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Letter

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Barriers to Formalization of Businesses in Cameroon: High Tax Rates

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Foreword



Clearly expressed in its National Development Strategy 2020-2030 (SND30), Cameroon's desire for the coming decade is to achieve sustainable growth driven by the manufacturing industry. Thus, the government hopes to increase (i) manufacturing value-added from 14.5% in 2017 to 25% in 2030 and (ii) the share of manufacturing exports to 54.5%. However, in the absence of an efficient industrial sector, the economy tends to specialize in the "end of the chain" activities, including extraction (mining and oil) and subsistence agriculture on the one hand and trade and services on the other.

According to the Third Survey on Employment and the Informal Sector conducted by Cameroon's National Institute of Statistics in 2018, nearly 90% of the Cameroonian labor force remains trapped in the informal sector. The sector comprises a

set of individual companies – generally non-agricultural – that operate on a small scale and are not registered with the competent authorities. Many entrepreneurs choose to operate informally because of barriers to formalization. For example, businesses spend an average of 624 hours to make 44 payments per year to the tax authorities. The total tax rate remains one of the highest in Central Africa, at 57.7% of business profits than 47.1% in Gabon (World Bank, 2020).

While the informal sector offers employment and income opportunities to more than 50% of the labor force that would otherwise have no means of survival (African Development Bank, 2020), it nevertheless constitutes a real obstacle to the achievement of emergence objectives. To contribute to the strategies put in place by the government to promote the formalization and competitiveness of local businesses, this third edition of the Fiscal Policy Letter, entitled "*Barriers to Formalization of Businesses in Cameroon: High Taxes Rates*," presents some possible solutions.

Beforehand, we determine the factors that explain the informality of companies in Cameroon. Drawing on the definition of informality as introduced by the British anthropologist Keith Hart in 1971 – then expanded by the International Labour Organization in 1972 – it emerges that informal firms are distinguished from formal firms by the absence of protection and official recognition of employees, family ownership of their activities, low incomes and wages. Among the elements that explain the informality of these

firms are: Limited absorption of surplus labor by the formal sector, high tax burdens, regulations in force, and corruption. We note that the informal economy plays an important role in job and income generation. Its existence responds to the needs of poor consumers by providing them with accessible, low-cost goods and services.

Following this article on the explanatory factors of the informality of companies in Cameroon, it seemed appropriate to analyze the nature of the relationship between taxation and economic growth. Using an error-correction model on secondary data from the World Bank between 1989 and 2018, we show that taxation negatively and significantly influences economic growth in Cameroon. Indeed, a 10-percentage point increase in tax revenue would contribute to a 9.5 basis point decline in growth. To reduce the tax burden on SMEs, which discourages formal private investment and consequently growth in Cameroon, we recommend that the authorities use non-tax revenue mechanisms to finance public goods and services.

The third article focuses on the link between the informal sector and tax revenue mobilization in Cameroon. Concerning the socio-demographic profile of the main actors, we point out that the taxation of their activities is particularly aggressive. Suppose the budget deficit necessitates either resorting to indebtedness or increasing tax revenues to be financed. In that case, we show that it would be more rapidly resolved with the

formalization of 90% of informal enterprises. This would also guarantee a degree of sustainability in public finances.

After highlighting the impact of taxation on tax revenue mobilization in Cameroon, we examine the implications of high taxation on local production units. We confirm the view that high taxation remains the main obstacle to the formalization of informal production units. To achieve this, we recommend that policymakers ensure that tax rates reflect their operating costs.

We finish the letter with an analysis of the transitional dynamics of Cameroonian companies to the formal sector. We estimate a simple regression model using annual World Bank data over the period 1991 to 2019. Our results highlight some strategies for the formalization of firms in Cameroon. We show that a 10% decrease in the tax burden on firms contributes to a decrease of about 4% in the number of firms operating in the informal sector. The improvement of the business environment, notably through the strengthening of fiscal transparency and the legal and administrative governance of small and medium enterprises, would promote a faster transition of many informal sector enterprises to the formal sector.

Mme Fri Asanga

Interim Chief Executive Officer
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Factors Explaining the Informality of Enterprises in Cameroon

Par Dr Vera Fuein Kum, Fellow in Economics Affairs– Nkafu Policy Institute

Summary: *The present article seeks to examine some of the factors that influence the informality of enterprises in Cameroon. To this effect, we define the concept of informality as was first introduced by the British anthropologist Keith Hart in 1971 and later expanded by the International Labour Organization in 1972 as referring to all economic activities by workers and economic units that are in law but not covered or insufficiently covered by formal arrangements. The size of Cameroon's informal sector can be assessed both at the macroeconomic and microeconomic levels and is characterized by but not limited to the following: Absence of official protection and recognition of employees; family ownership of enterprises; Low income and wages. Among some of the things that determine the informality of enterprises in Cameroon, we have limited absorption of surplus labor in the country, weak institutions, amongst others. However, the informal enterprises contribute significantly to the economy of Cameroon. Some of its major contributions include GDP growth, job creation as well as poverty reduction.*

To conclude, the informal economy can no longer be considered a temporary phenomenon. Moreover, the informal economy has a significant job and income generation potential. The existence of the informal economy also helps to meet the needs of poor consumers by providing accessible and low-priced goods and services. Therefore, to intervene in the best way to stimulate sustainable economic growth

and job creation, the informal economy needs to be better understood by individuals, partners, and governments.

1. Introduction

The concept of “informality” was first introduced by the British anthropologist Keith Hart in 1971. This was later expanded by the International Labour Organization in 1972. The ILO (2015) describes the “informal economy” as referring to all economic activities by workers and economic units that are in law but not covered or insufficiently covered by formal arrangements. The informal economy covers activities that are legitimate, but because these activities are unregulated and no taxes are paid, it is not considered part of the formal economy. Informality could be based on employment and economic activities (enterprises). Some of these activities include home renovation, car repairs, street trading, hairdressers, domestic workers, electronic repairing, plumbers, fruit or vegetable vendors, street food vendors, salesman, barbers, cobblers, etc.

According to Roubaud et al. (2014), the informal sector comprises tiny, unregistered individual enterprises operating on a small scale and whose activity enables them to produce at least part of what is on the market. These activities do not feature in the National Accounting.

The size of Cameroon's informal sector can be assessed both at the macroeconomic and microeconomic levels. At the macroeconomic

level, Cameroon's informal sector accounts for more than 57% of the country's Gross Domestic Product (Kamdem and Kakdeu, 2020).

This contribution is below that of Sub-Saharan Africa at 63.6% and above the contributions of Latin America and Asia, respectively estimated at 29.2% and 30.2% (IMF, 2019). Based on Roubaud's et al., (2014) definition of the informal sector, the contribution of the informal sector to the GDP, excluding agriculture, follows the same trend. Thus, we have 36% in Cameroon against 24% in Latin America and 14.2% in Asia.

