due to the limited resources of the supervisory body – COBAC (IMF, 2009a).

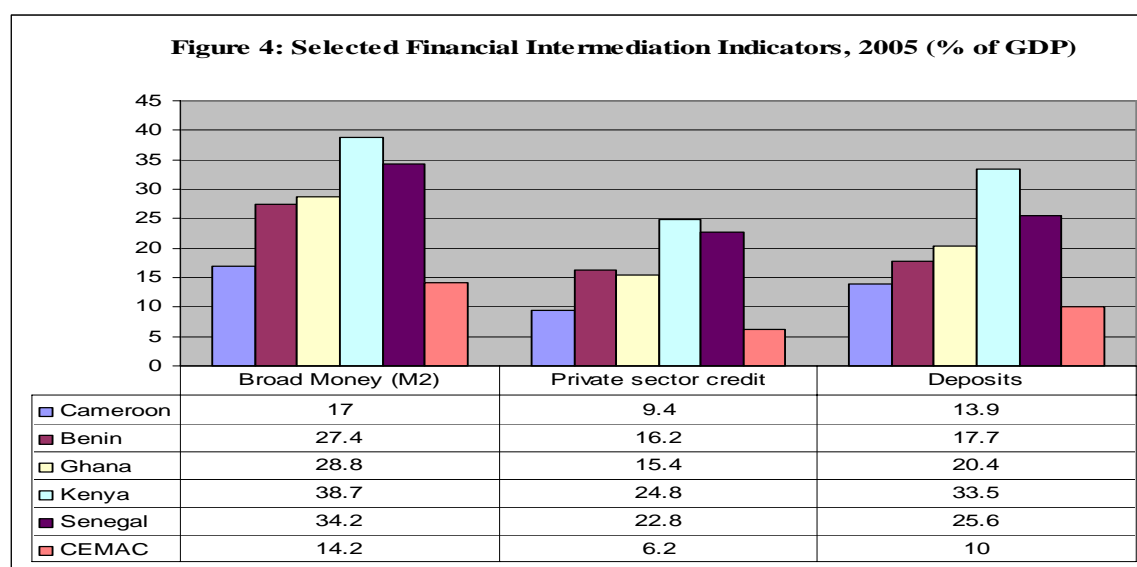
Unlike commercial banks, deposit and lending rates practiced by MFIs are unregulated and La Microfinance (2008) reports (based on a study conducted by COBAC in 2007) that the lending rate ranged between 6 and 78 percent, while the deposit rate varied between 0.3 and 16 percent. The large interest rate differential between the formal banks and semi-formal institutions is an indication of the segregation of the financial sector in Cameroon, which is blameable for the low level of intermediation discussed below.

Even the penetration of semi-financial institutions, the MFI in particular, is not far reaching as could have been expected, given their numbers and their objective of serving those sidelined by the formal financial sector. In 2002, 52 percent of them were located in the urban areas and three of the ten Regions of the country (Centre, Littoral and the North-West) had 60 percent of the MFIs, while four of the least served Regions (Adamawa, East, North, and South) had only 11.3 percent (Creusot, p.3).

According to Defo (1997), the informal financial sector in Africa plays and will continue to play an essential role in resource mobilisation and financing of activities in both the rural and urban areas. Informal financial activities are founded on precaution, solidarity, mutualism and easy access to liquidity when need arises. Deffo (1997, pp.243-4) noted that 48 percent of the population takes part in 'tontines' and in the early 1980s, tontines collected 66 percent of household savings in Cameroon. The informal financial sector however finances only short-term and small investments. Generally, some informal sector institutions do have bank accounts with the formal and semi-formal financial sectors, where they deposit excess liquidity. According to Aryeetey (1997), such a practice helps reduce the amount of currency outside the banking system, reduce the cost of savings mobilisation by banks and also reduce the transaction costs of depositors as they avoid travelling to banks and queuing up to make deposits and withdrawals. It however does not expose the individual members to banking services nor has any significant influence on financial intermediation in the country. It is difficult to give a good account of informal financial activities in Cameroon today without any recent study of the sector.

## **Financial Intermediation in Cameroon**

The low level of financial intermediation has been a serious problem in the financial sector in Cameroon, despite several initiatives to liberalise the financial system. Evidence suggests that increased financial intermediation leads to more efficient resource allocation and growth, and savings allocated to investments that are more productive (Benciveng and Smith, 1991; Conning and Kevane, 2002; etc.). Easy access to financial services facilitates access to health and educational services, thus affecting poverty and inequality. Compared with other Sub-Saharan Africa countries, the level of financial intermediation in Cameroon is rather low, though it compares favourably with fellow CEMAC members. The measurement of financial depth (ratio of broad money - M2 to GDP) is only 17 in Cameroon as against 39 percent in Kenya and 34 percent in Senegal. Credit to the private sector was only 9.5 percent of GDP, while Kenya and Senegal had 25 and 23 percent respectively. The ratio of deposits to GDP (13.9 percent) equally confirms that the level of intermediation in Cameroon is lower than in all the comparator countries as indicated on Figure 4.



