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# BURUNDI

## SELECTED ISSUES

July 7, 2022

Approved By  
**The African  
Department**

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# ECONOMIC GROWTH, FRAGILITY, AND NON-PRICE COMPETITIVENESS<sup>1</sup>

## A. Growth Dynamics

*Economic growth in Burundi was mainly driven by services before the outbreak of the global health crisis. In 2019, this trend changed, and agriculture took the lead, although the performance of traditional mainstay of agriculture has been unstable over the years, affected by conflicts. However, Burundi has implemented several growth-enhancing policies over recent years to support economic activities, including during the COVID-19 pandemic.*

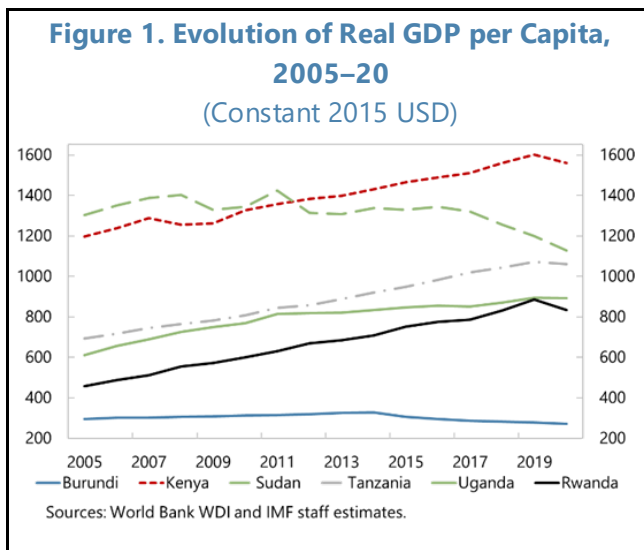
### Pre-COVID Drivers of Growth in Burundi

1. **Burundi's economic performance since 2000 has been highly unstable with a tendentially decreasing GDP growth rate.** In the 2000s, the country started its economic recovery in the aftermath of multiple waves of civil war, genocide, and political instability. Real GDP growth rate increased from less than 2 percent in 2000 to an average of 5 percent between 2004 and 2014. GDP growth rate fell sharply in 2015 as the result of the economic recession arising from the political and security crisis of 2015 followed by the withdrawal of donor support, and sharp deterioration of living standards. The economy was recovering from this political crisis when it was impacted by the COVID-19 crisis.
2. **Prior to the COVID-19 crisis, economic growth was mainly driven by services, cushioning weaknesses in other sectors during the years of conflict, though its impulse has been dwindling over time.** From 2005–2009, government expenditure surged, in part through donor support, while banking and insurance saw renewed demand following the return to political stability. Public services continued to drive growth during 2010–2014, with a notable expansion in education provision, but from 2015–2018, government expenditures began to stall; by 2019, public services and already weak market services almost flatlined. The COVID-19 pandemic exacerbated this downward trend.
3. **The contribution of secondary sector has been mixed and did not provide the dominant impulse to GDP in any recent historical period.** With the extraction and utilities industries remaining very small, manufacturing and construction dominated the sector. Both expanded strongly during the initial return to peacetime from 2005–2009, but slowed down quickly from 2010 onwards, with construction sharply contracting during 2015–2018. Manufacturing recovered during 2019, though construction provided a further drag on growth.

<sup>1</sup> Prepared by S. J. Koussere, with inputs from B. Kwizera

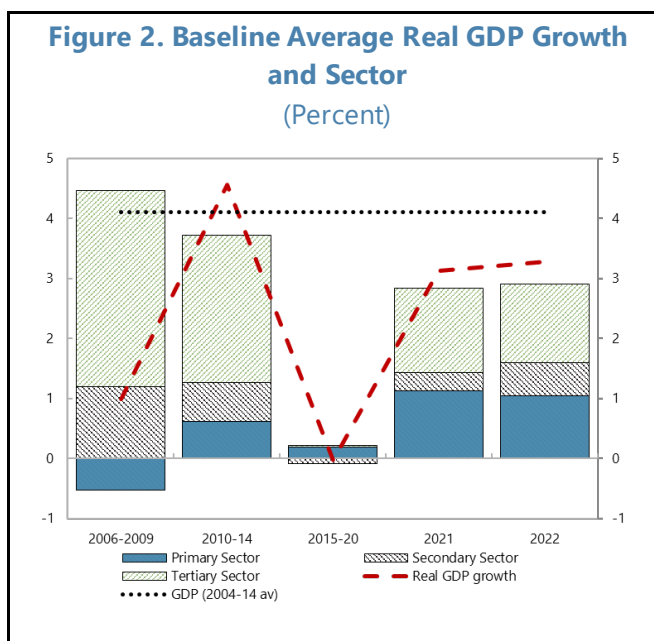
### Comparison Peer EAC Countries

4. The comparison of Burundi’s per capita real GDP with that of peer EAC countries including Rwanda, Tanzania, Kenya, South Sudan and Uganda shows that the country has the lowest per capita revenue and despite recurrent political, social and economic crises Burundi has gone through in past years, its per capita GDP has remained stable although tendentially decreasing in the last three years of the projection as real GDP has contracted in 2015 in the aftermath of the political crisis but also as the population growth rate had not declined (Figure 1).



### How the COVID-19 Impacted Growth Structure in Burundi

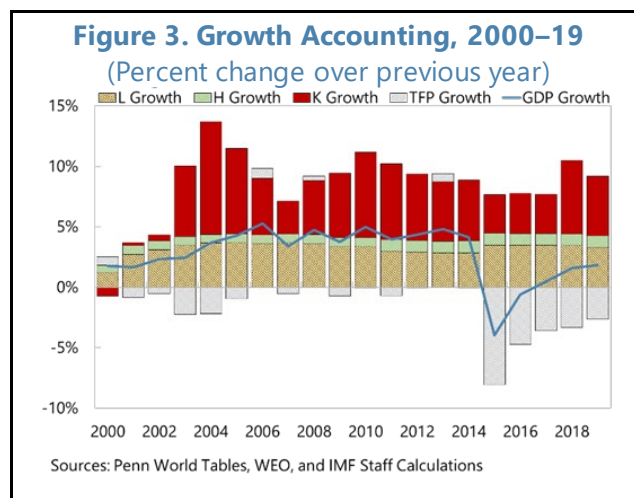
5. The outbreak of the COVID-19 crisis has led to a change in the Economic structure of the country. In 2019, 2020 and 2021, economic growth has become mainly driven by agriculture, although the performance of traditional mainstay of the sector has been unstable over the years, affected by conflicts. Dominant subsistence agriculture, coffee and tea, forestry, livestock, and fishing all endured several years of retrenchment prior to 2010, influenced by factors including population displacement and poor harvests. It picked up during 2010–14, but the political crisis in 2015 caused renewed civil unrest, stymying growth once again as significant numbers of people fled the country. The outbreak of the Global Health Crisis in China impacted the service sector, where the production of hotels, restaurants, transportation companies declined sharply due to reduced business flows with trade partners. During 2019–2021, agriculture provided the largest contribution to overall growth due to above-average harvests and herd restocking.



## Growth Accounting Decomposition

**6. A growth decomposition shows that the bulk of Burundi's growth pickup in the 2000s stems from improvements in the capital and Labor stocks.** The increase in capital and labor

stocks followed broadly improved macroeconomic policies and economic liberalization through the mid-2010s and the significant improvement in life expectancy at birth. Also, negative TFP growth weighed on GDP, in particular in the aftermath of the political crisis leading to negative GDP growth rate in 2015 and 2016. Thus, enhancing human and physical capital with well-conceived reforms and programs, and improving health conditions will promote private sector development, enhance productivity, and boost economic growth.



## Growth-Supporting Policies

*Burundi has implemented several growth-enhancing policies to support economic activities, including during the COVID-19 pandemic.*

**7. Burundi's 2018–27 development plan (Plan National de Développement, PND) in the aftermath of the 2015 crisis that has further fragilized the Burundian economy, the authorities have developed and adopted in 2018 a ten-year National development plan.** The long-term objective of this plan is to restore the structural balances of the economy through: (i) The strengthening of food self-sufficiency and the diversification of export through the promotion of agro-industrial, commercial, and extractive businesses. (ii) The development of the energy and artisanal sectors, (iii) The construction and maintenance of growth support infrastructure; (iv) Improving access to basic social services, in particular education, health and social protection, (v) The continuation of environment protection and territory development; (vi) Improving financial governance and decentralization; (vii) The development of regional and international partnership. A great emphasis is given to the primary and tertiary sectors by the authorities in their development plan as they see these sectors as of high growth potential for Burundi's future. Also, reforms in the secondary sector are underway to make the government draw more resources from its mining and industrial sector

## Agricultural Programs

**8. The agricultural sector contributes on average 39.7 percent of GDP, employing 84 percent of the labor force.** The Plan National d'Investissement Agricole (PNIA, 2016–2020) has supported agricultural production, through several measures, many of which are still being

implemented and expected to support agricultural production and cash crop exports over the medium term. These measures include:

- **Production.** (i) utilization of better-quality seeds; (ii) better access to fertilizers and at lower costs (iii) better global-to-local price transmission, which has increased producer prices and provided incentives to agricultural production; (iv) gradual production mechanization and modernization; (v) professional training, (vi) expansion of land utilization for agricultural production; and (vi) increased financing, including for women.
- **Coffee sector.** The Government has been implementing deep reforms to reorganize the coffee sector to support exports, including centralizing coffee sales and nationalizing part of the exports process. The BRB extended a loan to the Government in 2020 to invest in boosting productive capacity which is expected to increase production and reduce waste, which will boost exported coffee volumes in 2021 and beyond.
- **Fertilizers.** The BRB also extended a loan to expand the production capacity of a fertilizer firm, which was guaranteed by the Treasury.

