CENTRAL AFRICAN REPUBLIC ECONOMIC UPDATE
SECOND EDITION

Strengthening Domestic Revenue Mobilization to Sustain Growth in a Fragile State

NOVEMBER 2019
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<tr>
<td>BEAC</td>
<td>Regional Bank of Central African States (Banque des états de l’Afrique centrale)</td>
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<td>CAR</td>
<td>Central African Republic</td>
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<td>CEMAC</td>
<td>Central African Economic and Monetary Community (Communauté Économique et Monétaire de l’Afrique Centrale)</td>
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<td>CFAF</td>
<td>African Financial Community Franc (Communauté Financière Africaine Franc)</td>
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<td>COBAC</td>
<td>Central African Banking Commission (Commission Bancaire de l’Afrique Centrale)</td>
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<td>DDR</td>
<td>Disarmament, Demobilization, and Reintegration</td>
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<td>DFID</td>
<td>UK Department for International Development</td>
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<td>DGID</td>
<td>General Directorate of Taxes and Land (Direction générale des impôts et des domaines)</td>
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<td>General Directorate of Customs and Indirect Duties (Direction générale des douanes et des droits indirects)</td>
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<td>DRID</td>
<td>Regional Directorate for Tax Administration and Lands (Direction régionale des impôts et domaines)</td>
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<td>DRM</td>
<td>Domestic Revenue Mobilization</td>
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<td>EAC</td>
<td>East African Community</td>
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<td>ECF</td>
<td>IMF Extended Credit Facility</td>
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<td>Fragility, Conflict and Violence affected countries</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>ICTD</td>
<td>International Centre for Tax and Development</td>
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<td>NRPP</td>
<td>National Recovery and Peacebuilding Plan (Plan de relèvement et de consolidation de la paix)</td>
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<td>RRA</td>
<td>Rwanda Revenue Authority</td>
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<td>Small and Medium Enterprises</td>
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<td>Sub-Saharan Africa</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>UNU-WIDER</td>
<td>United Nations University World Institute for Development Economics Research</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>VAT</td>
<td>Value Added Tax</td>
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This is the second edition in a series of Central African Republic Economic Updates. The series will analyze evolving economic trends in CAR on an annual basis to assist the government and its development partners to identify emerging opportunities and address persistent challenges. The editions are prepared for the World Bank Spring Meetings in April. Each edition presents an overview of CAR’s evolving macroeconomic position, followed by a detailed exploration of a specific topic. The objectives of the series are to strengthen the analytical underpinnings of development policy in CAR and contribute to an informed debate on policy options to enhance macroeconomic management and accelerate progress on the twin goals of eliminating extreme poverty and promoting shared prosperity in a context of state fragility.

This second edition of the Central African Republic Economic Update was prepared by a World Bank team led by Souleymane Coulibaly (Program Leader) and Wilfried Kouame (Young Professional). Chapter 1 Recent Economic Developments was prepared by Wilfried Kouame. Chapter 2 Strengthening Domestic Revenue Mobilization in a Fragile State was prepared by Souleymane Coulibaly, Wilfried Kouame, and Diderot Guy D Estaing Sandjong Tomi (Economist). Mamadou Lamarane Deme (Senior Financial Management Specialist) provided useful comments on the DRM chapter.

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In addition, the team greatly benefited from consultations with key policymakers and analysts in CAR, including officials from the Monitoring Committee for Economic Reforms (Cellule Chargée du Suivi des Réformes Economiques et Financières CS-REF), the Ministry of Economy, Planning and International Cooperation, the Ministry of Finance and Budget, the Central African Republic Institute of Statistics and Economic and Social Studies (ICASEES), and the Bank of Central African States (BEAC).
Recent Economic Developments and Outlook

The Central African Republic (CAR) economy continues on a downward path. After peaking at 4.8 percent in 2015, the annual Gross Domestic Product (GDP) growth rate slowed to 4.5 percent in 2016, 4.3 percent in 2017, and then 3.7 percent in 2018 as renewed insecurity inhibited economic activity and delayed investment projects. The drop in the industrial sector, including the diamond sector which closed many purchasing offices and the forestry sector which temporarily halted log production, led to downward revision of the growth projections for 2018 and onward. There was a drop in the share of GDP for the industry sector (manufacturing, including wood processing). Agriculture and services drove growth, supported by domestic demand as the clearance of domestic arrears continued. The service sector, which represented 35 percent of GDP in 2017, is expected to grow at 41 percent in 2018.

CAR has not experienced a sustained growth episode since its independence in 1960 and poverty remains pervasive. With nearly 3.4 million people (71 percent of the population) living below the international poverty line (US$ 1.90 per day, 2011 PPP) in 2018, CAR remains one of the poorest countries in the world. GDP per capita dropped by almost half since independence, from US$ 602 in 1960 to US$ 335 in 2017.

Inflation declined and the external position is estimated to deteriorate slightly. Inflation eased at 1.6 percent in 2018 against 4.1 percent in 2017 due to declining prices of food products and manufactured goods. Downward pressures on domestic prices have also been reinforced by the tightening of the regional Central Bank’s monetary policy in response to lower reserve accumulation at the regional level. The current account deficit is estimated to deteriorate slightly from 7.8 percent of GDP in 2017 to about 7.9 percent in 2018.

Fiscal discipline needs to be maintained as the country is still at high risk for debt distress. CAR’s fiscal discipline continues to yield positive results in terms of reducing the ratio of debt-to-GDP at 48 percent. Debt indicators are forecasted to improve gradually over the medium-term, although the country is still at high risk of debt distress. The overall deficit on a cash basis is estimated to deteriorate from 1.6 percent of GDP in 2017 to 2.6 and 2.7 in 2018 and projected for 2019, respectively.

Domestic revenue remains below pre-crisis levels. Domestic revenue increased from 8.3 percent of GDP in 2017, to an estimated 9 percent of GDP in 2018. However, this is still about 2 percentage points below the 2013 pre-crisis levels and average levels in comparable countries. On the expenditure side, measures have been taken to monitor the recruitment of civil servants for more efficient management of government spending on public sector wages. As a result, the share of the wage bill over GDP is gradually shrinking from an estimated 6.5 percent in 2014 to 5 percent in 2018 corresponding to a drop of 1.5 percentage points. In addition, efforts to reduce foreign and internal debt and clear arrears have improved CAR’s fiscal position as interest payments on debt have decreased.

The improved security situation gives rise to a positive economic outlook with real GDP growth projected to expand by 4.7 percent. The Political Agreement for Peace and Reconciliation signed in February 2019 is expected to support economic recovery in the medium term as security is progressively restored, public services are gradually redeployed to the provinces, public and private investments increase, arrears are cleared, and reforms are implemented. Increased public and private investments, clearance of arrears, and increased imports of goods and services due to
a more secure Bangui-Beloko corridor should continue to sustain private consumption. Inflation is projected to fall below the regional Central Bank convergence criterion as food and manufacturing product prices continue to decline. The current account deficit is expected to improve in the medium term as diamond and forestry production pick up.

Strengthening Domestic Revenue Mobilization to Sustain Growth in a Fragile State

A deep structural weakness in CAR’s tax system keeps government revenue among the lowest in Sub-Saharan Africa. CAR’s domestic revenue is structurally below the potential of the economy and the average of regional peers including countries in fragile and conflict situations. The tax gap has ranged between 4 and 7 percent of GDP since 2000, representing about half of total tax revenues in 2016. The tax system is complex and characterized by substantial tax exemptions to private companies, many of which are not aligned to a long-term development strategy or investment code. The customs and tax administration have failed to recover about CFAF 84 billion since 2010 due to low capacity and structural weaknesses in fiscal controls. Legislation on property taxation has not been updated to reflect recent economic developments. As a result, revenue collected on property taxes is low and below its potential. CAR has a thriving informal sector that negatively affects tax performance, since it does not contribute directly to domestic tax mobilization. Such underperformance in domestic revenue mobilization calls for a sustained effort to boost domestic revenues to address CAR’s daunting development needs.

There is substantial scope to scale-up CAR’s domestic revenue mobilization. In the short-term, the government should reinforce targeted
audits and verifications; this should substantially increase tax recovery. There is also scope to further improve the business environment by limiting tax exemptions, closely monitoring existing exemptions and aligning them to a development strategy and investment code. An excise tax rate on telephone communications should also be considered.

In the long-term, authorities could rationalize and reduce the number of tax rates and exploit the revenue potential from property taxes; this could generate about CFAF 12 billion (US$ 22 million) in revenue. Additional reform options could include strengthening and enhancing tax policy, building capacity in the customs and tax administration, and introducing computer technology in the overall tax administration, especially at the border crossing posts of Gamboula and Mongoumba to limit fraud and increase efficiency. There also potential to introduce a community tax to bring the informal sector into revenue mobilization. Finally, business-friendly reforms that focus on the justice system, protecting minority investors, and facilitating construction permit acquisition will help attract private investors and firms that are in the informal sector into the formal sector, and thereby broaden the tax base.

Increasing domestic revenue will take time but lowhanging fruit can result in important “quick wins”. CAR can take advantage of “quick wins” by learning from its peers. Like CAR, Rwanda’s economy was negatively affected by a deep-rooted civil war. Rwanda’s reforms started with “low-hanging fruit” for quick wins such as increase in excise tax rate before tackling more complex issues, especially major administrative reforms. Rwandan authorities integrated tax and customs services under a single revenue authority for a clearer line of command and accountability. Introduction of severe measures to punish wrongdoing sent a clear signal that corrupt behaviors would not be tolerated under any circumstances. New stringent codes of conduct were adopted, training opportunities were provided, and salaries of tax administration employees were increased. Finally, explicit efforts were made to establish a new social contract between taxpayers and the revenue administration to build public trust in tax authorities and encourage compliance. Strong leadership and sound managerial capacity coupled with steadfast commitment to implement tax and customs reforms were key to Rwanda’s success. The government of CAR should consider such measures as it establishes its own policies and practices to increase domestic revenue. The new peace agreement also represents an opportunity to break the pervasive cycle of instability and conflict, improve fiscal transparency, fight corruption, establish a new social contract between taxpayers and the state to encourage tax compliance.
With an average GDP growth per capita of -0.8 percent, CAR has not experienced an episode of sustained growth since its independence.

Economic growth in CAR slowed to 3.7 percent in 2018 as renewed insecurity inhibited economic activity, disrupted agricultural, forestry, and mining production, and delayed investment projects.

Inflation declined to 1.6 percent in 2018 and should reach the CEMAC convergence criterion in the medium-term as manufacturing and food prices dropped.

The debt-to-GDP ratio continues to decrease and should reach 49 percent in 2018, with an overall balance including grants of 0.4 percent of GDP. However, government revenue remains below its pre-crisis level.

The current account deteriorated slightly at 7.8 percent of GDP in 2018 as imports continue to soar. CAR’s external position should improve in the medium-term.

CAR’s economic prospect is positive with the signing of the Political Agreement for Peace and Reconciliation in the Central African Republic in February 2019 and projected to grow at 4.8 percent in the medium-term. The primary risk for CAR is the possible escalation of violence that will undermine the government’s ability to provide basic services.
CAR’s economic growth slowed to 3.7 percent in 2018. Renewed insecurity inhibited economic activity in 2018 by disrupting agricultural, forestry, and mining production, and delaying investment projects. The path of economic recovery picked up to 4.8 percent in 2015 and slowed progressively to 4.5 percent in 2016 and 4.3 percent in 2017; this was mainly due to conflicts and violence that negatively affected the security and humanitarian environment. The current account deficit is estimated to deteriorate slightly from 7.8 percent of GDP in 2017 to 7.9 percent in 2018 as imports continue to soar. The CEMAC zone continues to face significant reserve issues that pushed the Regional Bank (Banque des états de l’Afrique central, BEAC) to tighten its monetary policy and increase the policy interest rate from 2.95 percent to 3.5 percent in October 2018. This, combined with a decline in manufacturing and food prices in CAR, has resulted in an estimated reduction in inflation to 1.6 percent in 2018. Such fiscal discipline continues to yield positive results, with a reduction in the 2018 ratio of debt-to-GDP to 48.5 percent. The fiscal outturn including grants is likely to generate an overall surplus of 0.7 percent in 2018.

The signing of a peace agreement in early February 2019 brings hope for the security and conflict environment, both of which remain major downside risks for the country. Urgent attention is needed to deliver vital public services that were delayed by the conflict. Thousands of displaced people will now be seeking their way back home, thereby raising significant pressure on government expenditure.
Poverty incidence measured in terms of headcount averaged 75 percent in 2016, and the country is one of the poorest and most fragile countries on the continent. If these challenges are not addressed urgently, the country risks falling into crisis again.

This Economic Update builds on the previous Update, relying on peace and stability as a condition for domestic resource mobilization. The report reviews recent economic developments, assesses factors affecting domestic resources and outlines operational strategies to leverage domestic resources. It also shares good practices of peer countries that have or are on their way to successfully mobilizing domestic revenues after long periods of political instability.

1.1 Recent economic developments

1.1.1 A fragile security situation slowed CAR’s economic growth in 2018

Global economic growth slowed slightly from 3.1 percent in 2017 to an estimated 3 percent in 2018.\footnote{World Bank. 2019. Global Economic Prospects, January 2019: Darkening Skies. Washington, DC: World Bank.} Elevated trade tensions, progressive removal of monetary policy accommodation in advanced economies, and important financial market pressures in several emerging and developing countries outweighed global uncertainty and slow growth. Despite the less favorable global environment, growth in low-income countries (LICs) increased slightly to reach 5.6 percent in 2018 as oil producers benefited from higher oil prices and output, and higher agricultural production and continued infrastructure spending supported growth in non-resource-intensive countries. Economic growth in Sub-Saharan Africa (SSA) is estimated to have picked up to 2.7 percent in 2018 from 2.3 percent in 2017, although at a slower pace than expected in April 2018, due to downward growth revisions in the three largest economies (Angola, Nigeria, and South Africa). Growth also trended up to 2.5 percent at the regional level with CEMAC countries having benefited from the rise in oil price and production and the dynamism of the non-oil sector, combined with the continuation of macroeconomic and structural reforms.

In such a context, CAR’s economic growth slowed at 3.7 percent in 2018, due mainly to renewed insecurity. After peaking at 4.8 percent in 2015, annual GDP growth slowed to 4.5 percent in 2016 and 4.3 percent in 2017, as renewed insecurity disrupted production. From about 37 percent contraction of GDP in 2013, CAR is recovering progressively but recovery remains fragile in light of a possible escalation in violence. Although CAR’s GDP growth rate outpaced the average of its regional peers, the country is still failing to catch up with its aspirational and structural peers\footnote{Box A1 in Technical Appendix describes the identification of structural and aspirational peers. CAR is particularly compared to Rwanda because CAR’s authorities expressed a willing to assess how they perform and learn from this country, which were also in a conflict situation but managed to increase substantially its tax revenues.} (Figure 1.1). CAR’s aspirational peers, Rwanda and Laos, are estimated to grow at 5.5 percent in 2018, while the average GDP growth of its structural peers should reach 6.6 percent.

CAR’s economic growth was driven by private consumption but remains below the average level of aspirational and structural peers. The negative hump shape in GDP growth in 2013 was the result of a political crisis that distorted both production and demand leading to a nearly 30 percent drop in household consumption (Figure 1.2). In addition, rising uncertainty has limited the ability of local firms to operate efficiently and has resulted in a deterioration of the trade balance. For the period 2017 to 2018, private consumption contributed significantly to the economic recovery supported by the resolution of domestic payment arrears. Nevertheless, the pace of economic recovery is above the average level of SSA and CEMAC countries.

The dynamic services sector contributed more to GDP growth. The service sector represented 35 percent of GDP in 2017 and is expected to surge to 41 percent in 2018. The industry sector consisting primarily of manufacturing (including wood processing) witnessed a drop in its share to GDP from 22.5 to 16.8 percent of GDP. The share of the agricultural sector also declined but more moderately from 42.4 percent of GDP in 2017 to 41.7 percent in 2018 (Figure 1.3). In contrast to the industry sector,
the contribution of the agricultural sector to GDP growth was positive. The drop in the share of GDP for the agricultural and industry sectors is explained by renewed insecurity in 2018 that disrupted agricultural, forestry, and mining production and investments.