**Source:** Author with data from IMF (2007a)

One of the critical issues now is how to mobilise long-term deposits to finance long-term productive investment in Cameroon. About 75 percent of deposits in Cameroon are of the short and medium term nature, and according to prudential requirements, long-term deposits must finance long-term credit commitments. As mentioned earlier, development banks created to finance such investments in Cameroon were liquidated because of mismanagement. The Cameroon Development Bank (BCD), Crédit Agricole and FUNADER (for the agricultural sector and rural development) and FOGAPE (specifically for SMEs) all failed to fulfil their mission.

The Cameroon National Credit Council adopted a project in January 2006 to set up the ‘Agricultural Bank of Cameroon’, envisaged as a majority private shareholding company with a reference partner. The configuration of the Board of Directors is to reflect the geography of the shareholding (CTSE-DRSP, 2007, Annex, p.20). Unfortunately, the IMF is not in support of this project because of the failure of previous development finance institutions. In one of their reports (IMF, 2009a, p.13-14), they stated “The mission questioned the appropriateness of this step, especially since previous government efforts to promote agriculture and SMEs through government-sponsored specialized financial institutions have failed”.

The Douala Stock Exchange (DSX) was created with the aim of facilitating the mobilisation of long-term capital for private sector investment. Unfortunately, its performance has been dismal (to say the least), despite generous incentives. There are at moment only three firms listed on the stock exchange, all resulting from the state floating its shares in these companies. These are SEMC<sup>29</sup>, SOCAPALM<sup>30</sup> and SAFACAM<sup>31</sup>. Cameroon’s General Tax Code outlines incentives offered to firms that float shares on the DSX (DGI, 2008; Articles 108 - 112):

- a reduction of the corporate tax rate to 20 percent over the first three years, if a company increases its capital on the stock exchange by at least 20 percent;
- a reduction of the corporate tax rate to 25 percent over the first three years, if a company places at least 20 percent of its capital on the stock exchange;
- a reduction of the corporate tax rate to 28 percent over the first three years, if a company increases or places less than 20 percent of its capital on the stock exchange.

Such companies are required to remain listed for at least four years. These incentives extend to gains/dividends from securities of less than 5 years maturity and other remunerations on stock market transactions for individuals, whose tax rate is fixed at 10 percent (instead of 15 percent for other benefits not arising from stock market transactions).

The banking sector in Cameroon suffers from excess liquidity (commercial banks’ deposits at the Central Bank in excess of the minimum required). As of April 2007, excess liquidity, reached about 25 percent of total banks’ deposits at BEAC (IMF, 2009a). This implies competition for the scarce lending opportunities and many banks concentrating credit on a few large creditworthy corporate customers. On the other hand, small and medium size enterprises (SMEs), with a limited credit history lack credits or pay very high interest rates than the large corporations. According to the IMF (2007a, p.35), the average cost for a loan is 11 percent for large corporations, 16.5 percent for SMEs, and 20.5 percent for households. As a comparison, interest rates on credit extended by microfinance institutions, which are not subject to the ceiling, range between 6 to 78 percent (La Microfinance, 2008). This is an indication of not only the segmentation of the market for banking services in Cameroon, but also its less competitive nature.

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<sup>29</sup> SEMC is acronym for [Société des Eaux Minérales du Cameroun](#)

<sup>30</sup> SOCAPALM is acronym for Société Camerounaise de Palmerais

<sup>31</sup> SAFACAM is acronym for Société Africaine Forestière et Agricole du Cameroun

Some initiatives linking formal with semi-formal financial institutions are observable in Cameroon. The most renowned are those of Afriland First Bank promoting the activities of MC<sup>2</sup> (Mutuelles Communautaires de Croissance) group of MFIs since 1992; and the CamCCUL network of Cooperative Credit Unions creating their own bank - Union Bank of Cameroon in 1999. Union Bank now has a new ownership (Oceanic International Bank with 75 percent of the shares) which we hope will maintain the arrangements with the CamCCUL group. Such initiatives might reduce market segmentation and increase the level of financial intermediation as substantial deposits mobilised by commercial banks are be channelled to SMEs and rural areas through microfinance institutions.

