INTERNATIONAL MONETARY FUND

REPUBLIC OF CONGO

SELECTED ISSUES

September 2014

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SELECTED ISSUES

July 7, 2014

Approved By	Prepared By Adrian Alter, Matteo Ghilardi, Dalia Hakura, Rodolfo Maino, Cameron McLoughlin, Maximilien Queyranne, and Ivo Razafimahefa
The African Department	

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EQUITABLE FISCAL CONSOLIDATION[1]

High levels of public spending and the depletion of oil reserves call for a fiscal adjustment in Republic of Congo over the medium to long term. Estimates of proven oil reserves suggest that oil revenues will decline decisively after 15 years.[2] Given the current very large non-oil fiscal deficit, this will have a major impact on fiscal aggregates. Staff proposes a fiscal adjustment path that aims at halving the non-oil primary deficit to around 30 percent of non–oil GDP by 2019, with a further reduction in the medium to long term. This reduction in the non-oil deficit should be achieved first and foremost by a rationalization of spending. In addition, effort should be made to raise non-oil revenues in an equitable way. In this context, this note proposes a strategy that could mitigate the adverse effect of fiscal consolidation on inequality and poverty. The first section reviews income inequality and poverty trends, and describes the redistributive role of fiscal policy in Republic of Congo. The second section discusses how fiscal consolidation can contribute to achieving distributional objectives through tax and expenditure policy reforms.

A. Poverty and Inequality: the Role of Fiscal Policy

1.   Poverty and inequality are comparatively high in Republic of Congo. Poverty in Congo was significantly higher in 2011 compared to countries with similar GDP per capita[3] (Figure 1); and Congo's poverty scores are similar or higher to other Sub-Saharan African (SSA) countries with significantly lower income. While the poverty rate went down from 50.7 percent in 2005 to 46.5 percent in 2011, the number of poor increased from 1.8 to 1.9 million.[4] In addition, poverty is widespread in rural areas (75.6 percent) and has increased sharply from 2005 (57.4 percent), while it has significantly declined in urban areas (from 53.4 to 29.4 percent in Brazzaville). As regard inequality, the GINI coefficient for disposable income declined in Congo between 2005 and 2011, and is now equivalent to the average Sub-Saharan African (SSA) countries (0.44).[5] But it remains above countries with similar level of income (0.39). As a result, Republic of Congo's performance in the human development index (HDI) is significantly below the average of countries with similar GDP per capita, and has improved more slowly since 2005.

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[1] Prepared by Maximilien Queyranne (FAD). The author would like to thank Mario Mansour and Patrick Petit (both FAD) for very helpful suggestions.

[2] Average production in 2012 and 2013 was 93 million barrels per year. After peaking at 118 million barrels in 2017, oil production is estimated to decline to about 18 million barrels by 2030.

[3] This analysis considers countries that have a per capita GDP (in PPP US $) between 25 percent above and 25 percent below that of Republic of Republic of Congo. The analysis in this note is based upon internationally comparable data, for which the latest observation is 2011 or 2012.

[4] The Republic of Congo's population grew at an annual average rate of 3 percent over the same period.

[5] The latest international GINI coefficient available is for 2005. For comparative analysis, the 2011 figure was estimated by applying the percentage point improvement between 2005 and 2011 taken from the national household survey, for which the GINI coefficient went down from 42 to 0.39 over this period.

Figure 1. Selected Poverty and Human Development Indicators

Poverty headcount ratio at national level (2011, percent of population)[1]
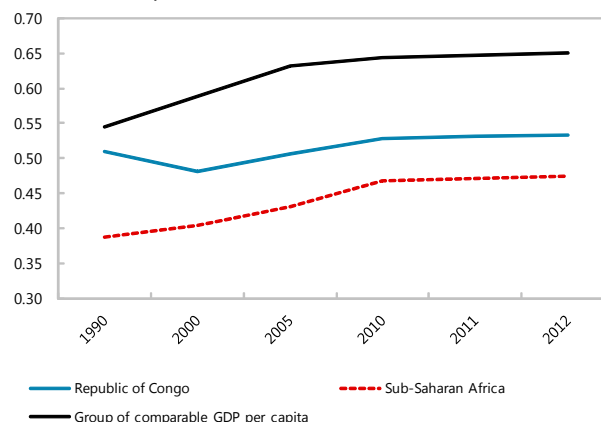
Human development indicator
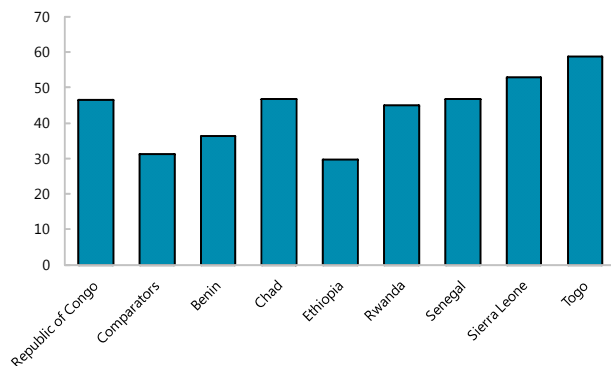
1/Comparators are developing countries that have a per capita GDP (in PPP US$) between 25 percent above and below that of the Republic of Congo.

Source: World Development indicators (World Bank).

Source: UNDP (HDI).

2.   Total government revenue and spending are particularly high in Republic of Congo. Total government revenue represented 111.7 percent of non-oil GDP in 2013, significantly above most oil exporting LICs (Figure 2). Oil revenue accrued for almost 75 percent of government revenue (at 34.5 percent of GDP). As a result, total government spending was also significantly higher than comparators, with the exception of Equatorial Guinea.

Figure 2. Fiscal Aggregates in 2013
(percent of non-oil GDP)

General government total revenue
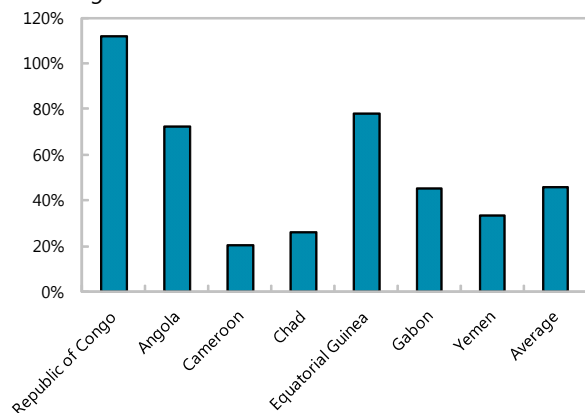
General government total expenditure

Source: IMF staff estimates.
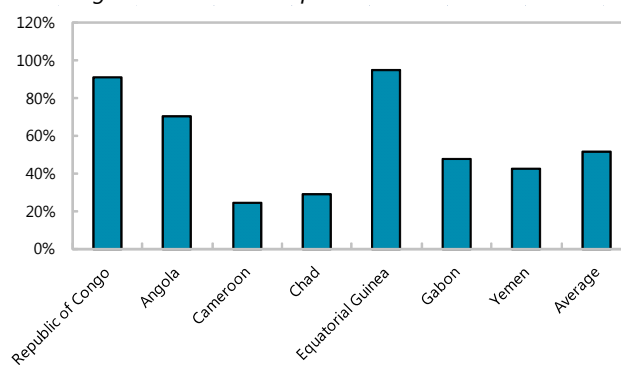
Source: IMF staff estimates.

3.   However, the low level of tax revenue significantly reduces the redistributive role of tax policy. Tax revenue accounted for only 6.7 percent of GDP in 2010, much lower than the average SSA countries (17.9 percent), and countries with comparable income level (23.4 percent). Hence, tax policy can only play a marginal role in achieving redistributive goals in Republic of Congo. In addition, the tax structure in Republic of Congo favors consumption taxes, which are less progressive than income

and wealth-related taxes. Income tax and property tax revenues (classified as other taxes) are particularly limited in Republic of Congo, even compared to other SSA countries.

Figure 3. Composition of Government Revenues

Share of government total revenues
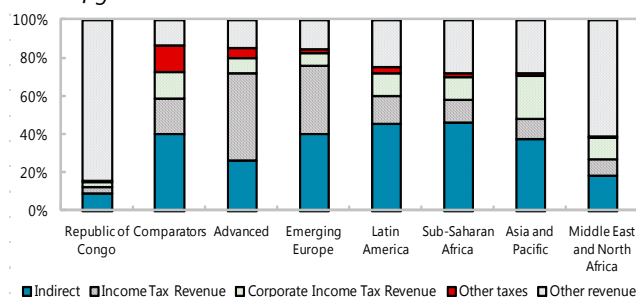
Composition of tax revenues (percent of GDP)

Sources: IMF estimates.
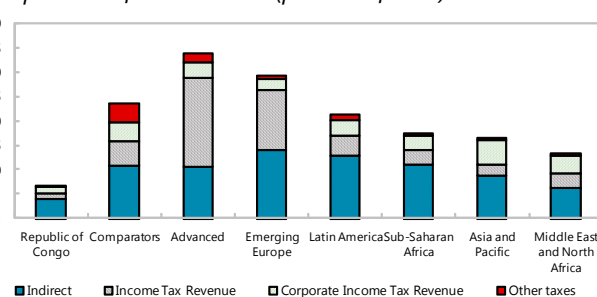
Sources: IMF estimates.

4.   Recent personal income tax (PIT) reforms have not strengthened its progressivity. The government reformed the PIT in 2011 and 2013, by reducing the rate of each bracket by 5 percentage points (except for the first bracket which was maintained at 1 percent), and increasing the four lower brackets.[6] Staff estimates that this reform is mostly regressive, as its benefits will accrue more to higher income families, and single people with intermediate level of income (Table 1). These results reflect (i) the larger impact of the reduction of the tax rates than the increase of the lowest brackets, which benefits more low income households; (ii) the large tax allowance on salary income and the family tax system, as they are proportional to income.

5.   Social spending was marginal in 2010, and largely crowded out by significant energy subsidies. Social spending was much lower than most SSA countries, and countries with similar income levels. In Republic of Congo, fuel subsidies were higher in 2010 (3.59 percent GDP) than aggregate spending on education, health, and social protection (2.51 percent GDP), and significantly larger than in the SSA region (1.38 percent). Large fuel subsidies may reflect the desire to share the country's oil wealth through the provision of petroleum products at below the international market prices, even if refined oil is imported. But such subsidies have a large fiscal cost and crowd out social spending. Fuel subsidies are usually poorly targeted, and benefits accrue mostly to higher-income groups, because they consume the most. In SSA, 44.2 percent of benefits from fuel subsidies in 2010 accrued to the richest 20 percent of the population, while the poorest 20 percent only received 7.8 percent (Arze del Granado, Coady and Gillingham, 2010).

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[6] Tax brackets are as follow (2014 budget act): 1% (0-0.46 million CFA), 10% (0.46– 1 million CFA), 25% (1–3 million CFA), 40% (3 to 8 million CFA), and 45% (+8 million CFA).