**CAR has not experienced a sustained growth episode since its independence.** For the period 1960 to 2017, economic growth was constrained by a succession of recessions due to armed conflicts and coups d’état, the most important of which was in 2013. The average real GDP growth was limited to about 1.20 percent driven by factors such as political instability, low of human capital (high infant mortality and poor education outcomes) and inability to attract foreign direct investment. As a result, the economy never experienced a growth spell, defined as a period during which the growth trend changes significantly up or down followed by a period of at least 2 percent average per capita GDP growth (Box 1.1). Lessons from previous periods of economic growth indicate that the increase of crude oil prices and the U.S. interest rate pose further risks to growth in CAR.
Economic Growth in CAR since Independence

CAR has not experienced an episode of sustained growth since its independence in 1960. A sustained growth period, also known as a growth spell, is a period during which the growth trend changes significantly followed by a period of at least 2 percent average per capita GDP growth. For comparison, the median length of growth spells is 6 years in Sub-Saharan African countries, 8 years in emerging market economies, and 10 years for other developing countries. Regional comparators in the CEMAC zone show one episode of sustained growth each country, except Chad, which experienced two growth spells. The average economic growth in CAR since independence is barely 1.2 percent, characterized by persistent fluctuations due mainly to conflict and political instability (Box Figure 1.1). Since independence, CAR has experienced three episodes of growth acceleration and five periods of growth deceleration. The two first episodes of growth acceleration were experienced during the 1970s with an average growth of 2.3 percent from 1970–74 and 1.8 percent from 1975–1979. The recent episode of growth acceleration occurred from 2007–2012, just before the recent crisis, with an average growth of 3.1 percent. The period after the recent crisis is the strongest in terms of GDP growth with average real GDP growth at 3.7 percent. The authorities should maximize efforts to sustain the current path of economic recovery and increase the likelihood of a growth spell for improved development outcomes and reduced poverty.

CAR could learn from factors that facilitate episodes of accelerated growth. These factors include improvement in human capital outcomes such as reduction of infant mortality and increased average number of years of schooling; ability to attract foreign direct investment inflow as well as official development assistance through grants and external debt; and relative political stability over the three periods of growth acceleration. Public infrastructure capacity, including an increase in access to electricity, also enabled growth in CAR by improving the business environment, and increasing production, and productivity. These factors should be considered as authorities look for ways to create periods of sustained growth.

However, significant weaknesses in CAR’s economy minimize chances for sustained growth. Recurrent conflict and violence represent the main challenges for CAR. These were the primary cause of the five episodes of growth deceleration, with the highest decline of close to 37 percent in 2013. Other factors affecting CAR’s ability to sustain growth include its vulnerability to external shocks such as an increase in crude oil prices and changes in the US policy interest rate; changes in the US policy interest rate that result in a deterioration of government revenues and CAR’s external position through the imports bill; and poor export performance. The new peace agreement and the current good pace of economic recovery represent real opportunities for the country to secure its first episode of sustained growth.

Breaking the cycle of insecurity and violence, securing political stability, building human capital, and attracting private investments are key to accelerating and sustaining growth. As discussed above, variation in economic growth since independence is one of the main characteristics of CAR’s economy, a factor that significantly hinders its development. The current pace of economic recovery and the recent peace agreement represent significant opportunities to implement reforms and secure a period of sustained growth. Authorities should focus their efforts on building capacity through continuous investment in education and health with the support of the international community. They should continue to tackle the infrastructure bottlenecks. The authorities should also implement business-friendly reforms, since, according to the World Bank Ease of Doing Business index, CAR is among the worst performing countries. These reforms should focus on the justice system, protecting minority investors, and facilitating the acquisition of construction permits. The capacity of the Cadre Mixte de Concertation pour l’Amélioration du Climat des Affaires (CMCAA), a public-private dialogue framework, should be reinforced in order to be able to work actively on improving the business environment.

(a) The box draws on the background paper “Episode of Sustained Growth in Central African Countries: Myth or Reality?” by Karakulah and Kouame (2019). Sustained growth periods are identified under two conditions: (1) the existence of structural breaks that occur when a country time series abruptly changes at a point in time. The changes might be identified as “growth upbreaks” if they result in a period of higher growth than before the structural break. The opposite situation refers to “down-breaks”, a situation in which growth is lower than before the structural break; and (2) periods of time that begin with a growth upbreak followed by a period of at least 2 percent average per capita income growth. Such periods are identified as growth spells. See Karakulah and Kouame (2019) for extensive discussion on growth spells analysis in the Central African Republic, the Democratic Republic of Congo, and the Republic of Congo.

The civil war in 2013 reshaped the sectoral composition of CAR’s economy. Since 1995, the agricultural sector has accounted for an average of 50.9 percent of GDP. However, the civil war resulted in a decline in the share of the agricultural sector compensated by an increase in the share of the services sector. The contribution of the agricultural sector dropped from 50.7 percent of GDP in 2012 to 39.6 percent in 2017 while the share of services increased from 30.4 to 39.3 percent of GDP over the same period (Figure 1.4). The increase in the contribution of the services sector to GDP can be explained by the presence since 2013 of several humanitarian agencies, especially the UN Multidimensional Integrated Stabilization Mission in the Central African Republic (MINUSCA). The reason for the decline of activity in the agricultural sector may be attributed to the deteriorating security situation in 2013 and after, especially in the rural areas where the population suffered the worst of the violence from armed groups. The agricultural sector in CAR is clearly vulnerable to war, with similar evidence found during previous episodes of violence and coups in the country since independence in 1960.

Despite the reshape in sectoral contributions to GDP, there has been no significant reallocation of the labor force in CAR. Even though the contribution of the agricultural sector to GDP dropped by 20 percent between 2012 and 2017, the sector still employs more than 85 percent of the labor force. The share of the agricultural and industrial sectors in the labor force decreased from 86.1 to 85.6 percent and 6.8 to 6.4 percent in 2010 and 2017, respectively, while the share of the services sector increased by 15.6 over the same period (Figure 1.4). This situation raises concerns about productivity growth in the CAR economy in general, and more specifically, in the agricultural sector. CAR experienced a relative labor productivity drop that exceeded 2.5 percent per year over the period 1970–2015, one of the worst performances among SSA countries.3

1.1.2 The CEMAC monetary policy needs to remain on track

CEMAC’s monetary policy continues to tighten in response to the lower reserve accumulation. Despite the improvements in the CEMAC regional growth and the implementation of policy commitments, net foreign assets were below projections at the end of September 2018; this, due to delays in external financing, mixed program performance, and slow repatriation of exports proceeds. In response, the BEAC tightened its monetary policy by increasing its policy rate from 2.9 percent to 3.55 percent at the end of October 2018.

Inflation in CAR is estimated to ease at 1.6 percent in 2018, reaching the CEMAC convergence criterion for inflation. In response to the recent economic crisis in the region, CEMAC tightened its monetary policy which contributed to a decline of the inflation rate in the region. The inflation rate is expected to decline from 4.1 percent in 2017 to about 1.6 percent in 2018 as manufacturing and food prices decline. Inflation is projected to fall below the CEMAC convergence level over the medium term.

Credit to the economy is rebounding despite a tightening of the regional monetary policy, indicating a weak transmission mechanism in the CEMAC zone. In CAR, credit to the economy is estimated to increase by 5.5 percent in 2018 after a 0.1 percent decrease in 2017. The rebound

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is driven primarily by the increase in credit to the private sector, although still at a very low level. Nevertheless, the credit to the economy remains at about 13 percent of GDP.

Nonperforming loans (NPLs), while declining gradually, remain above their pre-crisis level. NPLs reached their highest level in 2015 at about 31 percent of total gross loans. Since then, NPL has declined and is estimated to reach 22 percent in 2018, with substantial sectoral disparities. Critical sectors for the economy such as mining, manufacturing, and real estate appear to have the highest NPL ratios, reaching more than 50 percent of total gross loans. NPLs are due primarily to the large stock of outstanding government payment arrears and government arrears to its suppliers. Key recommendations of the Central African Banking Commission (COBAC) have been implemented, although delays have been observed in recommendations on internal control and anti-money laundering.

Financial soundness indicators suggest that banks are moderately resilient although the ratio of NPL declines. Banks in CAR remain adequately capitalized. In the latest estimation, average capital adequacy remains high at about 32 percent, liquidity assets at 27.1 percent of total assets and 186 percent of short-term liability. Deposits are estimated to have increased by 17 percent over the period 2016–2018.

1.1.3 Fiscal discipline needs to be maintained

The fiscal situation improved in 2018 due primarily to an increase in grants and streamlining of government expenditure. After an overall deficit in 2017, the fiscal position of the country continues to improve and is estimated to generate an overall surplus of 0.7 of GDP 2018–2019. The situation is better relative to other countries in SSA but behind the estimated fiscal surplus of about 2 percent in the CEMAC zone (Figure 1.5). In the midst of the civil war, CAR’s overall deficit reached 6.5 percent of GDP, far behind the fiscal outcomes in aspirational, regional, and structural peers. The fiscal situation improved over time and the performance of CAR outpaced its regional, structural and aspirational peers. Improvement of the fiscal situation may be attributed to efforts to rationalize government expenditure through sound management of the wage bill since 2014, and an expected increase in grants as a share of GDP in 2018. However, the fiscal situation in cash-based deteriorated in the period 2017–2018 as the pace of economic recovery slowed. After an overall surplus in cash-based of 1.3 percent of GDP 2016, the overall balance in cash-based declined at 1.7 percent in 2017 and is estimated to reach a deficit of 2.6 percent in 2018.

“Streamlining government expenditure” is the new motto of CAR’s Ministry of Finance and Budget. Efforts to rationalize government expenditure entail sound management of the wage bill. In this regard, measures have been taken to monitor the recruitment of civil servants for more efficient management of the wage bill. As a result, the share of the wage bill over GDP is gradually shrinking from 6.5 percent in 2014 to an estimated 5 percent in 2018; this corresponds to a drop of 1.5 percentage points (Figure 1.6). In addition, efforts to reduce foreign and internal debt and to clear arrears contribute to improvement of the fiscal position as interest payments on debt are decreasing.

Government revenue continues to increase gradually but remained below its pre-crisis level in 2018. Government revenue fell by about 50 percent during the recent civil war as state institutions collapsed. The fall in revenue in 2013
was driven by a decline in both domestic revenue and grants. Since then, government revenue has caught up due to gradual economic recovery, support of the international community through grants, and implementation of reforms to strengthen tax revenue collection. Despite these efforts, the level of government revenues in 2018 as a percentage of GDP remains below its pre-crisis level and also below the average government revenue of regional, structural and aspirational peers. It is worth noting that the average government revenue in CAR is about 16.6 of GDP, more than 500 points below the average level in aspirational, regional, and structural peers (Figure 1.7).

**While grants continue to represent a substantial share of government revenue, their contribution is declining.** During the period 2014–2018, the share of grants as a percentage of GDP gradually shrunk, despite a positive trend between 2017 and 2018 (Figure 1.8). This downward trend has been mitigated by a gradual increase in tax revenue that surged to 8.4 percent of total GDP in 2018 corresponding to an upward push of nearly 4 percentage points. It is worth noting the significant impact of the 2013 political crisis that dragged back government tax revenue from 9.9 percent in 2012 to 5.2 percent in 2013, even though the opposite trend in grants balanced the impact. In the short run, tax revenue is expected to keep its upward trend to average around 8.7 percent of GDP even though it will remain below the level prior to the crisis. This trend is expected to continue with the implementation of ongoing reforms and efforts.

**Dynamic private consumption has boosted the collection of indirect taxes.** Indirect taxes, including VAT and excises petrol taxes, increased from 3.6 percent of GDP in 2017 to 4.2 in 2018 (Figure 1.9). The improvement was due primarily to dynamic private consumption that boosted VAT collection and revenues from petrol taxes. The recent streamlining of petroleum price...
CENTRAL AFRICAN REPUBLIC ECONOMIC UPDATE: STRENGTHENING DOMESTIC REVENUE MOBILIZATION TO SUSTAIN GROWTH IN A FRAGILE STATE

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Central African Republic needs to generate a primary surplus of at least 1.4 percent of GDP from the end of 2017 and onward. The fiscal effort is among the lowest in SSA (Figure 1.11) and Latin American countries. However, the fiscal effort is above the estimated primary deficit excluding grants and externally financed capital spending of about 1.4 percent in 2018 and 0.7 percent in the medium term (2019–24). CAR is among those SSA countries requiring a relatively lower primary balance to maintain its debt-to-GDP constant over time. As a comparison, the fiscal effort needed to maintain the ratio of debt-to-GDP constant is estimated at 5.5 percent of GDP for the Republic of Congo and 0.3 percent for the Democratic Republic of Congo. Since CAR is already at high risk of debt distress, fiscal efforts should emphasize domestic revenue mobilization to avoid further deterioration of the public debt.

**Fiscal consolidation efforts continue to yield positive results in reducing the ratio of debt-to-GDP.** The ratio of public debt-to-GDP dropped from 69.2 in 2014 to about 48.5 in 2018 corresponding to a 42.5 percent decrease in the stock of debt. The resolution of domestic arrears and streamlining of public expenditures contributed to reducing the stock of debt-to-GDP that has been decreasing since 2014. Domestic debt declined from 25.1 percent of GDP in 2017 to 22.5 percent in 2018 with the payment of domestic arrears. The country’s external debt also decreased from 27.8 percent of GDP in 2017 to about 26 percent in 2018. As shown in Figure 1.10, CAR is outpacing its peers regarding the path of public debt thanks to fiscal consolidation efforts. The ratio of public debt-to-GDP is estimated to reach the average level of structural peers in 2018 but will remain below the average level of aspirational and regional peers, all of which are on an increasing path, except in the CEMAC zone where the ratio of debt-to-GDP has been decreasing since 2016. Overall, the gross debt-per-capita ratio is estimated to reach CFAF 107,030 (US$ 187) in 2018 after a pick up at CFAF 123,868 (US$ 216) in 2014.

As a result of good performance in public debt accumulation, CAR needs a small fiscal primary surplus to maintain the current ratio of debt-to-GDP. To maintain its current ratio of debt-to-GDP constant, CAR needs to generate a primary surplus of at least 1.4 percent of GDP from the end of 2017 and onward. The fiscal effort is among the lowest in SSA (Figure 1.11) and Latin American countries. However, the fiscal effort is above the estimated primary deficit excluding grants and externally financed capital spending of about 1.4 percent in 2018 and 0.7 percent in the medium term (2019–24). CAR is among those SSA countries requiring a relatively lower primary balance to maintain its debt-to-GDP constant over time. As a comparison, the fiscal effort needed to maintain the ratio of debt-to-GDP constant is estimated at 5.5 percent of GDP for the Republic of Congo and 0.3 percent for the Democratic Republic of Congo. Since CAR is already at high risk of debt distress, fiscal efforts should emphasize domestic revenue mobilization to avoid further deterioration of the public debt.

**CAR is caught in the procyclicality trap.**

Procyclicality of public spending means that government spending and GDP growth move in the same direction. Since 2009, CAR is the most procyclical country in SSA, far beyond the procyclicality level of regional peers in the CEMAC zone. For comparison, Laos and Rwanda,


*See Vegh Gramont et. al. (2018) for extensive discussion on efforts needed to maintain the ratio of debt-to-GDP constant.*

*This section draws on Herrera, Kouame, Mandon (2019) “Why some Countries can escape the fiscal procyclicality trap and others can’t?”*
both aspirational peers of CAR, maintain a countercyclical fiscal stance (Figure 1.12). The experience from Rwanda is highly relevant for CAR, since Rwanda managed to escape the procyclicality trap after being highly procyclical during the 2000s (Figure 1.13). CAR can also learn from Rwanda on the peacebuilding process, the collection of domestic revenue, and fiscal policy management. While CAR structural peers are all procyclical countries, the magnitude of procyclicality is relatively lower compared to CAR. Although the contraction of CAR’s economy of about 37 percent in 2013 might explain the high procyclicality of the fiscal stance, CAR authorities should take action to reduce procyclicality.

**FIGURE 1.12** The procyclicality of the fiscal stance in CAR vs. peer countries, 2009–2016

A procyclical fiscal policy has consequences for macroeconomic stability and growth sustainability. The procyclical nature of fiscal policy, by which countries stimulate the economy during a boom and cool down the economy during a recession, has been associated with macroeconomic instability and amplification of economic fluctuations. Such fluctuations discourage new investment and undermine human capital through high employment, generating volatile government revenues and terms of trade, and undermining debt sustainability.7 As discussed in Herrera, Kouame, and Mandon (2019), several other factors such as corruption in political and public services spheres and limited credit to the private sector increase the procyclicality of the public stance and weaken growth acceleration. There is significant evidence from around the world that procyclical fiscal policies deteriorate welfare and poverty outcomes.8 The current situation of CAR’s economy highlights some of these consequences, underlining the critical need for the country to shift its fiscal stance.