In the phase of low level financial intermediation and following an IMF/World Bank assessment of the financial sector completed in June 2007, the government in April 2008 created a Committee to see into the implementation of the 'Action Plan to Reinforce Financial Intermediation'<sup>32</sup> (Republique du Cameroun, 2009). The committee worked on four themes: credit institutions, microfinance institutions, management of liquidity and judicial environment. The Committee presented its report to government in September 2009 comprising a series of proposed texts for government approval and implementation.

## **2) Constraints to Mobilising Domestic Resources in the Private Sector**

**a) Low incomes, unemployment/underemployment and a high dependency ratio** Income is the principal determinant of the capacity to save (Loayza, Schmidt-Hebbel and Serven, 2000). Incomes in Cameroon are very low with GDP per capita of only US\$1,116 in 2007, and the population growing at 2.6 percent yearly. As mentioned above, the results of the 2007 household survey indicate that 39.9 percent of Cameroonians are living below the poverty line. One of the causes of the high rate of poverty is the high rate of unemployment and underemployment. The unemployment rate (using the ILO definition<sup>33</sup>) was 4.4 percent in 2005, but 75 percent of those counted as employed were underemployed, - a sort of disguised unemployment (INS, 2006). The high rate of unemployment and underemployment implies a high dependency ratio i.e. those who are not working but have to feed, clothed, sheltered and provided with medical care by those working. From the 2001 Household Consumption Survey, the dependency ratio in Cameroon was 2.7 persons per worker. Such a high dependency ratio implies a low income generating capacity, which further dampens the capacity to save.

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<sup>32</sup> This is our translation from French of "Plan d'Actions pour le Renforcement de l'Intermédiation Financière" (PARIF)

<sup>33</sup> The ILO definition of unemployment ignores that in developing countries many people are underemployed i.e. working below their qualifications or experiences and can not sustain a living from their wages. They still depend on other members of the family for a livelihood. The ILO definition does not include such disguised unemployment.



## **b) Limited access to financial services**

As indicated earlier, Cameroon had no more than 35.5 bank accounts per 1,000 inhabitants as of June 2007, thus ranking Cameroon among the lowest in Sub-Saharan Africa in terms of financial intermediation. A number of reasons explain this low access rate: the limited penetration of especially the commercial banks, but even semi-formal financial institutions and some administrative hurdles. There are regulations governing the opening and closing of bank branches in Cameroon. Opening a branch requires authorisation from the Ministry of Finance, acting in consultation with the National Credit Council. This contributes in reducing the physical presence of bank branches in some parts of the country. Other administrative hurdles include the amount required to open an account, the maintenance fees and the minimum balance to keep an account. In addition, the use of non-cash payment instruments is limited as very few banks in Cameroon issue debit cards to customers and none issues credit cards. Cash withdrawals from the counter of bank branches is time consuming and remains the commonly used means to access deposited funds.

The hesitation of especially semi-financial institutions to move into the rural areas might be attributable to the absence of some vital infrastructure like electricity, road network (seasonal roads) and telecommunications. These are almost necessities in the operations of banks and MFIs nowadays – even in rural areas. These institutions use computers and need to be directly hooked-up with other branches.

## **c) Lack of long-term savings mobilisation infrastructure**

The problem in Cameroon now is not only with the quantity of savings mobilised, but importantly, the type of savings in terms of its ability to finance long-term investment projects. About 75 percent of deposits in Cameroon are short and medium term and this explains why the bulk of private sector credits in Cameroon is made up of short and medium term loans – respectively 65 and 34 percent; with just around 1 percent for long-term loans in 2005 (IMF, 2007a). The structure of bank deposits partly explains the structure of bank credits. According to prudential requirements, only long-term deposits must finance long-term credit commitments. The Douala Stock Exchange established to facilitate the mobilisation of long-term savings for companies has failed to meet expectations despite numerous incentives.

Elsewhere, development finance institutions (DFIs) play an important role in the development process by providing enterprises with long-term finance. All the development finance institutions in Cameroon created to provide long-term finance for investment were all liquidated during the financial sector reforms, due to mismanagement. As indicated earlier, the government is willing to create two development finance institutions: one for agriculture and the other for SMEs, but the IMF is against the

move. The IMF uses the failure of previous development finance institutions and the financial difficulties of the Postal Savings Bank and the Housing Loan Bank (all government-sponsored and managed) to bolster its argument against any new DFI in Cameroon.

