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Report No: 51657-BI

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED GRANT

IN THE AMOUNT OF SDR 12 MILLION
(US$19 MILLION EQUIVALENT)

TO THE

REPUBLIC OF BURUNDI

FOR A

FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

November 25, 2009

Finance and Private Sector Development
Eastern and Southern Africa
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective October 31, 2009

Currency Unit	=	Fbu
1,225	=	US$1
US$1.58989	=	SDR 1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities
AfDB	African Development Bank
AFRITAC	IMF Africa Technical Assistance
APB	Abattoir Public de Bujumbura
ARCA	Agence de Régulation et de Contrôle des Assurances
ARFIC	Autorité de Régulation de la Filière Café
ARTC	Agence de Régulation des Télécommunications
ATM	Automated Teller Machine
BANCOBU	Banque Commerciale du Burundi
BBCI	Banque Burundaise de Commerce et d'Investissement
BCB	Banque de crédit de Bujumbura
BGF	Banque de gestion et de financement
BNDE	Banque nationale de développement économique
BRB	Banque de la République de Burundi
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CFP	Country Financing Parameters
CIMA	Conférence Interafricaine des Marchés d'Assurances
CIP	Comité Interministériel de Privatisation
CNCC	Conseil National de Commissaires aux Comptes
CoA	Chart of Accounts
COGERCO	Compagnie de Gérance du Coton
COM	Council of Ministers
COTEBU	Complexe Textile de Bujumbura
DA	Designated Account
DFID	UK Department of International Development
DPL	Development Policy Loan
EAC	East African Community
ECOSAT	Encadrement des Constructions Sociales et Aménagement des Terrains
EMSP	Economic Management Sector Project
EPT	Electronic Payment Terminal

ERSG	Economic Reform Support Grant
ESMF	Environmental and Social Mitigation Framework
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
FIRST	Financial Sector Reform and Strengthening Trust
FM	Financial Management
FMA	Financial Management Assessment
FMIS	Financial Management Information System
FMM	Financial Management Manual
FPHU	Urban Housing Promotion Fund
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GNI	Gross National Investment
GoB	Government of Burundi
GTFP	Global Trade Facilitation Program
HIPC	Heavily Indebted Poor Countries
IBB	International Bank Burundi
IAS	International Accounting Standards
ICA	Investment Climate Assessment
ICB	International Competitive Bidding
IDA	International Development Association
IFAC	International Federation of Accountants
IFC	International Finance Corporation
IFR	Interim Financial Report
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INSS	Institut National de Sécurité Sociale
IPO	Initial Public Offering
IPSAS	International Public Sector Accounting Standards
ISA	International Standards of Auditing
ISR	Implementation Status and Results Report
IT	Information Technology
LCS	Least Cost Selection
MDG	Millennium Development Goals
M&E	Monitoring and Evaluation
MFI	Microfinance Institution
MoCIT	Ministry of Commerce, Industry, and Tourism
MoF	Ministry of Finance
MTR	Mid-term Review
NCB	National Competitive Bidding
NPL	Non-performing loans
OCIBU	Office du Café du Burundi
ONATEL	Office National des Télécommunications
ONATOUR	Office National de la Tourbe
OPC	Ordre de Professionnels Comptables
OPHAVET	Office Pharmaceutique Vétérinaire

OTB	Office du Thé du Burundi
OTRACO	Office de Transport en commun
PAGE	Projet d'Appui à la Gestion Economique
PCU	Project Coordination Unit
PDO	Project Development Objective
PE	Public Enterprises
PEMFAR	Public Expenditure Management and Accountability Review
PFM	Public Financial Management
PIM	Project Implementation Manual
PPA	Project Preparation Advance
PRGF	Poverty Reduction Grant Fund
PRSP	Poverty Reduction Strategy Paper
QCBS	Quality and Cost-based Selection
RCIP	Regional Communications Infrastructure Project
REGIDESO	Régie de Production et de Distribution d'Eau et d'Electricité
RTGS	Real Time Gross Settlement System
SBF	Société Burundaise de Financement.
SCEP	Service Chargé des Entreprises Publiques
SHNB	Société Hôtelière Nationale du Burundi
SHTB	Société Hôtelière et Touristique du Burundi
SIP	Société Immobilière Publique
SME	Small and Medium Enterprises
SOBUGEA	Société Burundaise de Gestion Aéroportuaire
SOCABU	Société d'Assurance du Burundi
SODECO	Société de Déparchage et de Conditionnement
SOE	Statement of Expenditures
SOGESTAL	Société de Gestion des Stations de Lavage
SOSUMO	Société Sucrière du Moso
SPP	Sociétés à participation publiques
SSA	Sub-Saharan Africa
ToR	Terms of Reference
TFP	Total Factor Productivity
UCAR	Union Commerciale d'Assurance et de Réassurance
USAID	United States Agency for International Development
VAT	Value-added Tax

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BURUNDI
Financial and Private Sector Development Project

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BURUNDI

FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

PROJECT APPRAISAL DOCUMENT
DATA SHEET

Date: November 25, 2009 Country Director: John M. McIntire Sector Manager/Director: Gerardo M. Corrochano/Marilou Uy Project ID: P107851 Lending Instrument: Specific Investment Loan	Team Leader: Sherri Ellen Archondo Sectors: General finance sector (35%) Themes: (P); Export development and competitiveness (S); Public Enterprises Environmental screening category: C

Project Financing Data

[ ] Loan [ ] Credit [X] Grant [ ] Guarantee [ ] Other:

For Loans/Credits/Others:
Total Bank financing (US$m.): 19.0
Proposed terms: Grant

Financing Plan (US$m)

Source	Local	Foreign	Total
BORROWER/RECIPIENT	0.0	1.0	1.0
International Development Association (IDA)	0.0		
IDA Grant	1.5	17.5	19.0
Foreign Private Commercial Sources (unidentified)	0.0		
Total:	1.5	18.5	20.0

Borrower:
Ministry of Finance, Republic of Burundi

Responsible Agency: An existing Project Coordination Unit (PCU) under the auspices of the Ministry of Finance

Estimated disbursements (Bank FY/US$m)

FY	10	11	12	13	14				
Annual	1.0	5.5	7.0	4.0	1.5				
Cumulative	1.0	6.5	13.5	17.5	19.0				

Project implementation period: Start December 21, 2009 End: February 28, 2014
Expected effectiveness date: April 1, 2010
Expected closing date: February 28, 2014

Does the project depart from the CAS in content or other significant respects? ***Ref. PAD I.C.***	[ ]Yes [X] No

Does the project require any exceptions from Bank policies? ***Ref. PAD IV.F.*** Have these been approved by Bank management? Is approval for any policy exception sought from the Board?	 [ ]Yes [X] No [ ]Yes [X] No [ ]Yes [X] No
Does the project include any critical risks rated "substantial" or "high"? ***Ref. PAD III.E.***	[X]Yes [ ] No
Does the project meet the Regional criteria for readiness for implementation? ***Ref. PAD IV.F.***	[X]Yes [ ] No

Project development objective ***Ref. PAD II.B., Technical Annex 3***
To strengthen the recipient's financial system and improve its business enabling environment.

Project description *[one-sentence summary of each component]* ***Ref. PAD II.C., Technical Annex 4***

1. **Modernizing the Financial Sector***:* The project will finance measures aiming, *inter alia*, at improving governance and transparency of the financial sector by: (a) modernizing financial sector infrastructure (payments systems), and (b) improving financial sector regulations.

2. **Improving Corporate Governance and Performance of Public Enterprises.** The project will finance technical assistance to improve performance and corporate governance of a select number of priority public enterprises (PE) selected by government, including: (a) *Office National des Télécommunications (ONATEL)*, (b) sale of 50 percent of the government's share in the coffee washing stations, (c) select operations in the sugar sector, and (d) reinforcing the capacity of *Service Chargé des Entreprises Publiques* (SCEP) in monitoring public enterprises (PEs) and preparing privatization of other selected PEs.

3. **Streamlining the Regulatory Environment for Business and Promoting Private Public Dialogue.** The third component supports the regulatory environment in Burundi including: (a) preparation of accompanying regulations for commercial legislation, (b) preparation of a number of new texts for the financial sector, (c) the review and modernization of the chart of accounts (CoA) for commercial banks, for insurance companies and for micro-finance enterprises, (d) support to the nation's accounting profession, and (e) institutional development for those institutions responsible for developing and promoting the private sector agenda.

Significant, non-standard conditions, ***if any***, for:
Ref. PAD III.F. none
Board presentation: No conditions

Loan/credit effectiveness: The annual work plan and budget for the first year of project implementation will be prepared.
Covenants applicable to project implementation:

Retroactive financing: No withdrawal shall be made for payments made prior to the date of this Agreement, except that withdrawals up to an aggregate amount not to exceed $400,000 equivalent may be made for payments made prior to this date but on or after June 1, 2009, for eligible expenditures.

Within three months of effectiveness, the PCU will recruit an independent external auditor acceptable to IDA.

I. STRATEGIC CONTEXT AND RATIONALE

A. Constraints to economic development in Burundi

1. Burundi is a small, landlocked country with a population of approximately 8 million. With an estimated per capita income of about US$110 (2007), Burundi is one of the poorest countries in Sub-Saharan Africa (SSA). About 70 percent of the population lives below the poverty threshold (US$1). It has a predominantly rural and agrarian economy. The agriculture sector dominates Burundi's economy, representing 46 percent of gross domestic product (GDP) and providing 90 percent of the population with income and employment. Subsistence farming dominates the sector, with commercial agricultural production (tea and coffee) contributing less than 5 percent of GDP. However, commercial agricultural remains critical for the economy as it generates more than 60 percent of export revenues. Burundi's small industrial sector consists mainly of construction, agricultural processing, brewing, and energy. Services comprise 37 percent of GDP (2007) and are largely concentrated on a growing public sector, which accounts for about 64 percent of the tertiary sector.

2. Burundi is resource-poor and had been strongly affected by civil war in the early 1990s, during which time a four-year economic embargo and several episodes of drought further impacted its economic development. In the late 1990s, international assistance came to a near halt, and subsequently, a regional economic embargo was imposed against Burundi, prompting an increasingly difficult and interventionist approach to economic policy from the Government of Burundi (GoB).

3. Burundi remains a fragile state and the impact of the current global financial crisis can be examined in terms of its impact through reduced flows from developed countries, as well as the indirect impact emanating from the ensuing slowdown in global economic activity and international trade. Previously strong growth in the agriculture and service sectors may be dampened by the effects of the financial crisis through the following channels: (a) reduction in foreign direct investment (FDI), which in turn, could affect production in the coffee sector (e.g., washing stations and processing mills), and (b) decline in worker remittances, which may affect all sectors, as households have less available incomes to spend in the market place and/or invest in productive activities. There is also a risk that donors' aid may decline as developed countries are wrestling with huge budgetary deficits. This will have a negative impact as half of the GoB's budget is financed by foreign aid.

4. Burundi faces numerous challenges, all of which are equally important. These challenges include economic diversification, the improvement of agricultural productivity, the increase and diversification of exports, the development and upgrade of infrastructure, and the improvement of access to financial services. More importantly, the country must support private sector development through an improvement of firm productivity. The GoB has committed itself to structural and financial reforms, including the state's complete disengagement from productive sectors of the economy, the liberalization of foreign exchange policies, a reduction of customs duties and specific non-tariff barriers, and the abolition of certain taxes. However, given the key role that the private sector is expected to play in Burundi's economic revival strategy, the GoB must continue its efforts to convince investors and the business community at large that the

economic outlook is positive and that future improvements to the country's regulatory framework will favor private sector growth.

(a) The private sector is small and faces one of the most unfavorable business environments in Africa.

5. The latest Doing Business Report ranked Burundi 176 out of 183 countries for the ease of doing business. The GoB recognizes that the development of the private sector requires an improvement of the "investment climate" in order to promote strong economic growth within a market economy and to reduce poverty. While such rankings only give an indication of the overall enabling environment in business, it is clear that the private sector in Burundi suffers from heavy regulatory burdens, low productivity, and other constraints.

6. The formal Burundi economy is very small and consists of about 3,000 registered enterprises, mainly small and medium size enterprises (SME) that employ some 37,000 workers. Firms surveyed as part of a recent Investment Climate Assessment (ICA, June 2008) indicated that nationally-based firms did not have a positive perception of the country's business environment. Its development is hampered, among other factors by:

- The limited access to, and high cost of finance. This constraint is one of the most commonly cited by Burundian companies;
- A cumbersome regulatory framework, including heavy taxation, weak tax administration, and a judicial system that remains unpredictable and inefficient in its role of resolving business disputes and enforcing business contracts;
- The poor access to, and high cost of key factors of production, notably electricity and transport;
- A poorly educated workforce; and
- A large concentration of ownership of economic assets and weak competition in the formal economy, while the informal sector thrives.

7. Thus major reforms are urgently needed to foster a more favorable business climate for investment in Burundi. They include: (a) clarifying business laws and administrative regulations to avoid provisions open to interpretation or discretionary decisions, (b) reforming the judicial system to reduce excessive delays in the commercial court and promote arbitration and mediation as a means to settle commercial disputes, (c) reforming the financial sector to improve access and lower cost of financial services, (d) strengthening the public-private dialogue, (e) facilitating business registration, (f) simplifying the tax system for small businesses, and (g) developing a better analytical understanding and a systematic approach to the reform of public enterprises. Successfully implementing the reforms will have the added benefit of facilitating starting a business, registering property, getting credit, protecting investors, paying taxes, enforcing contracts, and closing a business, all of which are Doing Business indicators.

(b) Limited access to and high cost of finance is the leading constraint to private sector development.

8. According to the ICA, costs and access to credit are the second most important constraint faced by the firms operating in Burundi. It is the most important constraint for the informal sector and in particular, for women. The country has a fairly dense network of financial institutions with seven commercial banks in Burundi, two financial establishments (a development bank and a housing fund), six insurance companies, 26 microfinance institutions, and two social security organisations.

9. Despite the presence of these institutions, the financial sector does little to contribute to the development of the country. Total assets of the financial sector are small, (Fbu 725 billion, US$604 million equivalent, as of December 31, 2007[1]) and the sector is rather underdeveloped, particularly in relation to those of countries belonging to the East African Community (EAC). Access to financial services is a problem for the majority of the population and for SMEs in particular. Only about 1.9 percent of the total population hold bank accounts, 0.42 percent use bank lending services, and four percent are members of microfinance institutions. There is little diversification in the financial products offered by banks and the lending services offered by banks are generally short-term. The other financial services (securities and miscellaneous operations, foreign exchange operations, leasing, securities release and encashment, etc.) are marginal. The banks generally have no units devoted to SMEs and most SMEs have difficulty obtaining loans. Two major reasons for this are the unavailability of the tangible collateral sought by banks and the absence of reliable information on borrowers.

10. Overall, the financial system suffers from a lack of transparency (illustrated for instance by the absence of chart of accounts (CoA) for all categories of institutions), and from serious governance, organizational, and capacity issues within all categories of institutions. These are kept alive by inadequate regulation and poor or non-existent supervision. Banks are vulnerable to many shocks, the payment system is archaic, microfinance institutions are still at an emerging stage, insurance companies develop in a haphazard manner, and social security organisms are facing deficits. Thus, in such an environment, access to financial services is and will remain limited. To resolve these difficulties and to allow the financial sector to fully play its role in the Burundi economy, fundamental reforms are required.

11. *Commercial banks dominate the sector with 79 percent of total financial institutions' assets, but suffer from internal weaknesses*, particularly with respect to governance, internal controls, and the process of granting and monitoring loans. The banking sector is also vulnerable to credit shocks, to variations in the terms of trade, and to a decline in foreign aid that finances half of government expenditures. Some banks are exposed to the coffee sector. Membership in the EAC provides many benefits to the country, however, in the short-term it may also constitute a source of vulnerability for the banking system. This is because of the competition from the sub-region to which the sector, as well as its customers, (especially in the trade sector) could be exposed. Government-owned banks are more seriously affected by these problems. Within these banks, governance is an important issue; exposure to public enterprises (PE) and particularly the coffee sector is larger, and their credit portfolio is of lesser quality.

[1] Annex 1 provides a more complete description of the financial sector and the issues it faces.

12. *Supervision of the banking system is plagued by poor data communicated* to the *Banque de la République de Burundi (BRB).* The system lacks a banking CoA, there is paper transmission of data by commercial banks, as well as inadequate human and physical resources. Capacity building and computerization are also required. The BRB manages a credit information center, a non-performing loan (NPL) information center, and an unpaid checks information center. They are of limited usefulness to the commercial banks, if only because of the lack of a unique identifier and because banks have only access to information of their own customers. There is no balance sheet information center.

13. *The payment system is archaic.* Check clearing is manual and the card payment system is reduced to its simplest expression. Reform and modernization of the system are priorities in view of its low level of development. BRB's charter makes only a brief reference to its responsibilities with regard to the payment system. There should be a clarification of the BRB's mission in the area of payment systems and means of payment. It would be advisable to establish, within BRB, a special service responsible for payment systems and means of payment which reports directly to the Governor. It is also recommended that the legal framework for payment systems be reviewed, as it is inadequate and obsolete, and needs to be brought in line with EAC standards.

14. A comprehensive clearing and settlement infrastructure must be defined and built. These developments should include, as a top priority, the automation of small value transactions (checks and direct transfers) within an automated clearing system. The establishment of an automated real time gross settlement system (RTGS) for large and urgent transactions is also needed, but in view of low transactions could be deferred for a few years. There is no operational card payment system in Burundi. It is recommended that the BRB organize, in concertation with the commercial banks and the postal service, a working group that will take stock of the development projects within individual institutions to promote synergies among them. It is also essential that the card system being designed provide for inter-operability to make the most of the sizable investments involved.

15. *The microfinance sector is facing major challenges.* All of the on-site inspections organized by the BRB revealed serious problems and violations of prudential rules, in particular in the areas of accounting, governance, and the absence of reliable internal controls. In addition, there is no CoA for microfinance institutions. In order to put the industry on a sound footing, it is essential to: (a) update the regulatory framework to facilitate the growth of a sound industry; (b) develop a supervisory program that is capable of preserving the health of the sector, and of deposits in particular; and (c) promote the professionalization of the industry itself, with improved human capacities, appropriate management tools, modern methodologies, and good governance.