### ***Import Substitution***

**9. Burundi's imports have increased over the years leading to a deteriorating trade balance and increasing FX needs.** The PND aims to reduce import dependence by boosting the domestic production of goods and services with the modernization and diversification of agricultural production, increased electricity supply (new power plants), and support to agrobusiness industries.

### ***Banking Sector***

**10. The Banking Act of 2003 has been updated with banking activities now governed by a new legal framework (Law n°1/17 of August 22, 2017).** This reform aims to increase credit provision to the economy and improve banking system regulation. Only institutions that are subject to the banking rules, namely banks, microfinance institutions, and financial institutions can grant credit and it is prohibited for any natural or legal person, other than a reporting institution, to carry out credit transactions. The Banking Act also leverages the digital technology to transform the banking and financial sector with online and mobile banking.

## **B. Drivers of Fragility<sup>2</sup>**

*Burundi is considered as a fragile state as the country has gone through several years of armed conflicts that have led to important economic and human losses and thousands of displaced families. The country was isolated for years in terms of international relationships and is among the poorest countries in the world. However, local authorities are currently making substantive efforts to make the country move out of fragility.*

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<sup>2</sup> Prepared by S. J. Koussere and B. Kwizera.

## Burundi's State of Fragility

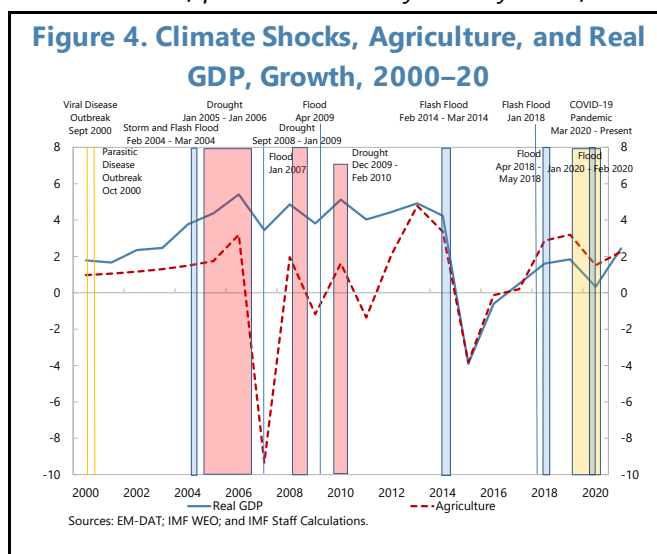
### 11. Burundi is considered a fragile state (FS) due to its political background, challenges in economic and public sector management, structural policies, and social inclusion and equity.

Its average CPIA score was at 2.9 in 2019, well below the 3.2 threshold, reflecting the complex dimension of the country's fragility. Compared to the average of Sub-Saharan African countries and peer fragile countries<sup>3</sup>, Burundi has a better score for structural policies and policies for social inclusion and equity and a worse score for economic management and public sector management and institutions.

### 12. The origins of Burundi's fragility are historical, political, and institutional, leading to weak economic performance for the country.

The country had gone through several ethnic wars and political instabilities for decades prior to the 2015 political crisis, which has further deteriorated the country's economic, social, and humanitarian indicators. Specifically, the drivers of Burundi's fragility can be classified as follows:

- Historically, Burundi has gone through several waves of political instability and cycles of violence.* For years, political power was contested between the two main ethnic groups in the country, the Hutu and the Tutsi with frequent clashes and coup d'états, leading to thousands of deaths, displaced families, and destruction of public infrastructure. In 2015, political violence resumed, leading to a further deterioration of economic, social, and humanitarian indicators in the country. The Arusha Peace and Reconciliation Agreement signed in August 2000 succeeded in bringing an end to a long episode of civil war between 1993 and 2003.



- The Burundian economy is highly dependent on rain-fed agriculture and vulnerable to climate shocks.* The agricultural sector, mainly fed by rain, contributes 30 percent of the country's GDP, and employs around 90 percent of labor force. This heavy dependence on rain-fed agriculture increases the country's humanitarian, social, and macroeconomic vulnerabilities to rising temperatures and extreme weather shocks. Climate change has increased the frequency and severity of floods and droughts in recent years, leading to food insecurity and increased poverty in certain regions.

<sup>3</sup> Peer fragile countries include the Central African Republic, Chad, and the Democratic Republic of Congo

- *Institutional and Governance weaknesses.* Several years of civil war have considerably limited the extent to which civilian institutions could be developed. Public sector governance has been poor driven by corruption and patronage rather than meritocratic criteria. Corruption, abuses of the judicial system, lack of security and of access to the judicial system, and criminality are all major concerns arising from institutional and governance weaknesses (World Bank, 2018).

## **UN Conflict Resolution, Repatriation of Refugees, and the Authorities' Efforts**

**13. The UN is playing a crucial role in the conflict resolution process in Burundi.** During the civil unrest that erupted on April 26, 2015, in Bujumbura, more than 325,600 Burundian refugees fled the country, and some 82,100 Burundian refugees sought asylum in the local region (Kenya, Mozambique, Malawi, South Africa and Zambia)<sup>3</sup>. However, as part of the resolution process, as of November 2020, the United Nations High Commissioner for Refugees (UNHCR) has facilitated the return of 102,761 Burundians since the start of the voluntary repatriation process of Burundian refugees that begun since September 2017.

**14. The government is taking steps to address possible human right violations.** Burundi has been subject to human rights violation in recent years, according to the reports of most international human rights defense organizations. In 2020, Amnesty International published that unlawful killings, arbitrary arrests, enforced disappearances and sexual violence were carried out in Burundi, mainly against perceived political opponents. The Burundian government is making efforts to address this situation. More than 5,200 prisoners including human rights defenders have been released in March 2021, to unclog prisons and improve the conditions of detention of overcrowded prisons according to a presidential decree. The Government has made significant strides in the combat against human trafficking. Over the past year, the Government has significantly increased investigations and prosecutions of suspected trafficking offenses, convicted traffickers, and referred victims for assistance. The country has also institutionalized anti-trafficking training for law enforcement, prosecutors, and judicial officials.

**15. More efforts are needed to move the country out of fragility.** Focus on investing in the country's long-term peacebuilding would be key. Transparency, social equity, the fight against corruption are all major actions needed to ensure political stabilization. Also, special attention should be devoted to building a stronger and more resilient economy. The development of the private sector is the stumbling block that will allow to create opportunities for sustainable and peaceful livelihoods for more Burundians. Taking measures to boost agricultural productivity while making it more resilient to climate shocks and climate change is also vital in this process.

## **Recent Security Improvements**

**16. Burundi has experienced security incidents in recent years leading the government to take security measures.** Several grenade attacks occurred in the localities of Vugizo, Mutimbuzi District, Bujumbura Rural and many other strategic locations in Bujumbura such as the airport, involving several killings. Officials claimed that most of the attacks had a terrorist motive while some

incidents were revenged by rebel groups such as the Red Tabara with political motives: assailants tend to target security personnel, entertainment venues, and the residences of local nationals. The current government has put security at the top of its agenda, engaged in dialog with opposition groups, and intensified efforts to increase security in Bujumbura and main cities.

## Standards of Living and Social Conditions

**17. Living standards are challenging in Burundi** (Staff Report Figure 6). GDP per employed person was low though rising until 2014 and started declining sharply in the aftermath of the 2015 political crisis. Burundi's population is mainly rural (87 percent of total population in 2020) and reliant on subsistence agriculture. Access to adequate farmland is increasingly important due to high population growth (3.1 percent in 2020), fueled by a high fertility rate (5.4 births per woman in 2020) and refugee inflows (3 percent of the population in 2020). As a result, food insecurity and malnutrition are present, particularly among children, as shrinking and overworked household plots have become less productive. This is compounded by poor access to clean drinking water (in 2017, only 61 percent of the population had such access). Given the high fertility rate and an average life expectancy of around 61 years, the average population age is low; in 2020, over 45 percent of the population was under 15 years old, resulting in a high dependency ratio.

**18. Health and education performance have improved, and unemployment rates have slightly declined over the years.** Infant and maternal mortality rates have fallen sharply (for infants, from 70 to 42 per 1000 live births between 2010 and 2020), and school enrolment rates have greatly improved, especially for females; a literacy rate of around 90 percent places Burundi in the top 20 of the 54 African countries. However, the shares of expenditures on health and education in GDP have fallen since 2010.

