# PROJECT INFORMATION DOCUMENT (PID)
# APPRAISAL STAGE

Report No.: PIDA19997

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|---|---|
| **Project Name** | Strengthening Institutional Capacity for Government Effectiveness Project (P149176) |
| **Region** | AFRICA |
| **Country** | Burundi |
| **Sector(s)** | Central government administration (70%), Public administration-Information and communications (10%), Public administration-Other s ocial services (10%), Public administration- Energy and mining (10%) |
| **Theme(s)** | Tax policy and administration (40%), Economic statistics, modeling and forecasting (20%), Macroeconomic management (20%), Public exp enditure, financial management and procurement (20%) |
| **Lending Instrument** | Investment Project Financing |
| **Project ID** | P149176 |
| **Borrower(s)** | Government of Burundi |
| **Implementing Agency** | MINISTRY OF FINANCE |
| **Environmental Category** | C-Not Required |
| **Date PID Prepared/Updated** | 13-Feb-2015 |
| **Date PID Approved/Disclosed** | 13-Feb-2015 |
| **Estimated Date of Appraisal Completion** | 13-Feb-2015 |
| **Estimated Date of Board Approval** | 22-Apr-2015 |
| **Decision** | |

## I. Project Context

### Country Context

1. Since 2004, Burundi has made good progress in establishing a relatively stable macroeconomic environment, rebuilding institutions, and consolidating peace and security. Burundi has recovered from the decade long conflict, which resulted in widespread destruction of economic and social infrastructure. Over the past decade, the Government’s economic and financial programs aimed to consolidate economic and political gains, promote inclusive economic growth, contain inflation, and strengthen policies designed to combat endemic poverty in rural and urban areas. Two rounds of elections took place in 2005 and 2010, respectively, with the following round scheduled for May 2015.

2. Over the past decade, economic growth has been stable and moderately positive, but

poverty remains prevalent. The Government has managed to stabilize the country's economy in a fragile environment, with output growth averaging 4.4 percent between 2006 and 2014. This performance led to a 1.4 percent yearly increase in real GDP. However, economic growth has remained insufficient to generate a sustained improvement in the living conditions of most Burundians. The share of the population deprived of basic food needs declined by 6 percentage points between 2006 and 2012, but at 60 percent remains one of the highest in the world. Moreover, inequalities between the capital and the rest of the country are still high as the share of the population with consumption below the basic needs stood at 61.5 percent in rural areas versus 41 percent in Bujumbura. Burundi's score on the UNDP's Human Development Index improved by 2.7 percent per year between 2005 and 2013 thanks to improved education and health outcomes, but Burundi still ranked 180th out of 187 countries in 2013.

3. Burundi's modest economic performance reflects the legacy of the conflict and limited fiscal space. The decade-long conflict undermined the country's institutions, limiting the government's ability to address its urgent development challenges. In addition to weak public institutions, narrow fiscal space makes the country vulnerable to shocks. The limited fiscal space is the result of multiple factors, including: (i) the low level of fiscal revenue, also due to recent setbacks in tax revenue mobilization; (ii) the very narrow export base which puts the country at a high risk of debt distress; (iii) the relative scarcity of external financing as grants continue to decrease; (iv) the very small domestic banking sector, with an almost nonexistent domestic financial market; and finally (v) the dominant share of the non-discretionary spending absorbing almost all domestic revenue, with salaries representing 60 percent of the tax revenues.

4. Burundi's medium term macroeconomic outlook reflects the need to balance fiscal sustainability and growth. Real GDP growth is projected to reach 4.7 percent, up from 4.5 percent in 2013 and 4.0 percent in 2012. This slight acceleration is driven by the rebound in coffee production together with the boom in the construction and tertiary sectors. However, the country's ability to sustain significant increases in per capita GDP will largely depend on its capacity to expand the available room for fiscal maneuvering, to diversify its economy, and to stimulate productivity with public investments. To this end, Burundi can benefit from its huge natural resources endowment, including minerals (gold, nickel, coltan, cassiterite, wolframite, copper, platinum, iron, etc.) in the eastern part of the country, and a rich agricultural zone in the central highland.

5. Sustainable economic growth and shared prosperity will heavily depend on improvements in government effectiveness. Following the progress made in stabilizing the country's economy, the Government needs to move on a path of faster and more inclusive growth to deliver its ambitious development agenda as outlined in the second PRSP. Further efforts are also needed to reduce the risk of renewed fragility, by building trust between the state and its citizens. Strengthening public sector governance and promoting a modern public administration better able to deliver services and effectively implement public policies is an essential pre-condition of sustained progress toward these goals.