At the microeconomic level, Cameroon has more than 2,500,000 Informal Production Units throughout the country (NIS, 2011). This article seeks to sharpen some characteristics of informal enterprises in Cameroon and why businesses find it difficult to navigate from the informal sector. The paper also explores some contributions of the informal sector to the Cameroonian economy. Notwithstanding, the paper presents some obstacles faced by these enterprises and thus proposes some feasible recommendations.

2. Characteristics of Informal Enterprises in Cameroon

The informal sector of enterprises in Cameroon is characterized by the following:

- Absence of official protection and recognition of employees
- family ownership of enterprises
- Absence of trade union organization
- Low income and wages
- Little job security
- Unregulated and competitive market
- Small scale operation with individual or family ownership
- Ease of entry
- Labour intensive and adapted technology
- Unauthorized use of vacant public or private land

- Unauthorized construction of structures and buildings
- Reliance on low cost and locally available scrap construction materials

Reliance on family labor and artisanal techniques for construction.

3. Determinants of Informality in Cameroon

The reasons cited for the growth of the informal economy during the last decades are mostly interrelated and, to some extent overlapping. Some of these reasons include:

- **Limited absorption of surplus labor:** The limited capacity of agriculture and the formal economy to absorb surplus labor coupled with increasing numbers of job seekers is responsible for the growth of the informal sector. With a growing population and higher urbanization rates that stand at 56% (World Bank, 2020), the informal economy tends to absorb most of the growing labor force in the urban areas since the manufacturing industry and off-farm activities, in general, do not grow at the same pace.
- **Barriers to entry into the formal economy:** Excessive costs, high tax burdens, government regulations, and corruption in areas such as business startup, granting of business permits, and land titles have forced most Cameroonians to remain informal.
- **Weak institutions:** The weak capability of formal institutions to provide education, training, and infrastructure, and other incentives for structural reforms has contributed to the growth of the informal economy.
- **Redundancies:** Structural adjustment programs during the eighties and nineties have fuelled the growth of the informal economy in Cameroon. The disappearance of public sector

jobs forced many laid-off workers to find other ways to survive. Thus, the global economic crisis of the 1980s and structural adjustment policies boosted the size of the informal economy due to the loss of jobs in the formal sector and reduced hiring capacities in other sectors of economic activity (CLING et al., 2012).

- **Economic hardship and poverty:** Most Cameroonians are unemployed and poor. Even the few employed do not earn sufficient income. To fight against such hardship and poverty, most Cameroonians resort to informal activities as a means of livelihood. The poverty rate of the country currently stands at 38.5%, according to the Institute of National Statistics.¹
- **More women entering labor markets:** There are growing numbers of women that enter the labor markets outside agriculture. However, although many women own micro-enterprises, only a small number of women entrepreneurs enter the formal economy. Women's participation within the informal economy tends to be higher when access and the right to ownership of land and other assets are denied.

4. Contribution of Informal Enterprises to the Economy

Informal enterprises contribute significantly to the economy of Cameroon. Some of its major contributions include:

- **GDP growth:** According to the IMF report, the informal sector in Cameroon contributes 20% to 30% in creating the country's GDP.
- **Job creation:** It provides employment opportunities as it currently occupies 90% of the active population in the country, most especially women (IMF, 2019).

- **Poverty reduction:** Informal enterprises provide paid jobs, as well as income to those engaged in it. This helps, if not to eradicate then, to reduce the rate of poverty.
- **Peace:** With the presence of informal enterprises, each individual can carry out his or her activity. He or she lives in a situation of total calmness. Informal enterprises lead each individual to a paid occupation, thus contributing to social peace and stability.
- **Source of foreign exchange earnings:** Exporting products of the informal sector helps to bring in foreign currencies

5. Obstacles Faced by Informal Enterprises

Informal enterprises face challenges that are sometimes similar to those experienced by formal enterprises. However, informal enterprises are much more vulnerable concerning these problems, some of which include:

- Infrastructure issues such as poor transport, storage facilities, water, and electricity
- Precarious employment as a majority of workers in the informal sector are poor
- Poorly developed physical markets
- Low productivity
- Limited access to land and property rights
- Limited access to formal finance and banking institutions
- Cumbersome taxation systems and labor laws
- Lack of information on prices, the viability of products
- Fewer market opportunities due to non-compliance to international standards
- Limited access to technology
- Lack of working capital

1. <https://ins-cameroun.cm/>

6. Measures to Improve on Informal Enterprises

However, designing effective policies to address informality is complicated by its multiple causes and forms, both across and within countries. Informality is a response to a set of country-specific characteristics and institutions, and there is no one-size-fits-all solution. However, some effective measures include:

- Improving access to and quality of education is one way to lower informality. Education reforms, especially technical and vocational training opportunities, should be accessible to enhance skills.
- Tax system should be redesigned to avoid increasing incentives for individuals and firms to remain in the informal sector.
- Policies to enhance financial inclusion by promoting expanded access to formal financial services can help lower informality. Countries where access to finance is greater, tend to grow faster and have lower income inequality.
- A range of structural policies to help increase incentives and lower the cost of formalization should be adopted. Some of these include:
 - Labor market regulations can be simplified to ensure greater flexibility and facilitate informal workers' entry into formal employment.
 - Competition policy can boost the entry of small firms in some sectors by eliminating monopolies.
 - Elimination of excessive regulations and bureaucratic requirements also helps.

7. Conclusion

To conclude, the informal economy can no longer be considered a temporary phenomenon. Moreover, the informal economy has the potential to create employment and generate jobs. The existence of the informal economy also

helps to meet the needs of the poor consumers by providing accessible and low-priced goods and services. Therefore, to intervene in the best way to stimulate sustainable economic growth and job creation, the informal economy needs to be better understood by individuals, partners, and governments.

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Taxation and Economic Growth in Cameroon: Evidence from 1989-2018

Ulrich D'POLA KAMDEM, Senior Economic Policy Analyst – Nkafu Policy Institute

Summary: *This paper aims to empirically evaluate the influence of taxation on economic growth in Cameroon for the period 1989–2018. The study estimated an error correction model on secondary data from the World Bank, International Monetary Fund, and Banque de France. Our results show that, in the long-run, taxation has a negative and significant influence on economic growth in Cameroon. Indeed, when tax revenue increases by 10%, economic growth declines by 9.5%. To reduce the tax burden on SMEs, which discourages formal private investment and growth in Cameroon, we encourage the authorities to use non-tax revenue mechanisms to finance public goods and services.*

1. Introduction

Cameroon has placed economic emergence at the forefront of its public policies. That is why in November 2020, policymakers released a document entitled: “National Development Strategy 2020–2030 for structural transformation and inclusive development.” This document represents the second phase of Vision 2035¹, aiming to make Cameroon an emerging country by 2035. So, the country needs resources to finance investments that will promote economic growth and development. Taxation, therefore, becomes a non-negligible tool. For example, in

2020, tax revenue was estimated at 2374,847 billion CFA Francs, approximately 58,63% of Cameroon’s budget. However, policymakers are confronted with a dilemma: Attain maximum revenue and economic growth with minimum distortions. Based on this background, our paper attempts to answer the question: What is the influence of taxation on economic growth in Cameroon? To answer this question, we present the debate on the economic literature in section 2. Next, we present some stylized facts in section 3. Finally, our results are presented and discussed in section 4, while section 5 concludes.