16. *The insurance sector* could play an important role in the development of the financial sector by intermediating risks and making long-term resources available, but its performance is marginal. The sector is outmoded, and has a very limited product range that is concentrated on mandatory auto insurance products (63 percent). The lack of organizational capacities and specialized competence in insurance are impediments to the development of the sector. The financial health and solvency of companies fall below regulatory requirements and international standards. There is no CoA. Arrears in premiums are also a problem. Technical profitability

appears to be satisfactory, but this may be the result of non-payment of claims by the companies. Moreover, overall profitability suffers from low financial returns associated with the lack of investment opportunities, in particular long-term placements.

17. The regulations, accompanying the sector, have many gaps (e.g., minimum capital requirement is too low) and supervision is non-existent. Insurance companies still operate under a temporary license that expired in 2003. It is urgent to set up an independent supervisory authority for the sector. A review of the regulatory texts is also needed, as is a chart of accounts. Training is required for supervisors and market participants. This is a priority before actions to reinforce the sector are taken.

18. For national insurance companies to participate in the development of the sector at the advent of the EAC, a number of actions are required: (a) recapitalizing the companies, (b) ensuring compliance with the rules on solvency margins and the constitution of technical provisions, (c) restoring the principles of good governance and combating conflicts of interest, (d) regulating brokerage activities, and (e) developing co-insurance in order to increase the capacity of local insurers.

(c) The poor regulatory environment for business impedes investment and constrains private sector development.

19. Firms in Burundi face numerous hurdles in terms of red tape, regulations and requirements in carrying out business activities. Many of the key laws which govern private sector activity, although new, do not have the appropriate accompanying regulations which result in arbitrary implementation, if any at all. Limited legislative capacity and the low priority attached to reforming the business environment in the past have created a sense of distrust of the judicial system to enforce contracts. In addition, gaps have been revealed in the legal framework. For example, the absence of an enabling law for credit reference bureaus reduces the scope of private sector initiatives in improving access to finance.

20. *Tax rates, as well as tax administration, create important problems for managers in the formal sector.* The value-add-tax (VAT) of 18 percent was recently introduced (August 2009). However, this new tax regime will require an extensive information and training program of the public. In addition, according to the ICA survey, Burundi's high tax rates are considered a major problem by the private sector. These conclusions are also confirmed in the recent Doing Business Report, where the total tax rate on profits for firms in Burundi was 278.7 percent, which may ultimately be cause for tax evasion.

21. *A cumbersome business licensing regime imposes unnecessary costs on the private sector.* A complex web of overlapping licenses and permits, many of which serve only a marginal function, govern the environment in which enterprises operate. This creates obstacles to the process of market development by raising the costs of business entry and growth, and creates barriers to transition from the subsistence and very small-scale economy to a more modern productive sector. Many entrepreneurs remain in the informal sector due to the high costs of formalization, partially associated with licensing requirements. Thus, small informal firms established are unable to grow and benefit from economies of scale or access additional benefits of formalization, such as commercial bank finance and business development services.

22. *The economy is characterized by a low level of application of the laws for businesses, as well as weak capacity to enforce commercial contracts and have commercial disputes resolved fairly, predictably, and professionally in the commercial court.* Burundi has only one commercial court in Bujumbura. It lacks adequate facilities, equipment, and skills, despite receiving training and equipment through *Projet d'Appui à Gestion Economique* (PAGE, Economic Management Support Project). The high turnover of magistrates also contributes to the poor performance of the court in the handling of caseloads. A number of measures have been taken by the GoB to improve the performance of the court and other sector institutions. These include salary increases to discourage corruption, increases in the number of magistrates, and a reform of the domestic regulations. In addition, the legal and judicial environment offers few guarantees for those banks that are inclined to finance SMEs. The main legal difficulties observed by financial system transactions lie in the implementation of legal provisions and the uncertainties arising as a consequence. In particular, the ineffectiveness, in practice, of some types of collateral (mortgages and the rare use of business goodwill as collateral) and in the functioning of collective procedures for clearing liabilities, result in a general lack of trust in the effectiveness and reliability of existing judicial mechanisms, and restricts the supply of financing. In turn, the judicial system moves slowly and judges lack training.

23. In an effort to provide quicker delivery of commercial decisions, an arbitration center was created in 2002, and the appropriate legislation was adopted in 2008. Almost 30 arbitrators, from various sectors have been trained, and some public education has been initiated. However, while the center has received some start-up funds from PAGE, it lacks the financial resources to further develop this tool for dispute resolution.

24. *Low cost advantages are eroded by the limited availability of skilled workers and the low productivity of labor.* Analytical evidence suggests that Burundi possesses a comparative advantage in the region in terms of low-cost labor. However, when taking into account total factor productivity (TFP) that includes the relative costs and returns to labor and capital together, Burundi's cost advantage evaporates.

(d) The economy is dominated by PEs.

26. A 2007 study found that government had shares in 48 entities (40 enterprises and eight financial institutions), of which 16 were fully publicly-owned. A handful of public enterprises dominate the exports of the country: coffee, tea, cotton, and sugar. The state owns the whole equity or owns a majority stake in 23 PEs other than financial institutions.

27. Most PEs face a difficult or even distressed financial situation. They are burdened by governance problems typically encountered by PEs in most countries, such as overstaffing and poor management, and often suffer from political interference from the state. Despite the fact that most of them are now "commercialized" (as joint stock companies), their governance remains unsatisfactory. In addition, the special entity created in the 1990s to oversee the PEs' portfolio (SCEP), does not have sufficient resources or the authority to bring about a real improvement of their performance. For 2008, only four of the larger PEs made a satisfactory profit. Their total debt has been constantly rising, reaching Fbu 1.5 billion (about six percent of GDP).

28. The PEs and the state, as well as the PEs between themselves, have accrued substantial cross-debt and arrears. The tight liquidity of some PEs is, in some cases, the result of late payments made by the state (including the security forces) of their bills due to the PEs. When some amounts overdue became considerable, the state compensated some enterprises (on a case by case basis) through a triangular swap with the state giving, for example, treasury bonds (five years) or notes to the commercial banks in exchange for the outstanding bank loans to the enterprises. The lack of strict payment discipline by the state has contributed to the worsening of the situation of a number of PEs and induced some of them to delay their payments to their own debtors, particularly suppliers, and thereby contributed to a spiraling build-up of arrears.

(e) Weak policy analysis, formulation, and implementation create uncertainty in the private sector.

29. Dialogue between the public and private sectors in Burundi has historically been very weak. Limited consultation and partnership with the private sector has tended to result in poorly informed public sector decision-making that often fails to foresee the impact of decisions on the private sector. A general lack of mutual accountability between the public and private sectors has also resulted in very weak policy implementation.

30. In addition, many of the private, para and public enterprises, including, but not limited to, the Ministry of Commerce, Industry, and Tourism (MoCIT), the National Bureau of Standards, the BRB, the Chamber of Commerce, and the Association of Accountants need support to strengthen their capacity to enable them to provide policy leadership and create the enabling environment for businesses to grow and be competitive domestically, regionally, and internationally.

31. A number of key policy reforms are already being implemented. While the first Poverty Reduction Strategy Paper (PRSP) progress report was being finalized, the new macroeconomic program for Burundi was agreed and signed between the GoB and the International Monetary Fund (IMF) on July 7, 2008. The objective of the Poverty Reduction Grant Fund (PRGF) arrangement is to support the implementation of the PRSP, consolidate macroeconomic stability, and further reduce poverty. The projected growth pattern is based on underpinning reforms in three areas: (a) a continued removal of major economic distortions in the primary sector (the principal sector)[2], especially in the coffee sector and food crops, to boost productivity; (b) a substantial increase in investment, driven by international aid and largely consisting of infrastructure renovation; and (c) further advances in trade liberalization with accession to the EAC, which will help diversify the economy, stimulate competition, and attract more investment. All of these reforms would benefit from continued technical and financial support from the donor community.

32. The project builds upon reforms under the Second Economic Reform Support Grant (ERSG II). The ERSG III (October 2009) is the third in a series of grants designed to assist the GoB in implementing the country's poverty reduction strategy to transition from a post conflict economy, with a focus on maintaining peace and stability, to one geared toward designing and

[2] Secondary sector growth depends on increased mining, petroleum sector reforms, and higher value-added from agro-processing, especially coffee. From the tertiary sector, trade, transport, and telecommunications are also expected to contribute to growth.

implementing policies to accelerate growth and human development. This grant will support the GoB to implement key policy actions in line with their PRSP targets to improve governance and foster private-sector driven economic growth. It proposes to: (a) consolidate reforms already underway in public finance management (as identified in the recent joint 2008 Public Expenditure Management and Financial Accountability Review (PEMFAR)), and (b) re-energize the reform process in private sector development, which includes the legal and regulatory framework for the general business environment, and the coffee and the domestic petroleum reform process. In addition, it aims at continuing diagnostic studies and supporting the development of a strategic approach in areas where action is needed but knowledge is limited (i.e., public enterprise reform). The proposed project will accompany the ERSG program to provide funding for the GoB to implement reforms for modernizing the financial sector and strengthen the BRB, improving the governance of the PE sector, and improving the business environment.

B. Rationale for World Bank involvement

33. The World Bank has recently re-engaged in a financial and private sector dialogue in Burundi, and has not had a stand-alone operation in more than a decade. The Bank's analytical and advisory activities (AAA) have underpinned investments and are the basis for the proposed project. The World Bank produced, in FY08, a technical note on public enterprises and commercial banks. The recent Financial Sector Assessment Program (FSAP, January 2009) identified financial system strengths and weaknesses and enabled the government to develop and implement a strategy to increase the financial sector system's contribution to private sector development and economic growth. In particular, the ICA, that was based on a detailed survey of enterprises, the FSAP, and the Diagnostic Study of the Legal and Judiciary (December 2008) resulted in a comprehensive review of the judicial review process, diagnostic studies on the coffee, tea, sugar, cotton, and fruits and vegetables sectors. An analysis of non-tariff barriers in the preparation for implementation of the EAC Customs Union and the annual publication of the Doing Business Report (2010) provided a summary of Burundi's competitiveness in comparison to other countries. Together, these reports identify constraints to Burundi's economic development and the GoB reform efforts.

34. The FSAP, ICA, and Doing Business reports identified a wide range of constraints to the growth of the financial and private sectors in Burundi. In response, the GoB's program seeks to address some of the priority constraints with the support of different projects, which includes ERSG. The ERSG series focused on areas of agriculture reform, commercial legislation, public enterprise reform, and some preliminary work in judicial reform (alternative dispute resolution). There is now a new window of opportunity for economic development, particularly since Burundi is trying to position itself for economic trade in the EAC.

35. Recognizing that resources are limited, the GoB is opening the economy and advocating a sound and stable financial sector and reliable judicial and regulatory processes, all of which are recognized as essential for broad-based and sustainable economic and private sector development. Economic development will be supported on several fronts, namely by stronger financial, legal, and regulatory systems that will help to facilitate enterprise access to finance and allow firms to operate within a more transparent business environment. The authorities have

demonstrated a strong willingness to undertake critical reforms, in particular in the financial sector. The Governor of the BRB has already launched reforms and has asked the support of the World Bank Group to implement the recommendations of the FSAP. The recent entry in to the EAC also imposes a number of financial sector reforms to conform to regional standards.

36. After a long hiatus in PE reform, the GoB has decided to revive PE privatization and reinforce the institutional capacity to monitor the performance and reinforce the governance of PEs. The GoB adopted a graduated approach starting with privatization transactions that have a high chance of success, visible impact, and strong demonstration effect, to build support for the program. Therefore, in late 2008, the government: (a) adopted an action plan to divest the key state-owned assets of the coffee sector; (b) passed a decree allowing to privatize parts of that sector (coffee washing stations and dry mills); and (c) authorized by decree the privatization of *Office National des Télécommunications (ONATEL)*. A tender for 26 lots of 117 coffee washing stations was issued during the summer 2009. It attracted offers from three bidders. The *Société Hôtelière Nationale du Burundi (SHNB)* in Bujumbura was also put out for sale in 2009 and bids were received from private investors in September. This hotel and the first three lots of washing stations are expected to be transferred to private investor by the end of the year. A decree was also issued to liquidate the *Office du Café du Burundi (OCIBU)*, the apex entity on top of all the government-owned assets in the coffee sector. Part of the old OCIBU will be transformed into a new regulatory agency for the sector, *Autorité de Régulation de la Filière Café (ARFIC)*. A study has also just been completed, analyzing the weaknesses of legal and institutional framework for privatization. It recommends a number of steps to modernize the privatization law and reinforce the capacity of the institutions responsible for privatization, SCEP and the *Comité Interministériel de Privatisation (CIP)*.

37. The support from the International Development Association (IDA) is timely. The proposed project is included in the World Bank's Country Assistance Strategy (CAS, July 8, 2008). Based on Burundi's PRSP, it aims at reinforcing a medium-term vision of sustainable development and economic growth. IDA has provided budget support through the ERSG series; programmatic lending to ensure continuity of the policy dialogue and the reform agenda. The series was initially accompanied by financing of the PAGE, in partnership with the International Finance Corporation (IFC) PEP-Africa program, which contributed to strengthening institutional capacity and supporting reforms expected to help the country transition to an economy focused on development objectives. Efforts were concentrated on reforms to the business legal and institutional environment to foster private-sector led growth. Through this program, the GoB modernized several key commercial legislations. These include the: (a) investment code, (b) tax code, (c) competition law, (d) bankruptcy law, (e) corporate restructuring law, (f) commercial code, and (g) mining code. The next step is to prepare the accompanying regulations and disseminate them in a systematic manner.

38. IFC is expected to increase its involvement in Burundi and undertake a key role in supporting the business environment through investments and advisory services to government and businesses. In the financial sector, IFC will continue to support Burundian banks through the Global Trade Facilitation Program (GTFP), a trade finance guarantee facility. Through PEP-Africa, IFC will continue to provide managerial and funding support to SMEs, including the Association of Burundi Women Entrepreneurs. It is also expected that the IFC Investment

Climate Team, working closely with IDA-financed consultants, will help the GoB undertake a range of Doing Business reforms.

39. The IMF provides technical assistance to the BRB, which is expected to continue in the wake of the FSAP. In particular, the IMF will provide support on monetary policy, foreign exchange markets, and banking supervision.

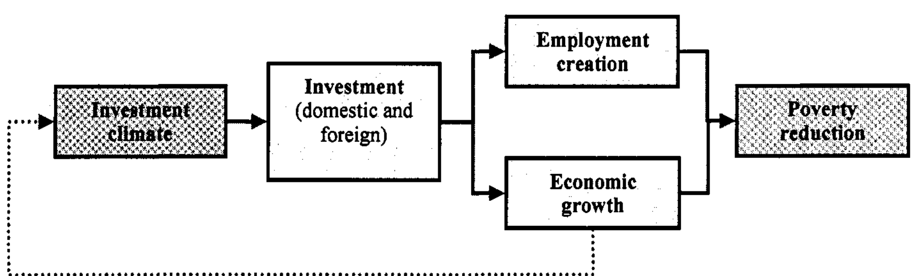
40. The Financial Sector Reform and Strengthening Trust Initiative (FIRST) supported BRB with the elaboration of a modernization plan of its information system. It is expected to increase its support for the preparation of a financial sector development strategy and action plan. The Government of the Kingdom of the Netherlands provides support on microfinance reform.

41. Other development partners do not anticipate entering into the proposed sectors, with the exception of assistance to BRB (IMF), microfinance (the Kingdom of the Netherlands), and some private sector work (United States Agency for International Development, USAID, is involved with incubators and provides some support to the Chamber of Commerce and private entrepreneurs in the coffee sector). Nor are other development partners involved in the strengthening of or privatization of public enterprises, an area which the GoB has confirmed as a priority, but lacks funds to execute in a professional manner.

C. Higher level objectives to which the project contributes

42. Poverty in Burundi is widespread. To attain the Millennium Development Goals (MDG) by 2015, Burundi needs to achieve at least a six percent economic growth rate each year. For this growth to be achieved, however, it is essential that the private sector invests and creates jobs (see Figure 1).

Figure 1: Investment Climate Reforms and Poverty Reduction



43. The proposed project contributes to the objectives defined in the CAS, in particular the pillar aimed at promoting sustainable and broad-based economic growth while targeting reforms to promote good governance and regional integration. These objectives are, in turn, consistent with the GoB's PRSP and its Letter of Financial and Private Sector Development Policy. The overarching objective is achieving equitable and sustainable growth by focusing on: (a) rural sector development, (b) making private sector the engine of growth, and (c) improving transport infrastructure to facilitate access to markets and unlock Burundi's economic potential.

44. The proposed project supports assistance to address the objectives cited above, as well as the GoB's objectives under the PRSP. The GoB is interested in implementing a series of reforms that will improve its standing in the Doing Business Report. Therefore, there are a number of activities that will support the regulatory environment for improving the business climate and investment in Burundi. In addition, for the GoB to be serious about positioning itself for tourism, modernization of the payment system (namely acceptance of credit cards) is essential.

II. PROJECT DESCRIPTION

A. Lending instrument

45. The proposed project is a specific investment lending financed by a four-year IDA-financed grant of US$19 million equivalent. It will focus on strengthening the building blocks for a platform of good governance and transparency in the overall business, financial, and public enterprise environment. It includes support to privatize selected key public enterprises that directly impact private sector growth. The project builds on reforms already underway, but it is conceivable that follow-up on the technical assistance operation will be needed. In the post conflict and fragile environment, it may take more time to build consensus and ownership, which are preconditions for the reforms to be sustainable.

46. Other development partners, including the African Development Bank (AfDB), IMF, IFC, USAID, and the Kingdom of the Netherlands, are providing parallel assistance to the GoB to undertake public sector reforms, private sector development, and reforms of the legal and judicial systems (see Section III A. on Implementation, Partnership Arrangements).