**Sectoral and institutional Context**

6. The lack of progress on several dimensions of governance has constrained the Government of Burundi (GoB) from effectively reducing poverty and improving human development. The 2012 World Governance Indicators provide a quick snapshot of the challenges confronting Burundi,

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showing that the country lags behind the Sub-Saharan Africa regional average on most dimensions of governance. In particular, Burundi ranks in the lowest tenth percentile on government effectiveness, the rule of law, regulatory quality, and control of corruption. The country, however, performs relatively well on voice and accountability, in itself a major achievement in a fragile post-conflict setting. Political stability has also improved over time.

7. The Government has recently adopted a number of corrective measures, and established new institutions notably the creation of the Anticorruption Brigade, the Court of Auditors, and the Office of the Inspector General, to curb corruption. Important achievements have also been made in economic governance reforms, including: (i) the effective operation of the Burundi Revenue Authority (Office Burundais des Recettes - OBR); (ii) the introduction of VAT; (iii) the revision of the customs code; (iv) a decree on the rules and regulations of the management of the budget and control, a key element of the implementation of the budget framework law (Loi Organique); and (v) the creation of a single treasury account and the strengthening of controls and audits. In 2011, the Government adopted the National Strategy for Good Governance and Anti-corruption (SNBGLC 2011-2015) and a related action plan, reflecting the government's commitment to move the governance agenda forward.

8. Despite these achievements, Burundi faces a number of challenges in creating the additional fiscal space required to promote growth and overcome the current fragility of its economy. Tax to GDP ratio remains low at 12 percent in 2014. Although the government is expected to limit current expenditure growth in real terms, unless additional revenue measures are introduced to offset the falling grants, it will struggle to reduce its deficit. Although the structure of the economy (mainly rural and informal) plays an important role, weaknesses in tax policy and tax administration and a lack of coordination between them limit the efforts to mobilize domestic revenue. In addition, a number of tax exemptions have been granted - counting for as much as 3 percent of GDP and about 20 % of collected tax revenue in 2013 - but there is little evidence of their impact. On the expenditure side, more rigorous planning and execution could improve efficiency and effectiveness. Finally, if properly managed, natural resources – especially mining – can potentially become an important driver of growth in Burundi, broadening the fiscal space and strengthening resilience to external shocks. In this context, strengthening the the country's statistical system is critical to promote transparent and informed decision making processes, guiding government policies.

Lack of Tax Policy Capacity Combined with Weaknesses in Tax Administration Undermines Revenue Mobilization

9. The establishment of the Burundi Revenue Authority (2009) has contributed to substantial improvements in tax administration and revenue mobilization, but trends are deteriorating. Although encouraging progress has been achieved since the creation of OBR in establishing new tax and customs administrations, the changes introduced in 2013 in the income tax and VAT laws – due to weak coordination between tax policy and tax administration – combined with the provision of generous tax exemptions have resulted in serious revenue slippages, leading to a decrease in the tax to GDP ratio from 14.3 percent in 2011 to 12.4 percent in 2013. To finance the fiscal gap, the Government had to borrow from the domestic banking system, up to 1 percent of GDP as of the end of June 2014.

10. Addressing pending weaknesses in tax policy is critical to increase fiscal space. In

Burundi, the tax policy suffers from three major weaknesses. First, the government lacks a medium- to long-term tax policy strategy that defines the country's overall fiscal policy direction and relates it with the existing administrative capacity, setting objectives – including the level of tax revenue, its efficiency and fairness. Consequently, the Government continues to struggle between several tax policy objectives without a clear framework to balance them. Second, the Government lacks macroeconomic and statistical tools and adequate expertise to carry out ex-ante impact evaluation and cost/benefit analysis of tax policy measures, including the provision of tax exemptions to promote economic investments. As a result, frequent legislative changes and sudden corrections of tax policy provisions have generated instability in the regulatory environment, and resulted in severe revenue slippages. Third, while in principle the Tax Policy Department (TDP) at the MFPDE has the mandate to ensure regular monitoring of the government tax policy, in practice this function is not performed.

11. The Government has taken important measures to increase revenues, and better coordination between tax policy (MFPDE) and tax administration (OBR) is urgently needed to sustain progress. In an effort to improve fiscal transparency, in 2014 the Government disclosed the full itemized list of tax exemptions granted in the previous year. Moreover, VAT exemptions on imported products and tax credits have been eliminated in the context of the revised 2014 budget. While the implementation of these measures has been critical to deal with revenue shortfalls, efforts to modernize the tax and customs administrations will require a better integration of OBR in Burundi's institutions, beginning with a closer relationship and more effective coordination between OBR senior management and the Department of Fiscal Policy at the MFPDE. Additional challenges include (i) the absence of a modern and integrated tax administration system (ITAS); (ii) the lack of effective intelligence, risk management, and investigation functions in the Tax and Customs Departments at the OBR; and (iii) the urgent need to streamline the Tax Department's organizational structure by strengthening human resources and functions of the regional offices.