Although ongoing fiscal efforts are yielding positive results, the procyclicality of the fiscal

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CAR authorities should move toward a more countercyclical fiscal stance by (i) maintaining the pace of ongoing fiscal efforts to bring public debt back to a sustainable level, since high debt fosters procyclicality; (ii) mobilize tax revenues to minimize dependence on ODA, which is often unpredictable and unstable; and (iii) scale up domestic revenues to support and sustain economic recovery.

1.1.4 The external position is weak

CAR’s external position worsens as imports continue to soar. The current account deficit rose from 8.3 in 2017 to an estimated 8.6 percent of GDP in 2018, driven by the deterioration of the merchandise trade deficit (Figure 1.14). CAR’s imports deficit rose from 22.7 to 24.5 percent of GDP as imports of petroleum products soared. The increase in the oil import bill is due to a combination of higher prices, U.S. dollar appreciation, and a gradual economic recovery and clearance of arrears. The latter boosts the demand for oil products with a direct impact on the merchandise trade balance. On the one hand, exports of goods are estimated to decrease slightly by 2.6 percent driven by the exports of wood products. On the other hand, a partial lift of the embargo on diamond exports from CAR continues to foster an increase in diamond exports, although the pace remains low compared to the current stock of diamonds. Overall, the terms of trade of the country should continue to deteriorate, but at a slower pace.
Since 2017, CAR’s current account deficit has remained above the average level of regional peers but relatively lower than its aspirational and structural peers. The current account deficit rose from 8.3 of GDP in 2017 to an estimated 8.6 percent in 2018 driven by the deterioration of the merchandise trade deficit (Table 1.1). The latter is higher than the average level in CEMAC and SSA countries (Figure 1.15). However, CAR’s external position is relatively stronger than its aspirational and structural peers. The current account deficit is expected to decline gradually over the medium term to 6.3 percent on average, as forestry exports pick-up.

The balances of transfers, service, and income are improving. Policy programs implemented by the IMF and World Bank are driving budget support to the public sector. Program transfers should rise by 63 percent from 1.9 to 3.1 percent of GDP, supporting an increase in net transfers. Project-related transfers remain constant at 1.5 percent of GDP. Private transfers are on a decreasing path and estimated to reach 5.7 percent of GDP in 2018. The deterioration of the current account balance is dampened by an improvement in the services and income account balance by 32 and 50 percent, respectively.

Recent reforms affecting regulation, entry, exit, and competition in the business environment are already yielding positive results. CAR’s foreign direct investment is estimated to double in 2017 from 0.4 percent of GDP to 0.8. Significant reforms in the business environment, continued economic recovery and an improved security situation, especially in Bangui, are attracting more foreign investment. CAR made it easier to start a business by reducing the paid-in minimum capital requirement for business incorporation. As a result, the country’s Ease of Doing Business score for starting a business increased from 37 to 60.9 in 2018 compared to 2017 (a score of 100 represents best international practice). The minimum paid-in capital decreased from 446.7 percent to 40.7 percent of per capita income. Supported by the reforms and positive outlooks, foreign direct investment is projected to reach 1.1 percent of GDP in 2019.

Non-debt creating flows fall behind the current account deficit, resulting in a decline of official

<table>
<thead>
<tr>
<th>TABLE 1.1</th>
<th>Central African Republic Current Account Balance, 2012–19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current account</strong></td>
<td></td>
</tr>
<tr>
<td>Balance on goods</td>
<td>–71.6</td>
</tr>
<tr>
<td>Exports, f.o.b.</td>
<td>–61.4</td>
</tr>
<tr>
<td>of which: Diamonds</td>
<td>–</td>
</tr>
<tr>
<td>of which: Wood products</td>
<td>–</td>
</tr>
<tr>
<td>Imports, f.o.b.</td>
<td>–165.0</td>
</tr>
<tr>
<td>of which: Petroleum products</td>
<td>–</td>
</tr>
<tr>
<td>Services (net)</td>
<td>–66.1</td>
</tr>
<tr>
<td>Credit</td>
<td>44.4</td>
</tr>
<tr>
<td>Debit</td>
<td>–110.5</td>
</tr>
<tr>
<td>Income (net)</td>
<td>–5.5</td>
</tr>
<tr>
<td>Credit</td>
<td>8.3</td>
</tr>
<tr>
<td>Debit</td>
<td>–13.8</td>
</tr>
<tr>
<td>Transfers (net)</td>
<td>61.4</td>
</tr>
<tr>
<td>Private</td>
<td>23.3</td>
</tr>
<tr>
<td>Official</td>
<td>38.1</td>
</tr>
<tr>
<td>of which: Program</td>
<td>11.0</td>
</tr>
</tbody>
</table>

Sources: CAR, authorities and IMF staff estimates and projections.
foreign reserves. The overall balance of payments is estimated to be in deficit in 2018 due mainly to the deterioration of the current account balance. Non-debt creating flows such as foreign direct investment fail to compensate for the deficit of the current account, resulting in a decline in foreign reserves. The latter are estimated to stabilize at 4 months of imports of goods and services in 2018, above the CEMAC average of 2.6 months.

1.2 Economic outlook and risks

The economic outlook for CAR is positive, assuming there is steadfast agreement to implement the peace agreement. Economic growth is projected to expand by 4.8 percent in 2019 and 5 percent in the medium term due to progressive restoration of security with the peace agreement, gradual redeployment of public services to the provinces, increase in public and private investments, arrears clearance, and steadfast implementation of reforms. Inflation is projected to reach the CEMAC convergence criterion as food and manufacturing product prices continue to decline. In parallel, the current account deficit is expected to decrease progressively in the medium term as diamond and forestry products pick up (Table 1.2).

On the supply side, the clearance of arrears combined with a more favorable security environment are expected to support higher agricultural and industry outputs from 2019 onward. Despite the reshape in the sectoral composition of GDP, the agricultural sector continues to contribute close to 37 percent of GDP in CAR. The cotton sector is expected to pick up as authorities continue to clear arrears and forestry activities are expected to expand in the medium term and contribute to the decline of the current account deficit. The industry sector dropped in 2018 due primarily to shrinking production in the mining sector. However, the sector is expected to pick up from 2019 onward. Wood processing products are likely to
benefit from the peace agreement and grow at a dynamic pace in the medium term. Recent critical reforms affecting the regulation, entry, and exit competition in the business environment are expected to stimulate foreign direct investment inflows in CAR for a positive impact on economic growth, job creation, and poverty reduction.

**Growth in the services sector is projected to continue.** The services sector is projected to grow at an average rate of 7.1 percent over the medium term. A dynamic services sector is supported by non-merchant services (administration and international cooperation), transport, trade and telecommunications; and progressive redeployment of public services especially in Bangui and secondary cities due to the improved security situation. The presence of humanitarian actors, especially MINUSCA, also contributes to growth in this sector.

On the demand side, private consumption and investments should continue to spur growth. Dynamic private consumption will continue to support economic recovery as the authorities have adopted a comprehensive and time-bound plan to clear domestic arrears. On the investment side, recent business environment reforms affecting the regulation, entry, and exit of competition are expected to stimulate investment after a slight decline in 2018. The authorities should implement business-friendly reforms, with a special focus on the justice system, protecting minority investors, and facilitating acquisition of construction permits to attract more investments.

Fiscal policy is expected to continue to yield good performance with a progressive decline of the ratio of debt-to-GDP in the medium term. The overall fiscal balance surplus, including grants, is expected to reach 0.6 percent of GDP in the medium term as CAR authorities streamline public expenditure and push the domestic resource collection agenda. Improvements in the fiscal position should help reduce the ratio of debt-to-GDP, and ultimately reduce the cost of servicing debt.

**Table 1.2** Central African Republic/Macro poverty outlook indicators (annual percent change unless indicated otherwise)

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018 e</th>
<th>2019 f</th>
<th>2020 f</th>
<th>2021 f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth, at constant market prices</td>
<td>4.5</td>
<td>4.3</td>
<td>3.7</td>
<td>4.8</td>
<td>4.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Private Consumption</td>
<td>96.0</td>
<td>95.9</td>
<td>95.0</td>
<td>91.9</td>
<td>90.9</td>
<td>90.3</td>
</tr>
<tr>
<td>Government Consumption</td>
<td>7.3</td>
<td>7.0</td>
<td>7.7</td>
<td>7.6</td>
<td>7.8</td>
<td>7.9</td>
</tr>
<tr>
<td>Gross Fixed Capital Investment</td>
<td>13.7</td>
<td>13.5</td>
<td>15.1</td>
<td>16.6</td>
<td>16.5</td>
<td>15.9</td>
</tr>
<tr>
<td>Exports, Goods, and Services</td>
<td>12.9</td>
<td>12.3</td>
<td>12.2</td>
<td>12.5</td>
<td>12.6</td>
<td>12.5</td>
</tr>
<tr>
<td>Imports, Goods, and Services</td>
<td>31.3</td>
<td>31.5</td>
<td>33.4</td>
<td>25.3</td>
<td>24.4</td>
<td>23.5</td>
</tr>
<tr>
<td>Real GDP growth, at constant factor prices</td>
<td>4.5</td>
<td>4.4</td>
<td>3.4</td>
<td>3.2</td>
<td>4.8</td>
<td>4.9</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4.6</td>
<td>3.0</td>
<td>7.1</td>
<td>3.5</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Industry</td>
<td>1.9</td>
<td>–0.4</td>
<td>–5.0</td>
<td>2.9</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Services</td>
<td>5.1</td>
<td>4.8</td>
<td>3.3</td>
<td>6.2</td>
<td>7.5</td>
<td>7.5</td>
</tr>
<tr>
<td>Inflation (Consumer Price Index)</td>
<td>4.6</td>
<td>4.6</td>
<td>4.1</td>
<td>1.6</td>
<td>3.5</td>
<td>2.6</td>
</tr>
<tr>
<td>Current Account Balance (% of GDP)</td>
<td>–8.5</td>
<td>–5.6</td>
<td>–7.7</td>
<td>–7.8</td>
<td>–6.1</td>
<td>–4.6</td>
</tr>
<tr>
<td>Fiscal Balance (% of GDP)</td>
<td>1.5</td>
<td>1.6</td>
<td>–1.1</td>
<td>0.4</td>
<td>2.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Debt (% of GDP)</td>
<td>56.6</td>
<td>54.3</td>
<td>49.4</td>
<td>49.0</td>
<td>45.2</td>
<td>37.3</td>
</tr>
<tr>
<td>Primary Balance (% of GDP)</td>
<td>2.1</td>
<td>–1.1</td>
<td>–2.0</td>
<td>–1.7</td>
<td>–2.5</td>
<td>2.3</td>
</tr>
<tr>
<td>International poverty rate ($1.9 in 2011 PPP)</td>
<td>72.9</td>
<td>72.9</td>
<td>72.2</td>
<td>71.4</td>
<td>70.5</td>
<td></td>
</tr>
</tbody>
</table>

Notes: e = estimate, f = forecast.
(b) Projection using neutral distribution (2008) with pass-through = 0.7 based on GDP per capita in constant LCU.
revenues from the most important public agencies and funds, in addition, to reducing parafiscal taxes as highlighted in the draft 2019 budget should generate additional tax revenues.

The current account is projected to improve in the medium term as the import bill declines progressively. Exports of goods and services are expected to grow in the medium term as forestry and cotton products pick up. Higher timber exports and the sale of stockpiled diamonds will improve the trade balance. A progressive decline of imports bill in the medium term will improve CAR’s external position with a gradual decline of crude oil prices.

Extreme poverty is projected to decrease by 2 percentage points by 2021. Implementation of the 2019 peace agreement is a critical step to economic recovery and poverty reduction. With an average economic growth at about 5 percent in the medium term, progressive provision of basic services, expansion of social protection extreme poverty is projected to decrease by 2 percentage points in the medium term. Dynamic private consumption and investments are expected to reduce poverty through economic growth and job creation.

The possibility of renewed violence is a significant downside risk for the country. As witnessed by slow economic growth in 2016–2017 followed by stabilization in 2018, CAR’s economic recovery remains highly vulnerable to violence. Escalation of violence will deteriorate the humanitarian situation, curb the increase in investments, and slow the rise in the production and exports of wood products and diamonds as well as agricultural products. Increased insecurity could also result in a decline in both private and public investments and international trade and could undermine government efforts to consolidate its fiscal position. Renewed violence will increase inflation due to potential disruption of imports of goods and services through the Bangui-Beloko corridor, undermining the gradual redeployment of public administration and services and stifle confidence.

CAR is also vulnerable to commodity price shocks and delays in CEMAC economic recovery. An increase in international oil prices would negatively affect CAR’s economic recovery with deterioration in the fiscal and external positions and reduction in private consumption. As estimated by the IMF, a US$ 10 increase in international oil prices would reduce CAR’s domestic revenues by about CFAF 4 billion (US$ 7 million), thereby reducing its ability to sustain economic recovery and invest in development. Although CEMAC countries committed to implementing appropriate policies in response to the recent crisis, the CEMAC economic situation remains challenging due to shortfalls in reserves accumulation and low path of recovery. Additional delays in the regional economic adjustments represent a downside risk for the region, including CAR. CEMAC countries need to implement appropriate fiscal and monetary adjustments and reforms to reduce downside risks.

CAR could take advantage of its reforms agenda to sustain growth and reduce poverty. A steadfast implementation of the National Recovery and Peacebuilding Plan 2017–21 NRPP) and the process of Disarmament, Demobilization, and Reintegration (DDR) will minimize security risks and stimulate growth. In 2018, project execution under the NRPP was estimated to represent about 3 percent of GDP, focused primarily on education, health, and infrastructure. Timely implementation of both the NRPP and DDR will support the peacebuilding process, facilitate redeployment of security forces, reinstate public services in the provinces, and reduce violence and insecurity-related vulnerability of the primary sector. The peacebuilding process will facilitate lifting of the ban on diamond exports imposed by the Kimberley Process Certification Scheme. The scheme was set up in 2003 by the UN General Assembly to prevent conflict diamonds from entering mainstream rough diamond markets.

CAR’s dependence on international aid represents a downside risk. External resources are critical to the stability and economic recovery in CAR. In 2018, grants were estimated to represent 45 percent of government revenue after two consecutive years of a drop of their share in government revenues. In such a context, even a slight disruption in the flow of international assistance will weaken CAR’s fiscal and external position and economic growth. To reduce its vulnerability to international aid flows, CAR should dedicate efforts to strengthen domestic
revenue collection, improve management of natural resources, and invest in development.

**Fiscal and structural reforms should stay the course.** As noted above, CAR’s fiscal efforts are yielding positive outcomes. Authorities need to maintain these efforts and structural reforms to secure fiscal stability and sustain growth. The BEAC and COBAC should implement their commitments and keep reforms on track to reduce vulnerabilities associated with low reserves accumulation and weaknesses in the financial sector. Domestic revenue remains below pre-crisis levels, and additional efforts will be needed in this area. The next chapter of this report analyzes the issue of domestic revenue collection in CAR and proposes policy options and reforms to strengthen tax revenue in a fragile context.
CAR’s domestic revenue remains among the lowest in Sub-Saharan Africa, reflecting a deep structural weakness in the tax system.

Inefficient tax instruments, weak tax administration and control systems, high tax exemptions, and persistent limited capacity are the reasons for CAR’s domestic revenues underperformance.

CAR can strengthen its domestic revenues by broadening its tax base, simplifying and reinforcing its tax system, taking advantage of the new peace agreement to establish a new social contract, and learning from peers.

Specific measures include modernizing the tax administration, curbing and monitoring closely tax exemption, and improving verification measures.

Improved implementation of property taxes could generate about CFAF 12 billion in tax revenues

Strengthening revenue mobilization in CAR will require strong political leadership and support to drive change.
It is urgent to address rising poverty and inequality in CAR. The country has come out of a long period of violence and political instability that significantly undermined economic conditions, negatively impacted government revenue, and eroded the effective delivery of public services. Poverty and inequality are rising, and the country ranks 188 out of 189 countries in human development, with a Human Development Index (HDI) of 0.36 in 2017 (UNDP, 2018). The country’s Human Inequality Coefficient is respectively 11.1 percentage points and 11.3 percentage points below the average in SSA and low-HDI countries, while income inequality remains higher at 49.2 percent. There are 27,406 refugees in neighboring states—of which 20 percent are under the age of five—and 655,956 people remain internally displaced (UNHCR, 2019). Addressing these issues in a sustainable way will require implementation of a set of mutually reinforcing measures and policies designed to: (i) strengthen DRM; (ii) ensure peace and security; (iii) strengthen the social contract between the population and the government; (iv) strengthen sustainable growth; and (v) fight poverty and promote shared prosperity.