#### **d) Excess liquidity in the formal financial sector**

Excess liquidity can also constrain resource mobilisation as it narrows the profit margins of commercial banks. Some of them might refrain from opening new branches and move towards disintermediation and hoarding of government securities. This is explained, at least in part, by the inability of bankers to assess the creditworthiness of potential borrowers and the enforcing of a maximum lending rate, which had prevented lenders from incorporating potential risk in the cost of the loans.

#### **e) The low level of monetisation**

The supply of money in the economy is very low – 18.1 percent in 2007<sup>34</sup>. UNCTAD (2006) reports monetisation rates in some developing economies of almost 80 percent. Such low levels of monetisation are attributable to the weak financial system but also to the fact that many Cameroonians save in the form of holding physical assets than use financial assets. This is typical of an economy in which the share of subsistence agriculture is still very high and where a large part of agricultural output is consumed within the household.

#### **f) Segmented financial sector**

The difference in interest rates practiced in the two markets indicates the extent of segmentation between the formal financial sector and the semi- and informal sectors. While commercial banks suffer from excess liquidity, MFIs do not have enough funds to lend to the poor and SMEs lack the appropriate collaterals to obtain credits from the commercial banks. This substantially constrains the level of financial intermediation in the country. The two cases of linkages cited above are insufficient to have a significant impact on the very low-level of intermediation in Cameroon.

#### **g) Scarcity of credit information on potential borrowers**

The problems of intermediation are visible in Cameroon via the difficulties of getting credit, despite the excess liquidity held by commercial banks. Apart from the well-established creditworthy companies, a majority of firms finds it hard to access credits. The availability of timely and reliable financial and credit information (e.g. recorded payment history) on potential borrowers is an important handicap as

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<sup>34</sup> World Bank's WDI database

it is difficult to assess borrowers' credit risk and allocate credit more efficiently. In terms of getting credit data, The World Bank's Doing Business 2010 report ranks Cameroon 135<sup>th</sup> out of 183 countries, worse than the 2009 rankings (Table 3). The report notes that firms in Cameroon consistently rate access to credit among the greatest barriers to their operation and growth. As indicated on Table 3, Cameroon scores only 3/10 in terms of the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders. As regards the ease of access to, and quality of credit information, Cameroon scores barely 2/6. There exist no private institutions providing credit information in Cameroon, and the number of individuals and firms covered by the public credit information registry represents only 1.8 percent of the adult population.

Table 3: Difficulties getting Credit in Cameroon

Getting Credit data	Doing Business 2009	Doing Business 2010
Rank	131 <sup>st</sup> out of 181	135 <sup>th</sup> out of 183
Strength of legal rights index (0-10)	3	3
Depth of credit information index (0-6)	2	2
Private bureau coverage <sup>35</sup> (% of adults)	0.0	0.0
Public registry coverage (% of adults)	4.9	1.8

Source: World Bank's Doing Business 2010 (World Bank, 2009)

### 3) Avenues for increasing DRM in the private sector in Cameroon

#### Extending financial services in the country

More than 95 percent of Cameroonians do not use banking services and increasing the extent of financial services in the country should be a priority. Government is urged to revoke the need for an authorisation to open branches and facilitate branch closure, conditioned only on the bank acting appropriately to protect the interest of customers, especially depositors. The only requirement may be for banks to inform the authorities of their decision to create a branch. The government can encourage financial institutions to extend their outreach, or make their number of branches proportional to the size of their financial assets. Cull et al (2009) report that increased competition from formal financial institutions in terms of extended outreach, influences the nature of services provided by semi-formal

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<sup>35</sup> Public and private coverage report the number of individuals and firms covered by a public credit registry or private bureaus as a percentage of the adult population, respectively.

institutions and the markets they serve<sup>36</sup>, but not their profitability. An improvement in rural infrastructure (electricity, telecommunications, and roads) can encourage banks and MFIs to open branches in such areas. Government can encourage private sector telecom companies to extend networks to rural areas or through some sort of public-private partnerships to open up the rural parts of the country to mobile communication.

Apart from extending financial services to hitherto underserved areas, access can be increased in existing financial institutions by lifting some obstacles such as: reducing the cost of opening bank accounts, maintenance fee and the minimum balance required in accounts. Extending the use of non-cash payment instruments can increase the use of financial services. Government is urged to instruct banks to introduce such instruments within a specified time limit. Instituting mobile phone banking (m-banking) should extend the outreach of financial institutions. The rapidly expanding mobile phone infrastructure in Cameroon can facilitate this. M-banking has the potential to be deployed rapidly and affordably to expand access to financial services among the unbanked population especially. M-banking is developing rapidly in countries like Kenya and Uganda, but not yet in Cameroon<sup>37</sup>. To encourage more Cameroonians to participate in the financial system, and lower income groups to save, information campaigns are needed<sup>38</sup> on the value of banking and savings, improved banking coverage, wider introduction of low cost banking products and fair returns on deposits.

