PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

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Report No.: 120762

Operation Name	BF - DPO2 series on Energy and PFM
Region	AFRICA
Country	BURKINA FASO
Sector	Central government administration (30%); Public administration- Industry and trade (10%); General energy sector (60%)
Operation ID	P163283
Lending Instrument	Development Policy Lending
Borrower(s)	REPUBLIC OF BURKINA FASO
Implementing Agency	Ministry of Economy, Finance and Development
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Corporate Review Decision	

I. Key development issues and rationale for Bank involvement

Burkina Faso's economy has recovered in 2016 and continues to improve. Following a slowdown in 2014 and 2015, growth has rebounded at 5.9 percent in 2016, and is projected to accelerate to 6.4 percent in 2017 for several reasons. The renewed political stability after the 2015 Presidential elections has restored confidence, brought back foreign investors and donors, and helped increase domestic demand. Favorable climatic conditions have led to higher agricultural output, particularly for cotton, while mining activities have remained strong.

Fiscal performance has, however, deteriorated, and fiscal space for Government's ambitions to address large deficits in infrastructure and social services has narrowed. The fiscal deficit widened to 3.1 percent in 2016 as increases in the wage bill were only partially offset by improved tax collection. In 2017, the fiscal deficit will further deteriorate to an estimated 5.4 percent of GDP, owing to substantially higher public investment under the new national development plan (PNDES). In this context, fiscal risks remain associated with a large wage bill and a narrow economic base for domestic revenue mobilization. The allocative and financial efficiency of the budget is weak, in particular due to slow and non-transparent public procurement procedures. Contingent risks are also associated with the financial situation of state-owned enterprises and agencies, notably in the energy sector.

The Government aims to increase access to electricity in an affordable and sustainable manner by shifting the generation mix towards renewables and cheaper imports. This strategy will also gradually reduce the fiscal burden of the sector. Burkina Faso has one of the lowest electrification rates in Sub-Saharan Africa at 18 percent, with only 4 percent in rural areas, where most of the poorest households live. Electricity tariffs are very high (24 cents per kWh), yet do not cover the full cost of service (26 cents per kWh). The resulting quasi-fiscal deficit represented 1 percent of GDP in 2014. The high dependency on imported hydrocarbons for power generation results in significant exposure to macro shocks, triggered by fluctuating international oil prices and an extensive logistics chain, which is prone to disruptions. The Government aspires to provide secure and affordable electricity to 100 percent of its urban and 40 percent of its rural population by 2025. To achieve this objective, there are two main challenges to address: (i) the energy mix has to be shifted toward least-cost sources, procured in a timely, transparent and cost-effective manner; and (ii) the sector, currently relying on budget transfers through fuel subsidies, has to be positioned on a financially stable trajectory. These two challenges are closely connected. Shifting the energy mix would structurally reduce the cost of generation from 20 to 18 cents/kWh by 2030 and help improve the financial situation of the energy sector.

Improved financial sustainability of energy utilities and the development of the strategic, institutional and regulatory framework for diversifying the energy mix are needed to attract private investment in the sector. Sector creditworthiness is critical to crowd-in commercial financing in new and cost-effective generation capacities, which would ultimately help secure the delivery of more electricity to households and firms, and therefore lay the basis for greater growth and better living standards. This strategy is fully aligned with the WBG principles of the "Cascade", to optimize the use of limited concessional resources by enabling private sector participation to deliver sustainable and affordable infrastructure services.

The proposed DPF series is closely aligned with the 2016-2020 PNDES and an integral part of the WBG strategy. It has been prepared in coordination with other partners, including the International Monetary Fund (IMF), and incorporates results of the Systematic Country Diagnostic (SCD 2016), lessons from previous development policy operations in Burkina Faso and other low-income countries as well as results from past and ongoing analytical work. Risks, while manageable, remain substantial notably in terms of institutional capacity and social environment.

II. Proposed Objective(s)

The proposed DPF series aims at supporting the Government in its overall efforts to promote sustainable and inclusive growth. The program development objectives of this series are to: (i) improve the financial sustainability of the energy sector; (ii) enable private sector participation in the energy sector and diversifying the energy mix; and (iii) strengthen tax collection and public procurement processes.