Mobilizing domestic resources is critical, not just as a way of raising government revenue but also as a means of shifting the country into a virtuous cycle of peace and security. Peace and security are essential pillars of a long-term development agenda. A peaceful and secure economic environment is essential to increasing capital inflows that contribute to raising government revenue. Increased government revenues can, in turn, be used to protect people and
their assets, creating a social contract that lays the foundation for taxpayer willingness to pay taxes to a government that safeguards them. This social contract also extends to businesses and households by generating confidence in their ability to produce and consume. Sustained growth can generate a shift in government spending to policies and programs that lift people from poverty and promote shared prosperity. This may in turn lead to an increase of domestic revenues within the channel of improved tax compliance, therefore reinforcing the virtuous cycle of domestic revenue mobilization (Figure 2.1).

CAR has some catching up to do in using domestic resource mobilization to invest in social sectors to reduce poverty. Compared with other countries in the region, CAR performs poorly in generating domestic resource mobilization; this affects government’s ability to invest in infrastructure goods and social and pro-poor programs. Domestic revenues in CAR are composed primarily of tax revenues, which reached 8.4 percent of GDP in 2018 against 0.8 percent of GDP for non-tax revenues. This is below the average of Sub-Saharan Africa low-income and fragile countries. According to recent data, an estimated 71 percent of people in the Central African Republic live in extreme poverty on less than US$ 1.90 per day. Inadequate funding in social sectors means that the government has limited capacity to deliver basic services, many of which rely heavily on donor funding. In the education sector, for example, as of 2016, public spending in education represents only 1.3% of GDP. This is far below the Global Partnership for Education’s recommended best practice levels of 4% to 6% of GDP. Although tax revenues have increased gradually since 2013—and are expected to reach 8.4 percent of GDP in 2018—this is still not enough to meet the growing needs of the population.

There is a potential to increase tax revenues, especially now that a peace agreement has been signed. Tax revenues are about 4 percent of GDP below the potential of the country and under their 2012 level mainly due to the low tax base, inefficient tax administrations, and a large and active informal sector.

2.1 Status of the tax system

CAR’s government revenue, although on the increase since 2013, remains among the lowest in SSA, reflecting a deep structural weakness in the tax system. CAR’s domestic revenues including both tax and non-tax revenues represent 8.2 percent of GDP in 2016 (most recent data available), the third lowest in SSA after Somalia and Nigeria (Figure 2.2). The country’s level of domestic revenues remains well below that of regional peers in CEMAC and countries affected by fragility, conflict and violence (FCV) in SSA. In 2016, average government revenues in FCV countries surged at 19.4 percent of GDP, which is about 2.4 times higher than in CAR. Domestic revenues in CAR were on an increasing path before dropping sharply from 11 percent in 2012 to 5.6 percent in 2013. Despite increases since 2013 and estimates that government revenues will reach 9.2 percent in 2018, the level remains structurally below the average of regional peers and FCV countries in SSA (Figure 2.3). Tax administration shortfalls, institutional arrangements, and the inefficiency of the tax system are critical in explaining CAR structural weaknesses.

Tax revenues continue to outweigh total government revenue, with an estimated share of 91 percent in 2018. Tax revenues are the primary source of domestic revenue in CAR and, since 2010, have represented on average 88 percent of government revenues (Figure 2.4). Non-tax
revenues dropped from 1.3 percent of GDP during the period 2005–2012 to about 0.6 percent of GDP since 2013 as the mining sector collapsed during the crisis. Production in the mining sector dropped, especially diamonds which were banned from export following in the context of the Kimberley Process. The restrictions were partially lifted in June 2015 and there is hope for a total lift of the ban with the new peace agreement. However, the contribution of non-tax revenue to domestic revenues in CAR is low compared to regional peers and FCV countries in SSA (Figure 2.5).
2.1.1 Tax instruments

CAR’s tax instrument is broadly similar to most peer countries, although the overall revenue collected is significantly lower, and CAR was underperforming before the crisis. In 2016, CAR was the fifth lowest performing country in collection of tax revenue as a percentage of GDP (Figure 2.6). CAR underperforms even compared to FCV countries in SSA, which collect on average 13.2 percent of GDP in tax revenues, almost double the performance of CAR. Similarly, tax revenues collected in CAR are well below the average level of CEMAC and SSA countries, which collected on average 10.4 and 16.2 percent in GDP in 2016, respectively (Figure 2.7). It is worth noting that CAR was underperforming in tax revenue collection before the civil war in 2013 (Figure 2.7). At that time, CAR tax and non-tax revenues were already below the performance of comparable countries such as Rwanda, FCV countries and regional peers in the SSA region.

CAR tax revenue remains below its pre-crisis level and structurally below the average level of comparable countries. Since 2010, CAR has underperformed in collection of tax revenue with an average of about 7.5 percent of GDP, while the average level of SSA countries is about 17 percent for structural peers and 14 percent for aspirational peers (Figure 2.7). Total tax revenue collected in CAR is more than 1.75 times below the average level in aspirational, regional and structural peers in 2017 and this is expected to remain the same in 2018. The recent crisis resulted in a significant drop in the ratio of tax revenue-to-GDP from 9.9 percent in 2012 to 5.2 and 4.4 percent in 2013 and 2014, respectively.

CAR underperforms in both direct and indirect taxes, although its weakness is more pronounced for direct taxes. Direct tax revenue collected on personal and corporate income accounted for on average 2.1 percent of GDP between 2005 and 2012, before declining to 1.34 percent of CAR’s GDP after 2013. This is at least 2 times lower than direct taxes collected in Rwanda, FCV countries and regional peers in SSA. The collapse of CAR’s economy in 2013 widened the gap between CAR and its comparable peers and the private sector paid a considerable price as a result of the crisis (Figure 2.7).

As in comparable countries, indirect tax revenues are the primary source of tax revenues in CAR (Figure 2.9). Indirect taxes, including taxes on international trade, contribute to at least 75 percent to the overall tax revenue in CAR. The contribution of indirect tax to tax revenues is relatively high compared to Rwanda with 59 percent, CEMAC with 62 percent and SSA countries with 52 percent (Figure 2.7 and 2.8). Comparable countries tend to have a more balanced contribution of direct and indirect tax to revenues relative to CAR, which relies heavily on indirect taxes.

Direct taxation

Corporate Income Tax (CIT) and Personal Income Tax (PIT) are the main components of direct tax revenues in CAR, although they represent less than one-fourth of total tax revenues. As in comparable countries in SSA, direct taxes in CAR are composed of CIT, PIT and other incomes taxes. However, the contribution of CIT and PIT to total tax revenues in CAR has been about 19 percent on average since 2013. The is low compared to Rwanda, an aspirational peer, where CIT and PIT represent on average 41 percent of tax revenue during the same period. Also, CAR underperforms relative to FCV countries in SSA, and regional peers in CEMAC and SSA (Figure 2.11).

Direct tax increased gradually from 2013–2016, before declining in 2017 as economic recovery slowed. With the collapse of the economy in 2013,
direct tax revenues declined to 0.9 percent of GDP; this due primarily to the collapse of the private sector and a drop in CIT revenue from 1.1 percent of GDP in 2012 to 0.18 percent of GDP in 2013. The pace of economic recovery supported a gradual increase until 2016, when renewed insecurity slowed growth and collection of direct taxes dropped to 0.7 percent of GDP in 2017 from 1 percent in 2016. Revenues from direct taxes are estimated to increase to 0.92 percent in 2018.

CAR’s personal income tax rate increases with level of income but does not account for taxpayer’s family charges. The average statutory tax rate paid by wealthy households correlates positively to taxable income. Households earning more than CAF 5,040,000 (US$8,631) are subject to a 40 percent PIT rate, while the income of households earning less than CAF 378,000 (US$650.3) is free from tax. While CAR’s tax policy on personal income shifts the direct tax incidence from poor households to those with a greater ability to pay, it does not account for taxpayer family charges. This reduces the ability to assess whether the tax system is fully progressive. The effects of positive redistribution from wealthy to poor households means that government spending should also be progressive, with transfers to poor households and a social safety net. In addition, progressive taxation with a higher tax rate for the upper end of the earning distribution does not necessarily imply a reduction in income inequality in the sense that, a higher tax rate can trigger a free-rider effect and nourish the cycle of tax evasion. In this regard, the impact of progressive tax policy may be muted.

CAR’s personal income tax system is relatively complex. However, compared to Rwanda, with only 3 tax brackets, CAR’s PIT system is complex. (Table 2.1). This is reflected in the number and application of tax rates. For labor and capital income, the tax rate applied depends on the job status of workers. Self-employed households working in the agricultural sector are subject to a minimum rate of 0.3 percent, while the rate is 1.8 percent for workers in the diamond industry, services and other industrial sectors. Harmonizing these rates would significantly improve PIT revenue collection.

The marginal statutory personal income tax rate in CAR is among the highest in SSA. The average marginal rate in SSA is 6 percentage points lower than in CAR, where the maximum PIT rate is 40 percent (Figure 2.12). Although this rate is slightly below the average in CEMAC (40.8 percent) and other FCV countries (43.4 percent), the marginal rate in CAR appears to be higher than the rate applied in 69.8 percent of others SSA countries (Figure 2.12). Almost a quarter of SSA countries applied a marginal rate of 30 percent—DRC, Kenya, Malawi, Rwanda, and Tanzania—while a rate of 35 percent is applied in one-fifth of countries—Cameroon, Ethiopia, Equatorial Guinea, and Sierra Leone.

The contribution of personal income tax to CAR’s tax revenue is low and reflects structural weaknesses in the personal income tax system. CAR’s effective PIT rate is estimated to be 0.8 percent of GDP in 2016, nearly 5.7 percentage points below the value in Rwanda (6.5 percent) (Figure 2.13). South Africa (14.8 percent), Burkina Faso (9.7 percent) and Kenya (8.4 percent) outperform countries in raising PIT revenue, while Nigeria (0.3 percent), CAR (0.8 percent) and Burundi (1.3 percent) lag behind, CAR’s performance is 3.6 percentage points below the average in SSA countries, where the contribution of PIT revenue was estimated to be 4.4 percent of GDP (Figure 2.14). CAR authorities could increase the contribution of PIT to levels in FCV countries (3.6 percent) and CEMAC (3.8 percent) by (i) reducing the number of brackets, (ii) harmonizing tax rates for self-employed workers across sectors, (iii) simplifying and digitalizing PIT declaration procedures, and (iv) strengthening capacity of the tax administration to monitor and undertake fiscal controls on formally registered firms (enterprises).

### Table 2.1 Statutory personal income tax rates and brackets in CAR and Rwanda

<table>
<thead>
<tr>
<th>Net Annual Income (in CFAF)</th>
<th>Rate (%)</th>
<th>Net Annual Income (in RWF)</th>
<th>Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–378,000</td>
<td>0</td>
<td>0–360,000</td>
<td>0</td>
</tr>
<tr>
<td>378,001–1,680,000</td>
<td>8</td>
<td>360,001–1,200,000</td>
<td>20</td>
</tr>
<tr>
<td>1,680,001–3,360,000</td>
<td>15</td>
<td>1,200,001 and more</td>
<td>30</td>
</tr>
<tr>
<td>3,360,001–5,040,000</td>
<td>28</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>5,040,000 and more</td>
<td>40</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

Source: CAR’s DGID and Rwanda Ministry of Finance and Economic Planning.
**FIGURE 2.12** Statutory PIT rates in CAR and SSA

![Graph showing statutory PIT rates in CAR and SSA](image)

Source: World Bank staff calculations based on data from CAR’s Ministry of Finance and Budget, KPMG, and TheGlobalEconomy.com

**FIGURE 2.13** PIT effective rate in SSA and CAR in 2016 (% of GDP)

![Bar chart showing PIT effective rate in SSA and CAR in 2016](image)


**FIGURE 2.14** PIT effective rate (% of GDP) by country group in 2016

![Bar chart showing PIT effective rate (% of GDP) by country group in 2016](image)

Corporate income tax

CAR’s statutory corporate income tax rate is aligned with the average rate in SSA and fragile countries in the region. As with 39 percent of SSA countries, CAR’s statutory CIT rate is fixed at 30 percent. The frequent alternative rates are 25 percent and 35 percent adopted by 15.2 of SSA countries in each case (Figure 2.15). The average CIT tax rates in the CEMAC region and fragile countries are slightly higher at 33.3 and 30.3 percent, respectively. However, CIT is levied on only a small number of companies due to significant tax exemptions and a large informal sector that does not contribute directly to CIT revenues. Both factors are a source of inequality and distortion among taxpayers.

The contribution of CAR’s corporate income tax to GDP remains the lowest compared to many African countries. The country’s corporate tax revenue averaged 0.4 percent of GDP in 2016, two years after the 2013–2014 political crisis that forced many companies and firms to leave the country (Figure 2.17). Although CAR is gradually recovering from instability, the contribution of CIT revenue to GDP remains below the average in Rwanda, where this rate surged to nearly 2.6 percent of GDP. Catching up to rates in FCV countries (2.5 percent), SSA (2.5 percent) and the CEMAC region (2.1 percent) could generate an additional CFAF 21 billion (US$36 million) in total government revenue (Figure 2.18).

CAR will need to restore the confidence of investors and businesses in order to improve performance in CIT collection. Attracting foreign direct investment (FDI) is one way in which CAR can mobilize corporate tax revenue. However, since CAR’s ability to attract and maintain foreign direct investment (FDI) is highly correlated with political stability, this has been a challenge for the country. The recent peace agreement should increase business confidence to attract and maintain foreign capital. CAR’s system has also been vulnerable to tax exemption and evasion. With nearly 60 percent of the country under the control of armed groups, the government’s ability to track or control financial flows in these areas is limited. Government reforms should focus on improving the business environment, rebuilding peace and security to attract foreign capital, curtailing tax evasion and increasing the contribution of corporate tax revenue to GDP.

Indirect taxes

The main source of tax revenue for CAR is value-added tax (VAT) yet revenues are low and remain below pre-crisis levels. Since 2013, VAT revenues have, on average, amounted to 2.1 percent of GDP and account for the primary source of indirect taxes and total tax revenues in CAR (Figure 2.19). This is lower than the average level of 3.18 percent of GDP for the pre-crisis period 2010 to 2013. The contribution of VAT to tax revenues represented
on average 35 percent of total tax revenues in 2010, with no critical difference before and after the civil war. However, the outturn of VAT revenues remains far below the average level collected in Rwanda, FCV countries, and regional peers in the CEMAC and SSA region, where VAT revenues collected amount to at least 4 percent of GDP (Figure 2.20). VAT revenues in CAR are estimated to increase slightly to 2.7 percent from 2.6 in 2017.

Tax on international trade, the second source of tax revenues in CAR, is low and estimated to decline in
Since 2013, tax on international trade amounted on average to 1.8 percent of GDP; this, from an average level of 2.9 percent during the three years before the crisis. This rate remains below the average of Rwanda and regional peers. Taxes on international trade represent about 35 percent of total tax revenues since 2013. Taxes on international trade revenue are estimated to decrease to 2.4 percent of GDP in 2018, after peaking at 2.6 percent of GDP in 2017, as total exports decline. This is mainly due to the drop in production of diamonds and a freeze on log production by forestry companies.

**Import taxes are the main source of taxes on international trade.** Since 2017, import taxes have accounted for more than 95 percent of taxes on international trade, supported by VAT on imported goods and custom duties (Table 2.2). The contribution of import taxes is expected to decline slightly from 96.6 percent to 95.3 percent due to the drop of imports VAT revenues at 27.6 percent of total taxes on international trade in 2018 from 42 percent in 2017. The increase in revenues from petroleum duty from 6.9 percent in 2017 to 18.7 percent in 2018 limited the drop in import taxes.