B. Project development objective and key indicators

47. The overall project development objective (PDO) is to strengthen the financial system and improve the business enabling environment. This will be achieved by: (a) modernizing financial sector infrastructure (payment systems) and improving financial sector regulations, (b) supporting measures in selected PEs to improve the governance structure, and (c) improving the regulatory environment for businesses. The key performance indicators at the outcome level are:

(a) The percentage of commercial banks and insurance complying with Prudential Norms has increased.

(b) The Recipient's share of ownership of asset value of selected public enterprises has decreased.

(c) The time to clear checks has decreased.

(d) The number of days to start a business has decreased as measured by the Doing Business indicators.

48. The above outcome indicators are complemented by results indicators related to specific components. The GoB will report on project performance on a semi-annual basis.

C. Project components

49. Among the principal challenges facing the GoB are: (a) expanding the scope of financial intermediation with the development of efficient and competitive banking and non-bank financial institutions; (b) reinforcing the environment for commercial banks and other financial institutions by strengthening supervisory and market oversight and payment systems; (c) improving corporate governance of a selected group of public enterprises; (d) improving contract enforcement through an alternative dispute resolution mechanism; and (e) improving the business environment through regulatory reform and other measures, including strengthening the capacity of private, para-public, and public enterprises to play their role in developing a competitive private sector.

50. The project is comprised of three technical components, all dealing with governance and regulatory environment for improving the business environment, namely: (a) modernizing the financial sector, (b) improving corporate governance and privatization of public enterprises, and (c) streamlining the regulatory environment for business and promoting private-public dialogue. There will be one administrative component to support project implementation.

51. The project components build upon activities already implemented and lessons learned from PAGE, as well as other IDA projects that had financed financial and private sector activities. As a result, it is recognized that: (a) genuine stakeholder participation in policy reform design is critical, (b) selectivity in project design is essential, and (c) institutional change, particularly where capacities are limited, requires long-term action. Priorities and hierarchies of the work program will be established in accordance with the implementation capacity of the executing agencies. An in-depth description of the components is provided in Annex 4 (Detailed Project Description).

Component 1: Modernizing the Financial Sector (US$7.1 million)

52. There are a number of urgent measures that need to be implemented without waiting for the elaboration and adoption of a full-fledged financial sector development strategy. These measures aim, *inter alia*, at improving governance and transparency of the sector. The project will finance technical assistance and capacity building activities for, but not limited to: (a) strengthening the supervision of commercial banks and microfinance institutions. Measures in this area are essential to increase governance and transparency. Project support will complement assistance already received by the BRB from IMF, Africa Technical Assistance (AFRITAC); (b) modernizing the payment system by focusing on electronic clearing and a card payment system; and (c) establishing a mechanism for the development of the non-bank financial sector including, but not limited to strengthening supervision of insurance companies. The insurance regulatory agency will be strengthened and will have the requisite authority and independence to fulfill its mandate (i.e., power to give and withdraw licenses, power to take sanctions, etc.). The FSAP recommended that this unit/agency be managed, if possible, by an expert on detachment from the *Conférence Interafricaine des Marchés d'Assurances (CIMA).*

Component 2: Improving Corporate Governance and Performance of Public Enterprises (US$5.3 million)

53. Burundi's privatization program began in the 1990's but subsequently stalled. It now needs to be effectively re-primed and accelerated. The project will finance technical assistance to improve performance and corporate governance of PEs by reinforcing SCEP's overall capability and monitoring of PEs, and by privatizing two selected PEs as well as government-owned assets in the coffee sector. This includes: (a) privatizing ONATEL, (b) selling 50 percent of the government's ownership in the washing stations of the coffee sector, and (c) finding a strategic partner for *Société Sucrière du Moso (SOSUMO)* through an increase in capital. In particular, the project will finance: (a) operational and financial audits; (b) preparation of the restructuring (as needed) or privatization plans including: (i) development of a privatization strategy, (ii) transaction advisers, and the (iii) development of a communication and staff retrenchment programs; (c) establishment of a system for monitoring and evaluating (M&E) performance; and (d) technical assistance and complementary actions required to ensure that the respective sector remains healthy, such as strengthening the regulatory environment in the coffee sector by assisting ARFIC. In addition, the authorities would like to find international banking strategic partners for two public banks, *Banque Commerciale du Burundi (BANCOBU*, Commercial Bank of Burundi) and *Banque Burundaise de Commerce et d'Investissement* (BBCI, Burundi Bank of Commerce and Investment). The project will focus first on BANCOBU, because of its size, its role in the economy, and the financial difficulties it is experiencing. However, if availability of funds permits it, the project will also support the privatization of a second commercial bank and other publicly-owned financial institutions. The project will finance the privatization adviser, the various administrative costs of the call for bids procedure (publicity in the media, data room, etc.). The GoB will ensure that due regard is paid to the applicable laws of the country related, but not limited, to labor, employment, social action plans, and collective agreements.

54. SCEP will work closely with the Ministry of Privatization and Good Governance. The respective sector ministries and BRB will oversee the privatization programs and down-stream activities, noted above. The project will also support activities to improve SCEP's institutional capacity to implement the privatization program and oversee the government's PE portfolio, including M&E.

Component 3: Streamlining the Regulatory Environment for Business and Promoting Private Public Dialogue (US$4.55 million)

55. The third component, which supports the regulatory environment in Burundi, builds upon efforts of PAGE and support under the ERSG programs. On the regulatory front, activities will include preparing accompanying regulations for commercial legislation which were updated with support from PAGE. These commercial legislation and regulations will be translated into English and disseminated. The Ministry of Justice will be responsible for the drafting/revision of relevant laws and accompanying regulations.

56. Government's efforts will be supported to improve corporate governance in the financial sector and public enterprises, as well as to encourage enterprises to prepare accurate financial accounts. The project will finance support to strengthen the accounting profession by working in

partnership with accounting training institutes to provide the appropriate training for certification of "Expert Comptable" (equivalent to certified public accountant). Training is anticipated to be in the form of both distance learning and on-site courses. Promoting public-private dialogue and strengthening those private, para-statal, and public enterprises that are pivotal to private sector development and regional integration is essential. These include support to, but not limited to, strengthening the Arbitration Center to develop Burundi's accession to the EAC; the Chamber of Commerce to organize their institution to be able to develop the necessary services to its members; the Association of Women, who are playing a major role in mobilizing women to contribute to Burundi's economic development; MoCIT; and the National Bureau of Standards to strengthen its capacity to support its effort to promote private sector development and ensure quality of exports. Finally, the project will finance two forums per year for two years to enable the private and public sector to meet and exchange ideas.

Component 4: Project Implementation (US$1.85 million)[3]

57. It is anticipated that the project will be implemented by the existing project coordination unit (PCU) under the auspices of the Ministry of Finance (MoF) and will have one person (a private/financial sector specialist) dedicated to coordinating its implementation and providing technical leadership. It has a proven track record of implementing activities for PAGE. However, as institutional development and capacity building is at the core of the proposed operation, it is necessary that the responsibility for the implementation of the respective reforms be vested to the concerned ministries and BRB. The BRB will be responsible for technical implementation of all activities related to financial sector modernization. The MoF will be responsible for the development of the insurance regulatory agency. SCEP, under the oversight of the Ministry of Good Governance and Privatization, will be responsible for the second component dealing with improving the governance structure and privatization of selected PEs. The MoCIT, in coordination with other respective ministries, will be responsible for activities related to business climate and regulatory framework in which the private sector operates.

58. In particular, the project will fund the operating costs of the PCU for years three and four[4], a communications program which has been very successful under PAGE, and technical assistance on an "as needed" basis to support its analytical efforts.

D. Lessons learned and reflected in the program design

59. Special attention has been given to ensure that the project design reflects IDA's experience in financial sector technical assistance projects as well as privatizations in other countries (such as Mali, Niger, and Togo that strengthened the financial sector and Botswana and Mauritania that had successful telecom privatizations). In particular, it is recognized that: (a) strong analytical underpinnings are essential; (b) genuine stakeholder participation in policy reform design is critical; (c) selectivity in project design is imperative; and (d) institutional change, particularly where capacity is limited, takes time. Project design also takes into account the challenges inherent in sectors with multiple stakeholders and interests, diverse links with the

[3] An additional US$200,000 is budgeted under "unallocated" expenditures.
[4] The current project will continue to finance operating costs for the first two years; the new project will only fund the additional costs such as the accountant, an additional procurement specialist, and a private sector specialist. Then it will pick up operating costs for remaining two years.

macroeconomic framework and the productive sector, the need to build consensus, particularly with labor unions on privatizations, long lead times for reforms to take effect, and the need for significant skill and capacity building. In this spirit:

- Project design is based on recommendations provided from analytical work undertaken over the past year, particularly on recommendations of the FSAP and the ICA.

- The project recognizes the importance of sequencing reforms for both financial and public enterprise sectors.

- Modernization of the financial sector will be focused on a few selected activities to avoid the development of an over-ambitious project which could lead to disappointing results.

- The decision to privatize PEs cannot be imposed on the government. It will occur only if there is a strong commitment from the authorities. Hence, it is important to have a graduated approach with privatization transactions that have a high chance of success and strong demonstration effects, and for which the government reiterated its will to go ahead. This is true for both ONATEL and the coffee sector assets which the government has clearly indicated its intention to privatize.

- International experiences also show that key factors of success are sustained communication campaigns and carefully designed programs to deal with labor redundancy. The project thus provides the technical assistance and other resources for continuous communication efforts and preparation of well targeted redundancy programs.

- The project will be implemented by a PCU under the auspices of the MoF that has experience in implementing a previous IDA-financed project, thus paving the way for smooth implementation.

- The project will focus on results.

E. Alternatives considered and reasons for rejection

60. Initially a project for US$16 million equivalent was envisaged. The approach to preparing the project was to build on a body of diagnostic work, policy discussions, and GoB and BRB priorities, in order to formulate a project that supports the shared-growth agenda. Following a minimum costing of the core components that constitute the project, the team concluded that the available IDA allocation of US$16 million was insufficient to ensure funding of a critical mass of activities. Following the Project Concept Note Meeting on February 12, 2009, the team prepared, as an Annex to the Minutes, a matrix of activities that could be completed with an additional US$3 million. These activities were validated during the appraisal mission.

61. The team had also considered that project implementation be directly in the MoF. However, this alternative was rejected as there is a PCU already under the auspices of the MoF. It has a proven track record of implementing activities for PAGE and can ensure implementation readiness.

III. IMPLEMENTATION

A. Partnership arrangements

62. In line with the Paris Declaration, the World Bank has been coordinating its efforts in financial and private sector reform with other development partners. The IDA-financed project will provide technical support where other development partners are not currently active, namely strengthening the financial sector and measures to improve the business environment. Annex 2 provides more detail on partnership activities in the financial and private sectors.

B. Institutional and implementation arrangements

63. The GoB requested a grant in the amount of US$19 million equivalent from IDA under the project. The government has expressed its intention to take rapid reform measures so that the population will see results quickly. Thus, the project will be implemented over four years. A mid-term review (MTR) will be planned 24 months following effectiveness of the Financing Agreement for the project.

64. As noted above, it is anticipated that the project will be implemented by an existing PCU that has a proven track record of implementing activities for PAGE. However, as institutional development and capacity building is at the core of the proposed operation, it is necessary that the responsibility for the implementation of the respective reforms be vested to the concerned ministries and BRB. The BRB will be responsible for technical implementation of all activities related to financial sector modernization. The Ministry of Good Governance and Privatization will be responsible for the second component dealing with improving the governance structure and privatization of selected PEs. For the privatization of the commercial banks, the ministry will share responsibility with BRB. The MoCIT, in coordination with other respective ministries, will be responsible for activities related to the improvement of the business environment and private sector development, including strengthening the National Bureau of Standards, further developing the Arbitration Center which started under PAGE. The preparation of the regulations to accompany recent commercial legislation will be the responsibility of MoCIT in collaboration with the Ministry of Justice.

65. The PAGE has an implementation structure that is already in place and which will be used to carry out the fiduciary and reporting functions for the new project. In particular, there are: (a) technical focal points that meet on a regular basis, (b) a technical committee which is responsible for following the project and meets on a quarterly basis, and (c) a steering committee that is responsible for national planning and meets on a semi-annual basis. The steering committee is comprised of the key ministries and the Governor of the BRB.

66. To maintain the bottom-up approach that began under PAGE, each executing agency will prepare the terms of reference (ToR) for consultants, including required qualifications of consultants and technical specification for the procurement of goods. Executing agencies will

implement their respective components and report to the PCU on a semi-annual basis, including any modifications to the procurement plan and/or training plans. To jump start the project and avoid any serious constraints, the newly recruited private sector/financial sector specialist will meet with the stakeholders on a monthly basis during the first year. These meetings will be included in the Project Implementation Manual (PIM).

67. Details of financial and disbursement arrangements are provided in Annex 7. The financial unit of PCU will also be responsible for financial management, maintaining overall records and managing disbursements of the project. There is currently a financial management system in place which has the capability to account for multiple projects. An additional accountant has been recruited to maintain exclusively the accounts of the new project.

C. Monitoring and evaluation of outcomes/results

68. The project's M&E system will be based on an agreed Results Framework that is set forth in Annex 3. The system will: (a) enable the executing agencies to respond to the GoB's need for information and data, (b) improve management of these agencies, (c) compare the country's business environment with international standards, and (d) attract potential investors.

69. The PCU will consolidate information and data received from the executing agencies. The focal points in each executing agency will be responsible for consolidating information and data relevant to their respective sectors.

D. Sustainability

70. The project has a good basis for sustainability, being founded on the GoB's vision that Burundi become a "producing rather than consuming country" and play an important role in the EAC. This vision is enshrined in the PRSP, with which development assistance is aligned. Trade and private sector development issues, as well as financial sector strengthening have been brought to the forefront of the reform agenda.

71. The project, as noted above, builds on substantial analytical work. In addition, it builds upon reforms financed by PAGE and ERSG. The GoB is committed to improve Burundi's performance as assessed by the ICA and annual Doing Business surveys. Similarly, while many aspects of reducing the cost of doing business can be tackled with low-cost actions, others require resources well beyond the scope of this project, namely infrastructure development (water, energy, roads, and rail). As a land-locked country, Burundi's private sector suffers from very high transport costs for both exports and imports. Critical to private sector development is further investment in infrastructure, not just in transportation, but also in power and water supply.

72. The project builds upon the government's ongoing privatization program. The GoB has aggressively liberalized the telecom sector. This is showing positive results through increased network coverage and lower prices. It has also made a public commitment to privatize ONATEL. The overall context for the telecoms privatization within the project is therefore very positive. With respect to privatizing the coffee stations, the GoB, on June 5, 2009, began the process by launching a tender for the sale of 117 washing stations in 26 lots. Bids for 36 stations

were received from three private investors (two foreign groups and one national investor) operating in the coffee sector. At least three lots are expected to be transferred to new private owners before December 2009. This latest development in privatization clearly indicates investors' appetite for assets in Burundi's coffee sector as well as the renewed capability of the institutions, SCEP, and CIP, to work effectively with advisers on complex privatization deals. The GoB is preparing amendments to the privatization law, based on the recommendations of the recently completed study on the legal and institutional framework of privatization.

73. This project will fund technical assistance and associated institutional and policy support for a well-defined, time-bound process to strengthen the financial sector and improve the ease of doing business (as reflected in Burundi's annual performance in the Doing Business survey, etc.). The project also focuses on strengthening capacity of key stakeholders of the financial sector in Burundi. A strengthened capacity and a strong understanding of the reform process are critical for the sustainability of the financial sector reform process underway. The capacity to analyze issues and to develop and implement strategies is crucial to the success of the reform programs. Recognizing the shortage of capacity, the project explicitly includes capacity building in all of its components.

74. The nature of most of these actions and the undisputed commitment of the current government to these reforms enhances the likelihood that, once implemented, they will be sustainable. A number of reforms have already been prepared under PAGE. These include: (a) the revision of the investment code, (b) the modernization of the commercial code and the companies act, (c) modernization of the mining code, (d) the framework for private/public dialogue, and (e) a number of key diagnostic studies for the divestiture of government shares in: (i) telecommunications, (ii) coffee sector, (iii) tea sector, (iv) cotton sector, and (v) fruits and vegetables. In addition, there are new banking and microfinance laws, and new statutes for the BRB.

E. Critical risks and possible controversial aspects

75. The overall project risk for procurement is substantial (see paragraph 87 below for more details).

Risk	Risk Mitigation Measures	Risk rating with Mitigation
The GoB does not have the will to conduct the reform program or reverses long-standing policies.	This risk is mitigated by ensuring that ownership and understanding of the project is both broad and deep throughout civil society. The ongoing communication program (under PAGE) will continue through the proposed project.	H
Change in the GoB in 2010 (elections) would be a risk if it resulted in a departure from current thinking on the proposed PE, private sector development and financial sector reforms.	Again, this risk is mitigated by ensuring that ownership and understanding of the project is both broad and deep so that it can withstand change in political leadership.	H
The privatization process will not be transparent and may be	There will be a clear action plan and timetable. In addition, reputable transaction advisers, some of	M

subject to political pressure or interference.	which have done preliminary work, will be hired.	
PEs' unions opposition to privatization and population misperception can block or delay.	Preparation of intensive communication campaigns, as well as staff redundancy programs will be adopted by specific PEs.	H
(a) SCEP does not have the full capacity to undertake a complication privatization such as coffee, telecom, and sugar. (b) BRB, MoF, and MoCIT do not have the full capacity to implement reforms.	(a) Reinforce the capacity of SCEP with the appropriate technical adviser. (b) Appropriate technical assistance will be provided in the project to support implementation.	M
Weak collaboration between ministries and the BRB is an impediment to the implementation of the project.	Bringing BRB on to the steering committee should improve the dialogue between the parties.	M
Cost overruns due to the underestimation of cost of activities and/or currency fluctuations.	During MTR, priorities will be examined and activities may be cut or an additional financing credit sought.	M
Weak capacity at the PCU to ensure proper and adequate financial management systems and controls of two projects.	The financial management systems are already in place and project will be managed by an ongoing PCU that has a good track record with financial management. The current financial management system that is capable of managing more than one IDA credit. An additional accountant has been recruited to maintain the books of accounts of the new project.	M
Low capacity of implementing agencies can cause delays in procurement.	Implementing agencies, i.e., BRB, MoCIT, etc. will be supported by an experienced procurement specialist at the ongoing project PCU.	M
Staff turn-over in government. Staff attrition in government is a constant challenge for building and maintaining capacity.	In order to address this challenge, staff, at all levels, are involved early during project design, appraisal, and implementation.	H
That the privatizations be undertaken without due diligence of environment and social implications.	The specific risks will be clearly identified during the due diligence carried out by professional transaction advisers and ensure that the appropriate clauses are included in the divestiture contracts. Proper budgeting will be made to ensure that retrenched workers are compensated according to the law and proper communication campaign is carried out under the project.	M

F. Grant conditions and covenants

Retroactive Financing

76. In the course of the program, there are several important activities that were agreed to be pre-financed by the GoB for the reimbursement of which authorization for retroactive financing is requested. Withdrawals up to an aggregate amount not to exceed US$400,000 equivalent may be made for payments made prior to this date but on or after June 1, 2009, for Eligible Expenditures as agreed in the financing agreement. These activities were not included in the Project Preparation Advance (PPA) because they were not directly linked with project preparation but are important to jump-start the reform program.

