

COUNTRY FINANCING PARAMETERS – CAMEROON

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Background

Macroeconomic Context

Since the mid-1990's, Cameroon has undertaken a comprehensive economic reform program, with a very positive impact on economic performance. Economic growth has been steady with a real GDP growth sustained at around 4.5 percent during 1997-2004, and inflation has been contained to less than 2.0, partly due to prudent monetary policy at the regional Central Bank, BEAC. In 2004, Cameroon has continued to maintain broad macroeconomic stability, with slowly rising per capita GDP. Growth performance in 2004 was good with GDP growth reaching 4.8 percent, and inflation remaining very low. The current account deficit has declined from 7.0 percent in 2002 to 1.2 percent in 2004 despite some appreciation of the real effective exchange rate, in part due to a stronger export performance and fewer oil-sector related imports. On the fiscal front, Cameroon has remained in overall fiscal surplus (including grants) of 1.4 percent of GDP in 2003. However there were slippages in the PRGF program due to lower payments on domestic public debt and utility bills, a deterioration of the financial situation of some public enterprises (especially CAMAIR and CAMPOST) and lower than expected rates of non-oil revenue mobilization (from 13.7% in 2003 to 13.1% in 2004) despite innovations in fiscal management.

The IMF suggested that the government should implement a staff monitored program (SMP), which could be replaced by a new PRGF arrangement after a satisfactory track record has been established. Under this scenario, the HIPC completion point could be reached in the first semester of 2006.

Due to the adoption of a series of prudent policies and successful negotiations with donors and international creditors, Cameroon's external debt has decreased significantly from 70 percent of GDP in 1995 to 50 percent in 2003. Also, Cameroon's debt service obligations have decreased considerably by an estimated \$100 million per year over the past few years. Foreign debt is projected to decline due mostly to debt relief to 39.6 percent in 2004. However, as the PRGF was declared off track, Cameroon is likely to incur arrears on external debt service after the Paris Club rescheduling expired on December 20, 2004. Nevertheless, debt service could be rescheduled after a new PRGF arrangement is in place. As a result of a prudent borrowing policy, Cameroon's debt burden indicators do not signal longer-term sustainability issues. The general terms of new borrowing are conducive to longer-term fiscal and debt sustainability. Under preliminary projections for economic growth and fiscal balances, Cameroon's prospects for meeting its debt and fiscal targets are strong. This will need to be confirmed by a revised Debt Sustainability Analysis in the context of a new PRGF.

On the fiscal side, as per the IMF recommendation, the GoC has adopted measures to strengthen non-oil revenue mobilization in the 2005 finance law adopted in Dec 2004, including raising the VAT from 17% to 17.5% and removing VAT exemptions consistent with CEMAC regulations.

Portfolio

Now that the wide-ranging third structural adjustment credit (SACIII) was successfully concluded in March 2004, the Bank's portfolio amounts to US\$ 228 million, and comprises seven operations in the transport, public/private partnerships, environment, rural development and

HIV/AIDS sectors (commitments: \$227.8 million; undisbursed: \$130.4 million). New IDA lending planned in the context of the FY04-06 Country Assistance Strategy would consist of a Sector Adjustment Loan in the Forestry sector that would pilot a progressive move towards programmatic lending and a Transparency and Accountability Capacity Building project (about \$10 million), that would pave the way for a PRSC. An education sector support project (about \$15 million) and a urban project (about \$15 million) are also under preparation. The overall Country Assistance Strategy for FY04-06, presented to the Board in September 2003, aims to strengthen the institutional framework for pro-poor economic management and service delivery, and to reduce selected constraints to private sector development.

After a notable improvement two years ago, the quality of the portfolio has been stable over the last year, with one remaining problem project. Percentage of projects at risk remains high owing primarily by the persistence of two country flags despite corrections of the underlying problems: in particular the country CPIA rating, and its governance indicators in particular, has increased significantly recently.

The following country financing parameters have been discussed with Cameroon authorities.

Cost Sharing

It is recommended to allow up to 100% Bank financing for individual operations in Cameroon. Given Cameroon's overall commitment to its development program (as spelled out in the PRSP) and in light of the fact that the Government of Cameroon is financing more than 75% of its overall development program (of which Bank-financed projects are only a small part), there is no need for specific, required counterpart contribution to individual Bank-financed projects.

In recent years, the Bank's financing as a share of project costs has been about 50% (83% in FY01, 49% in FY03 and 24% in FY04).