**CAR is in the upper bracket of African countries with a higher VAT statutory rate.** The country’s statutory rate of 19 percent is higher than the average rate in CEMAC (18 percent), FCV countries (16.3 percent) and SSA countries (15.9 percent). More than 36 percent of SSA countries apply a VAT statutory rate of 18 percent, and 24.4 percent of countries apply a 15 percent statutory rate (Figure 2.21). The lowest statutory rates are applied in Eritrea (4 percent), Nigeria (5 percent) and Liberia (7 percent). The highest statutory rates are applied in Madagascar (20 percent), Cameroon (19 percent), CAR (19 percent) and Congo (19 percent).

### Non-tax instruments

Non-tax revenues have declined over time and remain only a marginal source of revenue in CAR (Figure 2.22). For 2018, non-tax revenue in CAR...
comprised primarily registration fees on stamps (24 percent); state-owned forest and land use fees or charges revenues (17 percent); and revenues from water, forestry, hunting and fishing (17.8 percent). Other non-tax revenues including other withhold on salary and products account for about one-fourth of CAR non-tax revenues. Total non-tax revenues dropped from 1.34 percent of GDP on average over the period 2005 to 2012 to 0.55 percent of GDP on average since 2013. This downward trend is in line with that observed in the CEMAC zone, where non-tax revenues fell from 15 percent to 9.3 percent of GDP due to crisis in the region that affected primarily revenue from the oil sector. Fragile countries in the region experienced a drop from 5 percent to 3.5 percent of GDP, while in the SSA region, non-tax revenues dropped slightly from 6.6 to 6.3 of GDP.

Mining revenues dropped sharply in 2018 as production in the sector shrunk. The production in the mining sector dropped from 59,780 tons in 2017 to 12,530 in 2018 resulting in a collapse of non-tax revenues from the sector. Mining revenues dropped from 5.2 percent of total non-tax revenues to 0.6 percent in 2018, amounting to about CFAF 62 million (US$ 106,303) revenues collected. The mining production is should increase in 2019, stimulating thereby an increase in associated tax revenues from 0.6 to 2.4 percent of total non-tax revenues.

Efforts to streamline parafiscal agencies and transfer their revenues to the Single Treasury Account will reshuffle the composition of non-tax revenues. The sustained effort of the government to reform parafiscal agencies and taxes will change the composition of CAR non-tax revenues. In 2019, revenues from parafiscal agencies and special affectation accounts are expected to be at 59 percent of non-tax revenues (Table 2.3). Registration fees of stamps and curatorship; state-owned forest and land use fees or charges revenues; and revenues from forestry, hunting, fishing, and water, as well as other non-tax revenues will be reduced by more than half.

### TABLE 2.3 Contribution to non-tax revenue, 2017–19

| Source: World Bank staff calculations using data from CAR authorities. |
| Registration fees of stamps and curatorship | 21.7 | 23.9 | 10.4 |
| State-owned forest and land use fees or charges revenues | 21.5 | 16.9 | 4.6 |
| Revenues from forestry, hunting, fishing, and water | 13.2 | 17.8 | 7.2 |
| Mining | 5.2 | 0.6 | 2.4 |
| Revenues from parafiscal agencies and special affectation accounts | | | 59 |
| Authorization fees and mandatory regulatory payment | 4.8 | 13.5 | 5.3 |
| Public administrations | 1.2 | 1.1 | 2.7 |
| Social security and pensions | 0.2 | 0 | 5.5 |
| Other non-tax revenues | 32 | 26.1 | 3.1 |
2.2 Why is domestic revenue mobilization so low in CAR?

CAR has untapped potential for mobilizing domestic revenues. Key factors that inhibit CAR from reaching its potential for domestic revenue mobilization include a large informal sector, weak tax instruments, low tax compliance and poor tax-customs administration performances weakened by a fragile security condition. Tapping into its full potential will require (i) a revised tax policy aligned with those of best performers in the CEMAC region; (ii) a strengthened tax administration with the capacity to recover tax arrears and fight against tax evasion; and (iii) digitalized tax and customs administration procedures to promote transparency and reduce tax misreporting. Government commitments underpinned by a transformative leadership that places peace and stability at the center for sustainable development are also key ingredients to leveraging domestic resources.

2.2.1 Inefficient tax instruments

2.2.1.1 Large tax gap

Collection of tax revenues in CAR is consistently below the country’s potential. One way to assess the efficiency of a tax system is to evaluate the size of the tax gap, measured as the difference between tax potential and tax revenue effectively collected in the country. Accounting for the structure of the economy, the level of social development, and the quality of its institutions, an estimate of the tax potential for CAR\(^9\) highlights a structural tax gap. The tax potential for CAR has remained above tax revenues since at least 2000 by between 4 and 7 percent of GDP. For 2016, the tax gap is estimated to be 4 percent of GDP after picking up to 7 percent of GDP in 2014 (Figure 2.23). The difference between tax revenue collected and its potential level might be explained by tax administration shortfalls, institutional arrangements, and the inefficiency of the tax system, including inappropriate tax exemptions and parafiscal taxes that represent a significant shortfall for the country. A large informal sector also adds to CAR’s tax gap.

Ineffective collection of VAT revenue might explain the CAR tax gap. Collection of tax revenue in CAR dropped to less than 15 percent in 2014 before a gradual increase to 21.5 percent in 2018. The C-efficiency score\(^10\) of CAR is relatively low at 18.3 percent compared to Rwanda, one of its aspirational peers. For the latest year of data available (2017), the C-efficiency score for Rwanda was on average about 43 percent, more than twice the efficiency score in CAR (Figure 2.24). CAR authorities should increase the efficiency of VAT tax collection by improving the capacity of tax administrations to fight VAT fraud, strengthen controls, and minimize tax exemptions on goods and services.

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\(^9\) Tax potential is estimated using a simple macroeconomic model on the determinants of domestic tax collection. The estimation accounts for the structure of the economy (level of development, the importance of the agricultural sector, and the participation in international trade), the level of social development (education, inequality of revenue), and governance.

\(^10\) The C-efficiency score is computed as the share of tax revenues on goods and services in total consumption over the VAT tax rate. The score is computed for the latest data available for Rwanda.
2.2.1.2 Lower excise rate

Excise revenues in CAR are low and remain far below the average level in comparable countries. From 2005 to 2012, excise tax revenues represented on average 0.2 percent of GDP. After peaking at 0.6 percent of GDP in 2016, revenues from excise taxes declined at 0.5 and 0.4 percent of GDP in 2017 and 2018, respectively. Despite a relative increase in revenues collected after the civil war, excise taxes remain far below the average level of 1.8 percent of GDP and 1.3 percent in the CEMAC zone. Since 2013, excise tax revenues in CAR are more than 3.5 times lower than the average level collected in Rwanda and SSA countries. Although inefficiencies in the customs administration plays an important role in CAR’s underperformance, the low excise tax rate and coverage undermine the total revenue collected.

2.2.1.3 Significant number of tax exemptions

Tax exemptions represent a considerable loss in tax revenue for CAR. Total tax exemption amounted CFAF 2,387 million in 2016, representing about 3 percent of government’s revenues. On the total tax exemption, 43 percent was granted to the private sector and the remaining 57 percent to NGOs, UN institutions, and international forces (MINUCSA) (Figure 2.25). Tax exemptions to the private sector are mainly in the form of VAT, which accounted for 70 percent of total tax exemption, while exemptions in the form of corporate income tax accounted for nearly 19 percent (Figure 2.26). In theory, tax exemptions to the private sector may be used as an instrument to reduce the cost of newly established SMEs and to increase their competitiveness. However, those benefiting most from these exemptions are foreign companies who account for 90 percent of firms in CAR. Most foreign companies are net importers and operate primarily
in the service sectors (distribution, hotels); only a few of them produce locally. In this context, exemptions could not stimulate the development of the private sector, especially the manufacturing sector which is critically needed in CAR. It is therefore essential to align CAR’s private sector tax policy to medium- and long-term development strategies and to identify for exemption priority sectors that create jobs. These measures should be monitored for effectiveness.

The adoption of the new investment charter has significantly contributed to reducing the exemptions granted to the private sector, but efforts must be maintained. The authorities continue to pursue the implementation of the policy of rationalizing exemptions in a context of increased shortfalls in domestic resources. Thus, the adoption of the new investment charter in 2017 made it possible to establish a framework for allocating and regulating exemptions granted to private companies. Total tax and customs exemptions granted to private companies have more than halved, from CFAF 2.7 billion in 2016 to CFAF 1.6 billion in 2018 (Figure 2.27). It is crucial to continue efforts to streamline exemptions and, above all, to minimize the emergence of new forms of exemptions for the private sector outside the framework of the Investment Charter. In particular, the emergence of exceptional tax exemptions for the customs cordon in 2018 amounting to about CFAF 1.3 billion. Estimates for the first quarter of 2019 indicated an increase of about CFAF 1.5 billion. Tax exemptions granted to international forces and organizations remain high but reflect the continued support of the international community for the peace effort in CAR.

2.2.1.4 Higher VAT erosion index and weak VAT productivity

Despite a decreasing trend, CAR’s VAT erosion index remains extremely high. The erosion index highlights the extent to which a tax system can be weakened by measures that hamper the performance of collected tax revenue in relation to its potential. These measures include tax credit and tax exemption, fiscal incentives, temporary tax exemption, and other preferential measures that significantly erode the fiscal base. The erosion index is the discrepancy between the effective tax rate and the statutory rate. The higher the index, the higher the loss in tax revenue. Analysis for the period 2012–2017 shows that the VAT erosion index for CAR averaged 0.87\(^\text{11}\) (Figure 2.28). This means that nearly 87 percent of potential VAT was lost due to exemption or other preferential tax measures. Most of these exemptions were granted to the private sector in the form of VAT, amounting to CFAF 1.02 billion, or 43 percent of total tax exemption in 2016. This represents a tremendous loss in tax revenue. In addition, analysis of tax

\(^{11}\) The higher value of the erosion index that picked at 0.93 in 2014, one year after the 2013 political crisis, can be interpreted as the result of fiscal incentives to the private sector to create jobs.
exemption in 2016 reveals that 70 percent of total tax exemption was granted in terms of VAT, supporting the argument that CAR is losing a fair amount of tax revenue through tax exemption. Reducing the levels of these exemptions is, therefore, a critical way forward to improve VAT erosion. The adoption of the new investment charter in 2017 is expected to play a significant role in this regard.

Improving VAT productivity is critical to increasing CAR’s tax revenues through the VAT. In 2016, CAR’s VAT productivity\(^{12}\) was estimated at 0.2, structurally below the level in Rwanda of 0.43, and Cameroon (0.37) (Figure 2.29). While there has been some improvement since 2014, CAR’s VAT productivity remains low. Reforms to increase tax compliance and reduce the size of the informal sector can significantly improve CAR’s VAT productivity.

2.2.1.5 Lower tax buoyancy and elasticity

CAR has implemented a set of measures for the period 2003–2016 to raise domestic revenue. Assessing the impact of such measures and reforms is a daunting exercise and requires a long time series. Given limited data; tax buoyancy and elasticity may provide insights on the size and responsiveness of each tax to changes in policy. Indeed, tax buoyancy and elasticity are two sides of the same coin. They both measure the responsiveness of tax revenue to economic growth or output (GDP). However, the slight difference stems from the fact that tax buoyancy is a crude measure capturing discretionary policy as well as real economic conditions affecting tax revenue. Elasticity, a measure used more frequently, controls for the automatic switch in revenue. The difference between the two measures may, therefore, be “interpreted” as the impact of the discretionary policy rule.

For the period 1981–2016, CAR’s government tax revenue was inelastic while tax revenue on goods and services was highly elastic. For this period, the elasticity of tax revenue is estimated at 0.65, meaning that a one percent increase in output (GDP) will translate into a 0.65 percent increase in tax revenue (Figure 2.30). The elasticity of non-tax revenue is estimated at 0.75, almost ten percentage points higher than the elasticity of tax revenue. However, the elasticity of tax revenue on goods and services is estimated at 1.33 (Figure 2.31). This implies that one of the main reasons for CAR’s revenue gap is low tax capacity: the government can raise revenue even more only by working towards increasing the size of the economy without raising the tax rate.

Discretionary policies have only slightly affected CAR’s government tax revenue for the period 1981–2016. The impact of discretionary policies is estimated at 0.02 for tax revenue and zero for non-tax revenue (Figure 2.31). The same pattern holds for direct and indirect tax revenue; tax revenue on income, profit and capital gain; and tax revenue on goods and services. The meager impact of such policies on tax revenue can be associated with weak political and economic conditions in the country over

\(^{12}\) VAT Productivity = VAT/GDP\(^*\)\(^t\) Where \(t\) is the VAT statutory rate.
the period. Poor public financial management and a buoyant size of informality coupled with government inability to undertake and implement reforms are some of the key features that have significantly dragged the country’s domestic revenue mobilization performance. Government reforms, including tax reform measures such as changes in tax legislation and curtailing tax evasion, are designed primarily to restore tax buoyancy to output, broaden the tax base, and strengthen modern taxes in order to maximize the impact of discretionary measures. CAR needs to accelerate implementation of agreed measures with its financial technical partners in order to foster domestic revenue mobilization and generate higher discretionary policy impacts on government tax revenue.

2.2.2 Weak tax administration effectiveness

2.2.2.1 Weak Tax and customs administration performances

CAR’s tax administration performance is improving gradually but remains below the pre-2013 level. Since 2013, forecasts for average tax revenue have been estimated at 9.1 percent of GDP. However, only 6.6 percent was effectively collected, corresponding to a negative tax revenue gap of 2.6 percentage points (Figure 2.32). Nevertheless, this gap has declined sharply from 9.7 percentage points in 2013 to 2.9 percentage points in 2017, as tax administration performance improves gradually. Hence, tax revenue ranged from 5.2 percent of GDP in 2013 to 8.5 percent in 2018, corresponding to an average annual increase of 8.5 percent. This upward tax revenue trend was driven by the performance of the Fiscal Department of Big Enterprises (DFGE) which amounted CFAF 23.6 billion — 74 percent of total tax revenue in 2016 — while revenues from domain (CFAF 2.8 billion) and other fiscal agencies (CFAF 5.5 billion) only accounted for 26 percent of total revenues (Figure 2.33). However, revenues collected from each tax administration was below the forecast reflecting endogenous and structural weaknesses, preventing CAR to mobilize domestic resources.

Political instability and insecurity affect CAR’s tax performance. CAR’s general tax performance reveals two key patterns: the strong correlation between tax administration performance and political stability, between implementation of reforms to raise tax revenue in the aftermath of the crisis and tax administration performance. The virtuous cycle of DRM discussed above has stressed the need for a peaceful and secure economic environment as a pledge to leverage domestic
resources. The political crisis that emerged in 2013 has undermined the ability of the tax administration to operate efficiently. Ensuring peace should be a key focus for the central government to restore the effectiveness and efficiency of tax administration. Furthermore, weaknesses of tax administration performance are also associated with endogenous factors, including ineffective recovery of tax arrears, outdated tax legislation, limited human resource capabilities, and excessive use of manual procedures for tax declarations. Addressing these could significantly improve tax administration performance. And, regarding government reforms to raise tax revenues, the increase of tax administration performance is expected to continue, especially in light of the new peace agreement.

There are structural weaknesses in CAR’s fiscal control. Of the total amount of CFAF 14.3 billion of tax notified by the tax administration in 2017, only CFAF 3.1 billion was effectively confirmed, of which 2.4 billion was payment of principal and 0.7 billion was payment of taxpayer fines for non-compliance (Figures 2.34 and 2.35). Such gaps
between notifications and confirmations are the result of internal weaknesses in CAR’s tax system, ranging from limited human resources to weak tax administration productivity that results in a low level of cases closed during the fiscal year. Addressing these weaknesses can potentially generate more than CFAF 10 billion every year. Reforms in this area should focus on strengthening the capacity of the tax administration to overcome emerging challenges and speed up the process of tax verification to close cases. An incentive such as a special bonus program for staff with a higher number of cases closed per year could lessen the gap between notifications and confirmations.

Customs administration performance was mitigated over the period 2016–2017. In 2017, revenue from customs administration was to CFAF 52.2 billion against a forecast of CFAF 54.0 billion, corresponding to a negative gap of nearly CFAF 1.8 billion (Figure 2.36). The opposite pattern was observed in 2016, where the forecast was outpaced by CFAF 5.4 billion, with revenue of CFAF 46.9 billion. Overall, there is a positive trend in realizations. From CFAF 46.9 billion in 2016, customs revenue rose to CFAF 52.2 billion in 2017, corresponding to an increase of CFAF 5.3 billion in one year. Such good performance was underpinned by contributions from the oil sector (CFAF 16 billion), the forestry sector (CFAF 1 billion), and gold and diamonds (CFAF 26 million), which represent the primary source of customs administration revenue (Figure 2.37). Estimates for 2018 are for CFAF 52.5 billion and it is expected that this trend will continue in the short- and medium terms as the security and political conditions improve.