**19. Despite extensive efforts of the government to improve the health system, it is still fragile and not well positioned to handle large waves of the COVID pandemic.** Before 2019, There were less than 1 hospital bed per 1000 people (WHO recommended ratio: 3 per 1000), and less than one doctor per 10,000 people (WHO recommended ratio: 1 per 1000). In addition, as of 2017, only 53 percent of the population had at least limited access to basic sanitation facilities. Households benefitting from social programs and the government's social safety net were more resilient to the COVID-19 shock<sup>4</sup>. However, the other households suffered a net income loss that may threaten hard-won improvements in living standards. Important efforts have been done in recent years to better equip the health system, to handle the global health crisis, however, even more is needed to improve the country's sanitation system.

## Adaptation to climate change

**20. Adaptation to climate change has always been an important goal both for the population and the government.** Traditionally, Burundian farmers and breeders have always tried to adapt to climate change through new practices, including (i) the culture of tubers (cassava, sweet potatoes) more resistant to extreme climates, (ii) sowing staggering to prevent climate related losses, (iii) the preservation of harvest in granaries to guard against lean seasons and guarantee

food security at the family level, and (iv) the practice of transhumance for breeders. Many efforts of the government for reforestation programs have ended in failure especially during the waves of crises with more than 30.000 ha of forest destructed.<sup>5</sup>

**21. Several climate change mitigation and mitigation plans have been elaborated, including:**

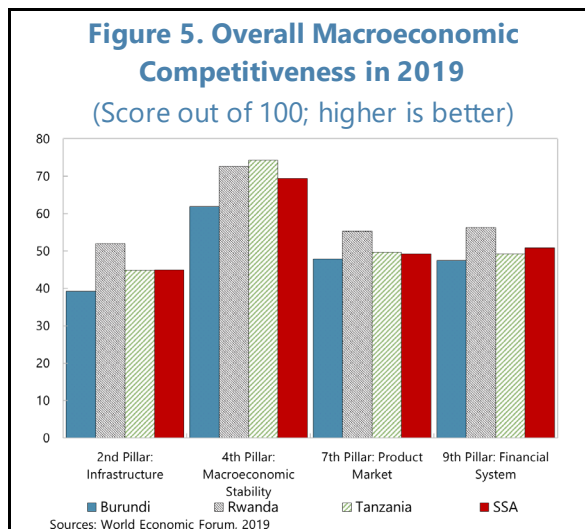
- The "Plan d'Action National d'Adaptation au changement climatique (PANA)" which aims to improve seasonal climate forecast for early warning signal, strengthen the management of existing protected areas and natural ecosystems and identify and promote drought-resistant forest species.
- The "Plan d'Action pour la Gestion Intégrée des Ressources en Eau (PAGIRE)" aiming at achieving the government vision for water sector by promoting and implementing a strategic framework based on legal and regulatory reforms the education of the population on water resource management.
- The " Stratégie Nationale et Plan d'Action en matière de diversité Biologique (SNPA-DB)" which main goal is to arouse the population awareness on the importance of the conservation of biological diversity and the sustainable use of biological resources as well as their integration in schools' curricular.

**C. Non-Price Competitiveness**

*Analysis of overall Macroeconomic Competitiveness measured by four selected pillars of the Global Competitiveness Index of the World Economic Forum including Infrastructure, Macroeconomic stability, product market and financial system, shows that Burundi ranks low in competitiveness. Identifying the basic bottlenecks is an important step to boost the country's production and competitiveness.*

**Analysis of Burundi's Competitiveness**

**22. After several years of instability in Burundi substantive efforts to improve competitiveness have been made.** However, overall macroeconomic competitiveness is still lagging. The comparison of Burundi with peer countries including Rwanda, Tanzania, and sub-Saharan Africa, based on four indicators of Macroeconomic competitiveness selected among the main pillars of the Global Competitiveness Index (GCI) shows that Burundi is lagging behind all peer countries on all four indicators. The economy ranks low on infrastructure, macroeconomic stability, product market and



financial system. With the lowest competitiveness scores (Figure 5), Burundi has to face the bottlenecks to its economy to be able to boost its overall macroeconomic performance.

**23. Key bottlenecks to Burundi's competitiveness, include climate shocks, energy and water constraints, and public management inefficiencies.**

- *Climate shocks.* Climate shocks are frequent in Burundi in forms of floods, river overflows, long droughts, and irregular rain seasons. Such natural disasters reduce crop yields, and intensify crop volatility, resulting in lower agriculture productivity. Higher temperatures induced by climate change could also reduce productivity including a fall in both labor supply and workers' output. In addition, these effects will likely exacerbate poverty by the fact that the effects of climate change will disproportionately penalize farmers in developing countries that depend on producing staples for their livelihoods.
- *Energy.* Burundi's access to electricity is one of the lowest in Sub-Saharan Africa, even though the country's cost of generation is considered relatively low as compared to its neighboring countries. Furthermore, most of Burundi's installed capacity, is mostly hydropower-based, and renewable energy potential is still to be tapped. The energy constraint is one of the main bottlenecks for growth and macroeconomic competitiveness for Burundi.
- *Water.* Burundi's economy relies on a rain-based agriculture. With the exacerbation of climate change these recent years in the region, the irregularity of rain seasons is increasingly leading to water shortages. And water shortage has proven to have an extremely negative effect on productivity not only in agriculture, but also for smelting, chemical and mining activities.

# PROTECTING SOCIAL SECTORS AND STRENGTHENING FISCAL AND GOVERNANCE FRAMEWORKS<sup>1</sup>

## A. Government Spending on Social Sectors

*Spending on social sectors has remained a top priority in Burundi, despite the economic challenges of recent years, including from the COVID-19 pandemic. As a result, key indicators in the health and education sectors point to notable improvements. Measures have also been taken to support employment.*

**1. Social sectors (health, education, water, hygiene, sanitation, and social protection) are one of the priorities of the Burundian government retained in the National Development Plan of Burundi 2018–2027.** The authorities have taken significant measures in recent years in favor of these sectors, notably: (i) providing free primary education; (ii) creating the education support fund; (iii) providing free health care for children under five and women giving birth; (iv) providing social protection to state pensioners and vulnerable people; (v) providing free care and medication for certain diseases such as malaria, leprosy, tuberculosis, HIV/AIDS; and (vi) revitalizing the institutional, legal and regulatory framework for social protection. In addition, considerable efforts have been made to strengthen the health infrastructure, including extending hospitals in all municipalities in the provinces. In the education sector, the authorities have built and equipped schools, provided free textbooks to students, recruited new teachers, and integrated graduates into higher education.

**2. As a result, certain indicators in the health and education sectors have improved.** According to WHO indicators, between 2018 and 2020 (the latest year available) for example, (i) neonatal mortality rate (per 1000 live births) decreased from 21.8 to 20.9; (ii) the infant mortality rate (probability of dying between birth and age 1 per 1000 live births) decreased from 41.3 percent to 38.6 percent; and (iii) under-five mortality rate (probability of dying by age 5 per 1000 live births) decreased from 59 percent to 54.4 percent. Immunization coverages for children have also been high. According to UNESCO indicators, the gross enrollment rate in pre-primary education increased from 15.4 percent in 2018 to 16.5 percent in 2019 (the latest year available), and up from 8.1 percent in 2011. In primary education, gross enrollment rates have remained well above 100 percent. In secondary education, the gross enrollment rate slightly declined between 2018 and 2019 (from 48.5 percent to 45.1 percent) but significantly increased from the 2011 level of 26.1 percent. Gross enrollment rates in tertiary education have remained low in recent years (around 5 percent or below).

**3. The COVID pandemic has added significant pressures on health spending.** Since July 6, 2020, a national mass screening campaign for COVID-19 for people showing signs of this disease was launched, under the theme "I protect myself, I don't contaminate anyone and once contaminated, I must heal". A single common COVID-19 response fund has also been set up for any

<sup>1</sup> Prepared by J. Bouhga-Hagbe, with inputs from S. J. Koussere.

partner wishing to support Burundi and a related account has been opened at the Bank of the Republic of Burundi. As of October 8, 2021, inflows to this account (BIF 58.9 billion or 0.9 percent of GDP) were from the Government (BIF 15 billion or 0.2 percent of GDP), IMF CCRT grants (BIF 39.3 billion or 0.6 percent of GDP) and fees collected for COVID tests (BIF 4.6 billion or 0.07 percent of GDP). Spending from this account starting on December 24, 2020, and ending on October 8, 2021, total about BIF 25 billion or 0.4 percent of GDP.

**4. The authorities are also taking initiatives to support employment.** In particular, they created the Investment Bank for Young People (Banque d'Investissements pour les Jeunes), the Investment and Development Bank for Women (Banque d'Investissement et de Développement pour les Femmes) and the Guarantee and Support Impulse Fund to support cooperatives in young people (Fonds d'Impulsion de Garantie et d'Accompagnement). Other projects supporting employment are also being implemented by the authorities with donor support, notably the economic transformation and employment project in Burundi, which is supported by the World Bank, the rural entrepreneurship, which will be financed by IFAD, as well as the agro-pastoral entrepreneurship and professional development project for young people, which is supported by the African Development Bank.