Table 1. Impact of recent PIT reforms on the average tax rate
(percentage points)

Taxable Income levels (FCFA)	Change of the average tax rate for a single person	Change of the average tax rate for a family with 2 children	Change of the average tax rate for a family with 2 children
232,000	0	0	0
732,000	5.8	0	0
2,000,000	6.2	6.1	5.6
5,500,000	6.2	6.4	7.2
15,000,000	4.8	6.4	7.2

Source: IMF estimates.

6.   The government has sharply stepped up its investment to address infrastructure gaps.
Public capital spending has risen from 6.1 percent of GDP in 2006, to 18.8 percent in 2010 (Figure 5).
As a result, the public capital stock in Republic of Congo has increased since 2006, and was
significantly higher than comparators (GDP per capita) in 2011, as well as oil exporting low income
countries (LICs,[7] Figure 5). According to the National Development Plan, the vast majority of capital
spending for the period 2012–16 is to be allocated to infrastructure (51.7 percent in 2014) and
economic development (16.7 percent). However, the share of capital expenditure allocated to social
development should be raised from 11.7 percent to 16.7 in 2014. According to the 2014 budget act,
social ministries are to receive around 14 percent of government capital expenditure.

Figure 4. Composition of Spending

Composition of social spending in 2010 (percent GDP)
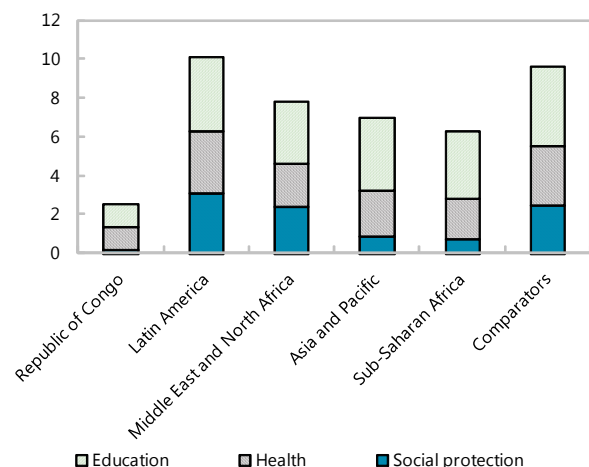
Fuel subsidies and social spending in 2010 (percent GDP)

Source: IMF estimates.

Source: IMF estimates.

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[7] Cameroon, Chad, Sudan, Vietnam, Yemen.

Figure 5. Capital Expenditure and Public Capital Stock

Public investment (percent of GDP)

Public capital stock (percent of GDP)

Sources: Center for International Comparisons; OECD; and IMF.

Sources: Center for International Comparisons; OECD; and IMF.

7.   Recently education spending and service provision have increased significantly. Public resources allocated to the education sector were limited in 2010 compared with other SSA countries and countries in the same range of income level (Figure 6). In addition, the composition of education spending was somewhat regressive. Primary education tends to be more progressive, as lower income groups have a larger access to this l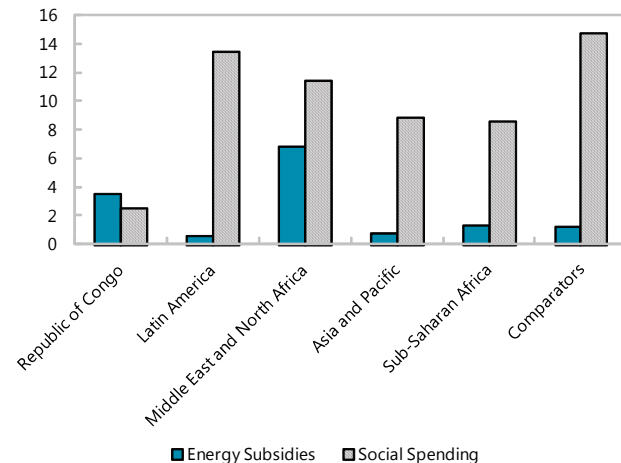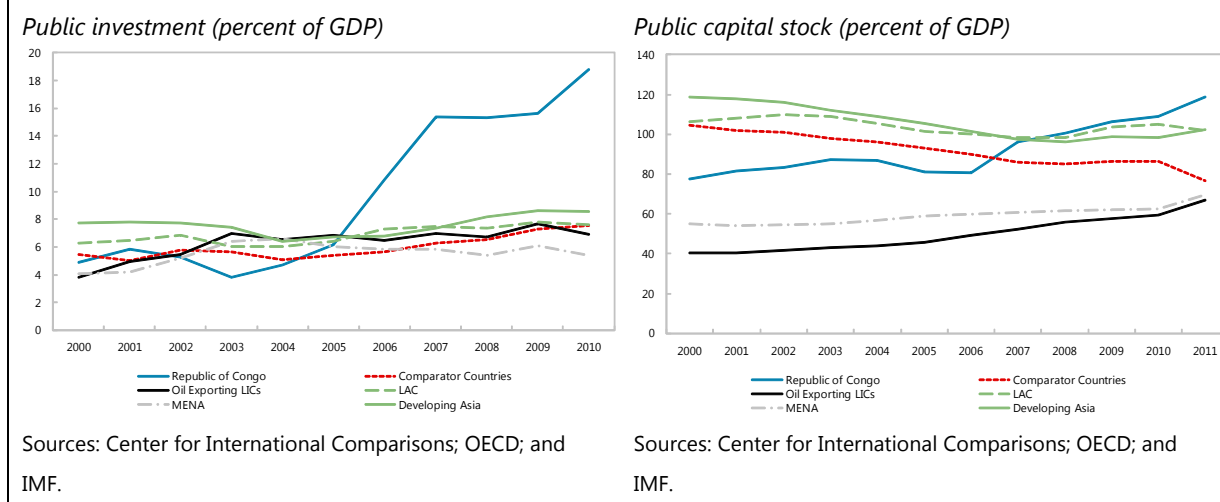evel of education. But the share of expenditure allocated to secondary and tertiary education in Republic of Congo was higher than in countries with a comparable income level. In addition, although Congo was performing comparatively well as regards the gross enrollment rate, the average class size in 2010 was significantly higher than countries with comparable GDP per capita, raising questions about service quality. Cognizant of these weaknesses, the government has progressively increased its education spending. The share of the budget allocated to the education ministries has risen from 6.1 percent in 2012 to 8.9 percent in 2014, with a nominal increase of 57 percent over the same period.

8.   Health spending and in-kind services have been insufficient to compensate large income and geographical inequalities. In 2010, health spending in Republic of Congo was among the lowest in SSA (Figure 7). As a result, the country's reliance on out-of-pocket spending, at 64 percent of total health financing, was amongst the highest in SSA region, according to the World Bank. Service provision is insufficient and access to healthcare professionals limited, particularly in rural regions, which are also the poorest. Health inequalities are high, with households in the lowest 20 percent of the income distribution suffering from significantly higher child mortality rates than the richest 20 percent.

Figure 6. Education Spending and Outcomes in 2010

Education spending in 2010 (Percent of GDP)
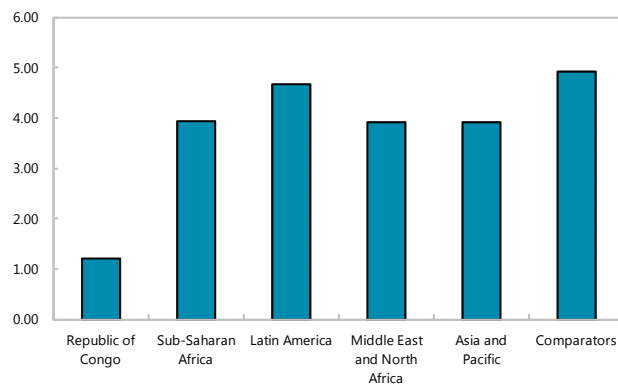
Education spending by level (percent of total education spending)

Source: The World Bank.
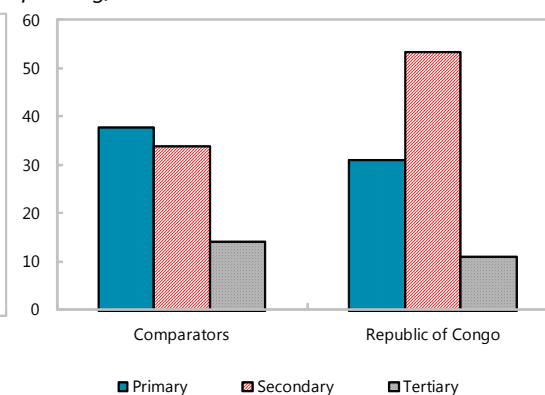
Source: The World Bank.

Gross enrollment ratios
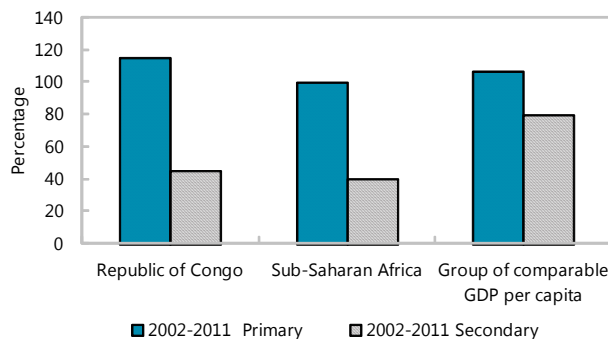
Average size class - Primary (number of pupils)

Source: The World Bank.
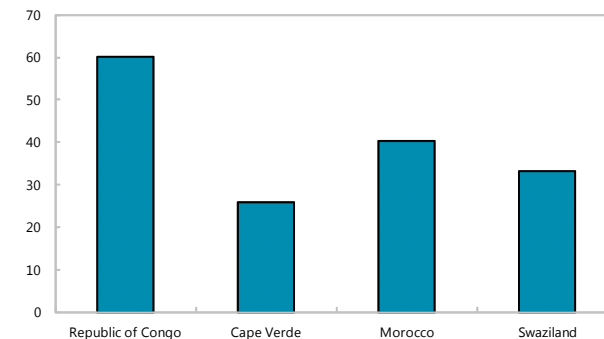
Source: The World Bank.

9. **The government has committed to implementing a system of universal healthcare insurance**. While budget allocations have increased for the education sector, they decreased for the Ministry of Health between 2012 and 2014 both in nominal terms (by 1.6 percent), and as a share of total budget spending (by 1.3 percentage points). However, the government is expected to spend USD 100 million over the next five years, with the aim of implementing a universal health coverage scheme, with World Bank support. This program would include fee waivers for the poorest households, as well as free service provision. Its financing is yet to be determined and will depend on funding from households' contribution and government subsidies to the poorest households.