### **Continue with effort to promote economic growth**

Promoting economic growth remains an important channel for enhancing DRM. Economic growth will create productive employment for the labour force, raise incomes and consequently domestic savings. Maintaining macroeconomic stability can be a priority. Evidence shows that as income levels rise, there is a high propensity to save within the LDCs. As indicated above, prioritising the improvement of the overall business environment can promote investment and economic growth.

### **Need for an institution to provide long term financing to the economy**

There is need for a development bank in Cameroon and the government needs to convince its development partners that such a bank will be properly managed and void of political interference. Perhaps, a development finance institution including a significant share of private funds and

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<sup>36</sup> i.e. as commercial banks compete MFIs away for urban and semi-urban locations, more poor areas and poor customers are reached

<sup>37</sup> Express Union (a MFI) has started a service with the use of mobile phones, which is now limited only to transferring money available in ones account. In Kenya for example, those with mobile phone accounts pay bills, deposit money, get small loans, receive and spend their wages using their mobile phones.

<sup>38</sup> like what the National Social Insurance Fund (CNPS) is currently doing with spots in the press encouraging pensioners to open accounts with financial institutions for their pensions

management, as proposed by the government, can be workable. Care should however be taken not to divert such an institution from its developmental goal with too much private-sector participation cum-profits maximisation, as it might end up not very different from a commercial bank i.e. careful arbitration between corporate performance interest and economic development mandate. Taping from the excess liquidity within the commercial banks and issuing long-term government bonds could be other options for mobilising resources for the DFI. Cameroon's foreign partners can also play a role, but with a predominant role for government and the private sector. For a start, a single development bank with an agricultural component and SME component is preferable to a development bank for each of the sectors. Separate entities for these sectors could be set-up subsequently - building on the experience of the initial institution.

The failure of the DSX to attract firms after several years of operation should make Cameroon rethink its decision of preferring the DSX to the regional stock exchange. A regional stock exchange might imply more guarantees for transparency and less likelihood for insider dealing, than a national stock exchange. It may attract more firms from the six countries and increase the level of transactions. There is need for Cameroon to dialogue with fellow CEMAC members on this issue and accept to trade-off some CEMAC institutions and functions for hosting the sub-regional stock exchange. A stock exchange, elsewhere than in Cameroon might not be very successful, as more than 50 percent of enterprises likely to enlist are found in Cameroon.

### **Increased monetisation of the economy**

The monetisation rate in the country is improvable through the intensification of commercial agriculture and the development of the market economy within rural areas, or improving farm-to-market roads to enable rural farmers' access to the market. The extension of financial services to rural areas or the development of rural financial institutions in which farmers can deposit savings could increase the level of monetisation and lead to increased savings mobilization.

### **Increasing financial sector integration**

Increased linkages between semi-formal and formal financial institutions (and especially commercial banks) will reduce market segmentation, increase the level of intermediation and reduce the excess liquidity with the commercial banks. The strength of the semi-formal institutions is derived from their flexibility, proximity to the customers, simple procedures and a higher loan recovery rate; but they lack sufficient funds, give predominantly short-term credits, offer a limited range of financial services, have inadequately trained personnel and higher interest rates. On the other hand, commercial banks lack knowledge of the economic, social and cultural characteristics of rural customers and the rural milieu though they have sufficient funds, qualified staff, and a large variety of financial services. A linkage

between MFIs and commercial banks will be complementary and increase the level of financial intermediation and the efficiency of delivering financial services to the population. Mees and Bomda (2006) describe such a linkage as downgrading by the commercial banks and upgrading by MFIs i.e. a process whereby a formal financial institution adapts its structure, its services and its products to the new environment, while a semi-formal institution ameliorates its structure, its organisation, and quality of its services to be compatible with more demanding needs (upgrading).

### **Creating credit registries/bureaus to provide financial data on potential borrowers**

Financial intermediation will remain low despite the largely liberalised financial system if credit information is lacking. Promoting credit and financial information institutions should provide commercial banks and other lenders the required information to assess potential borrowers' credit risks. Such institutions can collect and disseminate information on the financial position and payment record of the borrowers, thus curbing information asymmetry in the market, and enhancing banks' ability to assess and manage risks. It is important to note that there is an ongoing regional initiative in this direction i.e. to set up credit bureaus at the level of CEMAC.