2. Debate on the Relationship Between Taxation and Economic Growth: Where Does Cameroon Stand?

The relationship between taxation and economic growth is still not the subject of agreement among researchers in the theoretical and the empirical literature.²

At the theoretical level, two schools of thought dominate the debate. The first school believes that taxation is determinant to investments. So, high tax rates harm the level of investment in a country as it discourages entrepreneurs and

1. <http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/laws/1816.pdf>

2. For a synthesis of the theoretical and empirical literatures on the relationship between taxation and economic growth, see Alqadi and Ismail (2019): <https://www.hilarispublisher.com/abstract/taxation-and-economic-growth-theoretical-and-empirical-literature-review-33219.html>.



hampers creativity. This school recommends lowering tax rates. Supporters of this view include Jud (1985), Chamley (1986), King and Rebelo (1990), and Barro (1999), just to name a few.

On the contrary, the second school states that increasing the tax rates and adopting a redistribution policy will increase investments. Supporters of this school include Banerjee and Newman (1993), Galor and Zeira (1993), and Benabou (1996). This school also believes that high taxation is good, especially when used to finance public goods and services to raise entrepreneurs' revenues.

At the empirical level, Keho (2011) analyzed the relationship between taxes and output in Cote d'Ivoire for 1960–2006. The author used an Autoregressive Distributed Lags approach and demonstrated that all taxes except direct taxes positively influence economic growth. This result is contrary to Ogundana et al. (2017) who found that both direct and indirect taxes positively impact Nigeria's economy from 1994 to 2013.

In another perspective, Aydin and Osen (2019) analyzed the impact of tax revenue as a share of GDP on economic growth in transition economies, including 11 central and south-eastern European and Baltic countries during the transition process between 1995 and 2014. The authors used a dynamic panel threshold model. They found that the optimal level of tax revenue-maximizing economic growth is approximately 18% of GDP for full transition economies, 18.50% for developing economies, and 23% for developed economies. In other words, tax revenue as a share of GDP above the threshold level adversely affects economic growth, whereas a tax revenue rate below the threshold positively affects growth.

As regards Cameroon, to our knowledge, very few studies have attempted to evaluate the relationship between taxation and economic growth. Amin (1998) analyzed the impact of Cameroon's fiscal policy on economic growth for the period 1961 to 1994. The author found that public investment negatively affects private investment and

that private investment positively influences economic growth. Based on this background, this paper will provide fresh evidence and contribute to the debate in the economic literature.

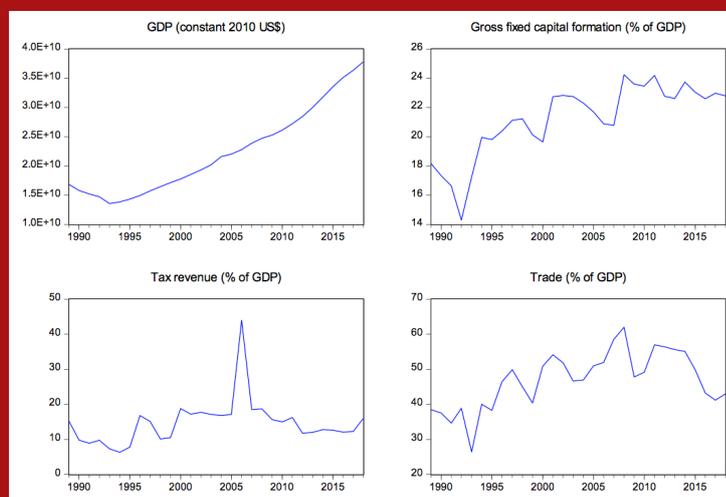
3. Stylized Facts

To ascertain the relationship between taxation and economic growth in Cameroon for the period 1989–2018, we follow the work of Al-tarawneh et al. (2020), who studied the impact of taxation on economic growth in an emerging economy. Our variables include tax revenue,³ gross domestic product, private investment, and trade.

Secondary data was collected from different sources, including World Development Indicators (2020) of the World Bank, Reports on the CFA zone from the Banque de France, and the World Revenue Longitudinal Data of the International Monetary Fund. Our period of study is 1989–2019 because of data availability.

As regards our variables, in graph 1, we observe an increasing trend of the GDP in Cameroon since 1995 while other variables show an irregular evolution. For example, 1992 represents the lowest level of private investment (Gross fixed capital formation expressed as a percentage of GDP), whereas the highest value was obtained both in 2008 and 2011. Regarding tax revenue, it is generally below 20% of the GDP even if we observed a pic in 2006 with 43.95%. Finally, on average, trade represents less than 50% of the GDP (exactly 46.92% for this study).

Graph 1. Evolution of Variables



Source: Author via Eviews 10

4. Results

We have estimated both long-run and short-run relationships between tax revenue, gross domestic product, private investment, and trade in Cameroon using an Error Correction Model.⁴

As regards the long-run relationship, we observe that private investment has a positive and significant impact on economic growth in Cameroon. Indeed, when private investment increases by 10%, economic growth increases by 10% in the long run. Also, taxation has a negative and significant impact on economic growth in Cameroon in the long-run. When tax revenue increases by 10%, economic growth declines by 9.57%. Finally, trade harms economic growth in Cameroon in the long-term. Indeed, when trade increases by 10%, economic growth reduces by 3.3%.

3. Tax revenue is defined as the revenues collected from taxes on income and profits, social security contributions, taxes levied on goods and services, payroll taxes, taxes on the ownership and transfer of property, and other taxes. https://www.oecd-ilibrary.org/taxation/tax-revenue/indicator/english_d98b8cf5-en#:~:text=Tax%20revenue%20is%20defined%20as,of%20property%2C%20and%20other%20taxes.

4. For more details Error Correction Model visit: http://www.ecostat.unical.it/Algieri/Didattica/Finacial%20Markets/Tutorials/LIBRO%20Asterious_Applied-Econometrics-387-392.pdf

Concerning the short-run relationship, private investment and tax revenue have a positive influence on economic growth. Indeed, when private investment increases by 10% in the short-term, economic growth increases by 9.8%, and when tax revenue increases by 10%, economic growth increases only by 1.9%. In the short-term, trade has a negative influence on economic growth in Cameroon.

5. Conclusion and Policy Recommendations

Our study aimed at empirically evaluating the influence of taxation on economic growth in Cameroon for the period 1989 to 2018. Our results show that in the long-run, taxation negatively and significantly influences economic growth in Cameroon, while in the short-run, the influence is positive. Also, both in the long-run and the short run, private investment positively impacts economic growth in Cameroon. This result corroborates that of Amin (1998). Moreover, both in the short-term and the long-term, trade harms Cameroon's economic growth.