77. *The following were agreed prior to Negotiations:*

- A separate segregated Designated Account denominated in US Dollars will be opened under term and conditions acceptable to IDA.
- Format of the Interim Financial Reports (IFR) and Annual Project Financial Statements have been agreed.
- Terms of reference for the auditor have been agreed.
- Draft Letter of Financial and Private Sector Development Policy.

78. *Conditions for Board:*

- None

79. *Conditions for Effectiveness*:

- The annual work plan for the first year will be prepared and agreed with IDA.

IV. APPRAISAL SUMMARY

A. Economic and financial analyses

80. The link between the development of the financial sector and economic growth is well established in the literature. If anything, the recent turmoil on the international financial markets has clearly demonstrated that link. However, given the character of this technical assistance operation, a quantitative economic and financial analysis is not an appropriate tool to assess the returns of this project. The pace and depth of the reforms envisioned in this operation will *determine* the ultimate economic and financial benefits of the grant.

B. Technical

81. The technical merits of the project design have been examined by IDA staff over the course of project preparation and are considered sound and in line with international standards. Project design is based on analytical work noted in paragraph 33.

82. The project draws heavily on the results of the FSAP and the accompanying technical notes and continuous policy dialogue with the authorities. The project thus aims to modernize the financial sector by developing a payment system (without which the nascent tourism sector cannot develop), revising an outdated chart of accounts for commercial banks, insurance companies and microfinance and strengthening supervision activities of both commercial banks and insurance companies in an effort to ensure strong and sound financial institutions.

83. The project also draws heavily on the results of the ICA that demonstrated the need to integrate policy reforms initiatives and improve the business environment with technical and financial support to help position Burundi for its participation in the EAC. The project thus aims to improve the business environment by reducing the costs of doing business, by improving the legal framework for the entry, exit, and operations of businesses. The project will thus concentrate on the preparation of regulations and subsequent dissemination for revised economic legislation. It will provide financial and technical assistance to the Bureau of Standards and Norms to ensure conformity and harmonization with the EAC and the newly created Arbitration Center (for the first two years) to support its effort in alternative dispute resolution. Finally in this area, the project will support the development of the accounting profession necessary to improve corporate governance and transparency.

84. Substantial preliminary work and foundations have been laid in the course of PAGE, which is winding down, and project preparation, with support of the PPA, namely technical assistance for: (a) initial preparatory work on the electronic payment system and insurance supervision; (b) SCEP to prepare the privatization strategy, review of the privatization law and begin the preparatory work for the privatization of ONATEL; (c) the preparation of the social plan and environmental protection plan for the privatization of the coffee washing stations; (d) the identification of supportive measures for the new coffee sector regulatory agency ARFIC and for fostering the creation of new private inter-professional association; and (e) support to the PCU for project preparation.

C. Fiduciary

85. Procurement for the proposed project will be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004, revised October 2006; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, revised October 2006, and the provisions stipulated in the Legal Agreement.

86. Procurement activities under the project will be carried out by an existing PCU of PAGE, which is an IDA-financed operation and has a good track record. The PCU will be responsible for: (a) selecting and recruiting consultants in charge of technical studies and technical assistance, (b) managing bidding process and awarding contracts for goods, (c) supervising quality of studies and supervising contracts of goods, (d) approving invoices, and (e) receptions of goods and services. Since most the services will not be furnished to the PCU but rather to the institutions involved in the reforms and activities financed by the grant, these institutions will be closely involved in the key step of the procurement process.

87. An assessment of the capacity of the PCU to implement procurement actions for the project has been carried out by the Procurement Specialist of the Bank Country Office. The procurement assessment started in April 2009 to end in August 2009. The assessment reviewed the organizational structure for implementing the project, procurement procedures, staffing and the interaction between the PCU and the other institutions involved in the implementation of the grant. While, the overall project risk for procurement is high before mitigations, it is judged to be substantial after mitigation. Training activities concerning procurement filing, the selection of the consultant and the drafting of ToRs were conducted during the first and second quarter of 2009.

88. The financial management of the proposed project will be carried out by the Financial Management Unit of PAGE. Thus a Financial Management Assessment (FMA) was carried out of the existing financial management arrangements in accordance with the Financial Management Practices Manual issued by the Financial Management Sector Board in April 2009. The overall risk rating for financial management is "moderate".

89. The objective of the assessment was to determine whether: (a) PCU has adequate financial management arrangements to ensure that funds will be used for purposes intended in an efficient and economical way; (b) PCU's financial reports will be prepared in an accurate, reliable and timely manner; (c) arrangements exist for an independent audit of the sources and uses of funds; and (d) the entities' assets will be safeguarded. The assessment also included the identification of key perceived financial management risks that may affect project implementation in achieving its intended development objectives and proceeded to develop mitigation measures against such perceived risks and outlined in the risk matrix in Annex 7.

90. Based on the assessments conducted, the proposed financial management arrangements, put in place by the PCU of PAGE, meet the IDA's minimum requirements for project financial management as per OP/BP 10.02.

D. Environment and social safeguards: Category C.

91. A number of project components are expected to lead to favorable social outcomes. There are numerous benefits to the project. Economic development will be supported on several fronts, namely by stronger financial, legal, and regulatory systems that will help to facilitate enterprise access to finance and allow firms to operate within a more transparent business environment. The GoB has aggressively liberalized the telecom sector and this is showing positive results through increased network coverage and lower prices. It has also made a public commitment to privatize ONATEL. With respect to privatizing the coffee stations, the GoB, began the process by launching a tender for the sale of 117 washing stations, and the sale of at least 13 washing stations is expected to be completed by December 2009 (without support of the project). Steps will be taken to modernize them and will ultimately improve the quality of the coffee and generate more business for the farmers.

92. The project has been classified as Category C because it is only financing technical advisory services that are unlikely to result in significant adverse environmental impacts. With respect to the coffee sector, the privatization of the coffee sector was started (and initially supposed to be completed) under PAGE. During the implementation of PAGE, an

environmental impact assessment was commissioned and is currently underway to assess potential environmental impacts of activities under the coffee sector reform. The project will finance the consultant fees of the privatization advisers for the ongoing coffee privatization process. Specifically it will cover: (a) the additional work the privatization consultants have been doing over the last couple months, since PAGE is running out of money; (b) the fees for a consultant to prepare environmental and social guidelines; and (c) the remaining funds are for complementary measures (regulatory agency, professional association of coffee growers). Thus, under PAGE, the government, as part of its due diligence to strengthen the coffee sector, recruited a consultant who is preparing an environmental and social impact assessment of the potential run-off and will put into place an Environmental and Social Mitigation Framework (ESMF).

93. The privatization of coffee washing stations may have environmental implications, in terms of potential water pollution. However, as the washing stations are privatized, the project would help ensure that the environment-related practices followed do not deteriorate. In fact, it would be expected that the practices would improve. As part of the negotiation of the sale, purchasers of the coffee washing stations will be required to put into place measures to minimize any negative environmental or social impact using the ESMF as the guideline.

94. With respect to SOSUMO, the project is only financing a transaction adviser for an increase in capital (or dilution of government shares). This transaction will not have an environmental consequence, however, it is anticipated that the consultants financed by this project, who will work on the preparation of the capital increase of SOSUMO, will examine the environmental and social aspects, using the ESMF. IDA is supporting the agricultural sector in Burundi, and the World Bank Group is preparing a follow-up agriculture development project. The development of the coffee sector will be one pillar of that proposed investment project. The two operations will work together to strengthen the environmental and social safeguards of the relevant institutions.

95. The third PE, which will be supported under this project, is the sale of shares of ONATEL. It is unclear at this time, what percentage of the company will be put on the market for sale. There are currently six telecom operators in the sector so the change of ownership of ONATEL should not have any significant safeguards impacts on the sector which cannot be mitigated. The ESMF will provide the mitigation measures required for potential safeguards' impact in the telecom sector and the installations of towers (noise from generates, radio signals from base stations – albeit minimal). The ESMF will also guide the client with regard to mitigation measures and the need for development of any further safeguard tools needed. Normally, the operators fall under national regulations for environment and health and safety which are enforced either by the sector regulator or by the environmental agency (or both). With the ESMF in place, the project will provide guidance to these agencies.

96. There may also be some social impact due to retrenchment of workers at ONATEL and/or the coffee washing stations. While the magnitude of such an activity is uncertain at this stage, the government has already begun consultations with the workers and the labor unions to ensure a smooth sale and agreement on a comprehensive retrenchment and social action plan prior to any future sales. The GoB has its own laws pertaining to retrenchment of workers,

however, it will be important to provide technical support in the implementation of the retrenchment/social action plan and public consultations strategy.

97. The government has already launched its efforts to address safeguard policy issues. Government began the process of carrying out an environment impact assessment of the coffee sector and has finalized the ToR to recruit an adviser to prepare a social plan. During project implementation (or perhaps sooner, since an environmental impact assessment is already underway), a consultant will: (a) review the existing environmental (water pollution-related) practices of the existing facilities, (b) provide recommendations regarding good environmental practices that the washing station operators could feasibly be expected to follow, and (c) lay out detailed environmental rules that the purchasers of the assets will have to abide by. The appropriate environmental requirements will then be reflected in the tender and sale documents for the washing stations that remain to be sold.

98. Based on the recommendations of this study, to prepare an ESMF, which will be jointly implemented by the Ministry of Good Governance and Privatization and the sector ministry. Government will ensure that the sale of these entities is conditional on the private sector purchaser putting into place measures to mitigate potential negative environmental and social impacts, including the retrenchment plan/public consultation strategy.

99. It was further agreed with government that the drafting of the mining regulations will take environmental considerations into account, including how any possible overlaps or legal ambiguities between the mining code and Burundi's environmental laws are to be interpreted. It will also be agreed that an environmental specialist will be part of the team to draft the mining regulations. This will ensure that any environmental aspects are adequately addressed. The ToR for the technical assistance to prepare the mining regulations will specify the need for attention to potential environmental implications.

E. Safeguard policies

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP 4.01)	[]	[X]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Physical Cultural Resources (OP/BP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OP/BP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP 7.60)[5]	[ ]	[X]
Projects on International Waterways (OP/BP 7.50)	[ ]	[X]

[5] By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas.

F. Policy exceptions and readiness

100. No policy exceptions are required. The project is ready for implementation. On an administrative level, project coordination will be the responsibility of an existing PCU with a good track record. A high level private sector specialist has been recruited to support the GoB to ensure that the activities will bring about the required results in the reform process. Under PAGE, there is an operational financial management system which is capable of accounting and reporting for multiple projects. This financial management has been assessed as satisfactory and an additional accountant has been recruited. In addition, the terms of reference of the auditor for the accounts of PAGE will be amended to include the financial accounts of the proposed project. There is a procurement specialist in the ongoing PCU, but an additional procurement specialist will be recruited (if needed). The 18-month procurement plan has been prepared and agreed. The PIM, which provides the framework for project implementation, and includes administrative procedures, budgets, accounts, and financial management information, has been completed and agreed with IDA. On a technical level, a high-level adviser to the BRB for supervision and the payment system has been recruited and will be in Bujumbura before the end of the year. As noted above, in late 2008, government: (a) adopted an action plan to divest the key state-owned assets of the coffee sector, (b) authorized by decree the privatization of ONATEL, and (c) passed a decree allowing to privatize parts of that sector (coffee washing stations and dry mills). A decree was also issued to liquidate OCIBU. Thus, the legal framework for privatization program in these two sectors is ready.

Annex 1: Country and Sector or Program Background

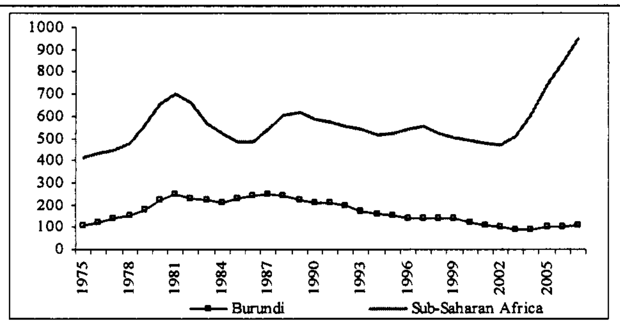
BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

A. Economic background

1. Burundi is a small, landlocked, resource-poor country that had been strongly affected by civil war in the early 1990s, during which time a four-year economic embargo and several episodes of drought took a further toll. In the late 1990s, international assistance came to a near halt and, subsequently, a regional economic embargo was imposed against Burundi, prompting an increasingly difficult and interventionist approach to economic policy from the GoB. During this period, the authorities rationed the scarce foreign exchange resources, resulting in an overvalued exchange rate (which had appreciated by about 197 percent between 1993 and 2000), and the rise of parallel exchange markets. To finance its fiscal deficit, the GoB relied on monetary growth and borrowing from the BRB. In recent years, however, the country has shown tentative signs of recovery.

2. Burundi's growth record has been one of protracted decline (Chart 1). Its per capita income in 2007 was at about one-ninth of the SSA average, roughly on par with its 1975 income per capita level. It fell by almost 40 percent during the war, from US$180 in 1993 to US$110 in 2007. Although Burundi has made some progress in the past few years, GDP growth rates of eight percent over the next four years will be needed for the country to reach its pre-war level of Gross National Investment (GNI) per capita by 2012.

Chart 1: Current GNI per capita. 1975-2007(in current US dollars, Atlas Method)



Source: World Bank, World Development Indicators

3. Until the early 2000s, Burundi experienced either low or negative GDP growth for almost a decade. Over this period, the war affected every sector and poverty worsened. The consolidation of the peace process has helped start reconstruction, and created positive prospects for the country, but the country has not experienced the typical post conflict bounce in GDP growth. Nonetheless, since 2000, the country has shown progressive recovery from the negative growth (average -1.8 percent) of the decade of political and economic turbulence to a positive growth rate of 5.1 percent in 2006. Economic growth is largely dependent on the widely fluctuating agricultural sector, mainly coffee. While the 2005 drought led real GDP to grow by only 0.9 percent, it came back strongly in 2006 to 5.1 percent and slightly decelerated to 3.7 percent in 2007, mainly due to poor coffee harvest. In 2008, despite the unprecedented increase in fuel and food prices, real GDP grew by 4.5 percent.

4. Prudent monetary policy and fiscal discipline have meant that credit to the economy has continued to recover, rising by around 11 percent during 2007, and projected to grow by 32 percent in 2008. This is driven by commercial bank financing of the coffee sector and of

business development. In effect, to avoid crowding out private investment, domestic financing has been limited to one percent of GDP in 2008 compared to 2.4 percent of GDP in 2007. Although the authorities try to exercise tighter monetary policy, elevated domestic borrowing has made money supply growth high.

5. Growth performance has been volatile, as changes in Burundi's annual GDP growth rates are largely driven by growth in agricultural output. The agriculture sector dominates Burundi's economy, representing 46 percent of GDP and providing 90 percent of the population with income and employment. Subsistence farming dominates the sector, with commercial agricultural production (tea and coffee) contributing less than 5 percent of GDP. However, commercial agricultural remains critical for the economy as it generates more than 60 percent of export revenues

6. The service sector, which accounts for 37 percent of GDP, has been steadily growing in recent years, largely due to a rise in public services, and to a much lesser extent, the transport and trade sub-sectors, while the financial sector remains weak. Credit and banking services are limited and the retail sector is based on small trading and shops. The financial sector is being held back by the dearth of feasible business opportunities domestically, and scarce foreign exchange. However, the currency auctions that began operating in 2002 have curtailed this latter constraint. Thus, business opportunities may improve as peace and political stability return. Burundi's identifiable natural tourism assets are limited, and although it could be recognized for its attractive cultural features, the tourism sector will remain feeble until peace is assertively re-established.

7. Burundi's industrial sector contributes about 17 percent of GDP. Agricultural processing dominates the country's small industrial sector, which also includes the production of beverages, cigarettes, consumer goods, and some construction materials for the domestic, and to a limited extent, the regional market. In the 1990s, production dropped significantly because of conflict, but output appears to have been revived in most industries.

B. Trade and capital flows

8. The impact of the current global financial crisis on Burundi can be examined in terms of its direct impact through reduced flows from developed countries, as well as the indirect impact emanating from the ensuing slowdown in global economic activity and international trade. Previously strong growth in the agriculture and service sectors may be dampened by the effects of the financial crisis through the following channels: (a) reduction in FDI, which in turn could affect production in the coffee sector (e.g., washing stations), and (b) decline in worker remittances, which may affect both sectors as households have less available incomes to spend in the market place and/or invest in productive activities.