## **V Conclusion**

### **Summary of Results**

Cameroon compares unfavourably with the average Sub-Saharan African country and developing countries in general in terms of mobilising resources domestically. This is true for both public and private sector resource mobilisation. Such performance cannot be attributed solely to the reduced fiscal, monetary and trade policy space resulting from membership of an economic and monetary union (with a supranational central bank, macro-convergence initiative and a common external tariff), as other countries involved in similar arrangements perform better. It is also worth noting that Cameroon is not an aid-dependent country, but is subject to the conditionalities of the IFIs, as evident in the various reviews of its PRGF arrangements by the IMF. Additional efforts at mobilising resources locally can free Cameroon from aid and consequently widen its policy space.

The Cameroon government is aware of the necessity to increase resource mobilisation locally and has initiated a number of reforms (including the April 2007 Fiscal Reform Commission and the Committee to see into the implementation of the 'Action Plan to Reinforce Financial Intermediation' (PARIF) in 2008), but effective implementation and impact of these initiatives is still awaited. The decline in oil revenue and envisaged import tariff reductions (resulting from EPA) makes it more urgent to boost efforts to

raise additional non-oil revenues. Tax rates on labour, income, and consumption are already high in Cameroon and any attempts to mobilise more tax revenue should avoid increasing tax rates.

### **Main constraints to DRM in Cameroon**

This study identified a number of constraints to mobilising more resources for development by both the public and the private sectors in Cameroon. The binding constraints to DRM are:

The large informal sector, producing 50 percent of output and employing 90.4% of the active population is a constraint to DRM in Cameroon. While a portion of informal sector activities are for subsistence and some may be untaxable, there equally exist an 'illegal' informal sector made up of tax cheats who do not want to pay formal sector taxes. The size of this sector can also be attributed to the complex procedure and costs for setting up and registering enterprises, inefficiency of the public administration, and other bottlenecks in Cameroon as highlighted in the World Bank's Doing Business 2010 report.

Another important constraint to enhancing DRM in Cameroon is the limited access to financial services. More than 95 percent of Cameroonians do not use banking services. This is attributable to a number of reasons: limited penetration of commercial banks, but even MFIs. There are equally administrative hurdles like the need for an authorisation to open bank branches costs of opening accounts, the maintenance fee and the minimum balance requirement. The use of non-cash payment instruments is limited as very few banks in Cameroon issue debit cards to customers and none issues credit cards. Limited outreach of financial institutions is also attributed to the absence of some vital infrastructure like electricity, practicable road network and telecommunications. The consequence is low financial intermediation despite a significantly liberalised financial sector.

The level of corruption in Cameroon (especially among tax and custom administrators) is also considered a constraint to DRM. Fighting corruption has been on the reform agenda since SAP in 1988, but results are negligible. Private sector taxpayers carry part of the blame as some refuse to register their firms and understate their turnover in order to pay lower taxes. Cameroon lost US\$575 million in 2004 because of fiscal fraud. Corruption also hurts tax revenue through the widespread illicit import of goods into the country mostly through the long border with Nigeria. Such goods do not pay tariffs and once in the country are sold in the informal sector without paying the required taxes and therefore compete unfairly with local producers or with those who import through the legal channels. The associations of entrepreneurs (GICAM) reports for example that the local sugar company (SOSUCAM) lost 65 percent of its turnover in February 2005 because of fraudulently

imported sugar in the northern part of the country. Such corrupt practices increase the tax burden on honest tax compliers, and leave the impression of a very heavy tax burden.

Other constraints to mobilising domestic resources in Cameroon include: an unattractive business environment, low economic growth and high level of poverty, tax exemptions, limited taxation of real estate property, lack of long-term savings mobilisation institutions, low level of monetisation, financial sector fragmentation, and scarcity of credit and financial information to enable lending institutions assess the creditworthiness of borrowers.

### **Strategies for Enhancing DRM in Cameroon**

This study also discussed channels for improving DRM in the public and private sectors in Cameroon. Here, we distil from the opportunities those that are likely to have a substantial impact on DRM. We go beyond identifying *what* action to take to stating *how* and timeframe of implementation, and potential impact on DRM.

Broadening the tax base through a reduction in the size of the 'illegal' informal sector should have a significant impact on public sector DRM. A number of policy initiatives can facilitate the process:

- In the short-term, the government is urged to streamline the process of starting/registering businesses by setting up a one-stop-shop for creating enterprises
- In the short to medium term, structures could be set up to provide informal sector firms with account and tax education and subsequently coerce them to keep proper records of their transactions using standard accounting procedures which could eventually be used by tax controllers to graduate them to the formal sector.
- The government could strive in the medium to long term, to systematically register informal sector firms in order to better monitor their evolution and select those to be formalised.
- In the long-term, create facilities for online declaration and eventual payment of taxes
- The 'legal' informal sector i.e. those involved in subsistence activities and incapable of paying formal sector taxes should be distinguished from the 'illegal' informal sector i.e. tax cheats.