**5. Budget allocations to social sectors in recent years are presented in Text Table 1.** In general, budget execution rates have exceeded 90 percent in social sectors, reflecting a relatively high absorption capacity of budget appropriations. Budgeted spending was significantly affected by the 2015 political crisis and the subsequent withdrawal of donor support. It declined from 12.8 percent of GDP in 2015 to 7.3 percent of GDP in 2016, before resuming its increase to stabilize around 9 percent of GDP or about a third of total spending since 2017. Most of the spending is allocated to the education and health sectors, which accounts for almost all of social spending.

**Text Table 1. Burundi: Budget Allocation for Social Sectors<sup>1</sup>**  
(In percent of GDP)

	2015	2016	2017	2018/19	2019/20	2020/21	2021/22
Health	4.9	2.0	3.0	3.1	3.0	3.6	3.3
Education	6.7	5.0	5.2	5.5	5.6	5.1	5.0
Water, hygiene and sanitation	0.8	0.1	0.3	0.2	0.2	0.2	0.2
Social protection	0.5	0.2	0.3	0.3	0.3	0.3	0.3
All social sectors	12.8	7.3	8.9	9.0	9.1	9.2	8.8
<i>Share in total spending (in percent)</i>	39.4	27.7	35.5	34.4	33.0	36.6	36.3
Total budget spending	32.4	26.5	24.9	26.3	27.5	25.2	24.2

Source. Authorities and staff estimates

1/ Includes spending from both domestic resources and donor support.

## B. Recent Revenue, Spending, and PFM Measures

*The authorities have recently taken measures to increase revenue and rationalize public expenditure within the framework of a general program of actions to strengthen the fiscal framework, including public financial management (PFM). The measures were taken in the context of the FY2020/21 and FY2021/22 budgets, though some of them are not yet fully implemented and their potential impact on public finances has not been estimated by the authorities. Staff expect these measures to improve the path of revenue and help contain spending as a share of GDP, which has been incorporated in staff's baseline projections.*

### Revenue Measures

**6. On revenue, the authorities have taken the following administrative measures:** (i) revision of the legal texts relating to municipal taxation, the land domain, in particular the texts on real estate expertise and those relating to the rental and sale of state land; (ii) strengthening the collection of taxes on mining sector activities; (iii) decision to reduce the informal sector through local taxation; (iv) strict application of the law concerning dividends to be paid to the government; (v) initiation of the revision of texts and the procedure for granting exemptions; (vi) acceleration of the process of recovery of arrears by the Burundi Revenue Authority; (vii) transfer of the collection of non-tax revenue, hitherto carried out by administrations in violation of the Law, to the Office Burundais des Recettes (OBR); (viii) improvement of revenue collection tools, namely revised laws and IT infrastructure at the Commissariat des Douanes et Accises; (ix) strengthening of mechanisms to fight against corruption, fraud and smuggling; (x) strengthening of the monitoring of the granting of exemptions; (xi) improvement of mechanisms for broadening of the tax base, in accordance with the new Laws on Tax Procedures and VAT; (xii) strengthening mechanisms for verifying and recovering arrears; and (xiii) strengthening of the monitoring of VAT reimbursements.

**7. The 2021/2022 budget in particular introduces new tax and nontax measures to boost revenue.** Tax measures with high revenue potential include: (i) a new tax on mobile phone megabits (18 percent of the cost); (ii) the non-exemption from income tax and VAT on sales made by companies; (iii) a new anti-pollution tax on imported used vehicles; (iv) a new road fee; and (v) the widening of the rental tax base to include land leases. Non-tax measures include the shift of the management of proceeds from the sale of health insurance cards from the health centers to the OBR, a new annual flat-rate road charge, and new or increased fees for issuance of exemption certificates, changes of tax declarations already processed, and reactivation of a customs agency deactivated due to an infringement.

### Expenditure and PFM Measures

**8. Significant expenditure and PFM measures have also been taken:**

- After June 30, 2021, implementation of a new “fair wage policy” started in the public sector. Under this new policy, salaries are based on the classification and rating of jobs. Under the previous policy, the same types of jobs could earn different salaries. In 2016, such unfair

wage disparities were recognized and the compensation for the adjustment of wage disparities was granted for 5 years from 2016 with an overall budgetary impact of 120 billion BIF (1.8 percent of GDP) over the entire period. An allocation of BIF 34 billion (0.5 percent of GDP) was set aside in the FY2021/22 budget to pay for the impact of the new wage policy. As of July 1, 2021, a hiring freeze was imposed in all government sectors, except in defense and security, education, health, and the revenue administration.

- Starting with the 2021/2022 budget year, and in order to allow better visibility and better control of the management of investments and their financing, a separation into commitment appropriations and payment appropriations has been made for investment projects running over a period of two years. The commitment appropriation corresponds to the overall cost of the investment project to be launched during the financial year concerned and the payment appropriation corresponds to the cost of the phase of work that will actually be carried out during the same financial year. The procurement plan is based on payment appropriations and not commitment appropriations.
- In order to ensure long-lasting and sustainable financing for the maintenance of the national road network currently in an alarming situation, a road maintenance fund has been created for the financing of the road network maintenance campaign "Zero Potholes" (« Zéro nids de poule »). The budget allocated to road maintenance increased from 8.2 billion (0.1 percent of GDP) to around 28 billion BIF (0.4 percent of GDP). To this end, the FY2021/22 budget introduced a financing mechanism to supply this fund with fees previously allocated to the financing of road maintenance expenditure.
- In order to limit the cost of rentals for the Burundi Road Agency as part of the implementation of the campaign called "Zero Potholes", tax exemptions were decided for the acquisition of new machinery and equipment intended for the construction and maintenance of roads, road work sites, maintenance, repairs, and spare parts for road work.
- In the energy sector, the FY2021/22 budget favored the financing of electrification projects in rural centers, villages, health centers, municipal colleges, trading centers and certain public infrastructures, such as municipalities isolated from the electricity network. This would contribute to improving the living conditions of the population and support the fight against poverty and help to achieve the Millennium Development Goals (MDGs). Only thirteen percent of the Burundian population has access to electricity, which is very low compared to other countries of the East African Community.
- In the health sector, the FY 2021/22 budget provided funding to adapt the existing health centers in all the municipalities of the country to the standards that can allow the reception of COVID-19 patients in the municipal health care structures.

## C. Key Features of the Public Procurement Law in Burundi

*Burundi's public procurement law (Law No 1/04 of January 29, 2018, amending law No 1/01 of February 04, 2008, on the public procurement code), which was promulgated on January 29, 2018, aims at strengthening public procurement procedures. Its key features are described in this section.*

**9. Purpose, Scope and Definition of Thresholds.** The law establishes the rules governing the award, execution, control, regulation of public contracts and the delegation of public services. The law applies to public contracts whose value excluding taxes is equal to or greater than the regulatory thresholds as defined in the implementing texts. The choice of the applicable procedure for determining the thresholds is made according to the nature of the public tender.

**10. Public Procurement Bodies.** The bodies for awarding, controlling, and regulating public contracts are: (i) the bodies in charge of awarding contracts set up with the Contracting Authority; the National Public Procurement Control Directorate or Direction Nationale de Contrôle des Marchés Publics (DNCMP); and (iii) the Public Procurement Regulatory Authority or Autorité de Régulation des Marchés Publics (ARMP).

**11. The DNCMP** is responsible for the a priori control of the procedure for awarding an amount greater than a threshold set by regulation and public service delegations, and for the a posteriori control of the procedures for awarding contracts for an amount below the said threshold. Its control is done through notices of non-objection and the necessary authorizations at the request of the contracting authorities when they are provided for by the regulations in force. It also provides follow-up missions for the execution of public contracts and public service delegations.

**12. The ARMP** regulates the public procurement system for sound application of legislation on public procurement and public service delegations. In particular, it develops, distribute and updates standard documents, procedures manuals, evaluation guides and appropriate software packages. Dispute resolution and disciplinary committees exist within the ARMP to resolve disputes or take sanctions against those who violate the procurement law and regulations. The decisions of these committees may be subject to legal appeal in courts.

**13. Public Procurement Procedures.** Before the end of February of each year, the contracting authorities are required to draw up annual provisional plans for the award of public contracts on the basis of their activity programmes. The contracting authorities, once their annual provisional procurement plans have been approved, publish no later than March 31 of each year, by means of a general invitation to tender, the essential descriptive characteristics of the works contracts, supplies and services whose estimated amounts excluding tax reach the DNCMP's a priori control threshold.

**14. Public Procurement Methods.** Open bidding is the rule. In this case, public contracts are awarded after competition between potential candidates. The contracting authority chooses the offer, conforming to the technical specifications, evaluated to have the lowest price, and whose tenderer satisfies the qualification criteria. Public contracts may exceptionally be awarded by mutual agreement or direct agreement under the conditions defined by law and after authorization from

the DNCMP and communication to the ARMP for information. Public contracts may be of a secret nature when the protection of the fundamental interests of national security requires this secrecy. These contracts can follow the over-the-counter or direct agreement procedure, depending on the nature of the tender.