9. The current global economic crisis has also affected Burundi's export activities, since a large share of Burundi's exports goes to developed countries. A fall in the demand for imports by countries that have been hit by the current global recession has a direct impact on demand for Burundi's exports. Furthermore, the contraction in the demand for imports by industrialized countries would affect not only the volume of trade, but also the prices of exports. Since industrialized countries account for a larger share of world imports of agricultural commodities

and other primary goods, the contraction in the demand for imports by these countries would have significant impact on world trade, and global economic activities in general.

10. The global economic slowdown is also likely to lead to a reduction in the flows of direct investments to Burundi. The global economic crisis and the ensuing financial stress might prompt potential foreign investors to look inward to evade uncertainty and consolidate their financial position, and consequently lose interest in doing business with Burundi and other comparable countries. In the past, FDI flows into Burundi have been very small even by African standards. In recent years, some countries have taken steps to invest in Burundi and FDI did rise, however, the current crisis may limit and/or delay further progress in this area. Privatizing the coffee sector was expected to boost FDI inflows in Burundi, but the large decline in the global demand for such commodities following the crisis, induced their prices to fall, and subsequently, the profitability of foreign investment in these sectors declined.

11. As noted in paragraph 5, Burundi is primarily an agrarian economy. Coffee is the main export of the country and the main source of cash income for close to 600,000 poor rural families. Although output declined sharply over the past ten years, the Burundian coffee has good potential for sales on specialty markets. Improving production, productivity, and prices, therefore, is an essential component of a growth and poverty reduction strategy and is one of the main themes of the private sector development objectives of the ERSG program. So far, progress in this area has been slow and subject to reversals, but recent decisions seem to indicate that the government is now determined to address more forcefully that politically sensitive issue. With funding from PAGE, international consultants were recruited to help define the most appropriate regulatory and organizational framework and identify options for privatizing coffee processing facilities. Following a detailed review of the report, the government has now chosen one of the strategic options proposed by the consultants, prepared an action plan, and initiated a communication campaign aimed at explaining its decision and engaging all the stakeholders in the reform process. ERSG III will accord the highest priority to supporting the proposed reform, monitoring implementation, and evaluating results.

C. Private sector development – improving the business environment

12. *Background.* The Burundi private sector is underdeveloped. Burundi's private sector includes a large number of small enterprises, most of which operate in the informal sector. The formal private sector includes about 3,000 registered enterprises, employs some 37,000 workers, and produces mainly for the local market. Construction, agricultural processing, brewing, energy, and communications are the main activities of a very small industrial sector. The ERSG III program will include a series of measures already initiated, but only partly implemented under ERSG I and II, namely: (a) to improve the business environment, (b) modernize the legislative and regulatory framework, (c) improve the dialogue between the public and the private sectors, and (d) provide tax incentives for SMEs.

13. The privatization strategy of the government is hampered by the poor financial performance of many public enterprises and by the lack of capacity of the institutions responsible for planning and monitoring the program. A 2007 study found that the GoB had shares in 48 entities (40 enterprises and eight financial institutions), and that several of these public enterprises are faced with a difficult financial situation. They are burdened by the governance

problems typically encountered in many countries, including political interference from the state. Their indebtedness increases faster than their turnover, and debt obligations often exceed cash flow. By the end of 2006, the overall debt of the 21 largest public enterprises amounted to Fbu 128 billion (about 14 percent of GDP), including debt to suppliers, the public sector, foreign lenders and local banks. SCEP does not have the capacity or the resources necessary to bring about substantial improvements in the performance of the sector and to plan and monitor the privatization program envisaged by government.

14. An effective private sector development strategy will require actions on many fronts, including investments in infrastructure (transport, energy, and communications), that will be supported by investment projects. The reforms being targeted within the ERSG III framework are: (a) improving the business environment, (b) reforming and privatizing the coffee sector, and (c) improving the supply of petroleum products.

15. *Reforming the business environment.* There is much room for improvement in the business environment. The average time for completing the steps necessary for registering an enterprise and the costs involved are high. Many firms report that "unofficial payments" to government officials are often necessary "to get things done." There is also the need to improve the legal and regulatory framework, simplify the tax system for small businesses, improve the performance of the Commercial Court, revise the privatization code, and assess the financial position of public enterprises. It will also support public and private sector initiatives to improve the dialogue between the government and institutions representing private enterprises.

16. *Improving the legal and regulatory framework.* In June 2008, the Council of Ministers approved a new draft investment code, which includes some of the best practices in investment legislation, including investor protection, freedom to transfer capital and dividends, and a streamlined approval process. The investment code was promulgated into law in September 2008. Its implementation has been complicated by the fact that provisions concerning tax incentives make reference to the tax code. Unfortunately, the revision of the tax code has been significantly delayed. The Minister of Finance recently decided to commission a PAGE-financed study aimed to revise/amend the section of the current tax code which is referred to in the investment code; the draft has been completed. With PAGE funding, the GoB is updating the 1993 commercial code and the 1996 company code. A competition law is also being drafted and two insolvency laws were recently adopted.

17. The draft commercial code and the draft code for public and private companies should be revised taking into account comments made by the Bank, IFC, and the IMF. Bank/IFC technical assistance may be required to complete the revision. Two prior actions under ERSG III include the submission to the Parliament of the revised commercial code and the submission of the revised code for public and private companies.

18. *Simplifying the tax system for small enterprises.* Paying taxes in Burundi is cumbersome and complicated by the multiplicity of taxes that discourages the formalization of businesses and leaves room for uncertainty and corruption. A study on the reform of the tax code completed in 2007 suggests replacing a large number of small taxes paid by small enterprises by a simplified tax, which is based on verifiable and mostly quantitative criteria. This reform would have several benefits: (a) it would help draw into the formal economy those informal entities whose

primary motivation for evading tax is not fraud but an inability to meet the complex and burdensome rules and regulations, (b) the newly formal businesses would have better access to credit and government contracts, thus increasing their contribution to the Burundian economy, (c) the reform would expand the tax base and provide the government with a more predictable revenue stream, and (d) it would reduce the possibility of corruption in the present method of estimating business turnover. The GoB is expected to seek technical advice (from Foreign Investment Advisory Services, FIAS) on the structure of a new tax system.

19. *Improving the dialogue between the GoB and the private sector.* Private enterprises consider that one of the most important initiatives to improve the business climate in Burundi is to strengthen the policy and operational dialogue between the government and private enterprises. In June 2008, a presidential decree established a public/private sector consultation framework, including a general assembly, technical groups, and a permanent secretary, but so far no meeting has been organized by the government under this arrangement. However, there is currently a private sector technical working group which is comprised of public, private (represented by the Chamber of Commerce), and development partners. This group meets monthly and is chaired by the Director of USAID.

20. *Improving the performance of the Commercial Court.* Burundi has only one commercial court in Bujumbura, which lacks adequate facilities, equipment and skills, despite receiving training and equipment through PAGE. The high turnover of magistrates also contributes to the poor performance of the court in the handling of caseloads. A number of measures have been taken by government to improve the performance of the court and other sector institutions. These include salary increases to discourage corruption, increases in the number of magistrates and a reform of the domestic regulations. The ERSG III program will focus on reducing delays in the judicial decisions on cases presented to the court. The percentage of cases whose duration exceeds 60 days would decrease from 40 percent in March 2008 to less than 20 percent in 2009. This is a prior action for ERSG III. In addition, under PAGE, support has been provided to the Commercial Court to create a database and scan the documents of businesses registered, guarantees and judgments which have been filed with the court. However, there is a need to ensure that this process has adequate resources to continue for the next couple of years.

21. *Limited availability of skilled workers and low productivity of labor.* While regulations do not appear to be a constraint, the main labor issue in Burundi is the immediate need for technical and professional skills in the labor force. Despite recent efforts and improvements, more than 40 percent of the population remains illiterate. The recently completed ICA indicated that nearly 5.6 percent of the employees interviewed reported having no formal education. The public technical and professional training schools do not appear to be able to provide for the private sector's skills requirements. Nearly all employees surveyed (94 percent) report the need for training, most with regards to technical and production competencies. Other training requirements mentioned include French and English language skills, as well as information technology (IT).

D. Public enterprise sector

(i) Overview of the public enterprises

22. The GoB owns stakes in 48 PEs called *Sociétés à Participation Publique (*SPP, Public Participation Companies*)*, eight financial institutions, and 40 other enterprises. The PE population includes a variety of enterprises, working in various sectors and with different ownership structure: (a) some 100 percent state-owned; (b) some with a mixed shareholding with state and private investors, but with the state as majority shareholder; and (c) mixed enterprises in which the state is only a minority shareholder. Among the non-financial PEs many are SMEs with less than 100 employees. A number of them have actually ceased their activities. There are 21 large and medium ones that are still operational[6] and employ permanently about 4,300 people. The largest ones are ONATEL and *Régie de Production et de Distribution d'Eau et d'Electricité* (REGIDESO), followed by PEs operating in the agriculture/agro-industrial subsectors (coffee, tea, cotton, rice, and sugar). The smaller ones operate in various lines of business: hotels, transports and other services. They are all monitored by SCEP.

23. The performance of the PEs has generally been weak. They suffer from poor governance and overstaffing. Most have obsolete assets. Many are in a difficult or even distressed financial situation, and they have become an increasing financial burden on the state and on the already weak banking sector. However, many contribute directly and also indirectly (particularly in agriculture) to the employment of large numbers of people and some play a major role in the country's exports, such as coffee. Many suffer from political interference in management and are handicapped by a lack of clarity in many aspects of their relationship with their majority owner, the state. Table 1 provides a detailed breakdown of the PEs.

24. The PEs have also been affected by the country's recent history of civil war and are still handicapped by the current post-conflict situation. The country's current difficult economic recovery, in its post conflict phase affects their revenues and cash flows, particularly through low controlled tariffs, large arrears in the payment of the bills by the GoB and other state entities to the PEs, and a widespread behavior of payment arrears *vis-a-vis* the PEs accumulate, with limited remedial actions taken by the PEs.

25. In 2006, the 21 largest PEs reported total revenues of Fbu 76.0 billion (about US$74 million) and contributed a value-added of Fbu 35.9 billion (about US$34.9 million*)* or about 3.8 percent of GDP. Their financial performance worsened in 2007 with total revenues of Fbu 74.7 billion (about US$64.7 million), and a value-added of Fbu 35.9 billion (about US$32.1 million*)* or about 3.3 percent of GDP. Their total assets and net equity at end-2007 amounted to Fbu 228 billion (about US$194 million*)* and Fbu 74.5 billion (about US$63.5 million), respectively. Their aggregated net result, a profit after tax of Fbu 9.1 billion in 2006, decreased to Fbu 1.1 billion only (about US$ 0.9 million*)* in 2007, a return of less than 2 percent on equity; the results vary by enterprise. Only five of the largest PEs showed a significant accounting profit after tax in 2006 and only three in 2007: ONATEL, Société de Déparchage et de Conditionnement (SODECO), and SOSUMO. The others reported losses or insignificant profits.

[6] Among the 24 large ones monitored by SCEP, three are under liquidation or stopped operating

Table 1: Burundi's PEs in 2006

PE	Sector and Activities	Staff	Total Assets Mi. Fbu	Total Turnover Mi. Fbu	Net Result Mi. Fbu
Air Burundi	Air transport	73	4,654	776	291
Alcovit[7]	Animal feed	0.00	0.	0	0
APB	Abattoir	24	467	255	48
APEE	Exports prom.	0.00	0	0	0
BCC	Coffee Exports	20	326	141	2
COGERCO	Cotton prod.	159	6,069	2,360	-122
COTEBU	Textiles prod.	0.00	0	0	0
ECOSAT	Real Estate Dev.	32	1,299	221	-21
SHTB	Hotel	50	1,591	777	28
SHNB	Hotel	70	1,709	1,606	30
OCIBU S.M	Coffee holding co.	107	2,208	4,864	1,097
OCIBU Patr.	Coffee (asset co.)	0	8,148	0	-164
FONDSTAB	Coffee (financing)	0	25,005	0	778
ONAPHA	Pharmaceuticals	0	0	0	0
ONATEL	Telecoms	573	29,250	17,143	1,672
ONATOUR	Peat prod.	56	898	772	82
OPHAVET	Veterinary prod.	0	0	0	0
OTB	Tea	800	20,490	10,700	2,151
OTRACO	Bus transport	50	2,828	600	74
REGIDESO	El. Power & Water	1102	61,552	12,764	589
SIP	Real Estate Dev.	50	2,671	506	-10
SOBUGEA	Airport Management	181	1,542	1,725	359
SODECO	Coffee (milling)	100	3,500	340	-778
SOGESTALs (5)	Coffee (washing)	265[8]	1,287	8,235	210
SOSUMO	Sugar production	445	13,775	9,837	2,862
SRDI	Rice	100	10,745	2,622	123
Total		**4,257**	**200,014**	**76,244**	**9,082**

Note: PEs are defined in the acronym/abbreviation section of the document.

26. Preliminary financial data for 2008 indicate that the performance of the 17 largest PEs still monitored by SCEP has improved, with an aggregated net profit of Fbu 8.8 billion (about US$8 million). Despite this apparent improvement (mostly due to better results in the coffee and tea sector as well as for REGIDESO), the results are still weak, with only five of the 17 PEs reporting a significant accounting profit. In particular, the PEs have not controlled their labor costs; their aggregate labor costs increased by 27 percent from 2007 to 2008 (and 158 percent from 2003 to 2008), significantly more than their sales.

27. Most PEs suffer from acute liquidity problems but survived by accumulating arrears. Some PEs used, until two to three years ago, loans from the local banks on which they then defaulted. The tight liquidity of some PEs was, in some cases, the result of late payments made by the state (including the security forces) of its bills due to the PEs. The lack of strict payment

[7] Like APEE, COTEBU, ONAPHA, and OPHAVET, it is now closed.
[8] Excluding about 880 workers operating the washing stations.

discipline by the state has, in turn, caused some of the PEs to delay payments to their own debtors, particularly suppliers, and thereby contributed to a spiraling build-up of arrears. The PEs and the state, as well as the PEs between themselves had thus accumulated substantial cross debt. In some instances when the amounts overdue became significant, the state reduced some of its arrears to the PEs through a triangular swap, with the state giving treasury bonds (with a five-year maturity) or notes to the local banks in exchange for the outstanding PEs' loan obligations to the banks. While providing relief to the PEs, these swaps have created a new budgetary burden for the Treasury. In contrast, the state has not accepted to compensate its dues to some enterprises with the profit taxes payable by those enterprises that reported profits.

28. In conclusion, the prominent public enterprises are burdened by large debts, often excessive in comparison to their assets and resulting in debt service obligations exceeding their cash-flow. Most PEs have negative working capital and many are technically bankrupt. The overall debt (including liabilities to suppliers) of the 21 largest PEs amounted to about Fbu 154 billion (13.4 percent of GDP) by the end of 2007. The aggregated debt of the 17 PEs still monitored by SCEP, decreased from Fbu 125 billion in December 2007 to about Fbu 100 billion, by the end of 2008. However, this was mainly due to a debt forgiveness program for REGIDESO (about Fbu 40 billion) in 2008; the debts of the other 16 PEs actually increased by Fbu 14 billion during the year.

(ii) Past privatization actions

29. Burundi launched its first PE reform attempts in the 1990s in the context of the structural adjustment programs. The main thrusts of its PE sector policy were: (a) restructuring/rehabilitating enterprises that were deemed strategic, (b) privatization of non-strategic enterprises that were profitable or potentially viable, and (c) liquidation of non-strategic distressed enterprises. However, its first tangible results are quite limited as explained below.

30. Although privatization was thus started in Burundi at the same time as many other countries, the results so far are very limited. Burundi has fallen behind most countries of the region, with only about 16 privatization transactions took place between 1991 and 2007, and of limited size. Only one transaction exceeded US$0.5 million in value and many were sale of assets or transfer of shares in enterprises which had already some private shareholders[9]. Half of those transactions were completed before 1994. Little could be done during the civil war until 2001. Still, no significant operations were concluded during 2004-2008[10], despite the official adoption of a number of plans and proposals following the GoB's statements since 2005 to re-launch the privatization program.

31. A new comprehensive PEs restructuring and governance improvement program is now urgently needed, together with sustained privatization efforts. The first privatization law was adopted in August 1991, but was amended in March 1996 and again in September 2002. The methods, steps, and procedures of the privatization of an enterprise are dictated by the privatization law as amended in September 2002 and by the Decree of November 1999, setting the sale procedures. Any privatization is first triggered by a decree of the President. A special

[9] Half of those were in amounts of less than US$100,000 in value. The total amounted to about Fbu 2.3 billion.
[10] The 2005 operations that were launched mostly failed to attract bidders or were interrupted by the transition GoB.

inter-ministerial committee (CIP) was set up to implement the GoB privatization policy and supervise all privatization operations. It was to be chaired by the minister who had privatization in his mandate and SCEP was initially established to deal with PEs primarily in a monitoring and advisory role.

(iii) Current privatization framework and recent progress

32. The authorities took a number of decisions before a new amendment to the privatization law was promulgated. The GoB started by: (a) liberalizing first in 2005 the coffee and telecommunications sectors, and later tea; (b) developing a graduated approach whereby the easiest privatization transactions would be attempted first; and (c) while preparing a roadmap for more important/strategic enterprises, carrying out relevant sector and other preparatory studies, enhancing the institutional framework and capacities and elaborating a communications plan. A list of 14 PEs[11] targeted for privatization was prepared in the context of the ERSG. This was converted into a 2006-2008 privatization program officially adopted in 2006. However, little was actually completed thereafter. The GoB focused particularly on the coffee sector and adopted an action plan for divestiture of assets in October 2006. Following a longer than expected delay, the GoB approved the new detailed time-bound plan for divestiture of key assets of the coffee sector in December 2008, an indicative trigger for ERSG III.

33. Another important preparatory step was the January 2009 decree authorizing the partial sale of equity of ONATEL. In addition, the SHNB hotel in Bujumbura was tendered for sale and bids were received from two foreign investors in September 2009. Finally during the summer of 2009, with the help of transaction advisers financed under the PAGE project, the GoB launched the bidding process for 26 lots of 117 coffee washing stations. The SHNB hotel and three first lots of washing stations (13 stations) are now expected to be transferred to private investor by the end of the year.