Based on the above findings, we recommend the following to policymakers:

1. **Prioritize the use of non-tax revenue mechanisms (for example, dividends and profits received from public sector companies) to finance public goods and services.** Indeed, during the period 1989–2018, tax revenue represented on average 14.66% of Cameroon's GDP. This is not far from the optimal tax revenue level that maximizes economic growth estimated at 18.50% of GDP for developing economies by Aydin and Osen (2019).
2. **Encourage the development of formal private initiatives in the country by simplifying the regulatory framework regarding business creation and investment.** As shown in our results, formal private investment is a significant source of economic growth in Cameroon. So, it needs to be highly encouraged. Policymakers should consider reducing the numbers of

required documents to startup businesses from 11 approximately to 3 (i.e., articles of association, photocopy of the ID, and the localization plan).

3. **Pursuit the reforms toward the structural transformation of the economy to export more manufactured products:** Indeed, trade is not a source of economic growth in Cameroon as the country exports natural resources (oil, cocoa, banana, coffee, etc.) and imports processed products in the majority.

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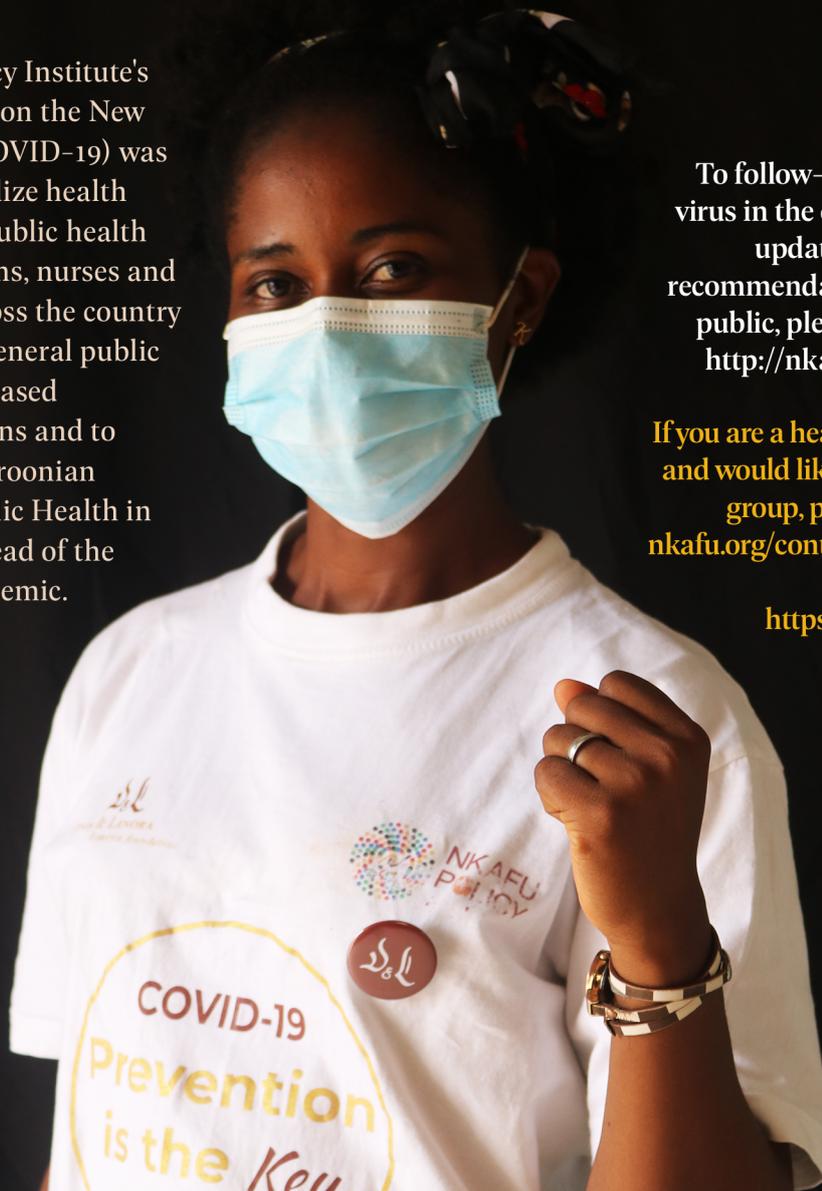
COVID-19

Taskforce

The Nkafu Policy Institute's Working Group on the New Coronavirus (COVID-19) was created to mobilize health professionals: public health experts, clinicians, nurses and researchers across the country to provide the general public with evidence-based recommendations and to assist the Cameroonian Ministry of Public Health in curbing the spread of the COVID-19 pandemic.

To follow-up the spread of the virus in the country and provide updated information and recommendations to the general public, please visit our website <http://nkafu.org/coronavirus>.

If you are a healthcare professional and would like to join the working group, please contact us here [nkafu.org/contact us](http://nkafu.org/contact-us). Participate in our webinars at <https://nkafu.org/events/>.



Prevention is the key.

Join us!

<http://nkafu.org/coronavirus>

Informal Sector and Tax Mobilization in Cameroon

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Summary: *In Cameroon, there has been significant attention on reducing the budget deficit by increasing state revenue through new avenues like the imposition of a tourist tax in hotels, a special tax on petroleum products, taxes on games of chance and games of entertainment, application of VAT on furnished rentals hitherto not subjected to any tax and the unsuccessful tax impose on mobile phones. Despite all these, the budget deficit is on the rise. Hence, it is important to start brainstorming on the possibility of increasing state revenue through tax from the hitherto untaxed informal sector to broaden the tax base. Therefore, this paper aims to scrutinize the opportunity and the challenges involved in taxing the informal sector and its social implication to the economy while indicating the way forward.*

1. Setting the Scene

In Sub-Saharan Africa in general and the CEMAC zone in particular, the year 2016 was characterized by a significant drop in global oil prices and most commodities on which these economies depend on. This price shock resulted in the drop of foreign currency reserves and budget revenue, which affected most countries in these zones. The reduction in foreign currency reserves and budget revenue was further compounded by the effect of terrorist attacks, floods, drought, and

the refugee crisis. In this light, economic growth in Sub-Saharan Africa, which was estimated at 3.4% in 2015, dropped to 1.4% in 2016 and was projected only to 2.9% in 2017 as reported by the 2016 Financial Bill report of Cameroon.

In the CEMAC zone and according to BEAC, the oil price shock significantly slowed down growth which dropped from 4.9% in 2014 to 1.6% in 2015 and was estimated to 1.9% in 2016. According to this same report, the 2015 budget and current account deficit widened and stood around 6% and 8% of GDP, respectively. With the overarching objective of transforming Cameroon into an emerging market by 2035, Cameroon is at a crucial moment to unlock its growth potential further, and this is possible if she can mobilize enough funds to stimulate economic growth at a rate of 5% per year during the next two decades if it is to become an emerging market economy. In this light, there has been significant attention on reducing the budget deficit by increasing state revenue through new avenues. Subsequently, the President of the Republic established a new fiscal policy guideline in his Circular No. 001 / CAB / PRC of July 28, 2016, relating to the need to broaden the tax base and secure revenue in the 2017 financial year. The tax base was broadened by the imposition of a tourist tax in hotels, a special tax on petroleum products, taxes on games of chance and games of entertainment, application of VAT on furnished rentals hitherto not subjected to any tax, and the unsuccessful tax impose on mobile phones.