Figure 7. Health Spending, Service Provision and Inequalities

Health spending in 2010 (percent GDP)
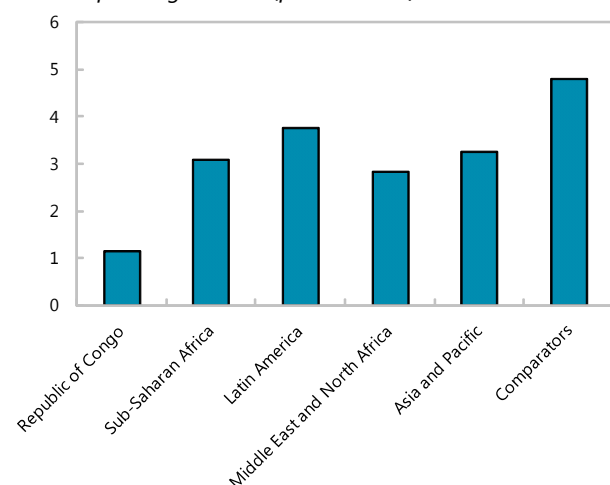
Source: World Health Organization.

Health care professionals in 2010 (per 1.000 people)
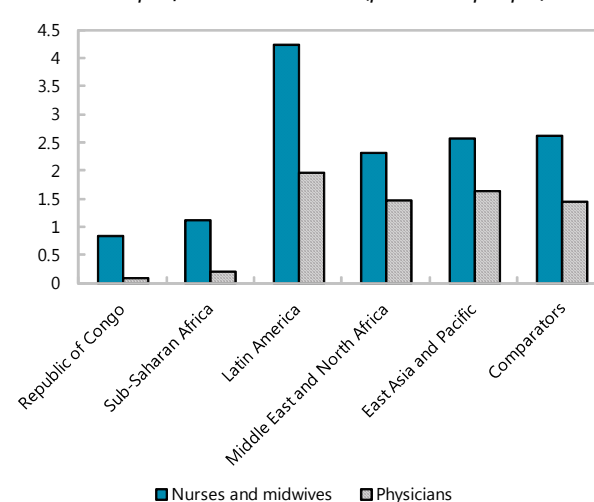
Source: World Health Organization.

Children mortality rates of and income distribution (2011-2012)
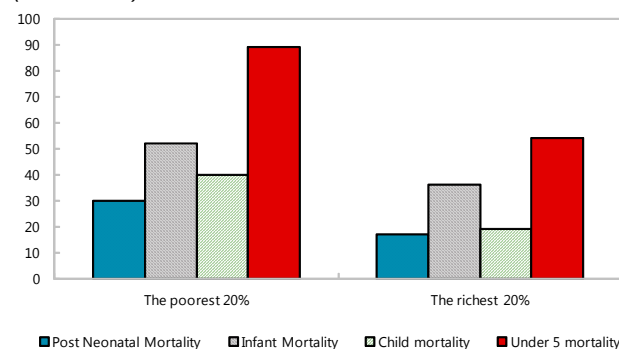
Source: 2011-2012 Demographic and Health Survey.

Densities of qualified workers per region (per 1,000 people)
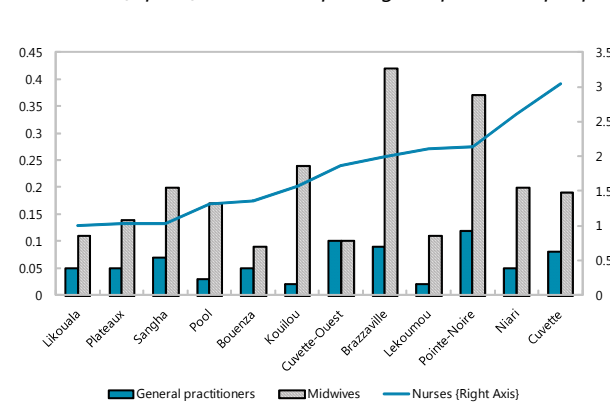
Source: 2011-2012 Demographic and Health Survey.

10.   Republic of Congo has also started implementing social safety net programs. Spending on safety nets in Africa has increased since 2005 on the back of food and financial crises, and increasing donor support in this area.[8] Congo has started late in comparison to other SSA countries, but is now preparing programs that provide transitory income generating activities for the unemployed youth, labor intensive work, self-employment and rural employment programs. In addition, a pilot conditional cash transfer program (Lisungi project) is being rolled out for 5000 poor households and 1000 elderly. The cost of expanding this program at a national scale is estimated at around 1 percent of GDP (Box 1).

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[8] See The World Bank, "Reducing Poverty and Investing in People, the New Role of Safety Nets Program in Africa", 2014.

Box 1. Initiating a Social Safety Net Through Cash Transfers

To address the challenges of high poverty and inequality, the Republic of Congo government is focusing on the development of a social safety net targeted at the poor and vulnerable groups. In its initial phase the four-year social safety net program (known as "the Lisungi project") would entail conditional cash transfers to 5,000 poor families and 1000 individuals of over 60 years of age in three areas (Brazzaville, Pointe-Noire, and Cuvette). Eligible households are those living below the food poverty line and that have at least one child (between the ages of 0 and 14 years) or an elderly person. Transfers to the households would be subject to conditions related to continuous schooling of children and regular health checks for all household members. The program would be monitored and evaluated regularly. Depending on its effectiveness, the program's coverage would be expanded to all eligible households in 2016.

The conditional cash transfer program is expected to improve the Republic of Congo's social and economic indicators in three ways. First, the cash transfers would reduce current poverty. The cash transfers would reach families that do not directly benefit from economic growth. Second, because they are conditional on education and health spending, they should have a positive impact on school enrollment rates and on child nutrition, thereby improving human capital. Finally, the transfers would improve household productivity by helping families to invest in economic activities and to gain access to microcredit because of the collateral provided by the cash transfers, and, thereby, boost employment and social cohesion.

The Lisungi project mimicks similar programs in other countries, such as Brazil, Mexico, Colombia, Ghana, Niger and Kenya. The success of these programs has depended on the quality of the management information system and the direct and regular payments to recipients.

An impact analysis carried out by the World Bank suggests that the cash transfer program could have a significant impact on poverty and inequality in the Republic of Congo. It is expected that the Congolese poverty rate would decline from 46.5 percent in 2011 to 38.9 percent--3.9 percentage points above the MDG1 goal (35 percent by 2015) if the program were to operate at a national scale. The Gini index of inequality would also drop between 8 and 11.8 percent. Applying the program on a national scale, involving payments of CFAF 20,000–25,000 on average per month to all of the poorest households with children and/or elderly in the country, would cost around 1 percent of GDP or about 2 percent of public expenditure.

Prepared by Dalia Hakura based on the World Bank 2013 *Congo, Republic of - LISUNGI Safety Nets Project report*; Available at: http://documents.worldbank.org/curated/en/2013/12/18794003/congo-republic-lisungi-safety-nets-project.

B. Strategy for an Equitable Fiscal Consolidation

11.   Fiscal consolidation should be based on progressive tax and spending measures, in order to protect vulnerable households during adjustment. In LICs, while fiscal adjustment can have an adverse effect on employment and inequality in the short term, this effect may be reversed in the long term. Inequality and unemployment may even decline over the longer term if fiscal adjustment helps bring down inflation—which is damaging to the poor—or corrects macroeconomic imbalances that are hindering growth. And as spending in developing economies is generally not progressive, cutting such spending can ensure fiscal consolidation while avoiding a surge in inequality.[9] Hence, fiscal policy should aim at balancing the provision of much needed public services with fiscal sustainability, through tax revenue mobilization, and prioritization of spending. Fiscal consolidation should be based on progressive tax and spending measures, in order to protect vulnerable households during adjustment. The government should not resort to across-the board spending cuts, which can hurt low-income groups. It should rather focus on improving the composition and efficiency of spending, to prevent that spending restraint affects the quantity or quality of basic services.

12.   A better-functioning PIT system would enhance tax progressivity. Strengthening the PIT yield can raise the tax ratio while strengthening progressivity. Implementing a zero-tax bracket for the lowest incomes would both simplify revenue administration and enhance tax progression. Rationalizing tax deductions is also needed, as they accrue disproportionally to the rich, and lead to significant revenue losses. Large tax allowances on salary income should be abolished, and be further reduced for professional expenses. The family tax system benefits based on the number of dependents (*quotient familial*) is a major hindrance to equity of the income tax, as it favors large high-income families, and should be replaced by a fixed tax credit that is the same for all taxpayers. In addition, there is no need for a tax incentive to increase the fertility rate in Republic of Congo which is among the highest in the world. Deductions for mortgage interest or for capital income should also be abolished, as only high income households are able to access banking loans or receive financial earnings.

13.   Develop property taxes. There is a large scope for increasing this tax in Republic of Congo. This reform could have a significant redistributive impact. To make it progressive, the tax could exclude the permanent residence below a certain threshold, to prevent the taxation of low income households. Property tax could be implemented gradually, as it requires a reliable land registry, as well as the administrative capacity to manage it.

14.   Minimize the use of VAT reduced rates and exemptions. Achieving redistributive objectives through consumption taxes usually proves to be costly. As the rich generally spend more in absolute terms, they tend to benefit more from exemptions or reduced VAT rates. Congo extensively uses these instruments for necessities, in particular on a large variety of food products and agriculture

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[9] IMF, "Fiscal Policy and Income Inequality", January 23, 2014.

inputs. An exemption for electricity and water consumption also exists, which is particularly regressive as only 37.8 percent of the population had access to electricity in 2011. Reducing the list of goods exempted or benefiting from reduced VAT rates would help raise revenues which could be used to increase targeted social transfers, administrative capacity permitting.

15.   As regard expenditure rationalization, the government should aim at cutting general subsidies. Reducing or abolishing fuel subsidies would create fiscal space for social spending. It would improve the progressivity of public spending, as higher income households consume more petroleum products. However, it would have a negative impact on the poorest households, as energy consumption represents a large share of their total consumption. Implementing this reform gradually and compensating vulnerable households would be critical to success.[10] In particular, targeted interventions on vulnerable households, through conditional cash transfers would be needed. But designing such programs requires significantly improving data transparency and reliability in Republic of Congo for informed policy decision making. Other mitigating measures can for example take the form of subsidies for public transportation.

16.   Containing the public wage bill and spending on goods and services could provide additional fiscal space for social spending. Purchase of goods and services (9.8 percent of non oil GDP) is particularly high in Republic of Congo in comparison to the average of oil exporting LICs (6.9 percent), and other CEMAC countries (excluding Gabon). Some expenditure rationalization is needed in this area. The wage bill in Congo (9.8 percent of non-oil GDP) is also higher than most other CEMAC countries. Progressive containment of the wage bill would help create fiscal space for social spending. The strategy should aim at ensuring an adequate level of recruitment in the health and education sectors, while reducing hiring in non priority sectors, using natural attrition.

17.   A change in the composition and level of public investment could also provide room for additional social spending. The capital stock accumulated in Republic of Congo by 2011 was significantly higher than countries with similar income level, and almost twice the average stock of oil exporting LICs. In addition, capital spending pressures will increase with the organization of the 2015 All-Africa Games in Congo. The proposed long term path aims at stabilizing the capital stock to GDP ratio at its 2011 level. The composition of public investment, which was largely concentrated on infrastructure, could also be geared toward social sectors to improve service provision. This approach will require evaluating current expenditure needs associated with the increase in education and health infrastructure.