(iv) Supervision and reform of PEs with SCEP

34. As noted previously, the GoB created SCEP in July 1986 to monitor the PEs and propose programs to reform the PEs. SCEP's institutional set-up and governance structure were subsequently amended several times. SCEP is directly under the purview of the new ministry at the Presidency, in charge of Good Governance, Privatization, and General Inspection of the state. SCEP is now headed by a general commissioner, who is also member of the CIP. Its high level staff now includes about ten experts with the status of civil servants.

35. Its role of strategic analysis of the PEs and preparation and implementation of the GoB policy on PEs, was expanded to monitoring and analysis of their detailed performance, and advice to the enterprises. However, it still falls short of a genuine control which is theoretically exercised by the PEs' boards[12], sector ministers and *Inspection Générale l'Etat* (State General

[11] OCIBU, BRB, Abattoir Public de Bujumbura (APB), REGIDESO, ONATEL, SOSUMO, Complexe Textile de Bujumbura (COTEBU), Union Commerciale d'Assurance et de Réassurance (UCAR), Office Pharmaceutique Vétérinaire (OPHAVET), OTB, Société d'Assurance du Burundi (SOCABU), Société Immobilière Publique (SIP)

[12] The PEs are joint stock companies falling under the Private and Public Enterprises Law. The rules applying to private joint stock companies thus also apply for PEs. There are only a few specific additional rules for PEs related mainly to their oversight by the state.

Inspector). SCEP sends one or two representatives to the PEs' supervisory boards but only as observers. SCEP has no ability to sanction the PE's management (for example when PEs fail to have their accounts audited by independent auditors). SCEP can only report its conclusions to the GoB, with the hope that the supervisory boards and respective ministries (particular the technical ministry) will take actions accordingly. This has seriously limited the impact that SCEP could have on improving the performance of the PEs.

36. SCEP was originally established with significant IDA support in the 1990s under the Business Law Reform and Modernization Project. IDA financed substantial technical assistance, training, and operating costs of the service, structured as a project implementation unit[13]. The subsequent interruption of IDA support and the civil war seriously impacted the capacity of SCEP. It was further weakened due to reduced financial means, de-motivation and rapid turnover of the staff, lack of political directions, and successive changes in the oversight of SCEP. The privatization law and its successive amendments gradually put greater emphasis on privatization in SCEP's mandate.

37. Since 2007, SCEP has benefited from some limited IDA support under PAGE: training and advisory services in the financial appraisal of enterprises, preparation of restructuring plans, and privatization proposals. A limited operating budget[14] and staff compensation, unclear political signals about privatization, and lack of genuine leverage on PEs' management, have continued to affect SCEP's ability to fulfill its mandate. SCEP has suffered from a high staff turnover and management changes.

38. The activities of SCEP and the CIP during the 2005-2008 period, focused on a number of essential preparatory steps. With support from PAGE, audits, sector studies, and valuation studies have been carried out for the tea, cotton, and sugar sectors in addition to the coffee sector. Technical assistance was provided to SCEP to enable it to make a quick diagnosis and assessments of seven PEs. Still, not much was achieved in terms of concluding the few privatization attempts that SCEP made. A number of tenders had to be re-launched as the offers from bidders were deemed inadequate or the authorities decided to change transaction structure. Actual sales consisted mainly in sales of shares held by the state or by other PEs in banks. Revenues from the privatization program (2005-2008) reached only Fbu 1.2 billion. They may increase substantially in 2009, if the closing of the transaction for the first coffee washing stations is effective by December 2009 as well as the sale of the *Société Hôtelière Nationale du Burundi (SNHB)/NOVOTEL* hotel.

39. As a prior action for the ERSG II, a study financed under PAGE was prepared to analyze the overall institutional capacity for PE reform, including privatization, and to recommend an action plan to strengthen that capacity. Its conclusions are discussed below. Specific reinforcing actions for SCEP will, therefore, be financed under the project as detailed in the Annex 4.

[13] Including financing of its key personnel as consultants.

[14] The privatization activities, primarily SCEP's work and advisers services, are financed by: (a) five percent of the dividends paid out by PEs and proceeds from privatization or liquidation of PEs; and (b) specific budgetary allocations.

40. SCEP evaluates the bids[15] and reports to the CIP who decides on the winning bid, and the sale price, and other transfer conditions[16], after negotiations by SCEP. Transfer of property is then carried out under SCEP's supervision.

41. The privatization procedures are not very different of those of many countries, but they are still among the least flexible and cumbersome[17]. In the future, the GoB should adopt a streamlined process, by which an indicative privatization program (listing a number of enterprises and assets) is approved every year (or two years) by the Council of Ministers (CoM), and the privatization transaction of a specific enterprise then needs to be approved only by CIP. The composition of CIP could also be amended to include fewer members, particularly ministers, and with more flexible quorum and voting rules. Unfortunately, the amendments to the privatization law promulgated in February 2009, do not enhance the privatization framework. On the contrary, any operation by which the majority control of a PE would be transferred to the private sector, must now be authorized by law. The GoB has recognized that this could slow down privatization, and that a number of features of the privatization framework could be improved to bring it closer to international best practices. Amendments to the privatization law are being prepared and could be submitted to parliament by the beginning of 2010. Still, the privatization of the coffee sector and ONATEL is not conditioned by these amendments to the privatization law.

42. The study financed under PAGE to analyze the overall institutional capacity for PE reform pointed out that other constraints also explain the poor performance of the privatization process so far: (a) the political events during 1993-2003 were clearly not creating an environment conducive to privatization, and thereafter investors potentially interested in privatization transactions may still have kept a wait and see attitude during the subsequent post conflict period; (b) from low public support for privatization to outright rejection from unions and some political parties, partly due to inadequate communication and misperception of privatization; (c) lack of financial and human resources of possible national buyers, specially for taking over bigger PEs; (d) lack of reliable data for many PEs; (e) lack of financial resources and expertise available for the preparation and completion of privatization transactions, particularly after foreign donors stopped supporting SCEP; (f) loss of capacity of SCEP due to high staff turnover[18], changes in the oversight of the Service and changes in presidency of SCEP; and (g) lack of clear political signals and of a steady drive throughout the political system to push for rapid implementation of specific privatization operations. The study also highlighted that during the transition phase of preparation of an enterprise for privatization, effective control of the enterprise remains in the hand of its board and its sector ministry, without real power[19] for SCEP.

[15] Not only on the basis of the offered purchase price, but also other criteria such as investments, and staffing.

[16] A percentage of shares can be set aside for priority purchase by the population.

[17] The initial steps are cumbersome and long: the privatization of each enterprise has to be authorized by the CoM, after an earlier authorization by CIP which is itself already a group of ministers and the CoM can again reject/change CIPs' conclusions .

[18] The bulk of the staff trained at the time IDA supported SCEP and who learned the job on the initial privatization transactions left.

[19] For example to prevent the PE's management of engaging belated capital investments that may not be useful or adequate later for the privatized enterprise.

43. The authorities' decision to advance with the privatization of the coffee sector assets and of ONATEL, two flag ship privatization, should provide a new impetus. If those privatizations are successful, they should build-up credibility of the process and support in the population for the privatization program. A new emphasis on communication efforts, as done in late 2008 and early 2009, complementing recent clear political signals at the highest level of the state in addition to clear instructions to SCEP and CIP to act diligently, should start bearing fruit. The steadily improving political stability and renewed economic development of the country, should also positively affect potential interest of international investors. Investors' appetite will also increase if preparatory work is of high quality. This implies significant development of SCEP's capabilities and provision of sufficient resources for the privatization process. This should be achieved through this project, with IDA funding, as well as through an increase in the GoB's annual operating budget allocated to SCEP.

(v) Current situation and future prospects of specific PEs

a. ONATEL

44. **ONATEL**, the historical telecom operator, has made accounting profits during the last six years and contributed significantly to Burundi's budget by paying taxes and duties (Fbu 7 billion in 2007). It has about 28,000 fixed lines and about 80,000 mobile customers, and employs close to 700 people. Since the telecom sector was liberalized, competition for mobile phone services is growing from a number of private operators, some of which are associated with international telecommunications companies. ONATEL is engaged in several investment programs and participates in a number of regional projects. It has a reasonable debt to equity ratio (63/37), as well as sustainable long term debt due to foreign lenders and short-term debt due to suppliers and the state. Still, because of weak collection of receivables, its actual cash-flow is insufficient to repay its short-term debt and at the same time finance its investment needs. Preliminary data show that it made a net profit of Fbu 4 billion on sales of Fbu 20 billion in 2008 – with basically no improvements in infrastructure over 2007. ONATEL is particularly weakened by a steady inflation of its labor costs (almost four fold from 2003 to 2008).

45. ONATEL needs to urgently improve the collection of its receivables and then to modernize and expand its technology and networks. Its major and most pressing challenge is to adopt a new business model to compete in a genuinely liberalized market and offer to the country a broad range of modern IT services. This will be best achieved through privatization with foreign strategic partner who will not only bring additional capital but also international management and operational expertise. Recognizing this, the GoB authorized the launch of the privatization process at the beginning of 2009. Currently, the GoB is thinking about selling upfront, at least 55 percent of ONATEL's equity to a strategic partner. Reputable privatization advisers with solid experience in telecommunications will be recruited. Their role would be to propose the best options and assist the GoB during the whole privatization process.

46. An adequate labor retrenchment program will be key for the success of this flagship transaction. The company's union is less reluctant toward privatization than in the past. The challenge will be to agree upfront with the personnel on this retrenchment program, fund, and fully implement it. Currently, the GoB is proposing to let the strategic partner implement the retrenchment after the transaction but fund itself the costs with the privatization proceeds.

Another question will be how the deal with the telecommunications infrastructure currently owned by ONATEL and the regional projects in which it is involved. It will be important to ensure open access for the other mobile telecommunications companies operating in Burundi, in the spirit of a liberalized but properly regulated market. Strengthening the capacity of Burundi's young regulatory agency, *Agence de Régulation des Télécommunications (ARTC),* will be essential. This will be pursued under the new IDA supported Regional Communications Infrastructure Project (RCIP). A more controversial issue is ONATEL's current investment proposals. Until the privatization transaction is completed and the new strategic partner has developed a new investment program coherent with a new business approach, ONATEL should refrain from major capital investment, other than that which it has already committed, and limit capital expenditures to essential maintenance expenditures needed to sustain quality services and market share.

b. Coffee sector

47. Coffee accounts for 70 percent of Burundi's export earnings and is the main source of cash income for close to 600,000 rural families that are among the poorest in the country. The Burundian coffee sector is increasingly inefficient and suffers from low and declining productivity. This is due to multiple causes: aging plantations, high intermediary costs, and an inadequate incentive framework. Production follows a cyclical pattern and but also declined significantly from year to year. From 42,000 tons in the early 2000s, production dropped to 6,500 tons in 2007-08, recovered in 2008-09 to reach about 25,000 metric tons, but is estimated to have declined again in 2009-10 to 6,000 tons. Reforming the coffee sector (filière, coffee value chain) is of high priority. The country's ecological conditions are favorable to the production of high quality coffee that could sell at premium prices on specialty markets. Despite a market structure that allows direct contracting with international coffee buyers, most of the production is now sold on the commodity market at relatively low prices due to ill-adapted processing strategy that does not foster specialty coffee. Declining and volatile production also affects buyers' perceptions on the reliability of Burundi as a supplier.

48. The reorganization of the whole *filière* was initiated with the gradual unbundling in the 1990s of the original OCIBU (the single state-owned coffee financing, collecting, processing, and marketing board) in a number of PEs. Reforms then stopped and resumed only around 2005, when a decree liberalized price setting, processing and marketing activities, reduced taxes on orchards, and removed explicit state guarantees for financing the sector. However, little else was accomplished. The GoB still owns most of the sector's assets and the filière's structure remains complex and confusing with a number of poorly performing PEs (*OCIBU Société Mère*, OCIBU Patrimoine, SODECO, five SOGESTALs). At the apex of the PE group, OCIBU plays a dominant role in financing (with the stabilization fund, and the smaller foreign exchange risk fund), regulation and certification, marketing and assets holding. Its 126 coffee washing stations are operated by five SOGESTALs, while SODECO is responsible for further processing of washed or fully washed coffee beans in its two dry mills. Eight PEs employ about 400 staff directly, and there are about additional 1,000 workers on the coffee washing stations. The PEs (excluding the Fonds) are heavily in debt, and their performance has generally been inadequate. During 2005-2008, they lost in total Fbu 2.2 billion. By the end of the 2007-2008 campaign, their aggregated equity was negative, minus Fbu 6.6 billion, and they owed Fbu 15.6 billion to the state – with no prospects for them to repay soon.

49. By financing the coffee campaign and as the primary purchaser[20] of coffee beans from the growers and as the major seller of coffee on the export markets, the PEs played a dominant role in the sector. The *Fonds de Stabilisation* (stabilization fund) is a significant financing channel for the coffee sector, through which major cash flows are passing before the coffee harvest and afterwards with the payment proceeds of coffee exports. Poor governance of the system thus has many negative effects on the profitability and sustainability of the sector. The PEs are also an important group of borrowers, through the short-term bank loans mobilized annually for the coffee campaign. For the financing of the 2008-2009 coffee campaign (the purchases from the coffee growers), the fund is expected to contribute Fbu 7 billion and consortium of local banks[21] about Fbu 15 billion in loans[22]. The banks accept the coffee as collateral and an elaborated revenue apportioning mechanism gradually distributes defined percentage of the sales proceeds for the service of the loans and to the various PEs and growers. In times of high international coffee prices and high production, the *Fonds de Stabilisation* could end the coffee campaigns with a significant positive balance. On the contrary, during the 1999-2003-period, its deficits[23] built up to about Fbu 19.5 billion that the GoB had to clear up by providing Treasury bonds to compensate the banks.

50. In 2007-08 in the context of ERSG I and II, the GoB agreed to adopt a detailed action plan to reform the sector and a time-bound plan of a chosen divestiture option of key sector assets[24]. International advisers were, therefore, hired to undertake a due diligence of the sector, recommend divestiture options, and propose detailed actions. They presented an action plan for the rapid transfer of the production assets to the private sector and professional associations, through an international tender for 117 washing stations and SODECO's two processing mills. They also recommended: (a) the liquidation of the OCIBU entities and later the SOGESTALs; (b) the creation of a new regulatory body for the sector, ARFIC, to which some OCIBU functions and staff would be transferred; and (c) fostering the creation of a private inter-professional association which would provide service to the producers and eventually run the Fonds after OCIBU will have been liquidated. Support to those important ancillary actions, will also be provided under the project[25]. Part of the staff of the PEs will not be hired by the new regulatory body, the inter-professional association or the private entities which will acquire the coffee processing assets. A key factor for the success of this phase of the reform will thus be the preparation and implementation of an adequate labor retrenchment program[26] for this staff.

51. The tender for the sale of 117 washing stations was launched during the summer of 2009. Three potential contenders presented offers that met the technical and financial requirements to acquire six lots out of the 26 lots of washing stations. By adopting a rigid stance about the market reference price, (as derived from the prior valuation done by the privatization advisers),

[20] Every year, a fixed price is set beforehand for the purchase of coffee from the growers; the system can generate significant losses if the actual sales prices on the export markets are lower than expected.
[21] In an important change from the past, the GoB no longer guarantees commercial bank loans.
[22] In previous years the amounts provided by the banks had been much larger, exceeding Fbu 25 billion in 2006-2007 when production and sales were higher.
[23] Those deficits reflect also the system whereby the GoB was fixing the purchase price from the growers.
[24] Adoption of the plan was also a condition of the HIPC completion point for Burundi.
[25] Until another project would provide long term support. The proposed IDA Agriculture Exports Promotion and Diversification Project could include support to the coffee sector starting in 2011.
[26] The cost for retrenching about 200 people of SODECO and the SOGESTALs would be Fbu 80 billion as per a preliminary estimate of the advisers. Total cost for the sector could be double that amount.

the CIP eventually decided to sell in a first phase only three lots of 13 washing stations for which the bid price met or exceeded the market reference price. Still, this successful bidding round confirms the interest of reputable investors for Burundi's coffee sector and the ability of Burundi's institutions to carry out a complex privatization with the help of advisers. So far thus, 13 washing stations out of 117 are in the process to be transferred to the private sector leaving 104 unsold ones under the SOGESTALs' management. The GoB should decide soon how to handle the original bids received for the other three lots of washing stations and when to launch a second round of bidding, possibly with slightly amended selection criteria, to allow inter alia local investors with less important financial and staffing means to also present bids.

c. Sugar sector

52. SOSUMO, the sugar producer, has 3,000 ha of plantations and processes its sugarcane plus sugarcane grown on another 400 ha planted by smallholders, in its old sugar mill. Its production is not sufficient to fully satisfy the demand of the local market, but SOSUMO regularly exports to the neighboring countries. It employs 500 people permanently, and hires another 1,500 to 3,000 daily workers during harvest. It has steadily maintained a good performance. It made a net profit of Fbu 1.5 billion in 2007 and has little debt. Preliminary data for 2008 show a net result of Fbu 0.5 billion on sales of Fbu 10.8 billion. Prospects for growth are good. Regional sugar demand is important and growing, and SOSUMO is the only producer in the large sub-regional area. In addition, there is significant acreage of land that is conducive for sugarcane growing and increased sugarcane production. SOSUMO has commissioned technical work and a comprehensive feasibility study to modernize its plant and expand production from 22,000 ton/year to 35,000 ton/year. To finance this project and increase competitiveness, the company which is still 99 percent state-owned, has recommended a full-fledged privatization with the search for a strategic partner. Following the favorable recent GoB decision and preliminary positive feedback from potential investors, the privatization process will now go ahead with support from the project.

d. Tea sector

53. Tea is Burundi's second largest export after coffee. About 52,000 families grow tea. Most production, processing, marketing, and regulatory activities of the sector are handled by the PE, *Office du Thé du Burundi* (OTB) which also provides some agriculture extension services and other support to growers such as maintenance of rural roads to the remote tea growing areas and the supply of fertilizers. OTB employs permanently about 800 staff. It processes tea leaves from its own plantations of 2,000 ha and from another 6,000 ha cultivated by smallholders, and owns and operates five processing factories. OTB reported losses of Fbu 2.5 billion on a turnover of Fbu 10.8 billion in 2007[27]. With a total debt of Fbu 21.6 billion and cumulated losses over Fbu 15 billion, it is technically bankrupt. It will be financially unable to modernize its factories and plantations and continue to provide the same levels of extension services to the smallholders.