Intriguingly, despite all these new strategies, the budget deficit has not improved as other State revenue dropped by 6.8%, as indicated by the 2016 report on the nation's economic, social and financial situation, and tax from other revenue drop from 669,920,000 in 2016 to 624,170,000 in 2017.

Based on this background, the informal sector might not escape from taxes for too long again, especially when concerns are rising about rising levels of the external debt contracted by the government. Hence, it is important to start brainstorming on the possibility of increasing state revenue through tax from the hitherto untaxed informal sector to broaden the tax base. Therefore, this paper aims to scrutinize the opportunity and challenges of taxing the informal sector and its social implication to the economy.

2. Characteristics of Foreign Direct Investments in Africa

The informal sector, which is described as the non-official, non-structured, and hidden sector encompassing all activities that would normally

be taxed yet are not registered, is considered by contemporary researchers as a great potential source of tax revenue in developing countries (Aranjo-Bonjean & Chambas: 2003). There is a growing recognition of taxing this sector's remarkable potential benefits in revenue, governance, and growth-related issues. As concern revenue, this sector forms a large and growing share of Gross Domestic Products, representing a potentially significant tax revenue source. In effect, taxing the informal sector will likely increase compliance among larger firms under the premise of tax morale (Torgler 2003). According to Loeprick (2009), formalizing the informal sector firms by enabling them to pay tax will likely accelerate economic growth. Further, and as concern governance, the payment of taxes by firms in the informal economy may be a way of engaging firms with the state, promoting good governance and political accountability. These assertions suggest that ignoring tax revenue collection from this sector will trigger serious operational problems for the government and increase the tax burden on a few compliant taxpayers to raise the much-needed tax revenue.



In Cameroon, and according to the NIS (2015) of the fourth Cameroon Household consumption survey, the rate of informality stood at 88.6% in 2014 against 90.3% in 2007. The informal sector produces more than half of national output, and much of it untaxed (World Bank, Doing Business Database, 2010). The share of informal workers in the Cameroonian labor force increased from 10% in 1980 to 14% in 2007. Cameroonian employment consequently remains overwhelmingly informal with wages that are untaxed. This sector being significantly important and growing indicates that ignoring the collection of tax from this sector might increase the tax burden on a few compliant taxpayers and reduce the governments' ability to spend on future infrastructure projects (Munjeji, 2017).

3. An Opportunity not Without Challenges and Drastic Social Implications

The interest in taxing the informal sector has received considerable attention in recent years due to the premise that it can increase government revenue, economic growth and can further

harness governance. Nevertheless, it is important to scrutinize the veracity of such a claim as it has not been without controversy. First, as a concern the revenue-generating axiom of tax revenue from the informal sector, it is important to underline that the tax revenue is likely to be very modest and insignificant. In the view of critics, the potential revenue yields are low due to high administrative costs, and the tax incidence is likely to be regressive. Secondly, increased taxation of small firms may ultimately hinder growth as companies might be taxed out of existence (Keen, 2012). This is further compounded by the remarkable difficulty of how to practically and meaningfully improve informal sector taxation. Meanwhile, policymakers have indicated very little interest in the area due to the very limited amount raised from this sector compared to larger firms.

Further, tax administrators' practical challenges include the hidden nature of the business, hence difficulties in monitoring, the lack of bookkeeping, and the significant number of unregistered businesses. Apart from these technical difficulties, taxing the informal sector can have social implications. Critics hold that these sectors' actors are generally low-income individuals, thus rendering taxation of such operations potentially regressive, as indicated by Pimhidzai and Fox (2012).

4. Way Forward to Mobilize Tax From the Informal Sector

Among the several drivers of the informality in this sector is the lack of tax law enforcement, high unemployment rate, low salaries, a high tax burden, and the time required to prepare a file and pay tax. For instance, in Cameroon, the time required to prepare, file, and pay taxes, is the longest in Africa according to World Bank, Doing Business Database (2010). In addition, the informal sector originated due to a low level of education, inability to gather sufficient initial

capital, ease of entry, quality of governance, levels of corruption, among others. Intriguingly, and according to Bairagya (2011), most politicians are relaxing essential laws. They avoid tax imposition in this sector to ensure that they will be persistently voted to power. This has therefore contributed to the growth of the informality sector to the detriment of the formal sector. Suppose the budget deficit must be reduced and eradicated in the short and medium-term by increasing tax revenue. In that case, the informal sector must be formalized by employing, among others, two strategies. First, Policymakers should encourage all businesses to register to the website “MyBusiness.cm.” This should be a prerequisite for all businesses operating in the formal and informal sectors to ensure that both sectors can benefit from government technical and financial support. Launched in April 2016 with UNCTAD¹ and the European Union’s support, the system simplifies the business creation process. It has also helped to support entrepreneurship promotion policies.

Secondly, entrepreneurs in the informal sector should be registered to one or more informal industry bodies – for example, the Association of Bayam Sellam, to facilitate the formalization of their activities and the implementation of better taxation procedures.

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8. Loeprick, J. (2009) Small Business Taxation: Reform to Encourage Formality and Firm Growth, Investment Climate in Practice: Business Taxation No. 1, Washington DC: World Bank.

1. <http://unctad.org/en/Pages/Home.aspx>



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Lower Tax Rates Will Reduce the Informal Sector and Boost Employment in Cameroon

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Summary: *The informal sector is an important pillar of developing market economies, employing millions of Cameroonians who are not employed in the formal sector. However, Informal Production Units have failed to formalize due to a burdensome tax rate. The taxation on resident companies is estimated at 33%, plus a 10% national tax rate imposed on companies by the council. This discourages the formalization of the informal sector. To formalize a greater number of businesses in the informal sector, policymakers should ensure that the tax rates reflect their operational cost while providing technical support to ensure that such businesses can transition to the formal sector.*

1. Introduction

The informal sector is an indispensable pillar of developing market economies due to a range of factors stemming from structural employment, the lack of economic opportunity, and higher unemployment rates across its mostly youthful workforce. In 2015, the ILO Recommendation No. 204 concerning the transition from the informal to the formal economy describes the “informal economy” as referring to all economic activities by workers and economic units – in law or practice – not covered insufficiently covered by formal arrangements. OECD (2020). In Cameroon, the informal sector spans employees

in the communication sector – commonly referred to as “**Call Boxes**” – small farm holders, market sellers, non-registered employees in the transportation sector.

This sector equally employs 90% of the active population and accounts for more than 50% of the country’s GDP, according to the International Labour Organization – **ILO (2017)**. This brings this number to 10 511 people employed in precarious jobs that rely on uncertain demand. As a reminder, the average income of people employed in the informal sector is 48,400 CFA francs per month; that is, 58,600 CFA francs in urban areas and 38,200 CFA francs rural areas (**EESI 2 – INS, 2011**).