Expanding access to financial services and increasing financial intermediation:

- In the short term, revoke the need for authorisation to open/close branches of financial institutions, requiring such institutions merely to inform the authorities of their decision. Government can work with formal and semi-formal financial institutions to reduce the cost of opening bank accounts, the minimum balance requirement and make sure new disguised charges do not replace suppressed ones.



- In the short to medium term, private sector financial institutions can be instructed and encouraged to implement non-cash payment instruments and introduce mobile phone banking (m-banking) in collaboration with mobile telecom providers.
- In the medium to long term, improving rural infrastructure (electricity, telecommunications, and roads) could facilitate the extension of the outreach of financial institutions (and especially the semi-formal) to rural areas.
- The process of creating credit bureaus at the level of CEMAC needs to be accelerated to provide financial institutions with reliable credit and financial information on the creditworthiness of potential borrowers; else financial intermediation will remain low despite a significantly liberalised financial sector.

Successfully fighting corruption in tax and customs administrations could significantly boost tax revenue.

- Within the short-term, systematically sanctioning and shaming (through wide publication of court decisions) of guilty officials and taxpayers alike, could have an impact on the level of corruption within the tax and customs administrations. .
- Within the short to medium term, rotating tax officials regularly to break networks created with taxpayers to defraud the state.
- Re-enforcing border controls to check illicit and import of counterfeit goods could impact government revenue in the short-term
- In the short to medium term, limit tax exemptions which are likely to be exploited by tax evaders. These should be replaced by carefully evaluated and targeted subventions to specific interest groups and their raison d'être re-evaluated on a yearly basis.

Extra efforts can help the collection of more real estate tax in urban areas.

- The immediate and initial effort is the effective implementation of existing legislation on property tax and property income tax.
- The medium to long-term initiative should be to expand the tax base by encouraging/obliging real estate owners to register their property within say a period of 5 or 10 years, to facilitate the collection of the tax. In order to raise more revenue, the tax should be progressive. It requires a strong political will to deal with the influence of the wealthy and the politically well-connected urban landowners. Exempting unexploited ancestral land from taxation might reduce the risk of social unrest by the indigenous populations.
- Areas designated for urbanisation could be provided with social amenities like water, electricity, roads, which should increase the value of the land and serve as an incentive for land registration

Create appropriate savings mobilisation instruments and institutions:

- In the short- to medium-term, creating a bond market to raise non-tax revenue from the public, rather than relying on advances from the central bank with risk of crowding out private sector initiatives.
- In the medium- to long-term, setting up a development bank with appropriate management structures void of political meddling. A single development bank (for a start), with windows that

handle issues related to agriculture, SMEs, and long-term investment projects. Private sector participation can be encouraged, but corporate interest should not dominate its developmental goals. Potential funding instruments could be long-term bonds, pension funds and excess liquidity held by commercial banks.

- In the medium to long term, dialogue with CEMAC members to merge the Douala Stock Exchange with the sub-regional stock exchange with location in Cameroon is commendable. A sub-regional stock exchange should imply more guarantees for transparency and less likelihood for insider dealing, and possibility of attracting more firms than a national stock exchange within the context of a monetary union. This might entail forgoing some CEMAC institutions and responsibilities to other members.

### **The role of Donors**

Donors are encouraged to support government initiatives aimed at mobilising more resources domestically. Donors can assist the government of Cameroon to implement trade liberalisation progressively so that other domestic tax revenue replaces international trade revenue, rather than using aid to compensate for rapid revenue losses. This allows the cultivation of a local resource mobilisation habit, rather than always expecting others to fill the gap. Aid should not be a disincentive, but an incentive for government to boost DRM. Aid to enhance DRM capacity in the short to medium term could be helpful.

Donors should allow the government of Cameroon to set up a development finance institution to provide funds to credit-scarce sectors like agriculture and SMEs and for long-term investment projects.

More generally, donor assistance to Cameroon should aim at enabling the country exit from aid by building the appropriate capacity and institutions necessary for raising resource domestically for its development. This is possible given that Cameroon is a resource-rich and not an aid-dependent country, but requires concerted effort from the government with the full support of the donor community to enhance DRM.