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[10] See IMF, African Department Report 13/2,Energy Reform in Sub-Saharan Africa, Experience and Lessons,

Figure 8. Selected Current Expenditure in 2013
(percent of non-oil GDP)

Source: IMF estimates.
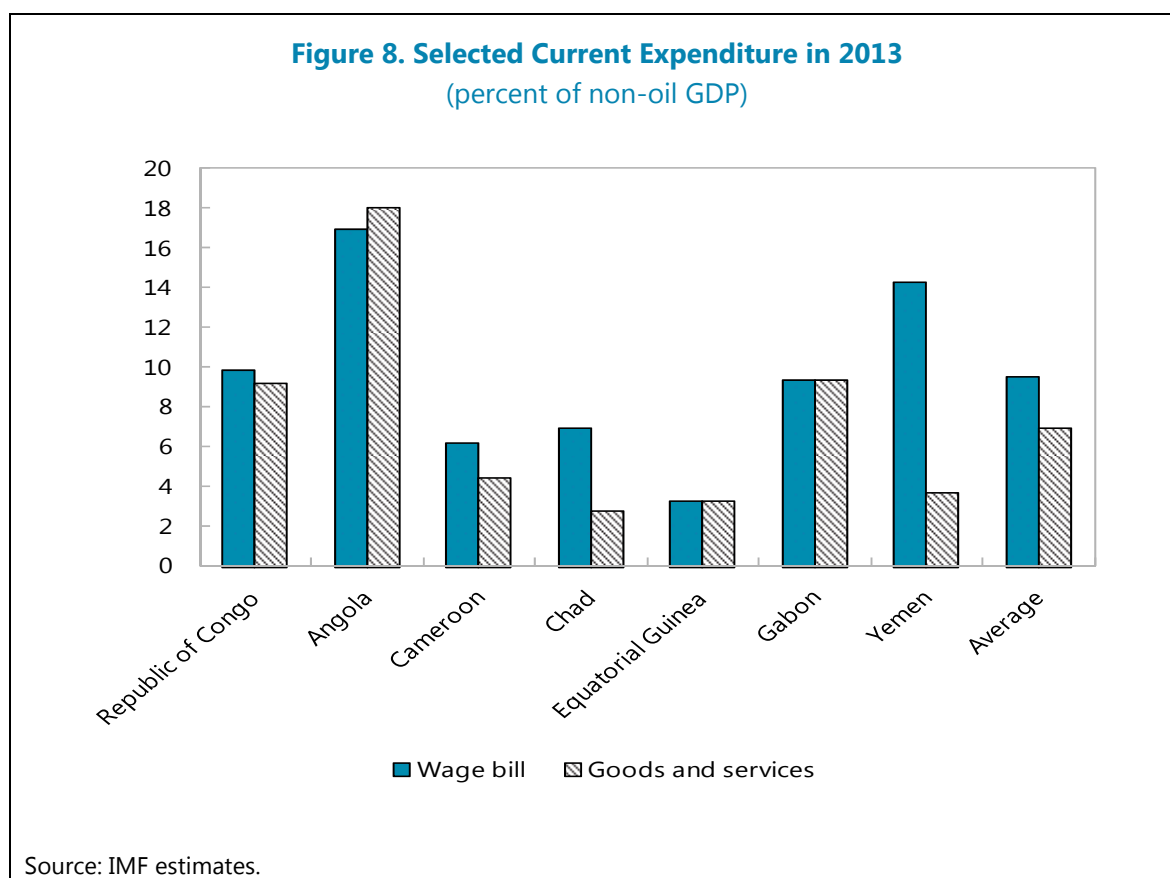
18.   Improving access to in-kind services by low-income groups would help reduce poverty and inequalities, and boost growth in the long run. In the education sector, the government should aim at prioritizing spending on primary schools, and improving service quality, in particular through the recruitment of additional teachers to close large staffing gaps (estimated at 14,000 teachers by the Primary National Education Council). In the health sector, the fiscal costs of the introduction of universal health coverage should be carefully assessed. The implementation should be sequenced, in order to increase progressively households' coverage while mitigating the impact on fiscal aggregates. Plans should be made in particular to determine the level of noncontributory coverage, in order to protect population groups unable to afford the cost of the insurance, while containing the fiscal costs. Progressivity should also be embedded in the design of social contributions to finance this healthcare scheme, as a flat price would weight disproportionally on the less well off. And in order to reduce poverty and inequality, this scheme should focus on expanding access to a broad package of essential health services for poor household; reducing health co-payment and user charges for low income-household; and ensuring access to health care facilities and professional, particularly in rural areas.

19.   Ensure adequate design of new social safety nets. As Republic of Congo is in the initial steps of designing new safety net programs, it should be mindful of design and implementation shortcomings which have been observed in other LICs. In particular, Congo should avoid fragmenting and duplicating small social programs, prevent bad targeting which can cause substantial leakages to non-poor households, and result in insufficient benefits levels for the most vulnerable people.

PUBLIC INVESTMENT, NATURAL RESOURCES AND DEBT SUSTAINABILITY[11]

The Republic of Congo's projected decline in oil revenue poses a challenge for the design of public investment paths that can foster economic growth while ensuring fiscal and debt sustainability. This note applies the Debt, Investment, Growth and Natural Resources (DIGNAR) model developed by the IMF's Research Department to analyze this issue. The model simulations highlight the importance of a prudent approach to public investment.

20.   The Republic of Congo's economy is heavily dependent on oil. Currently, oil production accounts for 58 percent of GDP, oil exports account for 78 percent of exports, and the government's revenues from oil represent 74 percent of total fiscal revenues. The government is drawing on its oil revenues to implement an ambitious investment plan to develop the economy and address social and infrastructure gaps.

21.   While oil revenues can help accelerate the Republic of Congo's development, the expected decline in oil production will lead to declining government revenue from oil over the medium term to the point that these revenues will be relatively insignificant by the early 2030s. The projected decline poses challenges in terms of designing sustainable public investment paths that can be properly financed and which allow a build up of savings that could support government spending in the post-oil era. This becomes of crucial importance given the current high level of government spending, concerns about the absorptive and implementation capacity of government spending, and spending pressures related to the hosting of the All-Africa Games in Brazzaville in 2015 and the 2016 presidential elections

22.   The Debt, Investment, Growth and Natural Resources (DIGNAR) model provides a framework to analyze the feasibility of public investment plans such as the one proposed by the Congolese authorities. The model is designed to analyze the nexus between natural resources revenues management, public investment, and public debt. The analytical framework is based on Buffie et al. (2012), Berg et al. (2013) and Melina et al. (2014) and includes a natural resource sector, investment efficiency, limited absorptive capacity, Dutch disease, and a detailed fiscal specification reflecting the operation of fiscal buffers. Taking resource revenues and public investment policy as given, the framework can simulate the macroeconomic outcomes of investing resource revenue, accounting for the investment-growth linkage and the feedback effect on non-resource revenue.

23.   The DIGNAR model provides a stylized representation of a small open economy with oil production and public investment needs like the Congolese economy. The particular features of the model are:

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[11] Prepared by Matteo Ghilardi (RES/SPR).

- Two types of households. Optimizing households have access to financial markets and can acquire international bonds with portfolio adjustment costs, which restricts the degree of capital account openness. The private sector pays a premium on foreign debt over the interest rate that the government pays on its own external debt. Non-optimizing consumers or rule-of-thumb consumers are liquidity constrained and consume all of their disposable income in each period.

- Three production sectors. Traded and non-traded goods are produced according to a Cobb-Douglas production function with three inputs: labor, private capital and public capital. The difference between these two sectors resides in the modeling of technological progress—assumed to be exogenous in the non-traded sector whereas in the traded sector is subject to learning-by-doing externalities and depends positively on previous-period output. The intuition is that once traded-sector production starts falling, knowledge and skills can be lost. The third sector produces oil and is assumed to be exogenously given with both price and quantities taken as given.

- The capital formation process is subject to absorptive capacity constraints and government inefficiency. In particular, effective government investment is just a fraction of government expenditure on investment. Furthermore, to capture the idea of rising investment costs due to absorptive capacity constraints, investment efficiency is assumed to fall when the expenditure level exceeds a certain threshold.

- The government finances its consumption and investment expenditure with taxes, debt and savings in the sovereign wealth fund (SWF).[12] In particular, taxes are collected from the oil and non-oil sectors. Foreign debt is subject to a risk premium that depends on the stock of external debt. In every period, the government can choose to close the fiscal gap with an increase in taxes and/or in debt, as well as by drawing down savings. In this note, savings in the SWF refers to government savings at the regional central bank (BEAC, in the Saving for Future Generations Fund and other funds) and government deposits abroad.

24.   Simulations consider several scenarios for public investment, its efficiency and oil revenues. In particular, three scenarios with different paths for public investment are examined:

- *Baseline scenario*. This scenario is based on the current projections. Public capital investment averages 16 percent of GDP over the 2014-2032 period. Moreover, the debt-to-GDP ratio averages 31 percent and oil revenues decrease from 33 percent in 2014 to around 2.5 percent of GDP in 2032.

- *Scaled-up investment scenario*. This scenario analyzes the implications of a large scaling up of public investment as discussed in the staff report for the 2014 Article IV consultation with the Republic of Congo. Public investment peaks at around 35 percent of GDP in 2018 before declining.

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[12] In the section we refer to the term "resource fund" as a synonym to the SWF.

- *High investment until 2017 scenario.* In this scenario public investment stays constant in percent of GDP until 2017 and then declines to the projected path of the baseline scenario.

Two additional scenarios are considered: (i) the baseline scenario but with an increase in public investment efficiency as a payoff of structural reforms and improvements in public financial management (PFM); and (ii) a scenario as in the high investment until 2017 scenario but with lower oil revenues due to an adverse shock to oil prices (and/or oil production).

25.   The baseline scenario delivers the best outcome in terms of debt sustainability and financial-assets accumulation in the sovereign wealth fund. As Figure 1 shows[13], the projected path of public investment delivers a sustainable and sizeable accumulation of public capital. At the same time, given the projected oil revenues, it allows for a sustained increase in savings in the SWF. There is also a mild but sustainable increase in the level of public debt in the long run owing to the government's policy to continue to finance investments by concessional foreign borrowing.[14] This produces an increase in non-oil GDP as well as an increase in private investment.