At the microeconomic level, Cameroon has more than 2,500,000 Informal Production Units (IPUs) throughout the country (National Institute of Statistics – NIS, 2011). In terms of distribution, rural areas account for 49.5% of these units, while the cities of Douala and Yaounde account for **33.3%** of IPUs. In terms of their management, 54.4% of IPUs are managed by women, while men manage only 45.6%.

Based on the economic opportunities and employment generated by this sector, it can be concluded that the informal sector is salient for Cameroon’s economic development as it permits a range of individuals to earn a wage, however uncertain. However, several informal sector



businesses fail to formalize even after years of operating in a particular sector or industry. Several reasons explain this inertia, but punitive tax rates have played a role in hampering businesses' transition from the informal sector to the formal sector. This paper will look at tax rates across Cameroon and examine the implications for informal production units. Before going further, one should note the different forms and types of tax rates imposed on businesses in the informal sector.

The rationale for this approach hinges on the fact that SMEs and informal sector production units face a different set of constraints. However, while the former can use credible means and institutions to influence tax policy, the former is cash-strapped and tend to employ individuals with little protection. This reduces the operating costs of such businesses and enables their owners to gain from higher profit margins.

2. Are Current Taxation Levels Punitive?

To determine if and how tax rates are punitive, one should compare this across Africa's tax rates. On average, African countries' tax structure is relatively similar to Latin America and Caribbean countries. Notable differences are Africa's relatively higher reliance on individual taxes and lower reliance on social insurance taxes. The average OECD tax structure differs substantially from that of the African average. African countries tend to rely less on individual taxes, social insurance taxes, property taxes, and more on corporate taxes and consumption taxes.

Between 2008 and 2017, revenue sources have shifted to VAT (an increase of 1.7 percentage points of total taxes) and individual taxes (an increase of 2.6 percentage points of total taxes). While the share of individual taxes is still lower than the share of corporate taxes,

corporate tax revenue has declined by 1.2 percentage points of total tax revenue during the same time frame. This declining rate can be attributed to lower collection rates as businesses that find the corporations tax punitive are unlikely to declare incomes and profits earned from economic activity.

3. Informal Sector Units Plagued by Higher Taxes

The taxation on resident companies is estimated at 33%, plus a 10% national tax rate imposed on companies by the council. This brings the tax rate to 33%; meanwhile, a minimum tax rate on turnover is estimated generally at 2.2%, 3.3%, and 5.5% of turnover based on the tax regime. Should businesses in the informal sector choose to transition to the formal sector, they are expected to pay 33% of their incomes on average. In addition to social security contribution and the local tax, these businesses see the formalization of their activities as a disincentive.

This is problematic as over 34.1% of informal sector production units operate in the industry, suggesting that they could easily transition to the formal sector. They provide goods and services that add value to the overall offering of the businesses and sectors they serve. It is important to note that the service sector contributes over 56% of GDP, hence ensuring such unit's transition to the formal sector. This paper proposes a range of level-headed recommendations based on the salience of taxation for the private sector and public spending implications.

4. Actionable Policy Recommendations

1). **We propose a tariff and tax schedule that reflects the operating costs and revenues from sales for businesses in the informal sector.** When businesses transition to the formal sector, they should only pay corporation tax after covering their operating costs. This will ensure that the government benefits from taxes from

incomes and value-added tax over the long run and give informal production units a chance to thrive and formalize their activities.

2). Businesses and startups in Cameroon are prohibited from paying taxes for three years once they begin their operations. **For businesses that employ over 5 to 10 employees during this period, they should continue to pay no taxes for up to two years, provided that their revenue does not exceed their operating cost.** This will not impinge on the rights of local councils as they will continue to impose business rates ranging from 2.2%, 3.3%, and 5.5% of turnover based on the tax regime.

3). **Finally, informal sector units should be given professional support from licensed agencies to ensure they have the right documentation, experience, and experience to be included in public sector bidding.** Informal sector businesses must be equipped with the skills to compete against established behemoths but equally allowed to provide vital goods and services to the public sector.

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Transitioning Companies Toward the Formal Sector in Cameroon

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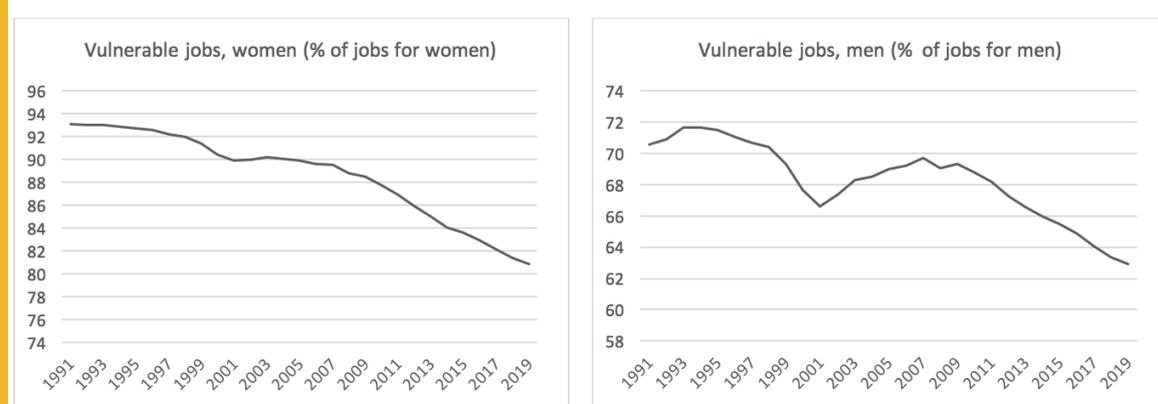
Summary: *The purpose of this paper is to analyze the transitional dynamics of companies to formalization in Cameroon. We estimate a simple regression model using annual data from the World Bank over the period from 1991 to 2019. Our results highlight some strategies for formalization and competitiveness of companies, nearly 90% of which fall under the informal sector (National Institute of Statistics, 2019). We demonstrate that a 10% decrease in the tax burden on firms contributes to a decrease of about 4% in the number of firms operating in the informal sector. On the other hand, a 10% reduction in individuals not completing secondary school would decrease the number of informal firms by about 2%. The transition of businesses to the formal sector requires further education on the need to formalize a business and pay taxes regularly in the educational system and improve the business environment, notably through the strengthening of fiscal transparency and legal-administrative governance of small and medium-sized enterprises.*

1. Introduction

According to the 2018 statistics of the National Statistics Institute of Cameroon, close to 92% of workers belong to the informal sector. For Hussmanns (1997),¹ this predominance of the informal sector is explained mainly by the incapacity of the formal sector of the economy – public businesses and parastatals, registered private sector – to provide job opportunities or adequate revenues for a rapidly growing workforce. Therefore, these informal activities give the possibility for many individuals who in other situations would not have a means of sustenance, a job, and income opportunities. Still, the latter remains subject to uncertainty and abject poverty. If the informal sector is globally known to ensure the survival of numerous workers, it nonetheless prevents the development of the country by encouraging weak revenues and reducing tax returns (Vincent Kouete, 2020).² According to the World Bank (2019), close to 70% of these businesses on average in Cameroon remain vulnerable to economic shocks.