**15. Candidates and Bidders.** Any candidate who has the legal, technical and financial capacities necessary for the execution of a public contract or a delegation of public service, as well as the experience of the execution of similar contracts may participate in the procedures for awarding public contracts and public service delegations.

**16. Award of Public Contracts.** The report on the provisional award of public contracts is drawn up according to an established ARMP model. Any tenderer may request a copy of the award report and any other relevant information provided to him within three (3) working days of receipt of his written request. Unsuccessful bidders may challenge the provisional award of public contracts as described below (see section on Litigation). A notice of final award is published in the official journal of public contracts or any competent newspaper within a period not exceeding 15 calendar days from the entry into force of the contract.

**17. Execution of Public Contracts.** Holders of a contract are required to provide a financial collateral to guarantee good contract execution when the nature, size, and time of execution of the contract so require. It is fixed in the tender documents. It varies from 5 to 10 percent of the basic market price and is refunded within one month after the expiry of the warranty period or after final acceptance of the works, supplies or services if the contract does not include such a time limit. Holders of contracts for intellectual services are not subject to this obligation.

**18. Public Contract Prices.** Contract prices are deemed to be firm, unless the tender documents provide that they are revisable or updatable.

**19. Reception of Public Contracts.** Acceptance of the contract takes place when the holder of the contract finishes performing the contractual services. The acceptance decision is pronounced by the contracting authority when the service is deemed to conform to the technical specifications of the contract. Acceptance without reservation entails the transfer of ownership.

**20. Litigation.** Candidates or bidders exercising a non-contentious or contentious appeal must first contact the person responsible for the contracts before contacting the dispute resolution committee of the ARMP. Whether non-contentious or contentious, the appeal has a suspensive effect of the procedure until the final decision of the body seized. The decision of the resolution committee of the ARMP is immediately enforceable. It may be appealed to a judicial body. However, this appeal has no suspensive effect except in the event of a court decision.

**21. Ethics, Corruption and Sanctions.** A Code of ethics and professional conduct for members of bodies involved in the award, execution, control, approval and regulation of contracts and public service delegations is drawn up by the ARMP. Violations of this Code can lead to sanctions, including exclusion from public contracts and prison sentences. The ARMP periodically draws up a

list of natural and legal persons excluded from any participation in public procurement (see [Sanctions disciplinaires \(armp.bi\)](#)).

## D. Governance Institutions in Burundi<sup>2</sup>

*Burundi has set up key institutions to strengthen governance, including better controlling the budget process and fighting corruption.*

### 22. Burundi's fiscal governance system comprises internal and external audit institutions.

Internal audits (accounting, administrative, technical, and physical) are conducted by the internal control department (Inspection Générale) of each public entity to ensure regularity, optimization of resources, improvement of performance, protection of assets, reliability of information and compliance of decisions with policies and rules. External audits are conducted by the "Inspection Générale de l'Etat (IGE)", which is under the supervision of the President's Office, and the external auditing court "Cour des Comptes (CC)", an independent audit body. These two institutions help address potential conflicts of interest that may impede the efficiency of internal audits:

- **The IGE.** It has several missions, including inspection and control over the operation and management of public services, institutions and bodies and private companies or associations legally placed under its control (decree n° 100/09 of January 15, 2010). The IGE's mission also covers all legal institutions and associations benefiting from financial assistance or guarantees from public entities, and it can carry out checks on companies and private associations deemed to be strategic for the government. The IGE's reports are submitted to the President's Office, which decides of their publication.
- **The Cour des Comptes.** It is the supreme control and audit institution in Burundi's institutional governance architecture (Law n° 1/002 of March 31, 2004). It is independent of the executive and reports to the national parliament which it assists in monitoring public fund management. The Auditors of the CC can examine and certify public accounts, audit the overall management of resources, recommend changes in the system, and monitor the implementation of these recommendations.

### 23. Beyond these two institutions, there are two other anti-corruption institutions.

The anti-corruption court (Cour Anti-Corruption or CAC) is in charge of designing policies for the prevention and repression of corruption and related offenses and the anti-corruption police (Brigade Spéciale Anti-Corruption or BSAC) is in charge of combating corruption and other organized crimes using an interdisciplinary approach integrating intelligence, investigations, and prosecutions.

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<sup>2</sup> Prepared by S. J. Koussere.

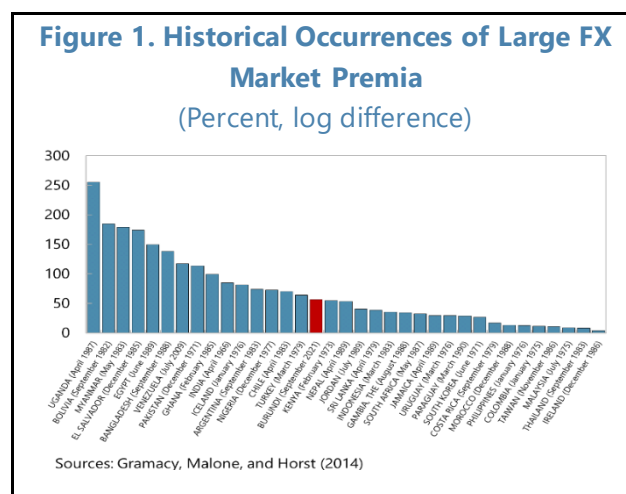
# THE PARALLEL FOREIGN EXCHANGE MARKET IN BURUNDI AND THE PATH TOWARDS REFORM<sup>1</sup>

*Burundi's foreign exchange market is characterized by strong restrictions that have contributed to external imbalances and led to the burgeoning of a sizable parallel market where the currency currently trades at close to a 60 percent premium. Going forward, unifying the exchange rate, and reducing these distortions is an important near-term objective for authorities.*

## A. Overview

1. **Over the last six decades, Burundi has had several episodes of transitions into and out of episodes of predominant parallel exchange rate markets.** The most recent one began in 2015 with the parallel market premium against the US dollar increasing from 1 percent in end-2014 to about 70 percent in December 2021, placing it among the highest instances of parallel premia observed since the 1960s (Figure 1).<sup>2</sup>

2. **This section draws on lessons from the literature and recent country experiences to understand the causes and consequences of parallel FX markets in Burundi and the key tradeoffs that authorities are likely to face when attempting a unification.**



## B. Parallel FX Markets: Occurrence, Pros, and Cons

3. **A parallel foreign exchange market system is one in which two nominal exchange rates that are substantially different from one another operate simultaneously in an economy.**

Typically, one of these is the official exchange rate that is fixed by regulation, while the other is a freely floating and market determined “parallel” exchange rate. Parallel markets typically emerge when authorities impose substantial volume or price restrictions at which official FX transactions can take place. In theory, a parallel exchange rate system can be beneficial under certain circumstances. For example, it can help ensure the stability of current account transactions (at the official rate),

<sup>1</sup> Prepared by N. Patel, in collaboration with M. M. Ly.

<sup>2</sup> The parallel market is informal under article 86 of a 2019 regulation, and any individual or legal entity that engages in the activities of foreign exchange in Burundi without prior authorization from the BRB is subject to criminal sanctions.

while shielding the terms of trade and hence the variation in imports and exports from volatile fluctuations in financial markets and the capital account (at the parallel rate).

**4. In practice though, parallel exchange rates in developing countries have rarely provided any benefits.**<sup>3</sup> Instead, economies characterized by parallel FX markets tend to suffer from increased uncertainty and depressed macroeconomic outcomes (IMF, 2018). This is in large part because parallel markets distort prices in the economy and create significant impediments towards efficient resource allocation. They generate sizable implicit taxes and subsidies in the economy depending on access to the official FX market, and in turn create incentives for rent seeking and misreporting (for instance for export revenues). For instance, exchange rate restrictions resulted in an estimated implicit tax on exporters amounting to 3.6 % of GDP.<sup>4</sup> In addition, parallel markets also impinge on the efficacy of monetary policy since the exchange rate is an important conduit of monetary policy transmission.

**5. Given that the costs of the existence of a parallel FX market invariably tend to outweigh its benefits, exchange rate unification becomes an important objective for policymakers whenever the parallel market premium becomes significant.** A reform to tackle parallel exchange rates relies on four key steps. First, a recognition of the channels through which exchange rates affect the economy, and an assessment of the vulnerability of various segments of the economy to large movements in the exchange rate. Second, an assessment of the equilibrium exchange rate for the economy that would be consistent with macroeconomic and external stability over the medium term. Third, agreement on a time horizon over which the transition to this equilibrium should be implemented. Fourth, implementation of a robust macroeconomic framework, including coordinated fiscal objectives and monetary policy frameworks and objectives, which would ensure a smooth transition as well as the sustainability of the new regime. The remainder of this section considers each of these factors in turn.

## C. Channels of Transmission of Exchange Rates

**6. The literature has identified three main channels through which exchange rates affect macroeconomic outcomes.** Chief among them is the textbook trade channel, whereby an exchange rate depreciation leads to an increase in import prices (and hence consumer price inflation) and a decrease in export prices, in turn boosting economic output via an increase in net exports. The strength of this effect depends on the trade elasticities—the sensitivity of import and export volumes to their respective prices.