Strengthening Management of Public Finances Remains a Priority

12. Since 2008, Burundi has made significant progress in modernizing the expenditure management system. A new organic budget law was adopted in 2008 (LOFP – Loi Organique sur les Finances Publiques). Rules on commitments have been tightened and exceptional public spending procedures (Paiements sans ordonnancements préalables), which were widely used in the past, have been brought under control and most of the existing extra-budgetary accounts have been closed or integrated into standard budget documents. The level of unreported extra-budgetary expenditures does not exceed 5 % of total expenditures. Budget execution rates improved significantly, going from 81.4 percent in 2006 to 97.6 percent in 2013. Capital spending shows the largest improvement, increasing from 45.9 in 2006 to 85.4 percent in 2013. As a result, the gap between the initial budget (Loi de Finance Initiale) and the budget execution law (Loi de Règlement) decreased from 47 percent in 2009 to less than 10 percent in 2012. Budget monitoring and internal control systems have improved since the introduction of the IFMIS in 2006, but still shows signs of inefficiencies and delays. Expenditure commitments have been better aligned with projected cash flows with the setting up of commitment ceilings for each line ministry on a quarterly basis. Internal budgetary controls have been further improved with the appointment of controllers of committed expenditures in three pilot ministries (health, education, and agriculture) in 2012. These improvements have been reflected in the latest (2012) PEFA report, where only 8 out of 26 PEFA indicators were rated D+, 9 were rated C or C+, and two indicators were not rated.

13. The gradual introduction of MTEF mechanisms over the past few years improved the alignment of the PRSP priorities to the budget. A central MTEF determines budgetary envelops for Ministries and other national institutions, respectively. Since 2011, central MTEFs consistent with the macroeconomic framework are used in the preparation of the budget. Forecasts of fiscal aggregates are done for three years on a rolling annual basis through the central MTEF and MTBF. Other important measures that have contributed to strengthen the direct links between development priorities and budgets include: (i) improvement of reliability of macroeconomic and revenue projections in order to set credible spending caps, (ii) validation by the Council of Ministers of multi-year inter-sector allocations reflecting the objectives of the second PRSP, and (iii) empowering line ministries to propose intra-sector allocations based on their own strategies and priorities. As a result of these initiatives, the composition of public expenditure has significantly improved toward priority and economic sectors, including education, health, and agriculture. Recognizing these achievements, the PEFA indicator on the budget preparation process (PI-11) was improved from B- in 2009 to A in 2012.

14. The Government remains strongly committed to continue the PFM reform agenda and progressively shift to program-based budget. Building on recent analytical work, including the World Bank programmatic PERs and the 2012 PEFA report , the PFM reform strategy (PFMS-II) seeks to: (i) improve budget formulation by strengthening the linkage between policies and budgets; and (ii) improve budget execution by generalizing planning, programming and budgeting around key sectors, strengthening cash management through IFMIS and overhauling treasury operations. An update of the current strategy is expected by early 2015, with the completion of the 2014 PEFA assessment. The Government is also intensifying efforts to begin a systematic dialogue on performance and develop key results indicators for key sector ministries (education, health and agriculture), with the aim of progressively introducing program budgeting.



15. Several challenges remain especially in the area of cash-management, public accounting and budget external control. A Treasury Single Account (Compte Unique de L'Etat) was introduced starting from 2010. However, the process of effectively integrating all relevant accounts and of creating safeguards against the (re-)creation of new separate accounts is still incomplete with limitations on short-term cash management. As a result, weaknesses persist in the execution and control of the expenditure chain – with significant accumulation of arrears. This is reflected by the low PEFA scores on the stock and monitoring of expenditure arrears (C or D). By the end of 2016, the stock of extra-budgetary arrears due to the private sector reached 6 percent of the total expenditure or 2 percent of GDP. A consolidated government statement is prepared annually, with information on revenue and expenditure. However, the public accounting information remains weak, with account balances often incomplete and submitted for external audit after 10 months of the end of the fiscal year. The Audit Court (Cour des Comptes) has begun to play a more active role in auditing executed budgets and reviewing critical public finance issues. The court audits the government's yearly accounts on time, and reports are available online for public access. However, the quality of the reports remains weak, and there is little evidence of any follow-up on audit findings. Finally, the framework of accounting and auditing has improved but falls short of IFAC standards, and additional efforts are needed to improve national accounting standards and auditing practices.