Cameroon's strong ownership and commitment for its development program is evidenced by the fact that it is principally financed through the government budget and counterpart funds, although donors make important contributions through program loans and grants, financing close to 25 percent of the investment budget commitments in the country in 2003 and 2004, a marked departure from the prevailing practice a decade ago when donor support was more important for government's budget support.¹ In actual terms, in 2003, the investment program was close to CFA 200 billion (US\$400 million), of which CFA 54 billion (US\$108 million) was foreign-financed through donor assistance, including the Bank, European Union, and the African Development Bank.²

The Bank-funded portion of the development program is well aligned with the priorities of the PRSP. Projects in the transport sector (Railway concession and Douala Infrastructure) supports the fourth pillar of the PRSP. An on-going project to support the fight against HIV/AIDS and a local development project in rural areas, together with an education project and a pilot urban project, both under preparation, will support the implementation of the sixth pillar of the PRSP. Finally a public-private partnership project supports the implementation of action

¹ The recurrent budget is almost exclusively financed from the national budget.

² In terms of budget executions, the ratio may be different because of a low execution rate of the investment budget due to procedures, disbursement guidelines, and mismatch between time-structure of investment projects and myopic nature of the budget.

plans for the privatization agendas of the main public companies, in direct support of third pillar of the PRSP, and a key priority for the Government as it strives to reach the HIPC completion point. As mentioned above, project performance has substantially improved over the past few years and is now relatively good with one project temporarily rated unsatisfactory. It is noteworthy that OED has recently confirmed satisfactory assessment of the Third Structural Adjustment Credit (SACIII) which was concluded in March 2004 and has been the backbone of our intervention in Cameroon over the past few years and has supported a set of politically complex and ambitious reforms in the transport, financial and forestry sectors as well as privatization.

In recent years, under the assistance of the IMF and the World Bank, the country has been undergoing structural reforms in order to improve its public financial management and successfully execute the vision for broad-based economic development, articulated in the comprehensive Poverty Reduction Strategy Paper (PRSP) produced in April, 2003.

- In order to accomplish these objectives, Cameroon has undertaken reforms in public financial management over the last several years, moving towards a more realistic and predictable budget. Curtailment of unnecessary expenditures under Bank and Fund adjustment operations, avoidance of leakages of public funds, and improvements in Treasury-budget linkages have all added credibility to the public expenditure process. Donor finances, including HIPC resources, are well incorporated into the national budget, and the new information system allows a proper tracking of donor expenditure. Furthermore, Cameroon has been one of the countries in Africa engaging to introduce medium term expenditure frameworks (in health and education sector) into its budgetary process in the mid-1990's and the operationalization of the MTEF into the budget is currently underway.
- Overall, some progress has been made by Cameroon in improving its public finance management system³. With regard to budget formulation, while the functional nomenclature makes it possible to correctly track expenditure devoted to fighting against poverty, the harmonization of the nomenclature for parastatal entities (EPAs) and for local communities would facilitate consolidation. With regard to budget execution, problems are evidenced by accumulation of arrears over the last year. Internal controls would need to be strengthened and a reform is underway. On the positive side, expenditure tracking surveys are carried out within the ministries of health and education. Finally, the public procurement system has been satisfactorily reformed over the last three years; but there is a need to focus on enforcing set rules and taking sanctions against identified cases of misconduct.

The country team will seek to apply the cost-sharing parameter as follows: 100% Bank financing might be expected in some projects/sectors where urgent actions are required such as HIV/AIDS, electricity and environment. In sector programs (possibly in the health, education, transport and forestry sectors) some financing from Government would be generally expected, all the more that a gradual move to programmatic support in these sectors will make the counterpart funding arrangements more natural and systemic. In projects providing support to local communities, financing may be sought from project beneficiaries in kind or in cash (e.g., National Community Driven Development Program -- PNNDP or urban projects). Generally, in projects, the option of financing 100% of individual investment contracts will be retained so as to rationalize and simplify the financing arrangements.

³ Cameroon meets 7 of the 16 indicators of the HIPC Assessment and Action Plan, as opposed to only 4 out of 15 in 2001.

Recurrent Cost Financing

The Bank will consider, on a project-by-project basis, financing recurrent costs taking into account (i) the sustainability of project achievements, (ii) future budgetary outlays. The Bank would continue to monitor the overall fiscal and debt situation, including in the context of the IMF's PRGF, and its implications for recurrent cost financing.

Recurrent cost financing in the past has been mainly for project operating costs. These have varied across projects: recurrent cost financing accounted for about 15%, 1% and 14% of Bank investment lending financing in FY01, FY03 and FY04 respectively. While relatively mixed, sustainability of projects, as rated by OED, has improved over the past 5 years. Since FY01, seven projects have closed and been evaluated, and except for one old problem project in the health sector, all have been rated with a likely sustainability. So far, OED⁴ has confirmed this evaluation for all but one project (a LIL in the higher education sector). These encouraging results are expected to be sustained on account of two positive developments: first, the government is more and more inclined to mainstream project implementation within existing institutional arrangements (the most prominent example of which is the CAPECE where it has decided to finance all recurrent expenditures), and second, the country assistance strategy is progressively moving towards programmatic support. Financing of recurrent expenditures will remain needed in the context of the foreseeable portfolio (mainly for project operating costs) in the following context : (i) some projects, notably local development projects in the urban and rural sectors, are expected to require *transitory* structures that will help support a nascent decentralization process, (ii) some activities require some emergency actions (such as in the context of the fight against HIV/AIDS) which the current capacity cannot deliver, (iii) some infrastructure investment projects may also require ad-hoc structures necessary for the time of investment.