**7. The second channel is the financial channel of exchange rates, which is particularly strong in emerging markets and developing economies.** When segments of the economy carry a

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<sup>3</sup> This is evidenced for instance by the fact that the parallel rate has tended to diverge persistently from the official rate, instead of fluctuating around it in both directions, as would be the case if it was serving the function of limiting exchange rate volatility for current account transactions.

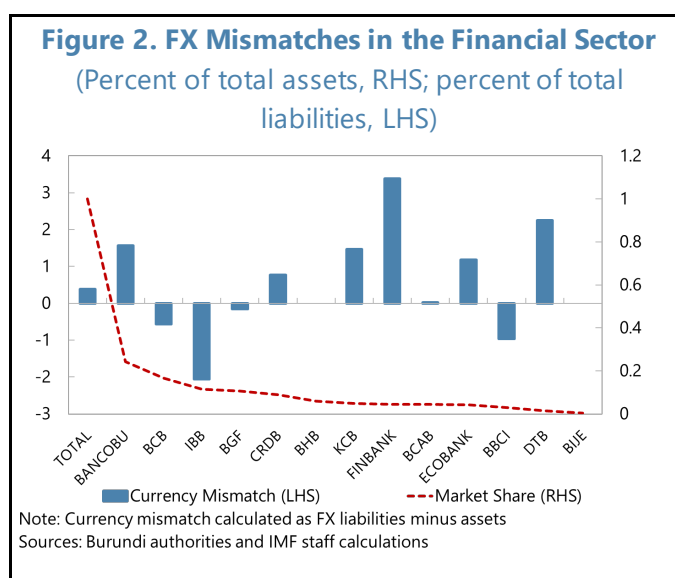
<sup>4</sup> Since exports in 2019 amounted to \$181 million, GDP was \$3 billion, and the parallel market premium was around 60% on average for the year, the implicit tax on exporters amounted to  $181 \times 0.6 = \$108.6 \text{ million} = 3.6\% \text{ of GDP}$ .

currency mismatch, typically due to unhedged foreign currency debt, they are vulnerable to a sudden tightening in financial conditions when the exchange rate depreciates. The tightening in financial conditions leads to a decline in credit, investment, and production. If currency mismatches in the economy are large enough, this channel can even offset the positive effect of an exchange rate depreciation on output via the trade channel (Kearns and Patel 2016).

**8. The volatility and uncertainty of the exchange rate have also been shown to be important drivers of macroeconomic outcomes, particularly for foreign investment, in addition to the trade and financial channels which are linked to the level of the exchange rate (Servèn, 2003).**

**9. Burundi's financial sector comprises of well-capitalized banks with minimal FX mismatches** (Figure 2). Consequently, the

trade and uncertainty channels are likely to be more dominant than the financial channel.<sup>5</sup> Depreciation of the official exchange rate is therefore likely to have a positive impact on both inflation and output, particularly if clear and guided communication through the transition and beyond can mitigate uncertainty in the path of the exchange rate along the way.<sup>6</sup> Having output and inflation moving in the same direction is a more pleasant scenario for central banks as opposed to one in which output falls as inflation rises, since monetary tightening can be used effectively in the former case to stabilize both output and inflation.



## D. Equilibrium Exchange Rate

**10. Recent experiences have shown that the post-unification exchange rate ends up very close to the parallel market rate** (Gray, 2021). However, this may not always be the case and having an estimate of the equilibrium exchange rate for the economy- usually a range and even if imprecise- is critical to anchor the unification.

**11. Ghei and Kamin (1996) outlined a theoretical framework to pin down the equilibrium exchange rate in a parallel exchange rate system.** They showed that it typically falls between the official and the parallel market rates. The fraction of exports and imports conducted at the parallel

<sup>5</sup> That said, currency mismatches and associated vulnerabilities may be present in the corporate sector, whose FX exposures are not as well documented as in the case of the financial sector.

<sup>6</sup> The current account may nevertheless experience a temporary deterioration before improving, in line with the "J curve effect".

vs. official rate, as well as the elasticity of exports and imports with respect to the exchange rate are its key determinants.

**12. On the empirical side the IMF’s external sector assessment (ESA) modules provide estimates of the equilibrium exchange rate, one that is consistent with macroeconomic stability and a current account profile that is in line with fundamentals.**<sup>7,8</sup>

**13. Both empirical and theoretical approaches typically pin down the equilibrium real exchange rate.** A second step towards operationalizing the transition is to determine the nominal exchange rate path that is consistent with this real rate, given the monetary framework that is in place. Box 1 summarizes how such a nominal exchange rate profile can be calibrated to achieve a given real exchange rate adjustment, given the time horizon over which it is sought, and how this varies depending on the monetary policy framework summarized by an average inflation target.

### Box 1. Quantifying Nominal Exchange Rate Adjustments to Address a Given Real Misalignment

Since the real exchange rate is the conceptually relevant measure to study the implications of movements in relative prices, misalignment of the exchange rate is typically measured in terms of the real as opposed to the nominal exchange rate. In practice though, policymakers often must use the nominal exchange rate as an instrument to achieve a real adjustment. This box summarizes how such a nominal exchange rate profile can be calibrated to achieve a given real exchange rate adjustment given the time horizon over which it is sought, and how this varies depending on the monetary policy framework summarized by an average inflation target.

Let  $m$  be the (log of) real exchange rate misalignment that is desired to be corrected,  $s$  be the current nominal exchange rate (official), and  $s_T$  the target terminal exchange rate which would eliminate the real exchange rate misalignment. Let  $e$  denote the starting real exchange rate, and  $e_T$  the terminal exchange rate post alignment.

The starting and terminal nominal and real exchange rates are linked to domestic and foreign price levels via the following relations

$$e = s + p_* - p$$

$$e_T = s_T + p_{T*} - p_T$$

Where  $p$  and  $p_*$  denote the domestic and foreign price level respectively.

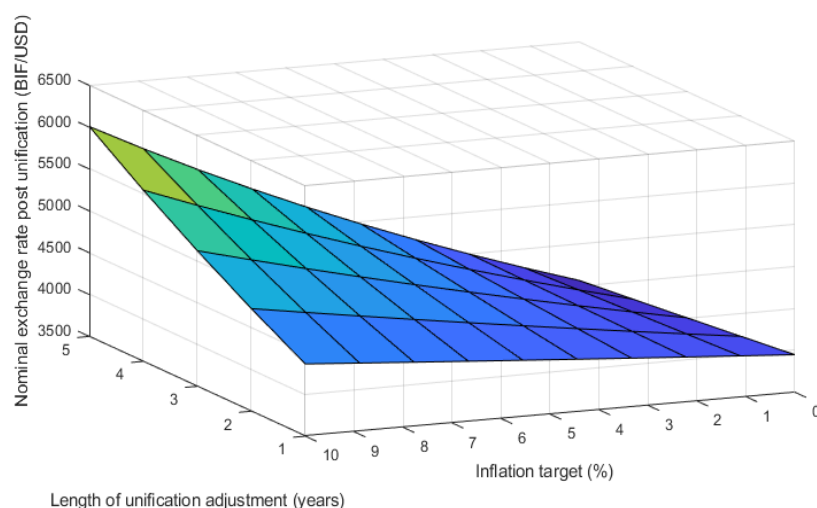
The targeted real exchange rate adjustment, which is equal to the current misalignment, is given by:

$$m = s_T - s$$

<sup>7</sup> Staff report for the 2022 Article IV Consultation, External Sector Assessment (Annex II).

<sup>8</sup> See Lee et al (2008) for a conceptual and methodological overview of different frameworks used to estimate the equilibrium exchange rate at the IMF.

### Box 1. Quantifying Nominal Exchange Rate Adjustments to Address a Given Real Misalignment (continued)



This misalignment can be expressed in terms of the nominal exchange rate and price levels as follows:

$$m = e_T - p_{T^*} + p_T - e + p_* - p$$

	Time Horizon	
Inflation	1 year	5 years
2%	4027.5	4027.5
10%	4362.9	6008.3

*Notes: The graph and table shows the terminal nominal exchange rate needed to correct a misalignment of 70 percent, as a function of the inflation target and the time horizon of adjustment. Foreign inflation is assumed to be 2 percent, and starting value of 2000 BIF/USD*

A rearrangement of terms in the above equation leads to the following equation for the terminal nominal exchange rate  $T$  periods ahead.

$$e_T = m + e + T(p - p_*)$$

Here  $p_*$  and  $p$  are the average annual foreign and domestic inflation rates over the  $T$  year horizon.

The condition shows that the nominal exchange rate adjustment has two components: (a) Correcting the real exchange rate misalignment ( $m$ ), and (b) average inflation differential over the adjustment period ( $T(p - p_*)$ ). Typically, this inflation differential is positive for developing countries, implying an equilibrium nominal exchange rate that increases with the length of the adjustment window.

For the case of an instantaneous adjustment discussed in the text for instance,  $T = 0$ , and the last term on the right-hand side disappears. In this case, the nominal exchange rate merely needs to adjust by the current misalignment of the real exchange rate. On the other hand, as the adjustment period  $T$  increases, the nominal adjustment needs to account for not only the current misalignment, but the change in the equilibrium real exchange rate over the transition period, as summarized by the inflation differential.