2.2.2.2 Inefficient property tax collection system

There is potential for CAR to more than double its domestic property tax revenue. Less than CFAF 1 billion was collected from land conservation between 2016–2018; this remains far below the country’s potential (Figures 2.38 and 2.39) and is due to structural weaknesses in the property tax system. Although recording of land titles is increasing, a large number are still not recorded due to (i) outdated property tax legislation; (ii) poor tax compliance; (iii) lack of public awareness on the value of obtaining a land title; and (iv) limited human and financial resources in the tax administration to undertake field activities. Current property tax legislation is outdated (August 1926 and May 1960) and fails to account for recent economic developments. For example, article 169 (12) of the 201714 General Tax Code states that the first house of a household used for non-commercial purposes is exempted from property taxes. In addition,

14 The code captures some articles of outdated legislation.
39

article 169 (11) of the same code states that houses located outside urban areas and which belong to nonprofit associations or physical persons are exempted from property taxes. These articles are inefficient and socially inequitable. For two households with two properties each. The first household that we assume to be rich has two villas while the second household that we assume to be poor has two small houses. The two households are assumed to live in an urban area (like Bangui for example) to make it consistent with article 169(11). Hence, according to article 169 (12) the two households are subject to a property tax on their second house while their first house is property tax-free. The question therefore is will that be fair? Revising this text to reflect on the country’s social inequality will be a good way forward to increase the contribution of property tax into total government revenue and improving the declarative nature of property tax system should be a priority.

2.2.3 A buoyant and complex informal sector

To broaden the tax base, CAR will need to tackle the issue of informality (including in the mining sector) to maximize government revenue collection without jeopardizing the development of newly established SMEs. A common feature in low-income and FCV countries is the large size of their informal economies. Recent estimates show that CAR is in the upper tail of SSA countries with an informal economy that makes up between 40 and 60 percent\(^{15}\) of GDP. The size of the informal sector in CAR was estimated to be 41.1 percent, nearly 3.3 percentage points below the average in FCV countries, and 1.3 percentage points below the average in SSA and the CEMAC region between 1991–1999 (Figure 2.40). The size of CAR’s informal sector surged 15 years later to 42.3 percent of GDP, the highest compared to FCV countries (41.7 percent), CEMAC (39.6 percent) and SSA (38.6 percent). And, although the challenge of informality is not specific to CAR, improvements have been recorded in Mauritius (21.1 percent), South Africa (23.9 percent) and Rwanda (34.0 percent). Zimbabwe (62.8 percent), Nigeria (54.4 percent) and Benin (52.7 percent) still lead the distribution. CAR can learn from the experience of good performers on how to design sound policies to effectively address this challenge.

A shadow economy is usually associated with poor economic performance, weak government management, and unstable political conditions. Evidence also tends to support a strong correlation

\(^{15}\) This number might be even higher, if accurate and relevant data on this matter was up to date. Informal discussion with government officials and CAR’s National Institute for Statistics (ICASEES) indicates that there has been no survey carried out to assess the effective size of the informal economy over the last 10 years. Hence, there is room for donors to support CAR’s government to track down the effective size of the informal economy and design sound policies tailored to country specificities to better channel resources from the informal sector to financing its development agenda.
between a growing informal economy and factor allocation from the formal to the informal sector during downturns. In this regard, the informal sector serves as a safety net and buffer against poverty for households seeking to reduce the impact of exogenous shocks on their consumption behavior over time. These households are more often located in the agricultural sector, which accounted for nearly 56 percent of CAR’s informal sector over the period 2005–2012. Moreover, firms operating in the informal sector are hard to reach, and most financial transactions are made in cash. As a result, a significant number of economic activities escape the tax authorities’ control, eroding government tax revenue collection. Even though firms operating in this sector pay VAT and cannot claim it back because of their informal nature, their potential contribution to government revenue can increase significantly if they are clearly identified and formalized. Indeed, countries that exhibit a higher share of the informal sector over GDP fail to mobilize domestic revenues. Hence, the growing size of CAR’s informal sector over the period 1991–2015 has significantly undermined the country’s capacity to collect tax revenue (Figure 2.41). The same pattern also holds at the SSA level with, however, a less pronounced slope. It turns out that, the elasticity of curtailing the informal sector on government revenue is higher in SSA than CAR, underscoring the need to design sound policies to gauge and assess the size of such a sector and measure the extent to which uplifting local firms from informality may generate additional resources without putting more burden on their ability to operate efficiently.

2.3 How can CAR boost domestic revenue?

In a country like CAR, revenue gaps persist for three main reasons: a narrow tax base, lack of a sound tax system and low tax effort, and low tax compliance due to a deteriorated social contract. With regards to the limited tax base, the prevailing level of economic growth and structural characteristics of the economy affect the feasibility and costs of collecting taxes. A sound tax system is expected to feature four basic elements: equity, economic efficiency, technical efficiency, and revenue stability. A low tax effort points to a weak tax administration and a low level of compliance on the part of domestic taxpayers, generally reflecting a weak social contract. In a fragile context as in CAR, all three drivers of revenue gaps are exacerbated, making it a daunting task to achieve the World Bank twin goals of poverty reduction and shared prosperity. These reasons are clearly highlighted in
the previous section that looked at factors affecting domestic revenue mobilization in CAR. This last section systematically uses them to explore how to boost domestic revenue mobilization in CAR, and concludes by looking at the experience of Rwanda, one of CAR’s aspirational peers. The last section shares also the experience of Georgia, which did remarkable progress in domestic revenues collection after an important crisis.

2.3.1 Broaden the tax base

Short-term solutions

To broaden the tax base, CAR should consider the following measures in the short term:

- Reinforce targeted audits and verification measures;
- Curb and closely monitor tax exemptions; and
- Increase the application scope of the excise tax rate.

Reinforce targeted audits and verification measures

Increase the recovery rate of taxes through targeted audits and other verification measures. A key feature of CAR’s tax system is the huge gap between tax forecasts and realization, which, since 2010, have amounted to about CFAF 84.4 billion in both customs and fiscal administrations. Although the fragile economic environment might continue to affect tax revenue administration performance, additional tax revenues can be collected through targeted audits and more verification measures. These targeted audits and verification measures should be conducted in a fair way so that they do not represent an additional cost for firms.

CAR’s low tax efficiency could be addressed by strengthening fiscal controls and improving tax recovery capabilities. Data from DGID shows that 53.3 percent of CAR’s tax revenue was not recovered in 2015, while nearly 90 percent of expected tax revenue to recover in 2016 has not been effectively collected. Moreover, in 2015, CFAF 14.9 billion, or 6.3 percent of the 2019 government budget, and 1.6 percent of 2015 GDP were not recovered. Sectors covering ITC (CFAF 7.5 billion CFAF) and forestry (CFAF 6.2 billion) have both accumulated the highest share of uncollected tax revenue. At an estimated 50.2 percent16 for ITC and 41.5 percent for the forestry sector these shares reflect weaknesses in domestic revenue mobilization for CAR. Such poor performance is rooted in three key factors: (i) limited human and financial resource capabilities for tax recovery services; (ii) a lack of clear methodology and risk analysis to implement tax recovery activities; and (iii) the use of manual procedures to undertake tax revenue recovery. CAR’s tax administration should take measures to address these issues by improving the efficiency of the recovery services to design a sound methodology for tax recovery rather than the use of ad hoc and outdated procedures; and strengthening capacity to use the SYSTEMIF software for improved productivity.

Effective audits and verification measures should be implemented. These include implementing the rules established by the law to reduce costs for firms and ensuring they are fair and announced ahead of time. Also, the rotation of civil servants (auditors) in charge of conducting the audits might be critical to reduce potential corruption. Authorities should also consider abandoning prior liquidation of taxes declared and paid spontaneously and promoting the use of new technology for payment of bills and taxes to minimize fraud — the introduction of Electronic Billing Machine (EBM) like in Rwanda is a very good example.

CAR should also reinforce legislation on tax recovery and coercive measures. Government authorities should reinforce CAR’s tax recovery by enacting laws to set a threshold for payment in cash, and by facilitating criminal actions against retention of withholding taxes, especially for VAT tax. Coercive measures, such as seizure of goods through their passage at the customs and interdiction to participate in public procurement should also be enforced.

Curb and closely monitor tax exemptions

CAR should curb and monitor tax exemptions closely. Tax exemptions in CAR are high; in 2016, they represented about 3 percent of CAR’s tax revenues and about 21 percent of domestic primary deficit. About half of all tax exemptions are for private companies. To broaden its tax base, CAR’s authorities need to curb tax exemption,
especially on VAT, CIT, and taxes on goods and services. This will require a long-term political commitment. More than half of similar low-income countries have been successful at eliminating tax exemptions by reducing statutory and discretionary exemptions (Guyana and Solomon Islands), ending tax holidays (Burkina Faso), ending CIT exemptions (Mauritania), and eliminating VAT exemptions (Uganda).

**CAR should revise policies governing tax exemptions.** CAR authorities could benefit from an in-depth revision of tax exemptions to minimize the negative impacts on domestic revenue collection. The current tax exemption framework in CAR might be completely ineffective in attracting private, domestic and foreign investment and growth. For fragile countries such as CAR, private investments, especially foreign investments, are driven primarily by security, availability and quality of public infrastructure, a skilled labor force, and a credible and fair legal system. Advantages related to taxation seem to play a minor role compared to these factors. CAR should focus efforts on improving the business environment by securing property rights; investing in infrastructure, such as electricity access and reliability; and simplifying administrative processes for tax payment, permits acquisition, and other related processes.

**Increase the application scope of the excise tax rate**

**CAR should review the application of excise tax rates on alcohol and tobacco products to increase domestic resource mobilization.** Excise tax revenues in CAR amounted to 0.36 percent of GDP, well below the average level in comparable countries. CAR has the potential to increase tax revenues through its excise tax rate and coverage.

Excise taxes are easy to implement and can be an immediate source of revenue. The current excise rate for alcohol products in CAR is 45 percentage points below that of Rwanda, where alcohol products are subject to a 70 percent excise rate. Even though rates have been added to the 2019 budget law for specific products such as champagne (CFAF 1,000 per liter), red and white wine (CFAF 600 per liter) and whiskey (CFAF 1,500 per liter), the total excise rate of under 40 percent leaves room to increase. Increases on alcohol products could be based on alcohol content, with a threshold (e.g., 5 percent) that would exempt low-alcohol products such as beer, but would apply to liquor with a high alcohol content. For tobacco products, the excise rate is 35 percentage points below the level in Rwanda, where a rate of 60 percent is applied. CAR should consider using a similar rate. In addition to those currently applied in the 2019 budget law, CAR could review the excise tax on tobacco products that contain nicotine levels beyond a specific threshold. By increasing the excise tax on alcohol and tobacco products, CAR could increase revenue by an estimated CFAF 0.6 billion per year.

**Excise rates on telecommunications can generate additional resources.** The current excise rate on phone calls in Rwanda is 10 percent while this rate is zero in CAR and Cameroon (Figure 2.42). In addition to Rwanda, other low-income countries such as Guyana and The Gambia increased imposed excise taxes on the telecommunications sector. Based on experience from these countries, the excise rate on telecommunications represents an option to leverage additional domestic revenues. In order to minimize the impacts of such new taxes on the poor, authorities could consider applying excise taxes of 10 percent on foreign calls beyond 10 minutes,
daytime domestic calls beyond 20 minutes and each MB of data usage above 3 GB. It is estimated that this could leverage an additional CFAF 1.3 billion per year.

**Long-term solutions**

To broaden the tax base, CAR should consider the following measures in the long term:

- Rationalize the number of tax rates;
- Tap the informal sector; and
- Exploit the potential of property taxation.

**Rationalize the number of tax rates**

CAR’s tax system is complex, with a proliferation of tax rates in each tax field, numerous tax bases, a multiplicity of tax brackets, and a strong tendency toward taxation on a forfeit basis. This complexity creates distortions and inequities and provides few incentives to formalize economic activities, to extend the tax base. The World Bank Ease of Doing Business 2016 report shows that a typical firm in CAR makes 56 tax payments in a year, significantly more than the average of 38 payments in Sub-Saharan Africa.

**Simplifying the tax systems and reducing the number of tax rates.** CAR has 5 brackets for personal income taxes (PIT) while Rwanda, an aspirational peer, has only 3. Yet PIT revenues collected in Rwanda are on average 9 times higher than in CAR. A similar difference in PIT revenue performance can be found in the Republic of Congo, which has 4 PIT brackets. CAR should consider reducing the number of tax brackets to simplify the system for the taxpayers. CAR can learn from countries where reforms have been successfully implemented. Georgia simplified its tax system by reducing the number of taxes to be paid from 21 to 7. Morocco targeted its tax base more directly by reducing the number of VAT special regimes., Jamaica introduced VAT on residential electricity consumption, and Seychelles converted the narrowly applied 7 percent Goods and Services Tax (GST) into a broad-based 12 percent GST.

**Reducing the number of tax rates can be supported by reorganizing income brackets.** Two scenarios could be considered:

- **Apply a minimum tax rate of 1 percent on the lower range of personal income bands while maintaining the current income bracket.** Broadening the tax base in CAR might involve associating all taxpayers as in regional peer country such as the Republic of Congo. A minimum tax rate will broaden the tax base and to include all households.

- **Apply a minimum tax rate of 1 percent on the lower range of personal income bracket.** CAR could reduce the number of PIT tax rate brackets from 5 to 3, as in Rwanda, and reduce the maximum income in each range of personal income bands. In addition to simplifying the current tax system, this would reduce the average tax rate on personal income. The current average PIT rate in CAR is 18.2 against 16.7 percent in Rwanda. A high marginal income tax on wealthy households of 40 percent creates a potential for tax evasion. In comparison, more than two-thirds of SSA countries have a marginal rate on wealthy households below 40 percent. The suggested scenario will reduce the average tax rate from 18.2 to 17 percent (Table 2.4).

**Tap the informal sector**

Tapping the informal sector and implementing business-friendly reforms will attract private investment, support economic recovery and sustainable growth. As noted earlier, there are major challenges to development of the private sector in CAR, including lack of access to infrastructure.

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**TABLE 2.4 Scenario of adapting CAR’s PIT brackets as in Rwanda.**

<table>
<thead>
<tr>
<th>Central African Republic</th>
<th>Rwanda</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Annual Income (in CFAF)</strong></td>
<td><strong>Rate (%)</strong></td>
</tr>
<tr>
<td>0–234,000</td>
<td>1</td>
</tr>
<tr>
<td>234,001–781,000</td>
<td>15</td>
</tr>
<tr>
<td>781,001 and more</td>
<td>35</td>
</tr>
</tbody>
</table>

Source: World Bank staff calculation. Note: The maximum income in each bracket would be equivalent to those in Rwanda, although the maximum tax rate is different.
and finance, and an ineffective judiciary sector. To promote business-friendly reforms, CAR authorities could consider the following:

- **Simplify procedures and reduce costs and constraints that limit the creation and development of business.** In the 2019 World Bank Doing Business report, CAR was ranked 183 out of 190 countries in terms of ease of doing business. The private sector in CAR requires bold reforms in almost all aspects. Short-term solutions include (i) simplifying tax declarative procedures, (ii) reducing the number of days it takes to start a business, register property, and get a construction permit, and (iii) enforce contracts. In addition to attracting new private investors, such reforms should encourage formalization of activities currently in the informal sector.

- **Tapping into the informal sector through community taxation.** CAR's low domestic revenue mobilization is also due to a large informal sector that represents about 42.3 percent of the economy. CAR can tap into the informal sector by introducing a community tax. As in several other SSA countries, economic activities are structured in organizations, associations and cooperatives. Including these in a community tax would broaden the tax base for CAR. In addition to increasing the tax base, community taxation encourages partnership between government and communities to develop solutions together. This, in turn, could increase trust in the tax system.