1. Hussmanns R. (1997): Secteur informel: historique Hussmanns R., définition et importance: BIT, actes du séminaire de Bamako, 10-14 novembre 1997.

2. <https://blog.secteur-prive-developpement.fr/2020/01/23/cameroun-90-de-la-force-active-piegee-dans-le-secteur-de-linformel/#>

Figure 1 » Vulnerable Jobs (in % of jobs) in Cameroon between 1991 and 2019

Source: World Bank (2019)

Despite the [strategies](#)³ put in place by public authorities in collaboration with the International Labour Office to enable entrepreneurs to operate in the non-registered sector by legalizing their activities and leaving this vicious circle of vulnerability for good (creation of business Formalities Centers and recognized/approved management centers), informal businesses keep multiplying by the day. Thereby creating a significant shortfall for the state (in terms of tax revenues) and is at the origin of numerous economic distortions like an unjust competition with legally registered economic entities (Mahaman 2009).⁴ This article has an objective to analyze the determinants of the transition of businesses towards the formal sector in Cameroon. After presenting the necessity to promote the transition towards a formal economy in Cameroon, we seek to present an estimation of a simple econometric model to evaluate the incidence of some macroeconomic variables in the transition process of companies towards the formal sector in Cameroon.

2. The Necessity to Promote the Transition of Businesses of the Informal Sector Toward the Formal Sector in Cameroon

To describe the informal sector,⁵ many studies cling to the fact that there is a strong correlation between the multiplication of informal businesses and their manager's perception of the payment of their taxes. Schneider (2003)⁶ defines this as "an assembly of economic activities partially or stolen from tax authorities and which contributes to the determination of the official national production." Therefore, the informal sector is constituted of institutions that operate within the rules vis-à-vis the registration of their activities at the level of social and fiscal services (Araujo and Chambas 2003).⁷ In sub-Saharan African countries, several factors slow the transition of numerous informal businesses towards the formal sector. According to Schneider (2003),⁸ the rise of the informal sector finds its origin in the multiplicity of bureaucratic regulations that exist on the subject, the

3. https://www.ilo.org/africa/countries-covered/cameroon/facet/WCMS_550528/lang--fr/index.htm

4. Mahaman Sani. Secteur non enregistré et mobilisation fiscale dans les pays en développement (PED): le cas des pays d'Afrique au sud du Sahara (PASS). Sciences de l'Homme et Société. Université d'Auvergne Clermont-Ferrand I, 2009. Français. fftel-00356166f.

5. Les critères qui permettent de caractériser ce secteur sont liés: au respect du droit du travail, l'application des règles d'hygiène et de sécurité minimales, le niveau ou même la notion de salaire minimum, les dispositions à prendre en matière d'enregistrement aussi bien auprès des services fiscaux qu'auprès des services sociaux.

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7. Chambas G., Araujo-Chambas G., Araujo-B.C. (2003): Taxer l'économie non enregistrée urbaine en Afrique Subsaharienne. Communication à la conférence « Hard to Tax », Atlanta.

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unsuitability of certain texts on national realities, and information asymmetry that exist between entrepreneurs and the tax administration. Hence the need to relax the regulations governing the activities of businesses, minimize them, adapt them to realities, and obtain information for the different actors (Lautier, 1994).⁹

According to Tanzi (1999),¹⁰ the weight of taxation explains the multiplicity of informal businesses in sub-Saharan African countries. According to the author, economic agents generally seek refuge in this sector to obtain maximum benefits. Krueger (1993)¹¹ shows that the importance of the informal sector finds its justification in inequalities that typically exist in the distribution and utilization of national riches. In Cameroon, taxation itself is viewed as a tool of oppression for businesses that consecrate close to 624 hours a year to carry out 44 payments; taxation and social pressure are estimated at 57.7% of commercial profits against 47.1% Gabon (World Bank, 2020).¹² So, reducing taxation in Cameroon encourages many businesses to shift towards the formal sector.

In Cameroon, like in the case elsewhere in sub-Saharan Africa, several businesses decide to operate in the informal sector to avoid tax payments (corporate tax in particular). This situation, unfortunately, does not come without consequences on the economic growth of the country. Apart from limiting the growth of tax revenues, the predominance of the informal sector contributes to the disappearance of formal businesses that face unfair competition more and more from the informal companies.

3. The Incidence of Taxation on the Transition Process of Cameroonian Businesses Toward the Formal Sector

To evaluate the incidence of taxation on the transition process of Cameroonian businesses towards the formal sector, we estimate a simple regression model while taking into account the proportion of informal businesses in the economy as a variable to be explained. The explicative variables retained are as follows: The enrollment rate at the secondary level; the choice to operate in the informal sector, which has a direct link with the level of education revenue per inhabitant, the sectoral origin of Gross Domestic Product, the degree of trade openness of the economy not forgetting the size of the population

Regarding the GDP per head, Stotsky and Wolde (1997)¹³ show that revenue per inhabitant equally influences the transition towards the formal economy from a taxation point of view. In effect, the more revenue per inhabitant increases, the more the population can pay taxes and consequently legalize the businesses they create. Meanwhile, suppose the population backgrounds show less trust in the public service. In that case, they will become reluctant to pay their taxes, which are essential for constructing infrastructures (markets, schools, roads, hospitals).

The Gross Domestic Product's sectoral origin also influences the transition of businesses of an economy of the informal sector towards the formal sector through taxation (Brun, Chambas, Guerineau (2007).¹⁴ According to these authors, sectors carrying out activities with low taxes (the agricultural) are more fortunate to have formal businesses than sectors with high taxes (the industrial sector).

9. Lautier B., (1994): L'économie informelle dans le tiers monde ; Edition La découverte.

10. Tanzi V., Tanzi V., (1999): "Uses and Abuses of Estimates of the Underground Economy" Economic Journal, 109;456, pp. 338-340.

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12. <https://www.pwc.com/gx/en/services/tax/publications/paying-taxes-2020/overall-ranking-and-data-tables.html>

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14. Chambas G., Brun J.F, Guerineau. S. Chambas G., Brun J.F, Guerineau. S. Guerineau. S. (2007): Aide et mobilisation fiscale dans les pays en développement. CERDI.

According to Brun and al (2004),¹⁵ the reduction of customs duties (within the framework of commercial openness)¹⁶ can equally influence the transition of enterprises of the informal sector towards the formal sector, notably through the multiplication of domestic goods exportation. This leads to an expansion of the volume of the tax base (Khattry and Rao, 2002).¹⁷

The size of the tax administration plays equally a major role in the transition towards a formal economy. According to Bird and Martinez-Vezquez (2005),¹⁸ when a country is highly populated and has a strong population distribution, tax mobilization can be hampered notably because of the small nature of the tax administration. In this type of scenario, some taxpayers can avoid tax control and decide to carry out their informal sector activities.