### Box 1. Quantifying Nominal Exchange Rate Adjustments to Address a Given Real Misalignment (concluded)

The graph and table show the nominal exchange rate required to correct a real exchange rate misalignment of 70 percent, depending on the number of years of adjustment and inflation rate, assuming a starting exchange rate of 2000BIF/\$ and an average foreign inflation rate of 2 percent.

The equation can also be used to highlight the role of a credible monetary policy framework. The variance of the equilibrium nominal exchange rate is given by

$$\text{var}(e_T) = T^2 * \text{var}(p - p_*)$$

If the monetary framework is weak and unable to generate stable inflation expectations, the volatility of the nominal exchange rate would increase. This uncertainty can hamper the credibility of the unification program, especially if communication is weak or speculative forces in the FX market are ripe.

## E. Speed of Adjustment and Managing the Transition

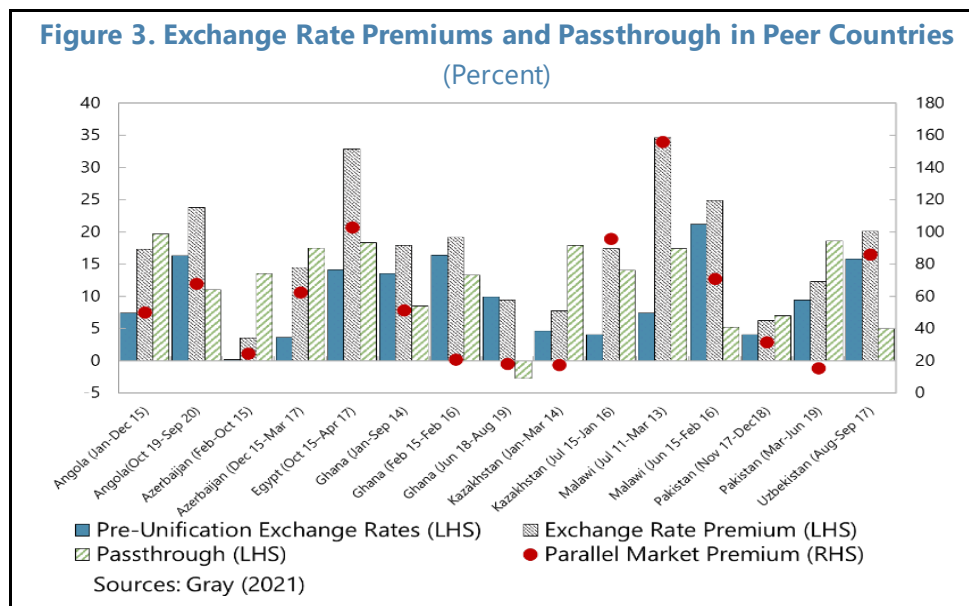
**14. ER unification may be achieved through two approaches:** An instant “Big Bang” approach which unifies the exchange rate instantly, or a gradual unification lasting for several weeks to months.

**15. Since the root cause of the existence of parallel markets is some form of government restrictions on foreign exchange transactions, it is in many cases feasible to drop the restrictions and attempt to achieve an instantaneous adjustment to the new equilibrium.** If implemented smoothly, this approach has the advantage of transitioning the economy swiftly to a new equilibrium and eliminating the distortions and inefficiencies linked with the parallel market. It is also easier to communicate, and hence offers more policy credibility. However, a fast transition also risks being disruptive and hence counter-productive if sizable segments of the economy have currency mismatches or are exposed to sharp exchange rate fluctuations in other ways, including via large implicit subsidies generated by a misaligned official rate. Notably, the financial sector could prove vulnerable to instant exchange rate unification. Moreover, a sharp exchange rate depreciation could trigger a sudden spike in inflation, which could become entrenched into inflation expectations if second round effects are strong (Text table 6).

**16. The alternative of a slow and drawn-out adjustment offers agents time to adjust smoothly.** However, the communication challenges associated with implementing a longer process are more challenging compared to the “one-and-done” approach of instantaneous transition. For instance, shocks occurring during the transition may change the equilibrium level of the exchange rate, generating uncertainty and questions regarding the commitment of authorities to continue with the reform. Such concerns may be particularly pronounced since FX market and availability may deteriorate during the transition while benefits mostly accrue once full unification is achieved.

**17. In either case, but particularly in the instant unification scenario, the inflationary impact of an exchange rate unification is one of the major concerns.** Figure 3 shows the

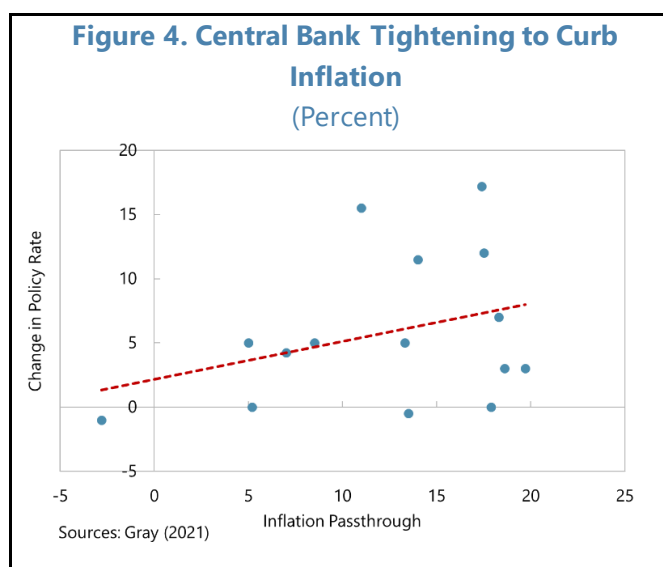
inflationary impact of recent exchange rate unifications. While unification does tend to increase inflation, the passthrough of exchange rate movements to prices during unification episodes is 12 percent on average, which is much lower than estimates during normal times. As discussed in Gray (2021), this is in part because in the presence of sizable parallel markets, the price level in the economy already reflects the level of the parallel exchange rate which is typically close to the post-unification exchange rate. Moreover, in instances where the post-unification passthrough was high, authorities were able to use monetary policy tightening more aggressively to tame inflationary pressures (Figure 4).



**18. A related concern is the possibility of a “free fall” of the exchange rate post-unification.** Recent country experiences with exchange rate unification have however shown that this is rarely the case (Gray (2021)). While the exchange rate does and can be expected to overshoot its equilibrium level moderately, it quickly stabilizes, and in some cases even appreciates (e.g., Angola and South Sudan) on the back of a credible unification initiative inspiring market confidence.

**19. These experiences suggest that for Burundi where the parallel market is**

**sizable,** the overall inflationary impact and risk of a free fall of the currency should be low, as the parallel rate will partly act as an implicit anchor for both the exchange rate and the price level post-unification. That said, sharp changes in relative prices could well materialize, even as overall inflation



remains curtailed. In particular, the price of imports which were prioritized and hence transacted at the official rate before the unification may spike in the aftermath of the unification. For these imports, a phase-in period characterized by subsidies and transfers could be used to ease the burden, particularly on the economically vulnerable segments of the population.

## F. Importance of a Robust and Sustainable Macroeconomic Framework

**20. Irrespective of the time frame over which the unification is planned,** the most critical determinant of its success is a set of macroeconomic policy frameworks that can not only help the economy navigate the transition, but also sustain the new equilibrium. Such a framework should first and foremost identify the root cause of the existence of the parallel market and credibly commit to eliminating it in the new regime. This typically entails a fiscal sector that utilizes market sources to borrow and shuns monetary financing and other forms of financial repression and broad-based restrictions on the FX market. With the burden of fiscal financing relaxed, the monetary regime can focus exclusively on price stability, which, as in many EMDEs, entails a moderate degree of exchange rate management and intervention to reduce excess volatility as well as for financial stability considerations (IMF, 2020). At the same time though, FX reserves should not be used systemically to target a given level of the exchange rate or influence its trend. Maintaining a sufficient, albeit not too large stock of FX reserves and using it judiciously, either in a rule based or discretionary manner is therefore likely to be an important component of the policy framework.

**21. Such an integrated policy approach, in line with IMF (2020),** would be particularly appropriate for Burundi given the objective of moving to an inflation targeting regime under the EAC framework. With the decline in monetary financing over the last few years, the country has already achieved significant progress towards facilitating this transition. At the same time, it is critical to ensure continued development of a deep market for government securities, one that can attract a diverse range of investors and enable the government to borrow at longer maturities. Apart from ensuring smooth market functioning, financing of the deficit, and providing room for monetary policy to pursue price stabilization, the development of a yield curve for the government bond market would also help anchor policy expectations as well as private borrowing costs.

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## FINANCIAL SECTOR: CURRENT LANDSCAPE AND VULNERABILITIES<sup>1</sup>

*Financial sector indicators appear healthy, especially given the recent economic downturn. Vulnerabilities, including on account of currency mismatches are low. While a sharp change in the official exchange rate may be disruptive for the trade sector, preliminary information does not show a systemic vulnerability in the financial sector. That said, despite the financial strength, longer term issues regarding the sector's inability to ensure appropriate allocation of credit across sectors and segments of the population remains an area of concern.*

### A. Key Features of the Banking Sector

#### Ecosystem and Concentration

- 1. The banking sector comprises fourteen commercial banks**, majority of which are either partly or entirely private owned.
- 2. Concentration has declined moderately with the entry of three new banks since 2014.** In addition, there has been significant churning in the market shares of individual banks.
- 3. Although individual banks have tended to specialize in certain lending sectors to some extent**, their portfolios are well diversified and there are no stark signs of segmentation in the banking sector. Barriers to entry, at least de jure, are minimal.