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## Appendix

Table A1: Gross Domestic Product by Sector of Origin at Current Market Prices

	2002 (Preliminary)	2003 (Preliminary)	2004 (Preliminary)	2005 (Preliminary)	2006 Estimated
	<i>(Billions of CFA francs)</i>				
GDP at current market prices	7,583	7,917	8,334	8,901	9,581
<i>Of which</i> : non-oil sector	7,048	7,431	7,792	8,187	8,634
Real GDP growth (%)	4.0	4.0	3.7	2.0	3.6
Primary sector	1,551	1,594	1,580	1,668	1,771
Food crops	1,050	1,058	1,034	1,128	1,211
Cash crops	139	146	144	136	135
Livestock and hunting	184	195	180	196	206
Fishing	91	96	90	110	115

Forestry	86	99	133	98	104
Secondary sector	2,243	2,247	2,368	2,583	2,943
Mining	1,082	985	1,096	727	960
Manufacturing	1,446	1,484	1,489	1,510	1,613
Electricity, gas, and water	46	50	76	73	78
Housing and public works	204	214	248	273	292
Tertiary sector	3,212	3,489	3,793	3,824	4,034
Indirect taxes net of subsidies	578	587	593	826	832
	<i>(Percent of GDP)</i>				
Primary sector	20.4	20.1	19.0	18.7	18.5
Secondary sector	29.6	28.4	28.4	29.0	30.7
<i>Of which: oil sector</i>	14.3	12.4	13.2	8.2	10.0
Tertiary sector	42.4	44.1	45.5	43.0	42.1
Indirect taxes net of subsidies	7.6	7.4	7.1	9.3	8.7

Source: International Monetary Fund (2007b, Table 2, p.3)

Figure A2: Structure of Central Government Revenue (% of total revenue)

	2002	2003	2004	2005	2006
Total revenue	100.0	100.0	100.0	100.0	100.0
Oil revenue <sup>39</sup>	26.4	23.2	25.7	28.5	35.5
Non-oil revenue	73.6	79.8	74.3	71.5	64.5
Tax revenue	94.6	94.8	92.4	91.9	94.5
Taxes on income and profits	19.6	19.6	18.0	17.0	14.6

<sup>39</sup> The increase in share of oil revenue in total revenue in 2005 and 2006 is largely attributable to rising oil prices and not oil output.

Taxes on goods and services	28.8	30.9	33.3	29.9	28.9
Taxes on international trade	12.4	12.5	14.1	12.3	11.4
Non-tax revenue	5.4	5.2	7.6	8.1	5.5

Source: International Monetary Fund (2007a, Table 11, p.12)

**Table A3: Structure of the Financial System in 2005**

	Number of		Financial System Assets		
	Institutions	Branches	CFAF billion	% of Total	% of GDP
Commercial banks	10 <sup>40</sup>	104	1741.1	84.4	19.6
Local	4	37	565.7	27.4	6.4
Foreign	6	67	1,175.4	56.9	13.2
Non-bank financial institutions	12	27	130.0	6.3	1.5
Microfinance institutions	714	714	95.0	4.6	1.1
Insurance companies	24	0	98.0	4.7	1.1
<b>Total financial sector</b>	<b>760</b>	<b>845</b>	<b>2,064.1</b>	<b>100.0</b>	<b>23.2</b>

Source: IMF (2007, p.28, Table III.1)

**Table A4: The Contribution of Foreign Assistance to Fiscal Indicators (% of GDP)**

	2003	2004	2005	2006
<b>Total revenue and grants</b>	16.7	15.4	18.2	47.6
Total revenue	16.0	15.2	17.6	19.3
Oil sector revenue	4.1	3.9	5.0	6.8
Non-oil sector revenue	11.9	11.3	12.6	12.4
Total grants	0.7	0.2	0.5	28.4 <sup>41</sup>

<sup>40</sup> There are 12 commercial banks in Cameroon now, but we could not lay hands on recent information about the banks concerning their financial assets and number of branches. Their websites could not provide all of this information.



<b>Total expenditure</b>	15.3	16.0	14.6	14.5
Current expenditure	13.2	14.0	12.1	11.7
Capital expenditure	2.1	2.0	2.4	2.9
Domestic investment	1.4	1.1	1.8	1.9
Own-resource financed	1.3	1.0	1.2	1.5
Debt-relief financed	0.1	0.1	0.6	0.4
Foreign-financed investment	0.5	0.8	0.5	0.7
<b>Overall balance, cash basis</b>				
Excluding grants	0.4	-0.4	2.2	2.9
Including grants	1.1	-0.2	2.7	31.3

Source: IMF (2008, Table 5, p.21) and IMF (2006, Table 6, p.31)

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<sup>41</sup> Total grants shut up exceptionally in 2006 due to debt relief resources from the HIPC completion point