Figure 1. Baseline Scenario
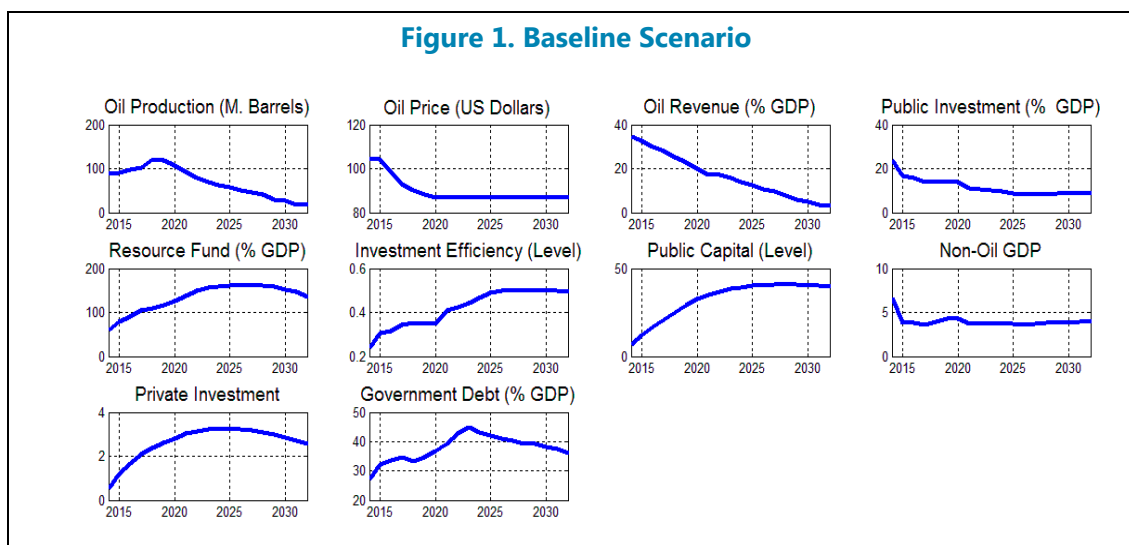
26.   The scaled-up investment scenario and the scenario with high investment until 2017 illustrate the dangers of a more pronounced scaling up of public investment. As Figure 2 shows, the scaling up of public investment to 35 percent of GDP lowers the efficiency of investment and results in an unsustainable level of public capital—higher investment initially results in a larger build up of capital stocks but without sufficient investment to cover recurrent costs, public capital begins to depreciate in future periods. Furthermore, this causes a quick erosion of the SWF and puts public debt on an unsustainable path. Similarly, maintaining public investment constant until 2017 at around 25 percent of GDP as in the high investment until 2017 scenario produces limited benefits compared

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[13] The variables are in percent deviation from a trend-growth path, unless specified in parentheses

[14] The predicted level of debt is slightly higher compared to the projected value of the staff report baseline value. This is caused by the presence of domestic and concessional debt in the simulations.

with the baseline scenario while contributing to an unsustainable level of capital and erosion in the SWF (see Figure 3). The increase in investment is more inefficient and produces only a mild increase in the stock of public capital and comes with a high cost, as the SWF is almost half the level observed in the baseline

Figure 2. Scaled-up Investment Scenario

Figure 3. Baseline Scenario with High Investment until 2017
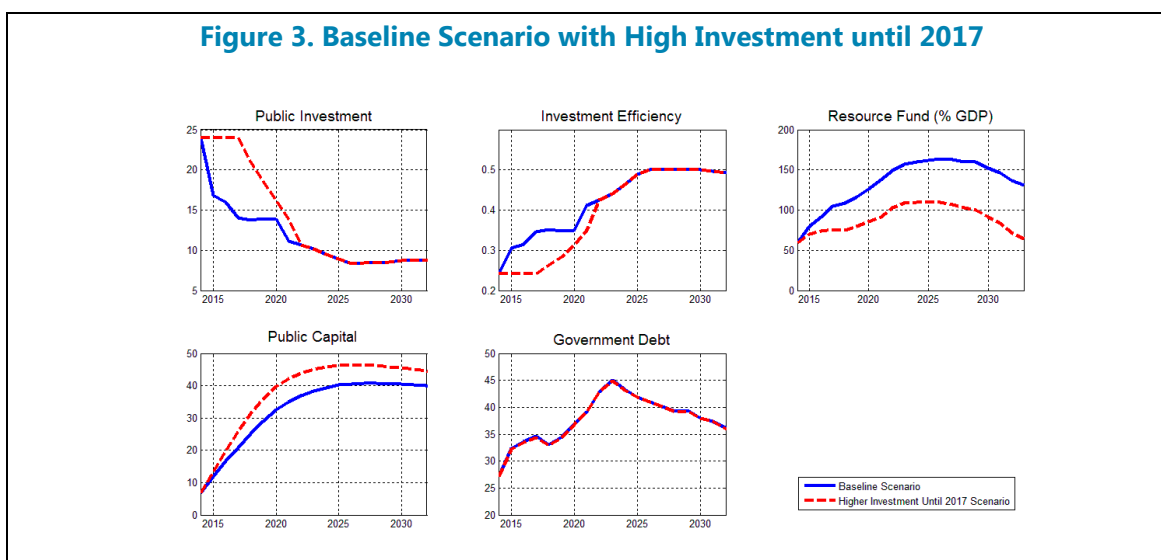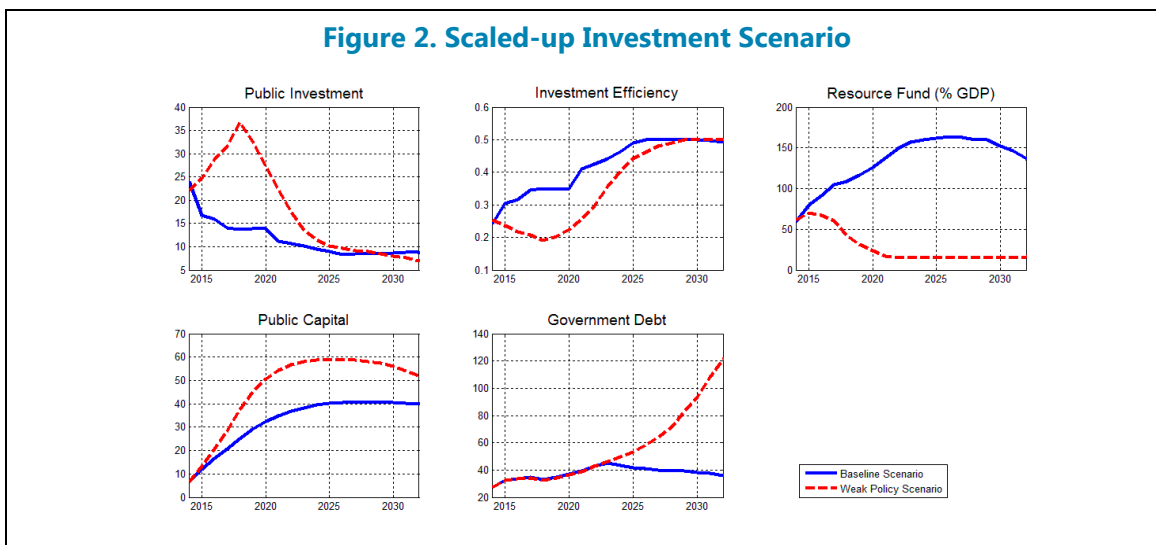
27.   Structural reforms and PFM reforms could play an important role in the country's development. The gains from improvements in the business climate and the government's policy implementation capacity are illustrated in Figure 4. The resulting increase in the efficiency of investment starts from the same level of the baseline scenario and consistently rising over time. This captures the fact that strengthening of policy frameworks, including public financial management, takes times to be reflected in better policy outcomes. Simulations indicate that an increase in efficiency produces a sustainable and higher level of public capital without affecting SWF savings and the ratio of government debt to GDP.

Figure 4. Baseline Scenario with Higher Public Investment Efficiency
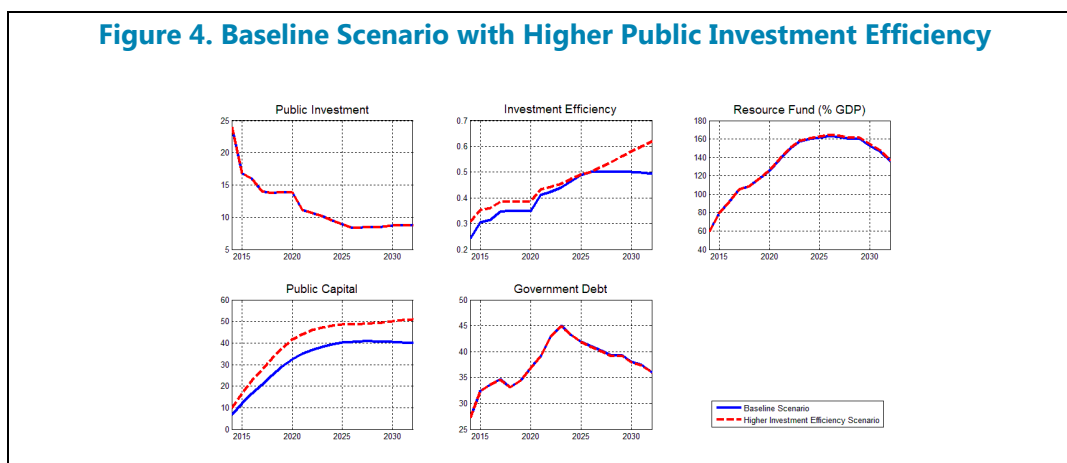
28.   Uncertainty about future oil revenues poses downside risks that could undermine the country's fiscal position, particularly in the scenario where adjustment of public investment spending is postponed. Figure 5 shows that an oil price shock impacts negatively oil revenues and results in quick depletion of the SWF to the minimum needed for the Republic of Congo to support the pegged exchange rate arrangement (assumed to be 15 percent of GDP). Consequently, the debt to GDP ratio increases to nearly 60 percent of GDP by 2032. A 20 percent lower oil price in the medium term results in reduction of the resource fund by almost three-quarters the baseline level at the end of the period. These findings are analogous for an adverse shock on oil production that leads to the same decline in the path of oil revenue.

Figure 5. A Decrease in Oil Revenues
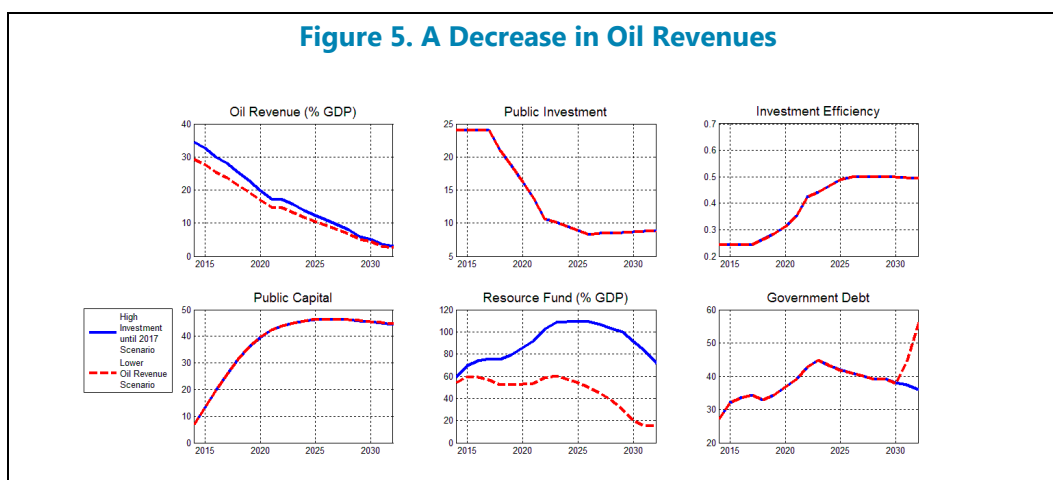
29.   In sum, the simulations highlight the importance of a prudent approach to public investment. The public investment path in the baseline scenario would be the most appropriate in terms of ensuring sustainability of public capital and debt as well as building up savings in the resource fund. Higher public capital can be achieved with structural reforms and PFM reforms rather than with a scaling up of public investment as this last approach puts pressure on the resource fund and on public debt. Furthermore, the simulations highlight the risks to the fiscal position of the country.