The fiscal consequences and the impact on debt sustainability of financing recurrent cost is expected to be marginal.

- First, debt relief under HIPC will contribute significantly to reducing the external debt burden for Cameroon. Debt sustainability analysis undertaken in the context of the country Assistance Strategy (2003) indicates that under the base-case IDA lending scenario in the CAS, the NPV of debt-to-exports ratio would fall from close to 150 percent in 1999 to 88 percent by 2006, three percentage points above the level projected at the Decision Point. The slippage in the PRGF program may have some adverse effects on these ratios; however under preliminary projections for economic growth and fiscal balances, Cameroon's prospects for meeting its debt and fiscal targets are strong. This will need to be confirmed by a revised Debt Sustainability Analysis in the context of a new PRGF.
- Second, Cameroon has in place a unified budget where current and investment expenditures – including externally financed expenditures are presented together. While dual budgeting is still present for separating investment from recurrent expenditure and handled by different Ministries, a comprehensive budget is used for fiscal projections and debt sustainability analysis.

Taxes and Duties

⁴ At the time of this report, OED rating was missing for two projects.

Cameroon's tax and customs regime are relatively liberal due to its reform efforts and its membership in CEMAC, (*Communauté Economique et Monétaire de l'Afrique Centrale*), the Central African economic and monetary union. Membership in the trade regime, with a common external tariff (CET) in place for trade with third countries, with no duty for goods traded within the community, has conferred credibility and discipline to Cameroon's overall policy. The CET has four rates: 5% (for essential goods); 10% (for raw materials and capital goods); 20% (for intermediate goods); and 30% (for consumer goods). Import tariffs are fairly low, especially for capital and essential goods.

With improved shares of domestic taxes and less dependence on the volatile trade taxes and oil revenue, the composition of Government revenue is more favorable now than it has historically been in the past. Since the 1994 devaluation, fiscal policy in Cameroon has become increasingly oriented towards strengthening public finances and raising the low non-oil revenue to GDP ratio by widening the tax base and reducing exemptions. Direct taxes account for close to 20 percent of total revenue, while the share of trade taxes has declined to less than 15 percent in 2003. Secondly, as part of the reform process, a value-added tax (VAT) was introduced in January, 1999 to replace the old turnover tax and was unified at 17 percent and recently increased to 17.5 percent. Finally, a fiscal reforms in the forestry sector, adopted in he July 2000 Finance Law have yielded substantial dividends to government revenue.

In recent years, the Government has made considerable efforts to widen the income tax base by increasing the number of households under the tax net, including a relatively buoyant corporate tax collection effort. Cameroon's corporate income tax is at 38.5 percent and its VAT is at 18.7 percent. Cameroon's top personal income tax rate has been significantly cut to 38.5 percent, down from the 60 percent reported in 2003. Bank-financed projects taxed at the same rates as the country's normal rates.

There are no taxes or duties that are unreasonable and the Bank may finance all taxes and duties associated with project expenditures. In individual projects, the Bank would examine whether taxes and duties constitute an excessively high share of project cost.

Local Cost Financing

Cameroon meets the two criteria for Bank financing of local expenditures:

- **Financing requirement exceeds public sector's own resources.** Foreign-financed expenditures account for close to 25 percent of total investment expenditure in Cameroon over the last several years. Even after taking into account already identifiable financing, the residual financing gaps between the resources and the requirements are currently \$0 in 2004, \$512 million in 2005 and \$334 million in 2006. The financing gaps before taking into account external financing are obviously higher. Due to the slippage in the Fund program and the delay in Paris Club rescheduling, the future financing gaps have become larger than anticipated.
- **Financing of foreign expenditures alone would not enable the Bank to play a meaningful role in Cameroon.** Event though. the distinction between local and foreign expenditures is somewhat arbitrary in Cameroon, because the country shares a common currency with other CEMAC countries, the CFA franc, which is pegged to the Euro, it is noteworthy that disbursement of local costs have been high over the past years (73 percent in FY01, 41 percent in FY02, 33 percent in FY03 and 56 percent in FY04) and are expected to remain so. Existing and

future Bank-financed projects have a high element in local expenditures: in particular, one are where the Bank is expected to scale-up its financing relates to local development and the financing of local capacity building (in the urban and rural sector).