III. Preliminary Description

To support the Government's reforms in the areas of energy and fiscal management, the series is organized around three pillars:

- **Pillar 1: Improving the financial sustainability of the energy sector.** The objective is to establish financial stability in the energy sector through a set of complementary measures. DPF1 supported the clearance of accrued cross-arrears between the state-owned electricity provider, SONABEL, the public oil importing company, SONABHY, and central government. DPF2 supports the allocation of adequate funds in the 2018 budget to continue arrears clearance and ensure timely budget transfers to the sector, introduces measures to reduce fuel costs for electricity generation, and to improve the collection of revenue through a revenue protection program, with a focus on the small number of high value consumers.

- **Pillar 2: Enabling private sector participation in the energy sector and diversifying the energy mix.** The objective is to enhance planning and implementation of a national strategy, develop an enabling framework to attract private sector participation in electricity generation and diversify electricity generation, and thus help the Government reach its ambitious objectives on access and energy mix diversification by 2025. The program supports the establishment of the structure in charge of sector planning at the Ministry of energy, the new regulatory framework creating of a competitive wholesale electricity market, and a standardized competitive process to cost-effectively procure new projects by Independent Power Producers.

- **Pillar 3: Strengthening tax collection and public procurement processes.** One key challenge for the Government will be to improve its fiscal performance, both by creating the fiscal space necessary to finance its ambitious investment program and by improving the efficiency of its spending. Actions under Pillar 3 aim at increasing tax revenue through reforms in tax policy and administration. In this second operation, emphasis is also on procurement procedures, with the issuance of relevant regulations that operationalize the 2016 procurement code for more efficiency and transparency.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The proposed DPF series is expected to help alleviate poverty and inequality in Burkina Faso. Increased access to electricity, which is less than 20 percent nationwide today, would not only improve households' living conditions but also boost firms' productivity and thereby lead to more job opportunities over time. Concurrently, the ability of Government to collect additional revenue will help fund more infrastructure and services, with concomitant benefits for the poor. Lastly, the efficiency gains achieved through faster and more transparent procurement procedures will also increase the value for money of public spending and improve the expected benefits for the population**.** These positive effects on poverty will however take some time to materialize fully, explaining why some mitigation measures are necessary in the shorter term, especially related to the electricity tariff policy.

A primary objective of the proposed series is to increase access to electricity through higher energy production and distribution capacity, and lower costs, over time. Among others, this combination will be achieved by shifting gradually to imported energy from the regional pool, renewable sources (e.g., solar), and off-grid solutions in rural areas. These sources are cheaper than current biomass and fuels and should therefore lead to lower electricity tariffs and/or subsidies from the central administration to the energy sector over time. Both will have pro-poor impacts by improving affordability for the poor or by releasing fiscal resources for other sectors.

Higher access to electricity will help enhance household living conditions. Today only one out of five households is connected to the national grid in Burkina Faso. Moreover, this average access rate masks significant variations across income groups since only 4 percent of the poorest quintile has access to electricity against almost 60 percent for the wealthiest quintile. The empirical literature suggests that improved access to electricity will bring higher benefits to the poor through the emergence of multiplier effects. These effects may occur through better performance at school (children can do their schoolwork at home after school in better conditions with electricity) and improvements in the quality of life by providing the opportunity to use appliances (refrigerator, television, and iron, among others).

The second channel through which improved access to electricity will help reduce poverty is the expected impact on firms' productivity. Many firms are constrained by low access to electricity. Even when they have access, load shedding can be significant. Improved and more reliable access to electricity will therefore help firms to produce more and at lower costs. Such positive impact can be especially important in highly energy-intensive sectors such as mining, fertilizers and agro-processing. Firms that are more competitive are more likely to increase their demand for labor, creating new jobs and making greater contributions to further poverty alleviation over time.

An important aspect of the Government's strategy in the energy sector concerns the reform of the electricity tariffs. Since the current average tariff, set at approximately US$0.21 per kWh, is already one of the highest in West Africa, the first operation supports the government's initiative to limit the pass-through from supply costs to tariffs by setting up a cap. Beyond this cap, the Government has to allocate subsidies to close the financing gap. Such an initiative aims at ensuring the financial viability of the sector by sharing the adjustment costs between customers and taxpayers. Concurrently, the Government has increased the tariffs for high-voltage clients at peak hours to better manage demand and increase the financial burden on large consumers. Over time, the expected decline in the supply costs of energy should help reduce the reliance on subsidies and thereby lower the burden on taxpayers.