16. The effective roll-out of the new IFMIS modules requires sustained capacity-building efforts and strengthening the IT functions at the MFPDE. Previous diagnostics (including PEFA 2012 and Burundi PER 2013) have highlighted several dysfunctions in the current IFMIS system,

including the fact that the latest legal texts and procedures are not yet properly implemented in the IFMIS. These shortcomings – combined with the absence of interfacing with other PFM databases and systems (including tax administration, debt management, customs, and the Payroll) make it difficult to reconcile the expenditures and undermine Government capacity to undertake regular reviews of public expenditures. To address these weaknesses, a new IFMIS system is expected to be rolled-out in 2015. Capacity building efforts are critical to adequately manage the transition to the new system, and a comprehensive IT strategy needs to be developed to ensure interfacing with parallel PFM systems modernization activities (including ITAS).

Failures to Produce Timely and Reliable Economic and Social Statistics Undermine the Effectiveness of the Government's Decision-Making Process

17. The regulatory framework governing statistics information collection, production, and distribution is clearly defined. The Statistics Law defines the fundamental principles and institutional framework governing the activities of services and organizations charged with public statistic data dissemination. It addresses the general way the National Statistics System (NSS) operates and its coordination. Official statistics' fundamental principles are recognized by the law, and include: data confidentiality, obligation to answer questionnaires, transparency, duties related to the frequency and dissemination schedules of statistics, as well as their alignment with international methods and concepts.

18. On average, statistical production does not comply with international standards, revealing structural weaknesses in human resource management system. Despite the strategic goals set in the National Statistical Development Strategy (2010-2014) the NSS produces limited data on an irregular basis and standard surveys are not conducted at regular intervals, substantially deviating from General Data Dissemination System (GDDS) guidelines. Specifically, data produced by the National Institute of Statistics and Economic Studies (ISTEEBU) does not often follow standard statistical methodologies, compromising the quality of the final output. Analytical capacity in data analysis is also weak, reflecting the lack of technical skills and the failure of current HRM policy to attract and retain qualified and high skilled statisticians.



19. Timely dissemination of national statistics poses an additional challenge. ISTEEBU outputs are not clearly defined and their dissemination schedule is not determined and publicly announced, as per international practices. As a result, the finalization of statistical products is significantly delayed after the data collection phase, to the point that is difficult to predict when most ISTEEBU publications will be disseminated. This ambiguity reduces predictability and undermines the credibility of the institution. As users are unaware of when statistics will be published, they commonly resort to sources other than ISTEEBU, undermining the demand for (and utilization of) national official statistics. This in turn reduces opportunities for citizens and civil society organizations to monitor the impact of government policies.

20. Recent reform initiatives confirm the government's commitment to statistics development, opening-up opportunities to strengthen ISTEEBU performance. A National Data Quality Assurance Framework (CNAQD) is expected to be adopted soon by the Cabinet. The framework defines clear timelines and establishes maximum turnaround time between data collection and publication date. Moreover, the government has recently (2012) approved the establishment of an independent HRM system for statisticians, governed by the staff regulation of the institute and independent from the Government HRM system. Finally, the recent change made to grant to the Board the authority to set

the remuneration policy is expected to opens\ up the opportunity to link staff pay to performance. To capture the potential benefits of these reforms, sustained efforts are needed to improve ISTEEBU's HRM system and promote corporate performance vis-à-vis producers and users of statistics.

Strengthening institutional reforms is critical to unlocking mining sector development and generating additional fiscal space

21. Burundi's mining sector consists of over 80 registered artisanal mining operations and a few semi-industrial to industrial exploitation permits about to come on-stream. Burundi possesses large mineral deposits, such as nickel (5 percent of international known reserves), and coltan (the 5th largest world reserve). In addition Burundi has considerable gold deposits and base metals such as cassiterite and wolframite. All of Burundi's mineral exports are at present exploited in an artisanal fashion. According to the World Bank (2014), this sub-sector of the mining economy generates an estimated 20,000 direct jobs, primarily in the northern provinces. Future semi-industrial and industrial projects may create upwards of 750 jobs in the coming 10 years, as mines move from construction and development phases to exploitation.