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FINANCIAL INCLUSION, DEVELOPMENT AND RISKS[15]

Congo's financial sector remains shallow, underdeveloped, and dominated by banks. The banking sector is highly concentrated with three banks accounting for 60 percent of the sector's assets. Lack of credible collateral and inadequate protection of creditors' rights hinders financial sector development. Despite a steady increase in private sector credit and the development of mobile banking outperforming regional trends, financial access in Congo remains among the least inclusive in the CEMAC and CFA Franc Zone. Capital buffers remain broadly adequate but single-borrower lending limits are not fully enforced.

30.   Underdevelopment of financial services and lagging financial inclusion are chronic problems in the Republic of Congo, similar to other countries in Sub-Saharan Africa. Recent research has shown that Sub-Saharan Africa (SSA) suffers from a "financial development gap"—measured by comparing financial development indicators with those in countries at a similar stage of overall economic development.[16] Only 9 percent of the total adult population has a formal financial account, placing Congo behind the CEMAC average (see Figure 1, top-left). Financial inclusion can be highlighted also from the perspective of the contrast between bankable "better-off" and "poor." [17] In Congo, 20 percent of the "better-off" population has a formal account compared with only 1.1 percent of the "poor." The ratio of bankable better-off to poor is around 18, making Congo one of the least financially inclusive in SSA (see Figure 1, top- and middle-right).

31.   Lack of financial access and wealth inequality are closely associated. For example, access to loans and insurance creates heterogeneous opportunities for businesses and growth.[18] Moreover, diversifying income sources to interest and dividend payments can augment the return and improve wealth.[19] Thus, when the "better-off" population enjoys better access to financial services than the "poor" they have higher chances to become richer, tilting the income distribution. The latest reported GINI coefficient (0.39 in 2011) by the World Bank shows that income inequality in Congo is similar to Cameroon, Chad and Gabon. Shallowness can be traced back to a lack of progress in improving the availability of creditor information and protecting investors (Singh, 2009).

32.   The aspect of financial inclusion related to gender inequality reveals a clear pattern in the SSA region. Women in Congo have much less access to financial services. Only 6.8 percent of women have a formal financial account compared to 11.3 percent of the male population. The ratio of

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[15] Prepared by Adrian Alter and Rodolfo Maino (AFR).

[16] See for example Allen et al. (2012d).

[17] The "bankable" population refers to the share of the adult population with access to a formal financial account. The "better-off" and the "poor" are the top 20 percent quintile and bottom 20 percent quintile, respectively, of the adult population ranked by income.

[18] For a discussion about the link between finance and growth see Levine (2005).

[19] Piketty (2003) shows that the composition of the top one percent of the population by income is dominated by income flows related to rents, interest and dividends.

men to women holding accounts is around 1.66 and it is much higher than in Sub-Saharan Africa frontier and emerging economies where this ratio is only 1.22 (see Figure 1, middle- left).[20]

33.   Mobile banking is well represented in Congo and it represents an alternative to traditional forms of financial services (see Figure 1, bottom-left). A recent survey found that almost 40 percent of the adult population has on occasion used mobile phone services to make financial transactions: to pay bills, to transfer or borrow money. This is the second highest share in CEMAC and CFA Franc Zone after Gabon and the fourth place in SSA (according to Global Findex database).

34.   The share of adults with formal savings is around 5.5 percent in Congo. Compared with CEMAC peers, it is the second lowest after Central African Republic. Nevertheless, the potential is very high. More than 30 percent of the Congolese have saved money, many informally. This ratio represents the second highest share in the CEMAC region. Most of these savings could be transferred into formal institutions that are safer and formally regulated (see Figure 1, bottom-right).
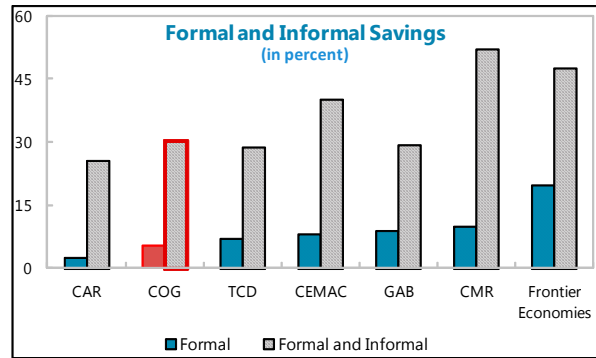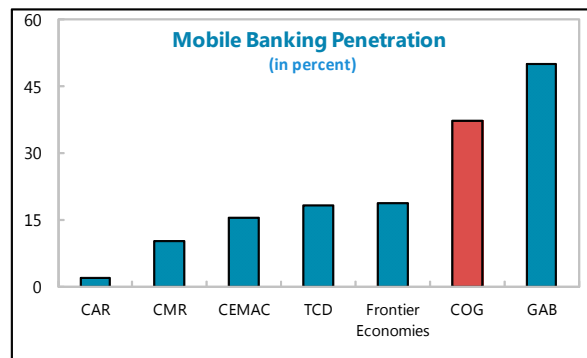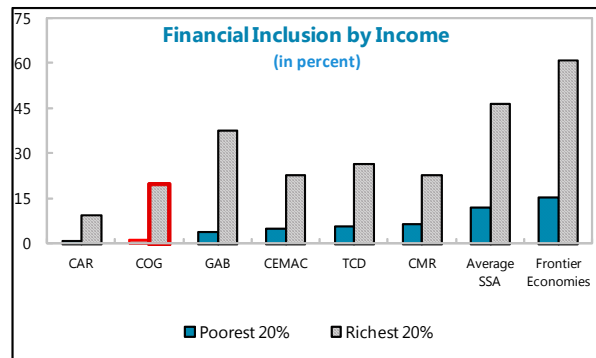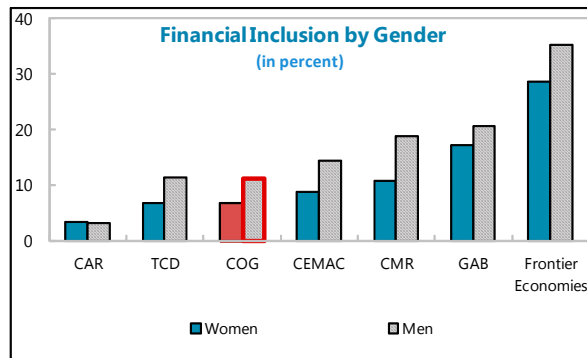
35.   The most important constraint behind not having a formal account mentioned by the Congolese is the lack of money (Figure 2 top-left). This is cited more than the averages across CEMAC area, SSA and Frontier economies. Moreover, banks are blamed for imposing high requirements (e.g. documentation) and offer their services at very high costs (e.g. opening and maintenance fees) compared with other banks in the region. The high costs are probably related to the relatively high overhead costs (see Figure 3) in Congo.

36.   There is a strong relationship between average standard of living (measured as GDP per capita) and access to financial services in SSA (see Figure 2, top-right). The CEMAC region lags behind the other African countries. For Congo, the financial access corresponding to the level of income is far below the average line in SSA that shows where it should be. Compared with SSA countries more than 20 percent of the adult population should have access to financial services according to this measure. Similarly, the comparison with the Human Development Index reveals a corresponding potential level of 28 percent of the population (see Figure 2, bottom-right).

37.   The supply of financial services (proxied by the number of commercial bank branches per capita) corresponds to the SSA average conditional on the level of the financial accounts in Congo. In terms of banking network, Congo is at the bottom of the list. Countries in the region with more developed networks like Gabon (with more than double the number of branches per capita) have a much higher penetration of financial access (around 19 percent).

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[20] The group of SSA frontier and emerging economies refers to following countries: Ghana, Kenya, Mauritius, Nigeria, Senegal, South Africa, Tanzania, Uganda, and Zambia. This group was constrained by data availability.

Figure 1. Republic of Congo - Financial Inclusion Statistics

Financial Inclusion - a Regional Comparison
(in percent)

Financial Inclusion by Income
(in percent)

Financial Inclusion by Gender
(in percent)

Financial Inclusion by Income
(in percent)

Mobile Banking Penetration
(in percent)

Formal and Informal Savings
(in percent)
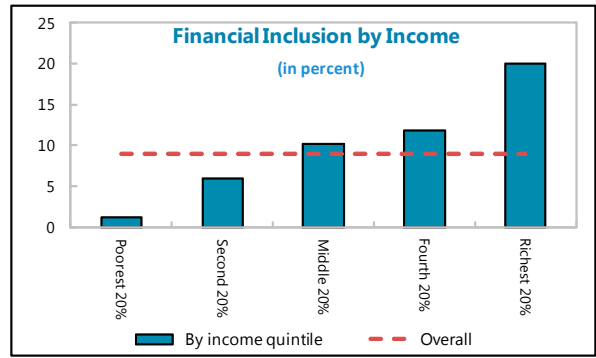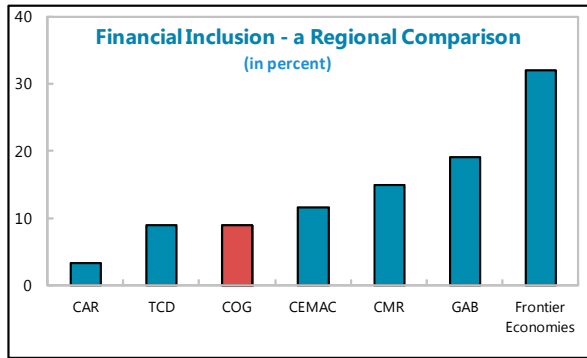
Note: CAR = Central African Republic, CMR = Cameroon, CEMAC =Central African Monetary and Economic Community, TCD = Chad, COG = Republic of Congo, GAB = Gabon

Source: Global Findex database (World Bank) and IMF staff calculations.

Figure 2. Republic of Congo - Analysis and Relationships of Financial Access and Development

Reasons for not having a formal financial account

Legend: Frontier; Congo, Rep.; SSA; CEMAC

Categories: Someone else in the family has an account; Religious reasons; Lack of trust in financial institutions; Don't have enough money to use them; Lack of documentation; Too expensive; Too far away

Financial Access and GDP per Capita

Financial access, in percent vs GDP per capita (USD)

Legend: Rest of SSA, Frontier, CEMAC w/o Eq Guinea

Financial Access and Commercial Bank Branches

Financial access, in percent vs Commercial bank branches per 100 thousand adults

Legend: Rest of SSA, Frontier, CEMAC w/o Eq Guinea

Financial Access and Human Development Index

Financial access, in percent vs Human development index (HDI)

Legend: Rest of SSA, Frontier, CEMAC w/o Eq Guinea

Source: Global Findex database (World Bank) and IMF staff calculations.