Prior actions related to fiscal management are expected to have positive effects on poverty over the medium term. The poor populations are the most dependent on essential public services. Improved tax collection will augment the fiscal space and free up supplementary resources for pro-poor spending. However, it has to be recognized that higher collection of indirect taxes (such as the VAT that is a tax on consumption) can lead to higher prices for some goods purchased from informal and/or small retailers and affect disproportionately poor households. Such negative impact is, however, expected to be limited because most informal firms will remain under the thresholds for VAT payment. Social protection measures such as conditional cash transfers could be explored by the Government and implemented to mitigate this adverse impact on poor consumers. Given the progressive nature of the tax system, the broadening of the tax base is expected to primarily target large entrepreneurs currently evading their tax obligations and is not expected to affect the poor entrepreneurs. Its simplification through the adoption of the new tax code should also protect entrepreneurs against abusive taxation.

Implementation of the new public procurement code will further increase the efficiency of public spending. Slow and non-transparent procedures contribute to substantial fiscal losses and reduce the impact of public expenditures on economic growth and poverty alleviation. The most important benefits are expected in implementation of the investment budget, which has been executed at a rate of 75 percent in recent years, with improvements expected to benefit infrastructure sectors such as transport and energy. The subsequent increase in the stock of infrastructure will in turn generate higher economic growth over time.

The reforms supported by the DPF series are not directly focused on the promotion of gender equality, but they may provide indirect benefits to the extent they contribute to raising access to electricity and increasing the fiscal space to finance such objectives. Some gender issues are partially driven by an insufficient allocation of resources to key services. The proposed second operation includes measures to promote tax collection as well as improvement in the procurement process that will help finance additional resource allocation toward the education and health sectors, with an emphasis on the enrolment of girls and delivery maternal health care services. The World Bank Group will continue to have a focus on these aspects in the dialogue with the Burkinabe authorities in line with the PNDES and CPF.

Environment Aspects

Implementation of reforms proposed in this operation is not expected to have large negative impacts on environment, forests, or natural resources. As a landlocked Sahelian country, Burkina Faso satisfies its energy needs by using the following sources of energy: imported oil, electric power and thermal hydropower, renewable energy (solar) and wood fuel. To mitigate the negative impact of these fuel sources on climate change, Burkina Faso has implemented extensive reforestation programs, promoted the use of butane gas, and developed solar programs (e.g., Zaghtouli, Zina). To support these actions, laws and regulations have been adopted including the institutional aspects. Adoption by the National Assembly of the Text N° 2015-1187 related to conditions and procedures for implementing and validating strategic environmental assessments, environmental and social impacts studies, devotes an important component to investments in the energy sector with clear categorization of policies and programs on energy in terms of generation, transmission, distribution, research or maintenance of infrastructure.

The reform program supported by the DPF series will have significant positive effects by helping shift the energy mix from traditional biomass and fossil fuels to imported electricity and renewable energy. A special emphasis will be on solar energy given the country's climatic conditions. Such a shift will reduce deforestation, lower local pollution, and reduce GHG emissions.

Related to fiscal management reforms, the activities supported by the proposed operation are expected to have neutral or positive effects on Burkina's environment.

In general, the borrower's capacities in terms of implementing, supervising, monitoring and evaluating the environmental aspects are ensured. Particularly, the National Environmental Agency *(Bureau National des Evaluations Environnementales, BUNEE)*, which oversees all projects expected to have adverse or positive environmental potential impacts, has the capacity to conduct high-quality environmental assessments. The framework, established at the national, regional and international levels, provides further assurances that the policy actions to be implemented under the DPF on energy and fiscal management will comply with sound environmental protection standards.

V. Tentative financing

Source:		($m.)
BORROWER/RECIPIENT		0.00
International Development Association (IDA)		75.00
Borrower/Recipient		
IBRD		
Others (specifiy)		
	Total	75.00

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