54. Burundi's tea sector faces similar problems as the coffee sector: obsolescence and inefficiencies of the factories and plantations, run-down infrastructure, lack of concern for

[27] Preliminary data show that it made a profit of Fbu 2 billion in 2008 thanks to substantially higher sales.

declining quality, failure to respond to world market trend for quality differentiation, low returns, and poor incentives to the smallholders. Still, studies financed by PAGE indicate that there are prospects to improve its competitiveness and increase export earnings and revenues for the growers, provided a sound privatization program is implemented. The GoB is now keen to go ahead. Preparatory steps to be taken include: (a) undertaking a technical and financial audit of OTB identifying assets that can be divested and assets to be closed, (b) recommending an appropriate divestiture model and development of a plan with detailed implementation steps, and (c) specifying the residual functions (regulation, extension services, etc.) of OTB and recommending the best structure to fulfill them. The project would finance those preparatory steps, while other donors are providing already investment support to sector[28].

e. Other PEs

55. The current situation and future prospects of the three other agriculture PEs are different. SRDI, a regional development entity employing about 100 permanent staff, has been responsible for the maintenance of the roads and irrigation networks, support to farmers, milling of paddy, and marketing of the rice in the Imbo area. After managing to break even during 2001-2006, it made a large loss of Fbu 1.5 billion on a turnover Fbu 3 billion in 2007 and has almost no equity remaining. For years, it did not modernize its assets and is now severally handicapped by obsolete plant and run-down agriculture infrastructure. It is unlikely that it could on its own mobilize the financing needed for the modernization of its fixed assets. A diagnostic study based on new financial and technical audits is urgently needed to allow preparation of a drastic restructuring and partial privatization plan. In the cotton sector *Compagnie de Gérance du Coton (COGERCO)* permanently employs about 160 people. Since 2001 it has been continuously making losses (except in 2004). It lost about Fbu 2 billion with the de facto bankruptcy of Complexe des Textiles du Burundi (COTEBU), the cotton spinning and weaving PE that was its key customer. It made a loss of Fbu 0.5 billion on a turnover of Fbu 1.3 billion in 2007. Its prospects are bleak with the steady decline of raw cotton production. The diagnostic study on the cotton sector financed under PAGE raises many doubts on the financial sustainability of the cotton production. Prospects of reviving the now closed COTEBU are even bleaker. The GoB still entertains the hope that a foreign industrial partner may take over part of its idle facilities.

56. **REGIDESO,** the power and water utility was quasi bankrupt at the end of 2007 with cumulated losses of Fbu 17.2 billion against a capital of Fbu 21.2 billion and total assets of Fbu 72.5 billion. Deteriorated facilities (partly due to years of civil strife), high technical and non-technical losses, low tariffs, and significant weaknesses in accounting and financial management, contributed to the company's inadequate performance. After cumulating losses during 1998-2004, it barely achieved a positive result in 2005-06[29], and made again losses of Fbu 0.7 billion for FY 2007[30]. By the end of 2006, it had accumulated very large short-term debt (mostly due to

[28] A EUR 3.5 million rehabilitation program of the European Union is now underway, covering the coffee as well as the tea sector.

[29] Essentially after a major reduction in the price of power supplied by SINELAC, the tri-country hydroelectric power generator on which REGIDESO is very much dependant for power supply.

[30] Preliminary data show that REGIDESO made a net profit of Fbu 3 billion in 2008.

SINELAC[31] - Fbu 31.2 billion). The PE has major investment needs with insufficient power generation capacity, many obsolete assets and particularly generation capacity and distribution networks which need to be upgraded and expanded. This could not be envisaged unless the enterprise was put back on a sound financial footing through a major financial restructuring program by an arrears-cleaning effort, debt reduction, and a large equity increase (implying a complex restructuring of the reciprocal REGIDESO, the GoB, and SINELAC obligations), tariff increases and a review of power supply conditions. A comprehensive financial restructuring program was implemented in 2008 as part of an IDA-supported Multi-sectoral Water and Electricity Infrastructure Project.

57. The remaining ten PEs monitored by SCEP are small. At the end of 2007, together, they employed about 600 people. Their total assets amounted to Fbu 17.5 billion and total debt to Fbu 6.5 billion. Most of them managed to barely survive, breaking even or making small losses. Their aggregated profit was Fbu 0.6 billion on a total turnover of Fbu 7.8 billion. They include mainly: (a) two hotel companies, Source du Nil and Novotel; (b) three transport enterprises, the small airline Air Burundi, *Société Burundaise de Gestion Aéroportuaire (SOBUGEA*, the airport management enterprise), and *Office de Transport en Commun* (OTRACO, a bus transport company); (c) two real estate development enterprises, ECOSAT and SIP; and (d) APB, a slaughter house and ONATOUR, a peat extraction operation. Of particular interest are the two hotel companies that own important hotels located in the capital city but in poor condition[32]. With a low occupancy rate, these hotels did not generate enough cash to finance a rehabilitation and modernization program much needed to face growing competition from smaller albeit more client-oriented private hotels. A first limited privatization attempt of STHB failed in 2000. The SCEP was authorized in 2008 to relaunch the privatization through the sale of its stake in SNHB. Two bids have now been received from international investors and this hotel could now be rapidly transferred to the selected bidder. Investors have also indicated interest for the SHTB. If the GoB decides to launch a new bidding process for this hotel soon, it is also likely to attract bids from reputable investors.

E. Financial Sector Reform

58. *Background.* There are seven commercial banks in Burundi, two financial establishments (a development bank and a housing fund), six insurance companies, 26 microfinance institutions, and two social security organisms. However, total assets are a small Fbu 725 billion (US$604 million equivalent), as of December 31, 2007. The commercial banks clearly dominate the financial sector, with 79 percent of total assets, followed by social security and microfinance (Table 2).

[31] The power producer jointly owned by Burundi, Rwanda, and the Democratic Republic of Congo supplies electricity from its Ruzizi hydropower plant.
[32] Operated in the past by international companies who withdrew subsequently.

Table 2. Assets of Financial Institutions in Burundi (2007) (In billions of Burundi francs)		
Institutions	Assets	Share (percent)
Banks	568.9	78.6
Microfinance	36.0	5.0
Insurance	36.0	5.0
INSS	36.0	5.0
BNDE	21.6	3.0
FPHU	16.4	2.3
Postal system	9.4	1.3
Total	724.1	100.0

Source: Burundi authorities

59. *Access to finance.* Access to financial services is limited in Burundi. Available data show that about 1.9 percent of the total population have bank accounts, 0.42 percent use bank credit services, and four percent are members of microfinance institutions (MFIs)[33]. Postal checking services manage about 120,000 accounts, mainly of civil servants. Movements on these accounts are rare, except at month-end when wages are paid. Bank branches are concentrated in the towns, with 45 percent of all branches located in Bujumbura alone. On the other hand, the postal checking administration has 57 offices and plans to install an office in each commune.

60. A breakdown of credit by economic sector shows a large concentration in the commerce sector, representing 60 percent of the outstanding credit of all banks at the end of 2008, whereas this sector accounts for only 12 percent of GDP. Financing of agriculture increased from four to ten percent of total credit, whereas the share of agriculture in GDP was 44 percent. The increase in credit to agriculture is mainly attributable to satisfactory coffee production in crop year 2007/08 (25,000 metric tons, compared with 6,500 metric tons the previous crop year) and the large needs generated by that production. With the expected decline in coffee tonnages for 2009 (about 12,500 metric tons), the share of credit to the agricultural sector may decline.

61. According to a 2006 study on the investment climate, 74 percent of microenterprises and informal firms, 67 percent of enterprises in the manufacturing sector, and 67 percent of enterprises in various sectors use internal funds or reinvested earnings as their first and foremost source for financing their short- or long-term assets.

[33] 130,000 bank accounts and 320,000 microfinance accounts.

Table 3. Credit Allocation by Sector

	2006 [(Fbu) million]	Share (%)	2007 [(Fbu) million]	Share (%)	GDP Percentage distribution	2008 [(Fbu million)]	Share (%)
Agriculture and related business	22,143	11	8,587	4	44	27,544	10
Industry	1,976	2	3,666	2	11	5,431	2
Construction	9,826	5	6,325	3	2	10,251	4
Commerce	132,261	67	144,118	70	12	158,295	60
Miscellaneous services	30,350	15	43,880	21	11	61,907	24
Total	196,556	100	206,576	1	100	263,428	100

Source: BRB

62. An analysis of the portfolios of Burundi banks and financial institutions shows that access to financing for SMEs is limited. In terms of clientele segmentation, only two banks and one financial institution out of the nine operating in Burundi have a unit that deal specifically with their clientele of SMEs. For the five banks which have provided data on SME lending, only 20-25 percent of credit outstanding was allocated to this category of customers. Only one banking institution, Banque Nationale de Dévelopment Economique (BNDE) participates in the financing of SMEs in the agricultural and livestock sector. Its financing capacity, however, remains constrained by a lack of resources and operational problems.

63. Most SMEs have difficulty obtaining credit because of a number of factors: (a) unavailability of the real guarantees required by banks, (b) weakness of the judicial system, (c) a supply of funds that is often ill-adapted, (d) an unfavorable business climate, (e) the inappropriateness of some regulations, (f) weaknesses in the financial reporting infrastructure, and (g) the low capacity of SMEs. In addition, the commercial banks have little incentive to develop lending to SMEs because, according to them, of the absence of creditworthy applicants (or at least of correctly formulated and presented projects) and a context of political and macroeconomic uncertainty, among other things.

64. The exclusive acceptance of real securities by commercial banks does not favor the financing of SMEs, which have little such collateral. Steps are needed to facilitate the use of endorsements, pledges, domiciliations, and the leasing or backing of stocks. Partial guarantee funds can be considered. The microfinance sector must be strengthened.

65. Moreover, financial institutions do not have the support of centers providing reliable information on potential customers. More than 20 years ago, the BRB set up a credit information center, a NPL-information center, and an unpaid checks information center. These are inadequate, however, because, *inter alia*, of the lack of a unique identifier and of access limited for banks to data on their own customers. In addition, there is no balance sheet information center.

i. Commercial banks

66. At end-November 2008, the total assets of Burundi's banks amounted to Fbu 568 billion, or 53.5 percent of 2007 GDP. Commercial banks, with a majority of private capital, predominate the financial sector. They hold 73 percent of assets, gathering 80 percent of

deposits, and distributing 69 percent of the lending of the banking system, including the financial establishments. The state is the majority shareholder in two banks, with over 55 percent of the capital, and in the two financial establishments, at over 80 percent.

67. The geography of the banking system has changed over the past two years with the entry in the capital of three Burundi banks of foreign banks with large pan-African networks. These are the West African banking groups of Bank of Africa, ACCESS PLC, and ECOBANK.

68. The market is relatively concentrated, with the three largest banks holding 79 percent of deposits and 74 percent of credits at end-2008[34]. The market shares of the four other commercial banks range from four to eight percent. The two financial establishments have only six percent of total banking system assets including the financial establishments, and in one case offer financing to agriculture, livestock, and microfinance institutions, while the other is specialized in financing housing. There is also a high concentration of bank branches in urban areas, as there are 66 such branches in the administrative centers of the provinces and Bujumbura and only seven branches are situated in rural areas.

69. At end-2008, the banking sector had extended credit to the economy in the amount of Fbu 263 billion (US$219 million). The distribution of these loans by sector shows a high concentration of 60 percent in the general trade sector. The vast majority of this lending is short-term. Indeed, 70 percent of the loans extended at end-2008 were short-term, while 29 percent were of a longer-term nature.

70. The profitability level of the commercial banks has remained relatively high over the past three years. The easing of the social conflicts and reconstruction have increased demand for bank services and lending, which led to an increase in financial intermediation margins. The growth in bank assets has accelerated in recent years, with assets rising from Fbu 282 billion in 2004 to Fbu 569 billion in 2008, or an increase of 102 percent (69 percent in real terms). This improved profitability could reflect the pronounced growth in loans granted in recent years.

71. The average cost of resources is low, and decreased from 4.8 percent to 2.8 percent between 2005, owing to the fact that a sizable proportion (over 50 percent in general) of customer deposits are unremunerated demand deposits. The average lending rate is high, but declined from 26.16 percent in 2005 to 17.0 percent in 2008.

[34] In terms of their total assets there are three large, one medium-sized, and three small banks.

Table 4: Commercial Banks in Burundi

Banks		Shareholders	Share (%)	Capital (millions of Fbu)	No. of branches	Staff	Assets (millions of Fbu)
BANCOBU	Banque commerciale du Burundi			3.5	18	300	95,463
		Public shareholders	55.4				
		Of which SOCABU	*20*				
		Private shareholders	44.6				
BBCI	Banque burundaise du commerce et de l'industrie			2.5	9	150	28,640
		Public shareholders	62.07				
		Of which BCC	*11.67*				
		Private shareholders	37.9				
BCB	Banque de crédit de Bujumbura	Private shareholders	65.0	3.5			150,047
		Of which BOA	20				
		BIO	20				
		Banque de Groof	20.3				
		Public shareholders	45.0				
		Of which SOCABU	*20*				
		GoB	10.6				
BGF	Banque de gestion et de financement			2.5	15	160	31,833
		Burundi Private shareholders	100				
ECOBANK (ex SBF	Ecobank	Private shareholders	80,4	3.5		88	28,467
		Of which Group ECOBANK	*75*				
			19,6				
		Public shareholders					
		of which SOCABU	*9,82*				
FINBANK	Finbank,	Group ACCESS BANK PLC	75	2.8		104	41,061
		Other private shareholders	*25*				
IBB	International Bank Burundi			3.9		346	193,350
		Private shareholders	100				

Source: Banque de la République du Burundi

Table 5: Financial Establishments

Banks		Shareholders	Share (%)	Capital (million of Fbu)	No. of branches	Staff	Assets (millions of Fbu)
BNDE	Banque Nationale de Développement Economique		84.02	6.1	2	76	21,577
		Public shareholders					
		Of which the state	*40.09*				
		Private shareholders	15.98				
FPHU	Fonds de Promotion de l'Habitat Urbain			2.8		1	16,350
		Public shareholders	85.17				
		Of which the state	*74.13*				
		Private shareholders	14.83				

Source : Banque de la République du Burundi (BRB)

72. The indicators of banking system performance show that the banking system is adequately capitalized. All banks respect the eight percent solvency ratio. The average solvency ratio of the banking system stood at 14.5 percent in November 2008. The smaller banks are generally better capitalized than the larger ones. Among the latter, the banks in which the state is the majority shareholder, have the lowest ratios.

73. Asset quality has improved since 2005. The ratio of NPL to total loans dropped from 20 percent in 2005 to 15 percent in November 2008. These improvements are attributable in part to the improvement in macroeconomic and political conditions in the country. The sharp increase in lending may have been the cause, which would constitute a potential risk factor. The level of provisioning of NPL has improved, rising from 81 percent in 2005 to 96 percent in November 2008.

74. The liquidity level of the banking system is also generally comfortable. The banking system overall has a liquidity ratio of 109 percent, exceeding the 100 percent liquidity ratio required by the BRB. However, some banks have ratios slightly below 100 percent, which does not necessarily represent a serious risk even though it is a violation of the regulation.

75. The legal and judicial environment constitutes a significant obstacle to the development of the banking system, its proper functioning, and its stability. The laws and regulations are not always applied in a coherent way. There are also problems with the registration of companies, property deeds, and guarantees. The good governance of the court systems is not always guaranteed. Moreover, the profession of statutory auditor remains poorly organized, which has a significant impact on the quality of work of some of its members. For lack of standards in respect of the conduct of their work, training, or supervision of the profession, the reliability of

corporate account certification is less than certain. As regards the credit establishments, there is no banking chart of accounts. Banks use an accounting scheme elaborated by the BRB to prepare their accounting and prudential reporting.

76. Globally, the banking sector resists well to credit risk but is highly vulnerable to the concentration of lending. Its vulnerability to the poor performance of the PE sector is limited. The banking system overall, can resist losses of up to 90 percent of the loans to this sector, given the low level of such lending in the banks' portfolios (11 percent). However, certain large or medium-sized banks would, in this case, have their solvency ratios fall below the eight percent threshold. One of the largest banks in which the state is a majority shareholder is particularly vulnerable to a deterioration in the quality of loans to public enterprises. The impact of shocks associated with the banks' exposure to the coffee sector is similar to that of exposure to public enterprises. The banking system's claims on the coffee sector represent about 11 percent of total claims, a percentage similar to that of the public enterprises. In addition, one of the largest banks in which the state as majority shareholder is particularly vulnerable to a deterioration in the quality of loans to the coffee sector.

77. Supervision of the banking system is plagued by poor data communicated to the BRB (lack of banking chart of accounts, paper transmission of data by commercial banks) as well as by inadequate human and physical resources at BRB (capacity building and computerization are required).

78. *Payment system.* The payment system in Burundi is characterized by the low level of bankarization, the preponderance of cash transactions, strong distrust for checks, and physical exchanges of payment instruments, which are the source of errors, delays, and costs. The number of accounts opened is estimated at 130,000 for the banking sector and on the order of 120,000 for the postal checking system.

79. The BRB charter makes only a brief reference to the BRB's responsibilities as regards the payment system. It is recommended to clarify the BRB's missions in the area of payment systems and means of payment, in particular regarding the surveillance of payment systems in a manner consistent with EAC standards. It would be advisable to establish, within BRB, a special service reporting directly to the Governor, responsible for payment systems and means of payment and covering three main functions: (a) definition of the strategy and policy for modernizing the infrastructure of payment systems and payment instruments in keeping with EAC action plans, (b) the management of modernization plans and, following their implementation, the operational management of automated payment systems under the direct auspices of the BRB, and (c) the surveillance of operators (both the BRB and outside operators) engaging in activities in this area so as to ensure the proper application of fundamental principles and international standards. This implies recruiting and training of the staff concerned.