**Exploit the potential of property taxation**

The declarative nature of CAR’s property tax system should be complemented with an outreach campaign to raise awareness on duties and the benefits of land titles. Land titles are assets that can be traded for access to bank loans and financial capital. In a country where nearly, 75 percent of people do not have a bank account, holding a land title represents an opportunity to present a collateral and increase thereby their participation of households to the capital market. CAR should consider (i) carrying out campaigns in urban and rural areas and in local language to raise awareness on the benefits of holding land titles and the need to pay property tax (a corresponding budget line should be provided for such campaigns) and (ii) simplifying declarative procedures and reducing delays for obtaining a land title.

**Strengthening the declarative nature of CAR’s property tax system will entail a series of measures.** From a forecast of CFAF 445 million in potential revenue from undeveloped property between 2016 and 2018, only CFAF 44 million was realized (or 9.7 percent) (Figure 2.43). Collection of state taxes was 63.6 percentage points below forecast over the same period (Figure 2.44). The government should address structural weaknesses in the system.
by (i) carrying out a national land and property census, (ii) digitalizing declarative procedures, and (iii) increasing capacity for recording and monitoring. A national land and property census should be carried out (including developed and undeveloped property) to provide a complete picture for authorities to enforce compliance. Discussions with staff in charge of land conservation in the DGID reveal that efforts are being made but there are challenges to find a technical partner able to undertake such activities and allocate the necessary financial resources for such a large-scale activity. The government should also increase the number of staffs for recording and monitoring. The authorities can exploit the potential of property taxation which can generate a minimum of CFAF 12 billion ($22 million) in a yearly basis (Box 2.1).

**2.3.2 Strengthen the tax system**

**Enhancing tax policy and administration**

CAR cannot strengthen its tax revenues without reinforcing tax policy and administration. Improving performance of the tax administration is critical to leveraging additional resource and urgent reforms are needed in this area. CAR authorities should standardize working methods by (i) establishing a manual of administrative and financial procedures; (ii) strengthening internal control and introducing risk-based management; and (iii) strengthening inspections of services through the implementation risk-based audit and control programs.
Building capacity of the tax administration is key to strengthening the tax system. CAR should build capacity of tax auditors by identifying needs and ensuring training in the collection and use of fiscal information.

CAR should pursue efforts to eliminate parafiscal taxes without economic justification and transfer other revenues into the Treasury Single Account. Tax revenues increases in 2018 reflect mainly the progressive integration of parafiscal taxes in the Treasury Single Account (TSA). Authorities should inventory parafiscal levies and audit public agencies related to parafiscal taxation in CAR. Actions have been taken in this direction, but there has been a significant delay in the implementation of these critical reforms. Completing these reforms will require steadfast commitment and strong political leadership. The authorities should continue to audit public agencies to which these revenues are assigned.

Modernize CAR’s tax system

Extend computerization of public administrations and maximize the use of existing software. In addition to improving the efficiency of the tax system, use of computerized systems could limit abuse and corruption and facilitate the sharing of information between the various bodies of the tax administration. The adoption of the SYSTEMIF software in the fiscal administration and ASYCUDA for the customs administration is a step in the right direction. However, these systems are not being used to their potential: several functionalities of SYSTEMIF, such as the control of tax recovery and the registration of declarations are not being used; and actualization of tariffs in ASYCUDA is not systematic. There is scope to maximize use and interconnection of these systems. With the peace agreement in place, customs offices may also be progressively computerized. The government should also prioritize the following:

- introduce the use of a computer system for electronic tracking and control of movement of goods in transit (electronic seals);
- ensure the interconnection of DGDDI computer systems with those of Cameroon; and
- introduce the use of a computer system for management of VAT.

Invest in computerization of Berbérati, Gamboula, and Mongoumba customs posts and non-intrusive inspection (NII) systems. To date, only Bangui and Beloko customs posts are computerized. With the significant traffic at Berbérati, Gamboula, and Mongoumba, computerization of these posts would result in increased efficiency and significant customs revenue. Use of computer systems will eliminate the need for manual transactions that are vulnerable to fraud and corruption. CAR authorities should also consider investing in non-intrusive inspection (NII) technologies that allows customs authorities to inspect and screen vehicles and personal items through x-ray or gamma-ray imaging. Use of such systems will require an investment in human capital.

Move progressively toward electronic methods for registration, tax payment, and controls to increase efficiency in tax collection. CAR authorities could take advantage of new technologies to boost the performance of the tax system. Current plans for household and enterprise surveys present opportunities to establish a single taxpayer identification number. This would facilitate identification and monitoring of taxpayers. Electronic payment of bills and taxes should be promoted to facilitate fiscal control, collection, and enforcement. Efforts for electronic payment systems could initially be rolled out for large taxpayers and foreign firms, since they are likely to be more familiar with new technologies.

Take advantage of the peace agreement to reestablish nonfunctioning custom posts. CAR revenue underperformance is also related to nonoperational customs posts as a result of the conflict. The peace agreement should allow authorities to progressively re-open nonoperational custom posts and to introduce the use of ASYCUDA to limit fraud and increase the efficiency of collection. Table 2.5 summarizes the main policy recommendations.
## Summary of policy recommendations

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Measures to be realized in the short term</th>
<th>Measure to be achieved in the medium and long term</th>
</tr>
</thead>
</table>
| **Administrative measures** | • Strengthen human resource capacities and tax collection services through training and technical assistance;  
  • Pursue efforts to eliminate parafiscal taxes without economic justification and ensure the transfer of revenue to the Single Treasury Account;  
  • Strengthen the capacity of tax auditors and provide training on the collection and use of tax information;  
  • Strengthen public awareness on the advantages of land titles to encourage reporting of land property and stimulate property tax collection;  
  • Strengthen tax payment procedures and reduce the cost for businesses to assume their tax responsibilities, particularly in terms of VAT. Intensify communication with reporters around this measure in the context of the agreement signed with the operators; | • Streamline the number of tax rates and avoid the proliferation of tax rates for a better understanding of taxpayers and improve efficiency in tax collection;  
  • Reflect on the possibility to establish a system of community taxation of the informal sector;  
  • Standardize working methods and procedures by establishing a manual of administrative and financial procedures at the DGDDI and DGID;  
  • Simplify reporting procedures and reduce delays in obtaining land titles to stimulate property tax collection;  
  • Conduct a national survey of land properties to ensure optimal and efficient taxation of property taxes;  
  • Increase the capacities of the property tax department, particularly in terms of land property identification, controls, and verifications, the ability to enforce tax rules;  
  • Plan and ensure the revision of the property tax legislation; |}
| **Streamline exemptions and derogations** | • Delete in the budget law (at the level of general provisions relating to resources and charges), regulatory authorization for all holders of public authority to grant an exemption or exemption from duties, taxes or duties or to create or modify a tax, duty or taxes or parafiscal charges;  
  • Adopt a law setting out the conditions for granting, the nature and scope of exemptions from tax and customs legislation;  
  • Render obsolete, repeal and outlaw derogations outside the codes such as (i) exemptions and franchises granted by decrees, (ii) exemptions and franchises granted by letters;  
  • Have requests for tax exemption examined by the competent structures in this field, namely the DGDDI and the DGID;  
  • Involve DGDDI and DGID in the preliminary work of the drafting of agreements containing franchise and exemption clauses;  
  • Review and bring the legal derogations into line with tax and customs legislation; | • Establish a joint structure at DGDDI and DGID for the management of tax and customs exemptions from the legislation. This structure could also be competent for the two levels of management identified above, namely (i) studies and opinions before taking any action containing clauses exempting, abating or reducing taxes and duties (ii) implementation of the benefit of the exemption: study of applications for tax exemptions, liquidation of exempted rights, issue of the means of assumption of responsibility, and payment of liquidated duties and monitoring of the use made this means of payment; |}
| **Controls and verification measures** | • Establish a targeted control and verification mechanism at the customs and / or tax level; | • Establish a transparent risk analysis methodology for collection activities and apply existing legal rules to make them more equitable;  
  • Rotating the officials (controllers) responsible for conducting the checks could be a key factor in reducing the risk of corruption;  
  • Ensure the interconnection of the computer systems of the DGDDI with those of Cameroon;  
  • Introduce the use of IT systems for VAT management;  
  • Ensure the digitization of land declaration procedures for better tracking;  
  • Strengthen and promote the use of new technologies for payment of invoices and taxes in order to reduce administrative burdens and fraud;  
  • Accelerate the implementation of the interconnection of financial boards for greater efficiency and transparency.  
  • Create a customs and tax data backup site to limit the risk of information loss;  
  • Introduce the use of computerized electronic tracking and control systems for the movement of goods in transit (electronic seals);  
  • Gradually move to electronic methods of recording, paying taxes, and monitoring to increase the efficiency of tax collection. |}
| **Modernize the tax system: digitization and computerization** | • Maximize the potential and use of SYSTEMIF and ASYCUDA software. This involves, for example, ensuring the control of tax collection and the registration of declarations in SYSTEMIF and guaranteeing a systematic update of tariffs in ASYCUDA;  
  • Invest in the computerization of customs posts in Berbérati, Gamboula and Mongoumba and non-intrusive inspection systems;  
  • Acquire the necessary equipment for the computerization of the competent administrative services of the Ministry of Finance and Budget (notably the DFGE, DFME and DFPE, DRID and DGDDI). | • Ensure the interconnection of the computer systems of the DGDDI and DGID;  
  • Introduce the use of IT systems for VAT management;  
  • Ensure the digitization of land declaration procedures for better tracking;  
  • Strengthen and promote the use of new technologies for payment of invoices and taxes in order to reduce administrative burdens and fraud;  
  • Accelerate the implementation of the interconnection of financial boards for greater efficiency and transparency.  
  • Create a customs and tax data backup site to limit the risk of information loss;  
  • Introduce the use of computerized electronic tracking and control systems for the movement of goods in transit (electronic seals);  
  • Gradually move to electronic methods of recording, paying taxes, and monitoring to increase the efficiency of tax collection. |}

Source: World Bank staff

Notes: Some of the reforms mentioned above have already been initiated but need to be continued and strengthened.
2.3.3 Establish a new social contract

Building a strong social contract is essential to increase trust and compliance. Evidence from several countries in Africa (see Ali et al., 2014)\(^{19}\) point out that tax attitudes are positively associated with the provision of public goods in Kenya, Tanzania, Uganda, and South Africa. Social capital plays a critical role in the government’s ability to collect domestic revenue (see Kouame, 2019)\(^{20}\) and other related studies). Kouame (2019) argues that the relationship between taxpayers and the state can be assimilated as a contract based on trust. The level of trust reflects the level of satisfaction with the contract and taxpayers’ willingness to pay their taxes. While we are not able to assess the link between the social contract and tax collection in the CAR directly, due to lack of available data, evidence points to the importance of trust in authorities’ ability to leverage domestic revenues. CAR authorities should work on reinforcing the social contract by providing essential public goods and services to the population and building taxpayers’ trust by establishing a more inclusive economy and institutions that will stimulate the collection of domestic revenues.

The social contract in CAR is constrained by a low level of security. At the time of independence in August 1960, CAR was an emerging state with no experience of the social contract between the government and citizens to pay taxes in exchange for security. In fact, the colonial regime established in CAR was extractive and exploited violently the population living under its rule.\(^{21}\) This situation continued after the independence until the major crisis in 2013, with every new violent clash between armed groups leading to additional displacement, looting, destruction of facilities providing services, and departure of staff (private sector, state, and NGO staff). The ability of an ill-equipped and trained security apparatus in need of reform to bring armed groups under control was limited, while the legitimacy of the state was undermined by the absence of a clear social contract between authorities and citizens. Progress on security sector reform and reconciliation has been very slow due to weak human and financial capacities and a lack of consensus among political leaders, security actors and armed groups.

The recent peace agreement provides a unique opportunity to develop a new social contract in CAR. Introducing a social contract in CAR will be a challenge, given the current situation in which local strongmen use violence, extraction and identity politics to serve their objectives. A social contract requires a commitment by the state to achieve growth by delivering stability and providing services to its citizens. Elections were an essential step in the peacebuilding process, but they are not a quick fix, and the more challenging issues of reconciliation, power sharing, and state building need to be addressed. Delivering services is not only about reinstalling services and institutions, as they often never existed locally, nor is it only about patiently building capacities in line ministries, as it would result in a continued focus on Bangui. It is about being innovative, agile, and sufficiently aware of the political and security context. Capacity building and technical assistance are important, but the internal political processes and the progressive appropriation of institutions by communities and society are even more so. This is the condition on which a social contract between the state and its citizens can be rebuilt, a key ingredient to leverage domestic revenues for the development of the country. The new peace agreement brings hope for stability, recovery, and the new social contract. However, implementation of the agreement will require a steadfast commitment from each side to succeed.

2.3.4 Learn from peers

Official development assistance funds a large proportion of public spending in CAR, as is the case in many low-income developing countries recovering from conflict. Donors almost entirely fund the CAR public investment budget. To effectively meet its long-term development goals, the government needs to mobilize more domestic revenues by optimizing its tax policy and tax administration. With regards to tax policy, one key

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\(^{21}\) CAR Systematic Country Diagnostics, Report No. 125268-CF.
issue is broadening the tax base, focusing on the wide divergence between effective and statutory tax rates. There is considerable scope to raise tax revenues without increasing tax rates by reinforcing tax and customs administration, reducing tax exemptions, and fighting fraud and corruption (including with the tax authorities themselves). With regards to tax administration, building institutional capacity is an important component in the reform agenda. First, the government should provide a governance framework within which the revenue authorities can perform effectively. Second, the government needs to train and provide incentives for staff within revenue collection services to maximize their performance. Third, organizational improvement, IT-related procedures, and manpower upgrading need to be complemented with sufficient attention to accountability and anti-corruption institution building and cost-effectiveness of administration. In this last section, we revisit the experiences of Rwanda and Georgia.

**DRM Lessons from Rwanda: Policy and Administrative Reforms in a Post-Conflict Context**

Rwanda’s tax system dates back to colonial rule (1885–1962), when the first tax legislation was passed. This included a graduated tax, a tax on real property, and a profits tax. In 1968, six years after independence, the country enacted laws to introduce customs and excise duties, but otherwise made few changes to the colonial era tax system. Additionally, the tax system suffered from weak administration and enforcement, which led to poor tax collection and low tax revenue ratios, as characterized by the IMF.23 This issue was further exacerbated during the genocide, when the average tax revenue ratio fell from 8.2 percent to 3.6 percent of GDP.24 In comparison, Burundi, which had a similar GDP per capita and neighbors Rwanda, had an average tax revenue ratio of approximately 15 percent of GDP during the same time period.

Over the past two decades, Rwanda’s tax system has undergone major policy and administrative reforms, which have contributed to widespread improvements across the revenue system.

**In the immediate aftermath of the genocide, Rwanda sought to quickly stabilize the economy.** During this time, the government implemented a series of tax policy reforms to increase domestic revenues. In 1997, it also established the Rwanda Revenue Authority (RRA), which is a joint tax-customs semi-autonomous revenue authority responsible for revenue collection and enforcement. Since 2000, the government’s development program “Vision 2020” has provided Rwanda with a strong impetus to improve its capacity to mobilize domestic resources. Many of the reforms have helped the tax system align with the objectives of Vision 2020, including macroeconomic stability and reduced dependence on foreign assistance (Table 2.6). Tax policy reforms since the early 2000s have focused on widening the tax base, including the establishment of a Value-Added Tax (VAT) in 2001, as well as encouraging foreign direct investment and strengthening tax compliance. In 2000, Rwanda also began to roll out its National Decentralization Policy, which involved fiscal decentralization.

As part of this process, Rwanda began to channel resources collected through local tax sources, such as taxes on property, directly to districts. In 2009, Rwanda joined the East African Community (EAC) Customs Union, which led to a number of new measures to harmonize Rwanda’s tax policies with those of the EAC in order to facilitate intraregional trade. Meanwhile, Rwanda also introduced reforms to modernize and improve the efficiency of its tax administration system (Figure 2.45). In 2003, the RRA restructured its organization along functional lines (e.g. human resources, information technology, domestic taxes) rather than around specific taxes (e.g. income tax, VAT). Around the same time, the RRA began to adopt new technologies to computerize administrative processes, such as tax returns processing, taxpayer audits, and tax filing. Efforts to modernize the RRA are ongoing.