Taking into consideration annual data provided by the World Bank from the period 1991 to 2019, our results establish that a 10% decrease in tax pressure on businesses contributes to a decrease of about 4% of the number of businesses operating in the informal sector that will transfer to the formal sector. Admitting the fact that most informal businesses are created by persons who have not had a long educational career and therefore less committed to paying taxes, we also show that a 10% reduction in the number of individuals who do not complete their secondary education will decrease the number of informal businesses about 2%. This last result corroborates that obtained by Sani (2009), demonstrating that there exists a direct link between the level of education of entrepreneurs and their choice to operate in the informal sector.

As to what concerns the influence of other variables on the process of transition of businesses towards a formal sector in Cameroon, we seek to show that 7% of businesses that become legalized every year emerge from the agricultural sector (given the low taxation in this sector); while an increase of 10% of industrial companies increases the number of informal companies about 0.1%. Following Brun and al (2004), we show equally that commercial openness positively but contributes very little in terms of transition towards the formal sector in Cameroon. A 10% increase in the degree of commercial openness of the country would arouse an increase in the number of informal businesses from 0.05%. Due to the small nature of the tax administration or, better still, the further materialization of procedures, we demonstrate that an increase of 10% would encourage close to 1% of companies to stay in the informal sector. Brun, Chambas, Guerineau (2007) justifies this by affirming that countries that easily benefit from external financial support are less “oppressive” when carrying out internal resource mobilization

4. Conclusion and Recommendations of Economic Policies

This article's objective was to analyze the determinants involved in the transition of businesses towards the formal sector in Cameroon. Having characterized the informal sector, we used a simple econometric model to appreciate the incidence of some economic variables in the transition process of Cameroonian businesses towards the formal sector. The main result on which we are concluding indicates that a 10% drop in tax pressure on businesses in Cameroon contributes to a decrease of about 4% in the number of businesses operating in the informal sector, which would transition towards the formal sector.

15. Chambas G., Brun J.F, Combes J.L. (2004): « Inégalité, pauvreté et mobilisation fiscale ». Communication aux 6ème journées scientifiques du réseau d'Analyse Economique et Développement de l'AUF. Marrakech.

16. S'obtient en additionnant le montant des exportations et des importations d'un pays, que l'on divise par 2 puis par le PIB de ce pays, le tout multiplié par 100.

17. Khattry B., Rao J.M., (2002): “Fiscal Faux Pas? An Analysis of the Revenue Implications of Trade Liberalisation », World Development, Vol 30, pp 1431-1444.

18. Bird R.M, Martinez-Vasquez J Vasquez J Vasquez J, Torgler B. (2005): « Societal Institutions and Tax Effort in Developing Countries », working paper, Georgia State University, 04-06.

Given that the decision to operate in the informal sector is strongly linked to some structural parameters, socio-economic and even demographic that encourage entrepreneurs to carry out their activities in the “shadows” to

maximize profits, we formulate the following recommendations for authorities:

- **Incorporate into the Cameroonian educational program lessons to formalize businesses and regularly pay taxes from the primary level.** As affirmed by Sani (2009), “the more people are educated, the more they are apt to accept taxes because they will be more apt to understand that it is from these revenues that the state finances expenditure for public interest like schools, health centers, road...”
- **Sensitize and support existing informal businesses on the necessity to strengthen the resilience of their activities to economic shocks.** This sensitization consists notably to educate or advise on the necessity to register their activities at the level of tax authorities and trade register and subscribe to an insurance policy to reduce the vulnerability of their activities in the face of any eventual shocks that could arise unforeseen.
- **Ameliorate the business environment by strengthening tax transparency as well as the administrative and legal governance of small and medium-sized companies** (dematerialization of procedures, the fight against corruption and tax harassment): A strategy like this one would help to obtain the tax potential of businesses while encouraging those operating in the informal sector to shift towards the formal sector.

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Summaries of articles of the previous number- Overcoming the challenge of fiscal transition in Cameroon

Kouam, J.C., D’Pola, K.U; Tchegho, J.M (2021), “Overcoming the Challenge of Fiscal transition in Cameroon,” *Fiscal Policy Letter*, Nkafu Policy Institute, Denis & Lenora Foretia Foundation, January 2021.

Analysis of the Determinants of Fiscal Pressure in Cameroon

By **Dr. Jean Cédric Kouam**

Senior Economic Policy Analyst – Nkafu Policy Institute

Summary: This article aims to analyse the factors explaining the fiscal pressure in Cameroon. By considering World Bank data from 2000 to 2020, we show that the prevailing socio-economic conditions strongly influence budgetary pressure. Variables such as the number of vulnerable jobs, internet users, democracy and corruption also affect taxation. Finding practical and rational solutions to these factors is necessary to relieve Cameroonian economic activity from asphyxiating taxation.

Fiscal Exemption in the Agricultural Sector: Stakes and Challenges for the Economy of Cameroon

By **Dr. Jean Cédric Kouam**, Senior Economic Policy Analyst – Nkafu Policy Institute & by **Mr. Jean Maurice Tchegho**, Research Intern – Nkafu Policy Institute

Summary: To achieve the objectives, set in the 2020–2030 National Development Strategy, the government of Cameroon has defined a series of measures aimed at strengthening resilience to shocks in several sectors of activity including

agriculture. Among these measures are tax waivers and exemptions. This article examines the stakes and challenges of tax exemption in the Cameroon agricultural sector. The aim is to reduce the economy’s dependence on imports and promote “made in Cameroon.” However, while such a measure generates losses in budget revenue in the short term, it nevertheless allows the country to produce more and import less, which compensates for the deficit caused by the suppression of specific tariff and non-tariff barriers.

Taxation and Foreign Direct Investments in Cameroon

By **Ulrich D’POLA KAMDEM**

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Summary: This note’s objective is to analyse the sensitivity of foreign direct investments (FDIs) to taxation in Cameroon to implement the national development strategy 2020–2030. The note collects secondary data from various sources, including the World Bank’s Doing Business reports, the United Nations Industrial Development Organization’s survey, and statistics from the United Nations Conference on Trade and Development to name a few. Drawing on Pesse (2018) empirical work, the note shows that taxation negatively influences FDIs fluctuations. In other words, the attractiveness

of FDIs would depend heavily on the authorities' fiscal policy. In a global context of declining FDIs, the following recommendations are made: (i) Reduce the corporate tax burden in Cameroon to bring it in line with the sub-Saharan average, and (ii) Merge certain ministries to limit public operating expenditures – which are unproductive most of the time – and encourage the development of private initiatives.

Accelerate the Fiscal Transition Process in Cameroon

By **Dr. Jean Cédric Kouam**
Senior Economic Policy Analyst – Nkafu Policy Institute

Summary: *The adoption of a Common External Tariff within the framework of sub-regional integration and the ratification of the agreement on the African Continental Free Trade Area will*

impact the level of Cameroonian tax revenues in the coming years. To compensate losses of customs revenue resulting from trade liberalisation, it is essential to accelerate the fiscal transition process. Success would achieve economic growth projected in the National Development Strategy 2020–2030. To succeed, we recommend reducing at least 10% of the number of informal businesses each year, speed up the process of diversifying the economy, accelerate the modernisation of the tax administration, further simplify the tariff barriers to the export of local products and taxing imported products a little more.

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