22. Recent upward trends in mineral export earnings suggest that mining can provide much-needed additional fiscal space. At present the sector contributes to less than 1% of total GDP, similar to Rwanda. Burundi's highest export earnings of late come from gold (US$120M), though it is suggested that total declared gold exports in 2013 (2.8 tons) represents only one fifth of total gold exports. Should attention be given to formalization of the sector, gold could make a more significant fiscal contribution, by way of export earnings and royalties. Furthermore, a recent study has evaluated the value of the Musongati nickel deposit at more than US$ 100 billion (40 times the country's GDP). The 2011 Country Economic Memorandum (CEM) projected that government annual revenue from mining could exceed US$200 million (8 percent of GDP) in the case of one large scale nickel mining project, and an estimated price of nickel at up to US$7.3 per pound (depending on market conditions). This is consistent with a recent feasibility study for rare earths which projects a total contribution of an estimated US$24M in taxes over the next 10 years.

23. The government is implementing critical reforms to improve the sector's legislative and regulatory framework, providing momentum to build on effective dialogue and reform institutional governance of the sector. Since adoption of the revised mining code in October 2013, the government has pursued further important reforms: (i) drafting of a comprehensive set of mining regulations to mainstream implementation of the new mining code; (ii) amendments to the existing MEM structure to align itself to revised roles and responsibilities envisaged as laid out in the revised mining code; (iii) drafting of a national mining policy (hitherto non-existent); and (iv) the government's decision to complete its EITI candidacy in 2015. Altogether, these reforms constitute best practice on mineral development.

24. Moving forward, addressing pending institutional gaps in the mining sector is critical to successfully implement the new policy and regulatory framework. Specifically, the relatively low tax collection requires urgent attention to mining revenue policy and administration, to better formalize the predominantly artisanal and small miners (ASM economy). At the same, several technical areas require commensurate systems and human resources to be strengthened in the Ministry, namely for revenue collection and management as well as mineral inspections and audits. Finally, efforts are needed to establish safeguards and best practice concerning local benefits and

environmental management, while focusing on the institutional needs required for regulating industrial projects, such as Musongati, coming on stream in the next 5-10 years.

## II. Proposed Development Objectives

The Project Development Objective (PDO) is to: Improve fiscal management by strengthening Government institutional capacity to produce timely statistics for policy making, mobilize domestic revenue, improve public expenditure controls and improve mining regulatory framework.

## III. Project Description

**Component Name**

Modernizing revenue policy and administration

**Comments (optional)**

**Component Name**

Strengthening public expenditure management and control (including project coordination)

**Comments (optional)**

**Component Name**

Improving national statistics system (ISTEEBU)

**Comments (optional)**

**Component Name**

Improving Mining regulatory capacity and mine practices

**Comments (optional)**



## IV. Financing *(in USD Million)*

| | | | |
|---|---|---|---|
| Total Project Cost: | 26.00 | Total Bank Financing: | 20.00 |
| Financing Gap: | 0.00 | | |

| **For Loans/Credits/Others** | **Amount** |
|---|---:|
| BORROWER/RECIPIENT | 0.00 |
| IDA Grant | 20.00 |
| BELGIUM, Govt. of (Except for MOFA - DGIC) | 6.00 |
| Total | 26.00 |

## V. Implementation

## VI. Safeguard Policies (including public consultation)

| **Safeguard Policies Triggered by the Project** | **Yes** | **No** |
|---|---|---|
| Environmental Assessment OP/BP 4.01 | | x |

| | | |
|---|---|---|
| Natural Habitats OP/BP 4.04 | | ✖ |
| Forests OP/BP 4.36 | | ✖ |
| Pest Management OP 4.09 | | ✖ |
| Physical Cultural Resources OP/BP 4.11 | | ✖ |
| Indigenous Peoples OP/BP 4.10 | | ✖ |
| Involuntary Resettlement OP/BP 4.12 | | ✖ |
| Safety of Dams OP/BP 4.37 | | ✖ |
| Projects on International Waterways OP/BP 7.50 | | ✖ |
| Projects in Disputed Areas OP/BP 7.60 | | ✖ |

**Comments (optional)**

## VII. Contact point

**World Bank**
Contact: Marco Larizza
Title: Senior Public Sector Specialis
Tel: 473-4455
Email: mlarizza@worldbank.org

**Borrower/Client/Recipient**
Name: Government of Burundi
Contact: Pierre Sinarinzi
Title: Assistant to the Minister of Finance
Tel: 25779486872
Email: psinarinzi@yahoo.fr

**Implementing Agencies**
Name: MINISTRY OF FINANCE
Contact: Desire Musharitze
Title: Coordinator of the cellule
Tel: 25779988725
Email: mushdes@yahoo.fr

## VIII. For more information contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop

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