#### Role in channeling foreign exchange.

- 4. Commercial banks play an important role in facilitating the flow of foreign exchange across agents in the economy.** But the ultimate control over the official exchange rate at which these flows take place, as well as the sectors and firms that can receive FX via the official foreign exchange market, is heavily regulated by the central bank.

#### Banking Health Indicators and Vulnerabilities

- 5. Despite the sharp decline in growth induced by the pandemic, the banking sector has remained healthy.** With capital ratios of around 20 percent, a share of non-performing loans of less than 5 percent, and negligible currency mismatches as measured by net open FX positions, vulnerabilities appear to be subdued.
- 6. Burundi's banking sector also compares well with regional peers in terms of credit provided** to the domestic private sector as well as the number of bank branches per unit of the population.

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<sup>1</sup> Prepared by N. Patel.

## B. Non-Bank Sector Landscape

### 7. The non-banking sector includes mainly two types of entities:

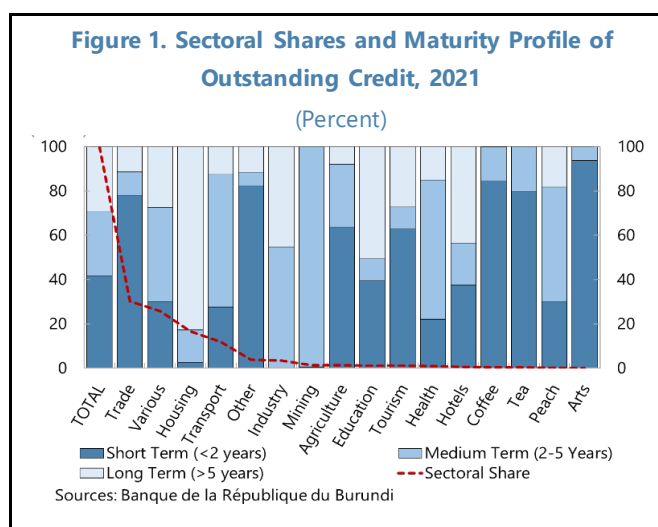
- a single development bank (BNDE), accounting for roughly 4 percent of the total loans in the economy. its regulatory framework is like that of commercial banks, although it is forbidden from accepting short-term demand deposits of less than a year.
- about 60 Microfinance institutions (MFIs). MFIs mainly cater to the housing and trade sectors, which make up more than half of their portfolio.

## C. Efficiency in Financing the Economy

### 8. The authorities identified two main shortcomings of the financial sector in Burundi:

#### **Credit Allocation Disparities**

- *Sectoral.* Credit does not appear to be allocated efficiently across sectors and individuals. While the trade (30.2 percent of total private sector credit), housing (16.7 percent) and transport (11.8 percent) are well served, others including the agriculture sector (1.4 percent) are credit deprived (Figure 1).



- *Demographics.* Young and women borrowers have been disproportionately underserved. This has recently led the authorities to launch credit funds which can help mobilize collateral to enable these groups to be able to access credit and create banks dedicated to these individuals.

#### **Low Share of Long-Term Credit**

- Despite a sharp increase over the last decade, the share of short-term credit (less than 2 years) in total credit remains high at around 40 percent (Figure 1). This underscores the difficulty for obtaining credit to finance long-term investment projects that are critical to boosting growth potential.

# MONETARY POLICY FRAMEWORK AND OPERATIONS DURING THE PANDEMIC<sup>1</sup>

*Burundi's monetary policy framework (MPF) targets monetary aggregates and comprises a set of official instruments complemented most recently with new tools.*

## A. Monetary Policy Objectives

1. **The main objective of the Banque de la Republique du Burundi (BRB)'s monetary policy is to have full control of money supply and achieve price stability.** To achieve this objective, the BRB's MPF comprises operational targets, intermediary targets, and policy instruments on which the BRB take discretionary decisions.
2. **To reach the targeted level of M2, the intermediate objective of the MPF, the BRB formulates in its Economic and Financial Program a target for the monetary base.** The framework relies on the assumption of a stable correlation between the money supply (M2) and monetary base on one side and between M2 and price dynamics on the other side.

## B. Policy Instruments

3. **The BRB uses four types of instruments to regulate the monetary base.**
  - *Mandatory reserves.* These are interest free compulsory deposits by banks to the BRB and are determined based on the monthly stance of current and term deposits of customers of commercial banks.
  - *Liquidity tenders.* Calls for tenders allow the BRB to ensure the proper functioning of the domestic financial system by withdrawing or providing liquidity, as needed. The interest rates on these market operations can be fixed or variable, upon BRB's discretion.
  - *Marginal lending facility.* This is a permanent lending facility available to commercial banks which they can use anytime they need liquidity. The interest rate on these operations is equal to the money market rate plus a given margin.
  - *Temporary advances on bills.* This instrument aims at providing liquidity to banks that grant long term credit to private investors.

## C. Monetary Policy Operations and Stance in 2021

4. **During 2020 and 2021, the BRB has implemented, through different channels, an accommodative monetary policy to mitigate the economic impact of the pandemic.** Since the

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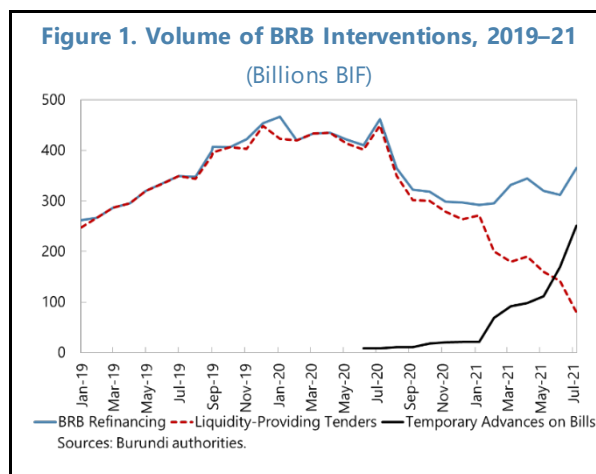
<sup>1</sup> Prepared by M. M. Ly.

outbreak of the pandemic, the BRB has used the refinancing window and has had recourse to the inter-bank market instruments to provide the banking system with additional liquidity.

## Use of Liquidity

**5. First, the BRB swiftly responded to the fall of commercial banks reserves and liquidity shortages using refinancing facilities and the seven days financing window (Figure 1).**

- Starting February 2020, the BRB increased its intervention in the interbank market through the provision of liquidity on call for tenders which increased by 11.8 percent between December 2019 and August 2020.
- In 2021, the BRB supported the banking system through the marginal lending facility which increased by 164.9 percent between January and August 2021.
- In addition, the BRB used the temporary advances on bills as collateral instrument to provide further support to commercial banks.
- The BRB's interventions proved successful. The deposits of commercial banks to the BRB had grown by around 14 percent during the first 8 months of 2021, a significant improvement compared to the same period in 2020 (decline by -16 percent). According to the Report of the BRB's Monetary Policy Committee for 2021-Q1, these figures could have been worse if the central bank did not step in.



## Use of Interest Rates

**6. The BRB has lowered the interest rate on Liquidity tenders from 3.07 percent in 2020–Q4 percent to 2.5 percent in 2021–Q1.**

- The BRB does not really use interest rates or the reserve requirement rate as monetary policy instruments. The reserve requirement rate has remained stable during past years (around 3 percent). The interest rate on other refinancing windows such as liquidity tenders is market determined as the results of commercial bank auctions. Given these characteristics and after discussion with authorities, the overnight rate (the interest rate paid by banks on the recourse to “Marginal lending facility”) is usually considered as a proxy of a policy rate since the BRB partly determines its level.
- Recently, all other interest rates in the inter-bank market have increased due to their indexation to the treasury bills’ rates that went up. Regarding the public, the interest rates

on outstanding loans have slightly increased during 2021–Q1 reaching 15.32 percent against 15.22 percent at end-December 2020.

### **New Tools/Other Initiatives**

**7. The BRB has created a number of new refinancing windows to influence directly credit** to the private sector and has engaged into direct lending as well.

**8. In July 2020, to stimulate long-term credit to the private sector,** the BRB launched a new instrument named advance on bills as collateral. This new instrument has longer maturity (5 years,<sup>2</sup> renewable once) than the call for tenders, allowing banks to provide longer term loans to domestic investors.

**9. BRB has also been providing loans to priority sectors through conventions guaranteed by the government.** These loans concerned mainly sectors like coffee, fertilizers, youth employment, maize, and modernization of the tax revenue office (Office Burundais des Recettes, OBR).

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<sup>2</sup> A 5-year contract is signed with yearly auctions to renew the associated liquidity provision.