Figure 3: Selected Indicators of Financial Development and Risks

Private Credit to GDP
(Percent of GDP)

Total Assets, Largest 3 Banks
(Percent of All Commercial Banking Assets)

Private Credit to Deposits
(Percent of Deposits)

Overhead Costs
(Percent of Total Assets)

Congo, Rep - Core FSI Indicators

Congo, Rep - Number of Commercial Bank Branches Per 100,000 Adults and Benchmark
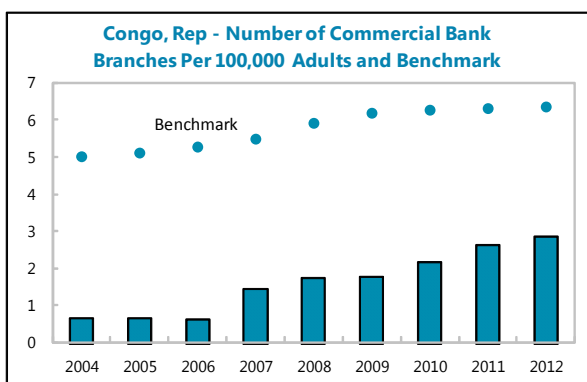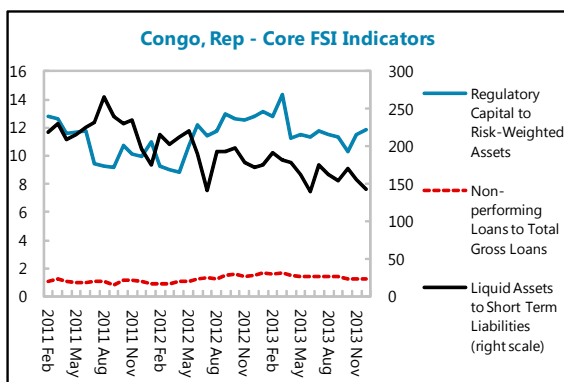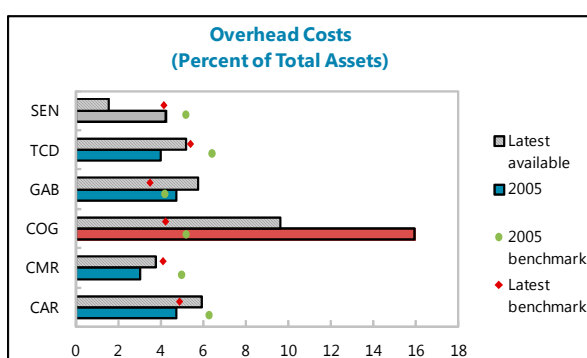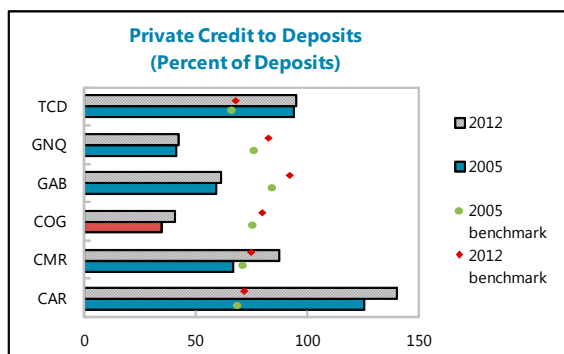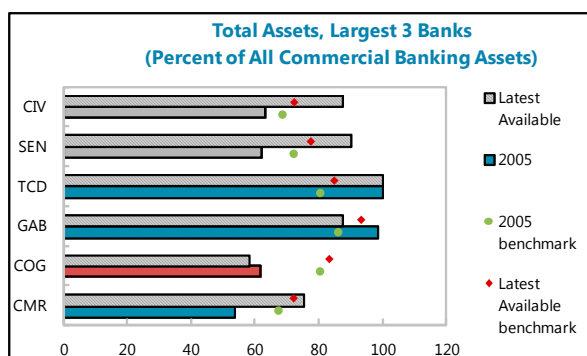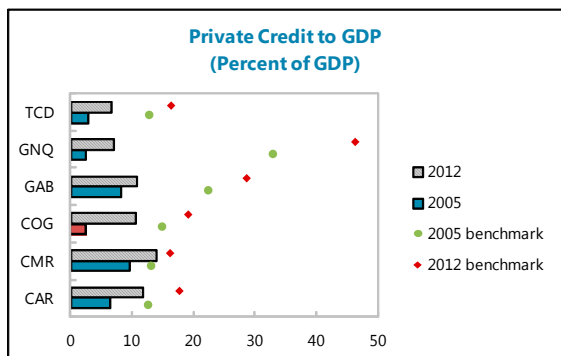
Note: CAR = Central African Republic, CMR = Cameroon, GNQ = Equatorial Guinea, TCD = Chad,
COG = Republic of Congo, GAB = Gabon, SEN = Senegal, CIV = Cote d'Ivoire

Source: World Development Indicators (WDI) database, country authorities and IMF staff calculations.

Box 1. Mobile Banking

Led by rapid mobile phone penetration, mobile banking ("*monnaie électronique*") is emerging as an innovative financial product in the Republic of Congo and CEMAC area. At the end of 2013, there were two active banks in Congo: BGFI Bank and Ecobank, each working in collaboration with a telecommunication operator (i.e., Airtel and MTN Congo), and so far they had exclusivity. The market has been recently liberalized, and telecom operators can collaborate with several financial institutions.

The mobile banking market has developed considerably in recent years, enhancing financial access. The number of active users with one of the banks almost tripled last year. In 2013, the electronic monetary base at this institution averaged CFAF 385 million and the transaction volume peaked in the third quarter at about CFAF 8.5 billion.

Figure 1. The evolution of mobile banking at a Congolese bank

Transaction volume (in CFAF)
Electronic monetary base (in CFAF)
Number of accounts (rhs)
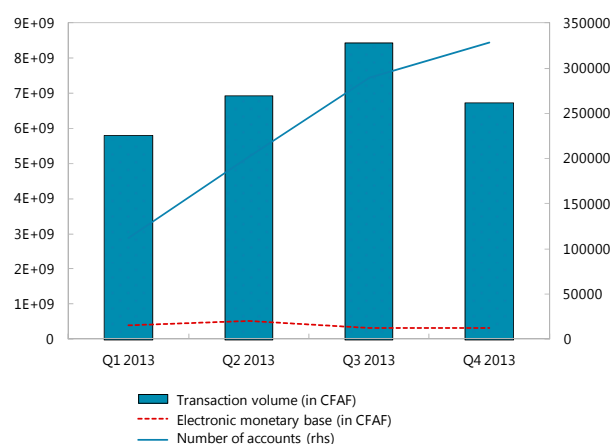
Fees are more competitive than those of the traditional banking. The transaction from a bank account to a mobile banking account is free of charge. The other way round, transaction fees vary depending on the amount transferred and can be as low as 0.2 percent. The costliest operation is to withdraw cash, which can be as high as 4 percent.

Risks related to mobile banking are mainly operational. The telecom operator has to collateralize the entire monetary base in an escrow account at the partner bank. Given the steady increase in the number of operations, operational risks could be addressed by (see Khiaonarong 2014, forthcoming):

- including mobile transfers in the payments system regulatory framework to ensure customer protection;
- updating the coverage of operational risks—such as potential disruptions or compromises on system integrity—as more operators enter into the market;
- AML/CFT measures to safeguard mobile payment systems from financial crime; and
- Coordinating with other CEMAC countries cross-border payments and, in particular, risk controls in interbank payment systems.

38. **The banking sector lacks depth, remains small and concentrated, with relatively high overhead costs**:

- Although deposits and credit have grown rapidly in recent years, they remain small in proportion to GDP (Figure 3). [21] The growth in deposits reflects the intensification (increase) in operations related to issuance of new instruments. Deposits are short term as well as loans, thereby avoiding a maturity mismatch. On the one hand, credit to the private sector, which is below the 2012 benchmarks for low-income countries, remains negligible, hovering around ten percent of GDP. [22] While bank intermediation should be a critical aspect of financial deepening and economic growth, it has yet to happen in Congo. [23] On the other hand, the ratio of deposits to GDP stood at 25 percent at end-2013. As a consequence, the loan-to-deposit ratio, which currently stands at 40 percent of GDP, has shown a lackluster improvement since 2005, remaining below the benchmark for comparable countries.

- The financial sector is dominated by commercial banks, which are, mostly, privately-owned subsidiaries of foreign institutions. The number of banks increased from six in 2010 to ten in 2013, including the state-owned *Banque Congolaise de l' Habitat* (BCH) and la *Banque Postale du Congo* ((BCP), which started operations in January 2013. The three largest commercial banks total almost 60 percent of total assets in the banking system, well below the benchmarks and all other CEMAC countries. Nonetheless, the commercial bank network development has not been robust and the number of commercial bank branches remained well below the benchmark for similar countries.

- Overhead costs remain high, not just comparing with other CEMAC countries but with benchmarks as well. The financial infrastructure constraints contribute to high overhead costs, which have increased compared with the 2005 data. Shortcomings in credit information lead to higher screening costs for financial institutions, translating into higher overheads. Similarly important is the ease of enforcing contracts and the costs involved. The longer it takes to foreclose on collateral and the more uncertain and expensive the process, the lower the actual value of the collateral provided by the borrower and the higher the risk premium the bank charges for the loan.

39. **Banks remain highly liquid** (Table 1). At the same time, banks maintain large deposits at BEAC. This excess liquidity by banks is mainly due to the difficulty in identifying sufficient lending opportunities, absence of domestic securities market, and the lack of a proper legal framework and a well-functioning judicial system. However, one Congolese bank has subscribed to issuances of Gabon

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[21] The benchmark represents the median value of a set of countries with similar GDP per capita characteristics.

[22] Short-term credit is concentrated in extractive industries' activities, public-sector work (BTP), and electricity. Long-term credit is negligible. At end 2013, credit to the private sector totaled CFAF 763.9 billion and represented 73.3 percent of total gross credits compared to 83.6 percent in 2012.

[23] The lack of collateral is one handicap of great economic importance for Congo. Land titles are not available and property rights not firmly established.

and Cameroon. In particular, it has participated in more than 11 percent of Cameroon's issuance from November 2011 to November 2013 and 15 percent of the Gabonese treasury bills issuance during 2013. These transactions indicate the search for yield by banks in the region and the need to develop a regional market for government securities.

40.   The Congolese insurance market developed significantly in recent years supported by vigorous economic activity in the country. Four companies now operate in the market. As at end-June 2013, collective turnover stood at CFAF 25.8 billion. The forecasts for all four companies for 2013 call for turnover of CFAF 16.1 billion. Three main factors account for this expansion: the opening of the market to competition, structural development (improving the penetration rate of barely 0.6 percent in 2012), and the expansion of the scope of insurance requirements in 2013. In addition to automobile liability and construction risk policies, coverage requirements were imposed for imported merchandise, creating the conditions for the development of transportation insurance.