These reforms were heavily supported by bilateral and multilateral organizations. Most notably, the UK Department for International Development...
### TABLE 2.6 Overview of key tax policy and administrative reforms in Rwanda

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Policy Reforms</th>
<th>Administrative Reforms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mid-90s to 2000</td>
<td>• Enactment of temporary export tax on coffee</td>
<td>• Creation of large enterprise unit to collect tax from 150 largest taxpayers – precursor to RRA (1997)</td>
</tr>
<tr>
<td></td>
<td>• Standardization of sales tax for domestically produced goods and imports</td>
<td>• Establishment of Rwanda Revenue Authority (1997)</td>
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<tr>
<td></td>
<td>• Increased excise tax for alcohol, soft drink and petroleum</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Developing tax administration capacity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Widening the tax base</td>
<td>Structural reforms • Reorganization along functional lines rather than tax categories (2003–4)</td>
</tr>
<tr>
<td></td>
<td>• Enactment of new income tax legislation (2005)</td>
<td>Introduction of other software to support customs operations, HR management, financial management, taxpayers’ audits</td>
</tr>
<tr>
<td></td>
<td>• Establishment of new excise taxes (2006)</td>
<td>Launch of Revenue Authorities Digital Data Exchange (RADDEX) to coordinate the flow of goods with Revenue Authorities of other EAC countries</td>
</tr>
<tr>
<td></td>
<td>Aligning with national decentralization policy</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Districts given local tax from taxes on trade licenses, property and rental income (2002)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bolstering tax compliance</td>
<td>Modernization • Collection of social security funds (2010)</td>
</tr>
<tr>
<td></td>
<td>• Enactment of policies to comply with EAC practices – i.e. elimination of internal tariffs, establishment of common external tariff</td>
<td>Implementation of electronic tax registration</td>
</tr>
<tr>
<td></td>
<td>Modernization (cont’d)</td>
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</tr>
<tr>
<td></td>
<td>RRA toll-free hotline for taxpayer inquiries established; RRA assigned more administrative fees &amp; charges to be collected</td>
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</tr>
<tr>
<td></td>
<td>Excise duty levied per new law, replacing 2006 law</td>
<td></td>
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<tr>
<td></td>
<td>Rwanda Revenue Authority (RRA) reorganized along functions; implementation of SIGTAS begins</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CIT rate lowered from 35%; Dividend withholding tax</td>
<td>Rwanda signatory to EAC Customs Union protocol; RRA assumes responsibility for audit, collection, &amp; enforcement of social security contributions from employers</td>
</tr>
<tr>
<td></td>
<td>introduced PIT rate categorized into 3 brackets with marginal rates of 0%, 20% and 30%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>RRA introduces e-filing and e-payment</td>
<td></td>
</tr>
</tbody>
</table>

Source: African Development Bank (2010); Land (2004); IMF (2000).

### FIGURE 2.45 Steps of administrative reform in Rwanda

- **2001**: VAT introduced at 15%; VAT department established
- **2003**: ASYCUDA++ implementation to collect non-tax revenue
- **2004**: PRA toll-free hotline for taxpayer inquiries established; RRA assigned more administrative fees & charges to be collected
- **2005**: Excise duty levied per new law, replacing 2006 law
- **2007**: CIT rate lowered from 35%; Dividend withholding tax introduced PIT rate categorized into 3 brackets with marginal rates of 0%, 20% and 30%
- **2009**: Rwanda signatory to EAC Customs Union protocol; RRA assumes responsibility for audit, collection, & enforcement of social security contributions from employers
- **2011–2012**: RRA introduces e-filing and e-payment

Source: Adapted from Nakamura and Williamson (2015)
(DFID) provided long-term technical assistance from 1998 to 2010 and invested approximately £24 million in the RRA over this period. DFID’s support to the RRA included guidance on the creation of laws and regulations for its establishment, technical assistance across all aspects of its mandate, and providing physical infrastructure, human resources and information technology systems. The IMF also provided a resident adviser between 1997 and 1998 to help establish and develop the capacity of the RRA.

Rwanda’s efforts to improve revenue generation through tax policy and administrative reforms appear to be largely successful. Between 2000 and 2013, Rwanda’s tax revenue ratio increased by four percentage points from 9.6 to 13.4 percent of GDP, despite declining tax revenues from international trade, due to trade liberalization and integration with neighboring countries through the EAC. However, this decline in revenues from import duties was offset by increases from domestic tax revenues, particularly from taxes on income, profits, and capital gains. Furthermore, Rwanda has made improvements to facilitate the process of filing taxes in recent years. CAR could learn from this concrete experience as the country strives to break the cycle of instability and conflict.

**DRM Lessons from Georgia: Tax and Customs Reforms in a Context of Fight Against Corruption**

Following independence and years of political instability, Georgia quickly reformed its tax policy and administration from 1994 to 1997. Tax policy reforms aimed to broaden the tax base, and to a lesser extent, increase tax rates. Additional measures included computerizing the tax administration and the VAT form, improving tax assessment methods, reorganizing the tax administration along functional lines, and increasing collection efforts by introducing penalties on non-filling or increasing interest charged for under-reporting.

In 1998–1999, Georgia strived to further its mobilization of domestic revenues by approving several fiscal measures. Georgia broadened its the tax base by eliminating several exemptions (VAT exemptions on agricultural products, supply/import of wheat, energy products, tourism, movies, and sporting events) and preferential rates. Tax offsets were also eliminated while excise stamps on cigarettes and alcohol were introduced in 1999. However, the impact of these measures has been somewhat limited by slow progress in implementation.

From 2000 to 2004, the Government of Georgia broadened its tax base and sped up reform of its tax administration. Fiscal policy measures led to a decline in the number of tax instruments from 21 to 8, the reduction of exemptions on VAT and profit tax, the cancelation of cuts in land taxes and car fees, and the increase of excise rates. Furthermore, in line with recommendations from the Georgia Anti-Corruption Council, the government reduced the number of ministries and staff, and increased wages of the remaining public servants. Measures to strengthen the tax administration included: adopting a code of conduct for tax and customs official; increasing coverage of the large taxpayers’ inspectorate; training customs officials on shipment inspections; adopting a new regulation on the registration of taxpayers and revising the associated taxpayers database; and implementing measures to reduce smuggling of tobacco and petroleum products (Table 2.7).

Moreover, with the increased importance of excise taxes, the government established an Excise Tax Inspectorate. A financial police office was also created.

During the period 2005–2017, tax revenue increases were supported by the computerization of the administration, measures to improve the tracking of funds, and the increase of taxes. The government completed the transition to a Treasury Single Account for revenues and expenditures and updated its database of taxpayers. Moreover, some tax entities were merged, and taxpayers were given the right to appeal taxation orders at a faster pace. Increases in excise taxes were introduced in 2010, 2015 and 2017 to reduce the fiscal deficit (after the 2008–2009 fiscal stimulus).

Government leaders shared a vision of the centrality of increasing tax revenues to restore the state. Government leaders in Georgia understood that to boost revenues, the tax system needed to be much simpler and enforceable. They wanted a system that both provided revenues and was conducive to business development and economic growth. They
established credibility early on, both through highly publicized arrests and by getting formerly corrupt tax officials to mend their ways. Foreign donor-financed tax advisers helped modernize the tax services, but many of the innovations and technology solutions adopted were homegrown. As elsewhere in government, technology was used to both improve efficiency and reduce opportunities for corruption.

**Sustaining improvements in tax collection remains a continuing challenge.** Policy makers need to further strengthen revenue administration and deepen the new culture of public service to generate trust in rules-based, objective enforcement of tax laws. At times, tax administration has been viewed as aggressive and sometimes arbitrary. New institutional arrangements to address these concerns, including an appeal process and a dispute resolution board that includes a member of civil society, are steps toward strengthening the accountability framework. Doggedness in maintaining zero tolerance of corruption was key to the success of customs reform, which included simplification of the import regime, modernization of procedures, and transformation of the customs service. The struggle to establish credibility took longer than in other areas, but the government’s persistence eventually paid off. Recruiting and training new staff, raising salaries, and heavily investing in new technologies and facilities were all critical. But at the heart of

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Tax Reforms</th>
<th>Customs Reforms</th>
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</table>
| The state of affairs in 2003 | - Government’s ability to collect taxes steadily deteriorated after the collapse of the Soviet regime  
- Increasingly sophisticated corruption schemes involving tax evasion, illegal tax credits, and outright theft of tax revenues | - Borders were very porous and unprotected  
- Bribery and smuggling were the rules, not the exception  
- There was no competitive recruitment or test of qualification to become a customs officer  
- Weak enforcement of the Customs code |

### TABLE 2.7 Overview of key tax policy and administrative reforms in Georgia

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Tax Reforms</th>
<th>Customs Reforms</th>
</tr>
</thead>
</table>
| Post-2003 Reforms | - Altering the mindset  
  - Introduce and enforce a policy of zero tolerance for corruption  
  - New laws were quickly adopted to reinforce the zero-tolerance policy | - Strengthening and Simplifying the Legal Framework for Customs  
  - A new law on customs tariffs with 3 rates (0, 5 and 12 percent) was introduced (2006)  
  - Simplification of the import licensing system (2005), limiting them to protecting public health, the environment, and national security  
  - Establishment of a single revenue service that unified the tax and customs agencies (2010)  
  - Introduction of a risk-management system, with inspections on less than 10 percent of all cargo |
| Changing staff incentives | - Arrests and harsh sentences for corrupt tax collectors and inspectors  
- Cameras installed in tax offices to deter corruption  
- Target volumes of collections were set and carefully monitored | - Replacing and Motivating Personnel  
  - Newly recruited staff received an extensive six-month training  
  - Salaries for customs officials increased from GEL 30 to roughly GEL 800 a month over 2003–05 |
| Simplifying the Tax Code and Broadening the Tax Base | - A new simplified tax code reducing rates, and eliminating some taxes (pollution, property transfer, gambling, tourism, advertisement, and other minor local taxes) was passed (2005)  
- Shutting down the operations of unlicensed small street vendors  
- The requirement that every commercial establishment purchase and operate electronic cash registers to record the VAT collected on each transaction | - Changing the Environment  
  - Renovation of the infrastructure at customs points  
  - Information on bribery in multiple languages at customs points |
| Streamlining tax administration | - Change in the filing dates on monthly declarations to the 15th of each month  
- Elimination of independent audit on annual filings  
- Introduction of e-filing  
- Introduction of risk-based management of tax audits  
- Introduction of a two-stage administrative dispute resolution mechanism to deal with taxpayer appeals | - Reforming institutions  
  - Reduction of the number of services at the border to just two: the border (passport) control and the customs service  
  - A one-stop shop to minimize the physical interaction between customs officers and traders  
  - Implementation of an automated risk-management system classifying importers into risk categories based on 15 criteria  
  - Electronic declaration and advanced declaration were also introduced |

the success were the institutional changes that changed the incentives and the rules of the game and strengthened the accountability framework, essential for the sustainability of these reforms. CAR could learn from this vigorous experience as it struggles to root out corruption in an economy that dearly needs public finance to scale up poverty-reducing and growth-sustaining expenditures.

Revenue Mobilization in Low-Income Countries: Lessons from Successful Country Cases26

The experiences of nine successful low-income countries (LICs) in tax revenue mobilization highlight three key lessons.

First, tax reforms require high-level political commitment and buy-in from all stakeholders. A high-level political commitment facilitates coordination of all relevant agencies and encourages implementation of tax reforms. Notably, in LICs where institutions are fragile and large taxpayers may use their political connections to avoid compliance, a high-level political commitment is critical to contain resistance of vested interests. In Burkina Faso, Mauritania, and Uganda, tax reform was driven by a high-level political commitment, even though the institutional environment was weak. Many of the country cases started their revenue reforms with weak administrative capacity and institutions. (e.g., Burkina Faso, Cambodia, Rwanda). A buy-in from all stakeholders helps secure political and social support for tax reforms. Effective communication with stakeholders that emphasizes the intended benefits of reforms—or the cost of maintaining the status quo—can help mitigate resistance to reforms.

Second, countries that pursue both revenue administration and tax policy reforms tend to see much larger and more persistent gains. Looking at the experience of the nine successful LICs, four main tax policy reforms can be highlighted as levers to enhance tax revenue: (i) removing tax exemption; (ii) reforming indirect taxes on goods and services; (iii) increasing excise taxes for specific goods; and (iv) simplifying the tax system. Removing exemptions enhances the tax base and increases tax revenues while reducing complexity (to enable more efficient tax administration). Reforming indirect taxes on goods and services has proved to be an efficient and strong revenue booster. The Gambia replaced a general sales tax with a VAT in 2013 to broaden its tax base and lift indirect taxes by 1–1.5 percent of GDP. Mauritania implemented VAT reforms (e.g., covering the mining sector, increasing the VAT registries) and improved VAT C-efficiency from 37 percent in 2009 to 72 percent in 2013. Increasing excise taxes for specific goods is one of the simplest and straightforward measures can raise revenue rather quickly without fundamental changes to the tax system. For example, The Gambia introduced an excise tax on cigarettes and collected the revenue equivalent to 1.1 percent of GDP in 2013. Burkina Faso increased the excise tax for alcoholic beverages, as did Mauritania on tobacco. Simplifying the tax system is critical to fostering taxpayer compliance, as seen in the reform examples in Burkina Faso. A simplified tax system with simplified legislation makes tax administration more efficient in weak states that lack basic institutions such as security and a well-functioning judicial system.

In addition to tax reforms, successful revenue mobilization rests on broad-based strategies that recognize that what and whom to tax (tax policy) go hand-in-hand with how to tax (revenue customs administration). Such changes take time, however, and should be seen in a longer-term perspective. In most of these case studies, revenue administration reforms figured prominently and covered a broad spectrum of legal, technical and administrative measures. These included strengthened management, governance, and human resource capacity; establishment of large taxpayer office; use of information management systems for registration, filing and management of payment obligations, and an enhanced audit and verification program.

Lastly, a successful strategy often starts with low-hanging fruit to build momentum. These include simplifying the tax system and curbing exemptions; reforming indirect taxes on good and services (e.g., excises, VAT); strengthening segmentation (e.g., the establishment of large taxpayer offices); taking advantage of IT systems to improve information sharing and risk-based audit.

REFERENCES


Central African Republic Systematic Country Diagnostics, Report No. 125268-CF.


4
TECHNICAL ANNEX
**BOX 4.1**

### Identification of Structural and Aspirational Peers

**Structural peers**
The underlying assumptions of structural comparators is that the economic performance of CAR can be compared to other countries with similar structural characteristics as follows:

1. **Similarities in key socio-economic characteristics** – Based on the economic literature, it is well known that characteristics such as geographic constraints, demographic factors and exporter status play an important role in the structure of the economy and development outcomes. CAR’s economy is characterized by three of these: it is a commodities exporter, it is landlocked, and the population size, real GDP per capita.

2. **Similarities in economic growth trends** – The identification limits the comparators to countries with a median GDP growth of 2 percentage points higher than the GDP growth of CAR over the period of analysis but grew much faster over time.

Using this methodology, structural peers for CAR have been identified as Burkina Faso, Mali, Malawi, Niger, Rwanda, and Uganda.

**Aspirational peers**
The underlying assumptions of the structural comparators is that at some point in time, CAR used to share similar structural characteristics with one or more countries. However, over time those countries managed to grow faster, creating a gap between them and CAR. The structural characteristics of the economy and identification formula are similar to the ones discussed above with the important difference that real GDP per capita is the main variable used to choose the aspirational peers. Also, similarities in the initial conditions is assumed. – For the case of CAR, the identification of structural peers is limited to a set of countries having a GDP per capita within a +/-10 percent range during the initial period of analysis.

Empirically, employing the above conditions, the comparators are identified using the uniform and objectives formula below:

\[
(100 - D) \leq \frac{\text{Average}(x_{pot})}{\text{Average}(x_{crit})} \leq (100 + D); \text{pour } x \in X \text{ et } T_{bi} \leq t < \frac{T_{bi}}{2} \quad (1)
\]

\[
(100 - D) \leq \frac{\text{Average}(x_{pot})}{\text{Average}(x_{crit})} \leq (100 + D); \text{pour } x \in X \text{ et } \frac{T_{bi}}{2} < t < T_{bi} \quad (2)
\]

Where, \(T_{bi}\) is the initial period of comparison; \(T_{bi}\) the final period of comparison; \(X\) the set of criteria/conditions defined above; \(D\) the distance between the potential comparators and CAR; \(x_{pot}\) : variables/conditions for the potential comparators at time \(t\); \(x_{crit}\) values of the criteria defined for the country of interest; CAR in this case.

After identification and validation with the authorities, Rwanda and Laos were identified as aspirational peers for CAR. Georgia is added as an aspirational peer in Chapter 2 to learn from its successful reforms and domestic resource collection as the country increased significantly its domestic revenues after a major conflict.