41.   The banking system is sound showing a satisfactory compliance with CEMAC prudential ratios (see Table 1). The ratio of non-performing loans (NPLs) to total loans has remained low during the last decade and banks have maintained capital above the minimum levels (8 percent). Nevertheless, rapid credit growth—fueled by activity in construction, transportation, telecommunications, and tourism—poses risks as standards might loosen by banks in an attempt to gain market share. Furthermore, some banks are not respecting limits (thresholds) regarding individual lending. Although profitability has shown a remarkable path in recent years in a rapidly growing banking system, dividends and profits repatriation have also been high, signaling limited domestic investment. The returns on assets (RoA) and on equity (RoE) ratios have improved in 2013 to reach 1.9 and 20.8, respectively. Notwithstanding gross NPLs decreased to 2.3 percent in 2013—after reaching 2.9 percent in 2012—banks provisioning in relation to NPLs continued to deteriorate in 2013.

Table 1. Financial Soundness Indicators of the Banking Sector, 2009–13

	2009	2010	2011	2012	2013
	(Percent, at year's end)				
Capital Adequacy					
Regulatory capital/risk weighted assets	19.0	13.1	9.9	12.7	11.9
Percentage of banks at 10% or more	100.0	83.3	57.1	77.8	70.0
Percentage of banks between 6 and 10% minimum	0	16.7	28.6	11.1	20.0
Percentage of banks at less than 6%	0	14.3	14.3	11.1	10.0
Capital (net)/assets	6.0	8.0	7.0	7.7	9.6
Asset Quality					
Foreign exchange loans to total loans	2.0	8.7	12.5	0.8	0.4
Past-due loans to gross loans	1.2	1.0	0.4	n.a	n.a
Non-performing loans	1.5	1.1	1.2	2.9	2.3
Provision as percent of past-due loans	91.0	60.0	75.3	60.0	58.7
Benefits and Profitability					
Net profit (before tax)/net income	33.6	45.4	42.8	32.0	35.1
Return on assets	1.9	1.8	1.4	1.3	1.9
Return on income	23.3	22.0	19.7	17.4	20.8
Cost/Income	59.0	67.4	71.6	80.9	89.9
Liquidity					
Liquid assets/total assets	59.0	51.4	42.7	37.2	29.1
Liquid assets/short-term commitments	270.0	245.0	196.4	172.4	142.7
Loans/deposits	39.0	40.6	39.2	42.4	59.3
Liquid assets/total deposits	68.0	61.1	49.4	42.2	34.2
Excess reserves/broad money	14.0	38.0	20.0	16.0	27.0

Sources: Congolese authorities and IMF staff calculations.

42.   The microfinance environment in the Congo is expanding, dominated by the network of credit unions and remains relatively concentrated in Brazzaville and Pointe Noire.[24] The sector includes 62 institutions—the majority of them located in Brazzaville (23) and Pointe Noire (13). Also,

- MUCODEC institutions represent more than half of all microfinance institutions (33). Between 2009 and 2012, the total customer base increased by 10 percent on average in the sector to reach 344,000 at end-2012. Close to four-fifths of customers are affiliated with the MUCODEC network. The microfinance sector employs 1,499 persons, of which one-third working for the MUCODEC.

- Over the period 2009–12, the rate of growth of deposits (averaging 17 percent per annum) outpaced that of credit (2 percent). Deposits increased from CFAF 125.3 billion in 2009 to CFAF 191.9 billion in 2012, more than 80 percent going to the credit union network. While credits increased by 7 percent between 2011 and 2012, deposits grew by 20 percent. Over 80 percent of credits are provided by the MUCODEC institutions.

43.   The microfinance (MFI) sector is becoming increasingly important in the Republic of Congo and an effective implementation by COBAC of prudential rules is critical at this stage. MFIs account for a significant and probably increasing share of deposits and credits in the country albeit their exact size is difficult to assess. However, there is room to continue to strengthen corporate governance and management practices and the sector's regulatory framework.

44.   The policy agenda should include measures to address the main barriers to financial access. Improving legislation, property rights and documentation should improve access to finance. The efforts to create a good environment for microfinance and mobile banking should continue by fostering collaboration between commercial banks and microfinance institutions and telecommunication companies. Ongoing implementation of the electronic payment system for taxes and utilities has to move forward and development of the banking branches network encouraged.[25]

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[24] Mutuelles Congolaises d'Épargne et de Crédit (MUCODEC).

[25] For a more detailed discussion of the policy recommendations for financial development in Africa see Allen et al. (2012a).

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SPECIAL ECONOMIC ZONES

The Republic of Congo introduced a Special Economic Zones (SEZ) framework in 2013. SEZs are intended to encourage the creation of value added industries and employment in key sectors that are expected to gradually become engines of non–oil growth. However, the dual-track development approach might create distortions and hinder overall growth and welfare. Contributions of SEZs to macroeconomic performance have been uneven across countries and continents. The Republic of Congo could learn from the experiences of successful and failed SEZs. In particular, the availability of infrastructure and proximity to international trade nodes have typically supported the success of SEZs. Fiscal incentives seem to have had less impact.[26]

45.   The Republic of Congo introduced a draft legal framework for Special Economic Zones (SEZs) in early 2013. The SEZ strategy is aimed at raising investment, diversifying economic activity and exports, reducing unemployment, facilitating technology transfers, and supporting integration into the global economy. It would reduce dependence on the oil sector and ultimately contribute to poverty reduction. In addition to the government providing infrastructure and facilitating administrative procedures, a central feature of the framework for the SEZs is that fiscal incentives would be provided to encourage exports receipts repatriation.

46.   The fiscal incentives are broadly similar to the median worldwide for SEZs. The fiscal regime covering the SEZs was introduced in the 2014 budget law. The fiscal regime distinguishes three types of zone activities: special economic zones, industrial zones, and free-trade zones. The fiscal incentives are gradually reduced overtime but remain indefinitely below the general tax code in the long run for most cases (Tables 1 and 2). The package of incentives is somewhat comparable to that provided in SEZs in other countries.

Table 1. Worldwide SEZs: Fiscal Regime[1]			
	Exemption (Number of Years)	Rate Reduction (Percent)	Rate Level (Percent)
Median (CIT)	10	50	15
Average (CIT) [2]	26	55	14

Source: ILO database (2007 and partially updated thereafter), CNRS (2010).
[1] The table shows an average of tax treatments documented in the ILO and Atlas databases.
[2] To compute the average figures, exemptions unlimited in time are considered as granted for 100 years.

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[26] Prepared by Ivo Razafimahefa (FAD). The note was mostly completed while he was a desk economist for the Republic of Congo, prior to joining FAD.

Table 2. Republic of Congo: Fiscal Regime for SEZs			
	Special Economic Zones	Industrial Zones	Free Trade Zones
Corporate Tax (standard rate: 30%)	First 6 years: exempted 7th to 10th year: reduced rate to 5% After 10th year: reduced rate to 15%	First 5 years: exempted 6th to 10th year: reduced rate to 10% After 10th year: reduced rate to 20%	Exempted
Personal Income Tax (standard rate: progressive to 30%)	First 6 years: exempted 7th to 10th year: reduction of 50% After 10th year: reduction of 25%	First 5 years: exempted 6th to 10th year: reduction of 50% After 10th year: reduction of 25%	Exempted
Dividend Tax (standard rate: 20%)	First 6 years: exempted 7th to 10th year: reduced rate to 5% After 10th year: reduced rate to 10%	First 5 years: exempted 6th to 10th year: reduced rate to 5% After 10th year: reduced rate to 10%	Exempted
VAT (standard rate: 18%)	Export: zero Sales in SEZ, Republic of Congo, and CEMAC: general tax code	General tax code	Imports: exempted Domestic sales: zero

Source: Authorities of the Republic of Congo.

47.   As of now, the companies operating in the SEZs focus primarily on the domestic market, as opposed to predominantly export-oriented activities in other countries. With the aid of international partners in the private sector, the authorities intend to attract investments in the SEZs in the following sectors: agro-industry, natural resource-based industrial activities, tourism-related activities, heavy manufacturing, and various services. Four geographical locations have been indentified: Ouesso, Oyo, Brazzaville (the capital city), and Pointe Noire (port and center of economic activity). The feasibility studies are completed in three of the four zones. The SEZ in Brazzaville is already functioning. Currently, about five companies are reportedly operating in this zone. Their activities include manufacturing of building materials and furniture. They focus mainly on the domestic market, although they intend to supply the sub-region and the international market in the medium term. The SEZ in Brazzaville is expected to create 15,000 jobs by 2020.

48.   SEZs seem to have contributed to strong macroeconomic performance in some regions, but have not had substantial impacts yet in sub-Saharan Africa. Various studies have attributed the high economic growth in some countries in Asia and Latin America to SEZs (Zhihua Zeng, 2010). Moreover, the SEZ strategy has been found to have led to a structural change in the economy, enhancing the share of the manufacturing sector and scaling up potential output (Farole and Akinci, 2011). However, no significant contributions of SEZs could be found in Africa, except in a few countries (Farole, 2011). Furthermore, the SEZ strategy seems to have led to revenue loss in some countries, as most SEZ frameworks have provided fiscal treatments more favorable than general tax codes (Ali Abbas et al., 2012). As SEZs contribute to expanding economic activities but do not contribute (fully) to government revenue, the ratio of the latter to GDP would be expected to decline. Defenders of SEZs might argue that government revenue would improve after some years following the introduction of SEZs, as the fiscal preferential treatments would be gradually phased out and the SEZs would have led to development of some sectors or regions of the economy outside SEZs. However, no thorough analysis could establish robustly such a mechanism using cross-country cases.

49.   Physical incentives seem to have outperformed financial ones in the success of SEZs. Measuring the success of SEZs through exports from, investment into, and employment in SEZs, Farole (2011) identified the main determinants of SEZs successes using a sample of 47 countries. The availability of adequate infrastructure – measured with power outages – is crucial for the development of SEZs. Administrative facilitation – measured here with speed of customs clearance – is also important. Moreover, an overall – not only SEZ specific – improved business environment and access to local market contribute to the success of SEZs. In contrast, trade agreements, fiscal incentives, and low wages seem to exhibit no contribution; conversely, the impacts are in some instances in the opposite direction.[27]

50.   Some general principles would need to be followed to ensure success of the newly created SEZs in the Republic of Congo. The first priority ought to be on improving the overall business environment through the swift implementation of the related action plan supported by the IFC. The main efforts on SEZs should focus on providing the required infrastructure, such as energy, telecommunications, and roads connecting the SEZs to trade hubs. Vertical integration to the local economy is also crucial. Given the narrow tax base and high dependence of government revenue on the oil sector, the authorities should be cautious as regards to fiscal incentives. In particular, strict control should be in place to avoid abuse of the favorable fiscal regime, which might lead to an erosion of government revenue. A cost benefit analysis, that carefully weighs the short term revenue impact of the fiscal regime with the anticipated long term benefits, should be undertaken by the authoritie

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[27] Kinda (2014) found that tax incentives do not improve FDI attractiveness, neither for FDI producing for exports nor for those producing for the domestic market.

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