80. The legal framework in the area of means of payment and payment systems is often insufficient or obsolete and some legal provisions are out of synch with practice.

81. The clearing system is manual, with banks physically exchanging checks at daily meetings at the Central Bank. The BRB unit responsible for clearing has only one old computer and no backup computer. Clearing is therefore delayed whenever the computer is down. A

complete clearing and settlement infrastructure must thus be defined and built. These developments should incorporate, as a top priority, the automation of exchanges of small values (checks and automatic transfers) within an electronic clearing system. This first stage should include the development of other payment instruments such as debit notifications, paper, card transactions, and electronic payments. Large value transactions should be processed outside the clearing procedure until a RTGS is installed. Automatization would come at a later stage when the number of large transactions would have increased susbstantially.

82. Burundi should be able to take advantage of various projects being undertaken under the EAC and to apply international standards and recommendations. A stocktaking of progress with the projects underway in Rwanda is recommended. The objective would be to establish cooperation with the Central Bank of Rwanda and, where appropriate, with the suppliers now being selected for their systems or installation, so as to accelerate the modernization of payment systems in Burundi and reduce costs and time lags.

83. There is no operational card payment system in Burundi. Most banks and the postal service have card projects, either individually or in the context of their multicountry group. These projects are still under consideration or in the initial test phase of installing a number of automatic teller machines (ATMs) or electronic payment terminals (EPTs) with several merchants. The few VISA cards issued are principally of the electronic purse kind. It is recommended that the BRB organize, with the banking association and the postal service, a working group to take stock of the individual projects underway, so as to promote synergy among them. It is essential that the card payment systems now being defined make provision for interoperability so as to gain the most from the sizable investments and enable bank customers to use their cards in any ATM or EPT installed by a bank or the postal service. Banks that have no card payment systems and which have not developed a specific plan for introducing them should work together to share the investments.

ii. Microfinance

84. MFIs are expected to play an important role in Burundi, where 80 percent of the population lives in rural areas. There are 26 MFIs licensed by the BRB, of which only 24 are operational. They offer primarily demand and savings deposits and short- and medium-term credit to about 320,000 persons,[35] or more than the banks and postal service combined. The total assets of these 24 institutions come to about Fbu 36 billion (US$30 million).[36]

[35] The data on the exact number of members of groups benefiting from joint loans lack reliability, and the true number of beneficiaries should approach 340,000.
[36] As of December 31, 2007, according to the institutions' financial statements.

Table 6. Microfinance in Burundi (June 2008)

Type of institution	Number of institutions	Main products	Customers/ Members	Deposits	Outstanding loans	Average loan	Average savings	Service points
				En million Fbu				
Microlending program	8	Financial services only	8,850	0	768	425		12
Microfinance enterprises	5	Savings from public and loans	39,300	2,666	2,135	1,059	68	27
Savings and loan cooperatives	11	Savings and lending to members	269,313	19,987	12,179	365	74	140
TOTAL	**24**		**317,463**	**22,653**	**15,082**			**179**

Source: Data collected by the mission from the BRB and RIM.

85. The industry is relatively concentrated, both geographically (mainly in Bujumbura) and structurally (six institutions group together 88 percent of members, 88 percent of savings, and 94 percent of outstanding lending).[37]

86. It is not possible to make precise statements about the financial health (portfolio quality, profitability, or efficiency) of the MFIs. The vast majority of the institutions do not have reliable financial statements, and operating subsidies are often not shown in the accounts. The institutions regularly have insufficient provisions, which, once corrected, sometimes change profits into losses. All of the on-site inspections organized by the BRB have identified serious problems and violations of the regulation, in particular as regards accounting, governance, or the lack of reliable internal controls.

87. Given the problems experienced by 98 percent of the population with accessing banks, microfinance has an important role to play. However, nearly 80 percent of members/customers are wage earners. Thus the industry continues to exclude a majority of the population (non wage-earners) while serving a market that is uncertain for it in the medium term, as the banking industry could rather easily serve these customers should it make this its objective. The financing of agriculture or production in general remains marginal, with the exception of two or three institutions such as UCODE (80 percent coffee) or COOPEC (80 percent agriculture). In addition, MFIs are restricted in their lending by regulation which limit their loans to 100 percent of their deposits and excludes leasing and mortgages.

88. To contribute to Burundi's development, the MFIs need to correct their major weaknesses in the areas of financial management, product management, personnel management, accounting, planning, internal controls, governance, transparency, and the quality of human capital. They should, to mitigate the lack of long-term resources, seek lines of credit. This approach would be facilitated by greater transparency in their operations. Improved supervision (including interim administration for a large MFI) would contribute to better management and governance.

[37] It should be clarified that some institutions that have only one service point can serve customers nationally.

iii. Insurance

89. The insurance sector should play an important role in Burundi's development through risk intermediation and making long-term resources available. In Burundi, the absence of supervision and institutions in poor condition prevent insurance companies from making an effective contribution.

90. The size of the insurance sector is quite modest by comparison with other countries in Africa. In 2008, the market consisted of six companies, one of which is specialized in life insurance. *Société d'Assurance du Burundi* (SOCABU), a company with majority public shareholding, had a monopoly on the sector until 1982. All of the insurance companies are fully owned by Burundian nationals. Two companies have the state and public enterprises as shareholders.

91. The turnover of the sector was US$10 million in 2007. Penetration (premiums/GDP) is one percent, or 2.5 times less than in Kenya and 4.5 times less than the African average; density (premiums/inhabitant) of US$1.3 is 15 times less than that of Kenya and 50 times less than the average in Africa. Total assets of the companies in the sector in 2007 were the same as in Rwanda five years earlier (US$30 million) and represents 3.2 percent of GDP or five percent of Burundi's total assets. The sector is highly concentrated. SOCABU represents half of the market, and the four largest firms (out of a total of six companies) represent 98 percent of the market.

92. The financial health and solvency of the companies are not consistent with regulations and with international standards. Consumers are poorly protected from the risk of default by the insurer and major disasters are not covered. Of the five companies governed by the insurance code, only one company appears to be in compliance with all the standards for share capital, solvency margin, and technical provisions (two companies are in compliance with the minimum capital norms). In addition, the companies suffer from arrears in premiums (US$3.5 million, or 32 percent of annual premiums).

93. The cost of services for customers is high for several reasons: the inefficiency of companies in controlling operating costs, the absence of co-insurance, and the cost of reinsurance. The ratio of costs to premiums far exceeds international standards for activities in this area (27 percent in Burundi as compared to 10 percent to 20 percent according to international standard, depending on distribution networks and products).

94. There are numerous gaps in the existing regulations, including: (a) the minimum capital standard (Fbu 30 million), which was justified for Burundi in the past, but is now totally inadequate; (b) the lack of a schedule for benefit payments; and (c) the lack of implementing decrees following the 2002 law in order to provide a specific inspection framework for supervision. The regulatory framework, apart from legal provisions directly governing insurance, also presents obstacles to the sound development of the sector. In addition, there is no CoA specific to insurance, much less to life insurance, and there is inadequacy tax incentive arrangements.

95. Supervision is non-existent. A 2001 decree called for the establishment of *Agence de Régulation et de Contrôle des Assurances* (ARCA), and 2007 decrees named the Director-General and the Board of Directors. However, the structure has never been operational. There has been no activity at ARCA. The general manager did not submit proposals for an operational structure nor a budget request to fund its establishment and its operations. The very conception of ARCA poses difficulties. The board chairman is the budget director from the MoF. This control body cannot autonomously set prudential and solvency rules, but rather proposes them to the MoF. It is the latter that is authorized to issue and withdraw the licenses of insurance companies. The text provides that ARCA will be financed for the first two years of its existence by the state budget, and subsequently by a fee levied on insurers.[38]

96. The current supervision situation, therefore, does not meet the International Accounting Standards (IAS) notably with respect to governance. The failure of establishing the insurance regulatory agency can be attributed to several factors: (a) a positioning within the administration that deprives it from independence and autonomy of management, (b) inadequate resources, (c) lack of knowledge and know-how to put into place such an agency, and (d) a lack of eagerness to establish the agency.

97. In the short-term, a three-fold approach is required to modernize the sector. First, it is urgent to establish an independent and knowledgeable supervisory authority with full powers to supervise the sector (i.e., to grant and withdraw licenses, impose sanctions). The supervisory unit will be established with adequate human and technical resources. The staff, including the general manager, will be hired through a competitive process. Technical assistance will be provided by an individual with experience, for example a CIMA inspector, tasked with launching its operations. The insurance law and the decree establishing a supervisory agency will need to be modified to provide independence and full powers to the agency. Second, it is important to encourage opening of the market to modernization of the sector through: (a) the development of brokers, whose activities are regulated within a framework to be established, and (b) the entry of foreign companies, but maintaining the obligation to create a local subsidiary. Third, the domestic sector should be restructured and solid supervision established. Several actions are required: recapitalization of the companies, compliance with the solvency margin rules and the rules on constituting technical provisions, restoring the principles of governance and combating conflicts of interest, and regulating brokerage activity.

iv. Social security

98. The *Institut National de Sécurité Sociale (INSS)*, created by the law of July 20, 1962, administers a pension system and an occupational risk coverage system for private-sector wage earners, contractual employees of the government and of public institutions, and military and police personnel. The Civil Service Mutual Association provides health coverage for civil servants. The pensions of civil servants are paid directly from the government budget.

[38] The budget allocation was Fbu 80 million for 2007–2008. The 2009 budget is Fbu 80 million plus about Fbu 15 million remaining from the 2007-2008 budget.

99. The major challenges for the INSS are: parametric reform (the pension system has been in deficit since 2007 and, at the current rate of use, the reserves will be exhausted by 2015), governance (management that is not bi-partite, employers/employees but government-led, contrary to the dispositions of the social security code), and organizational reform. This encompasses computerization, framework of internal control and internal audit, collection of contribution arrears (Fbu 5 billion, or 57 percent of all contributions), and cost control measures. Over time, an extension of coverage could be envisaged (five percent of the population are covered by a retirement scheme, and ten percent have health insurance).

e. Housing finance

100. The housing financing market in Burundi is very rudimentary and cannot even be deemed to be emerging. Although loans tripled between 2005 and 2008, the stock at end-2008 totaled only about US$15 million. Medium-term credit (maturing in 2–7 years) accounts for 62 percent of the total stock of loans granted by the banks and financial institutions. Banks supply credit for periods not exceeding seven years, and MFIs are not authorized to grant mortgage loans. The largest lender is the Urban Housing Promotion Fund (FPHU), which accounts for nearly three-quarters of the market. The FPHU initially supplied only mortgage loans to civil servants but has now broadened the scope of its activities to cover the entire population, including real estate property developers. It provides loans for mortgages, purchases of construction materials, housing improvements, and other products. At November 30, 2008, its loan portfolio totaled US$12.7 million, 46 percent of which were mortgage loans.

101. Problems are also found at the housing sector level. The housing sector in Burundi is characterized by unmet demand, high prices that make housing unaffordable for the majority of the population, and a deteriorating housing stock. The annual population growth of four percent and the youthfulness of the population underline the demographic challenge facing Burundi. Given the number of refugees that have returned to Burundi, estimated at 500,000, the demand for housing has risen. Available land is extremely rare, largely because of the enormous population pressure. The current and future supply of housing cannot meet the demand. The housing shortfall is estimated at 15,000 units a year. This situation has led to a huge upturn in prices over the past three years (100-150 percent).

102. Residential construction is insufficient. There are virtually no real estate developers. Their share in the housing supply is about one percent. The legal framework does not foster the creation of a viable housing sector and mortgage market. Only 46,000 properties have been registered and there is a large demand for title registration.

103. The main pillars of the land reform are: establishment of a cadastre, registration of property rights in rural areas, and amendment of the land code. The GoB intends to set up a national land commission responsible for land reform. Decentralization of the cadastre and land registration offices should facilitate access for rural areas and increase the transparency of the registration process. The objective of amending the land code is to modernize the existing law which dates back to colonial times.

Annex 2: Major Related Projects Financed by the Bank and/or other Agencies

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

1. ***Economic Reform Support Grant*** aimed at supporting the GoB in implementing the interim PRSP in three areas: (a) improving public expenditure management and the impact on the poor, (b) reviving agriculture export crop sectors (coffee, tea, and cotton) and ensuring better revenue distribution among actors, and (c) reviving the private sector by improving business climate, accelerating state divestiture, and (d) settling the GoB domestic arrears to the private sector.

2. ***Third Economic Reform Support Grant (ERSG III)*** development objectives are to: (a) consolidate reforms already underway in public finance management (as identified in the recent joint 2008 PEMFAR), and (b) re-energize the reform process in private sector development (the legal and regulatory framework for the general business environment, and the coffee and the domestic petroleum reform process). In addition, it aims at continuing diagnostic studies and support development of a strategic approach in areas where action is needed but knowledge is too limited (i.e., public enterprise reform).

3. ***Regional Communications Infrastructure Program (RCIP)*** aims to improve access to international connectivity by focusing on closing the terrestrial connectivity gap. Connectivity and transparency are the two over-arching development objectives of RCIP. The program will extend the geographic reach of broadband networks and contribute to lower prices for international capacity, while contributing to improvement in the GoB's efficiency and transparency through selected e-government applications.

4. ***USAID*** has been working on business climate areas, such as the SME capacity building. They have joined efforts with the Kingdom of the Netherlands to develop and incubator which will be launched in 2009. In addition, USAID has been providing technical assistance to a number of coffee washing stations.

5. ***Financial Sector Reform and Strengthening Trust (FIRST)*** will finance a program for developing a computerization plan for BRB. An additional request has been submitted to FIRST to fund the elaboration of a financial sector development strategy and action plan.

6. ***AfDB*** is providing technical assistance amounting of US$148,000 to train 42 members of the *Ordre de Professionnels Comptables* (Association of Professional Accountants, OPC). Training will be provided to enable practicing accountants to increase their qualification levels to that required by the International Federation of Accountants (IFAC). Given attrition and drop-out rate, it is expected that at least 20 OPC members will receive international certifications issued by IFAC.

7. ***UK Department for International Development (DFID)*** is providing funding to enable the GoB to purchase and implement an IT system for the VAT tax. The GoB is also providing funding for this activity. There is a shortfall in the funding requirement which this project will fill.

Annex 3: Results Framework and Monitoring

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

PDO/Outcome	**Outcome Indicators**	**Use of Outcome Information**
PDO: To strengthen the financial system and improve the business enabling environment.		
OUTCOMES		
1.a. Improved compliance of main prudential regulations [39] 1.b. Strengthened Financial Infrastructure 2. Reduced the GoB participation of selected PEs and the largest commercial bank 3. Improved legal and regulatory environment for PS enterprises	1.a The percentage of commercial banks and insurance complying with Prudential Norms has increased. 1.b The time to clear checks has decreased. 2 The Recipient's share of ownership of asset value of selected public enterprises has decreased. 3. The number of days to start a business has decreased as measured by the Doing Business indicators.	Monitor quality of information available on key financial institutions. If lacking, discuss with institutions management and authorities reasons for this situation and develop a road map for improvement. Monitor selected institutions' performance in meeting key prudential ratios annually. If no significant improvement in compliance, discuss with institutions' management and authorities reasons and develop roadmap for increased compliance
Component/Intermediate Results	**Results Indicators for Each Component**	**Use of Results Monitoring**
1. Modernizing the financial system	1.1 Percentage of electronic transfer of data from commercial banks to BRB on monthly basis	Improved quality of data/information permitting better supervision
2. Privatization and public sector reform of selected PEs (ONATEL, coffee washing stations, SOSUMO)	2.1 Number of financial audits are finalized for selected PEs 2.2 Number of tender documents are prepared for selected PEs 2.3 Number of financial and operational analysis of PEs completed by SCEP	Provide quality data/information on the public enterprise portfolio. This data will also be used to help establish a base market price for government shares

[39] For commercial banks, liquidity and solvency norms; for insurance companies, it is solvency and asset coverage norms.

3. Improved regulatory and institutional building for private sector enterprises	3.1 Number of new laws and codes adopted within EAC framework 3.2 Number of qualified accountants and auditors accredited by IFAC 3.3 Number of public private forums conducted	Support GoB's efforts to improve governance and financial accountability

Arrangements for Results Monitoring

Outcome Indicators	Baseline 2009	Data Collection and Reporting 2010	2011	2012	2013	Frequency	Data Collection Instruments	Responsibility
PDO Indicators								
1.a. Percent of commercial banks and insurance companies complying with main prudential norms has improved	50 0	50 0	60 0	75 50	90 75	Annually	Report	BRB
1.b Time to clear checks in Bujumbura has decreased	5 days	5 days	5 days	3 days	2 days	Semi-Ann	Report	BRB
2.a. GoB owned entities as a percentage of total selected (PE) assets has decreased	100	80	75	60	50	Annually	Report	SCEP
3.a Number of days to start a business has decreased	32 days	28	26	22	15	Annually	Doing Business	PCU
Components Indicators								
1.1 Percentage of electronic transfer of data from commercial banks to BRB on monthly basis	0	0	0	50	100	Semi-Ann	Report	BRB
2.1 Number of financial audits are finalized for selected PEs (21)	0	2	8	10	15	Annual	Reports	SCEP
2.2 Number of tender documents are prepared for selected PEs	0	1	3	3	3	Semi-Ann	Reports	SCEP
2.3 Number of financial and operational analysis of PEs completed by SCEP	0	2	8	10	15	Semi-Ann	Report	SCEP
3.1 Number of new laws and codes adopted within EAC framework	0	2	4	6	8	Semi-Ann	Report	PCU
3.2 Number of qualified accountants and auditors accredited by IFAC	5	10	20	25	30	Semi-Ann	Report	PCU
3.3 Number of public private forums conducted	0	1	2	3	5	Annual	Report	PCU

Annex 4: Detailed Project Description

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

Component 1: Modernizing the Financial Sector (US$6.9 million)

1. While there are a large number of measures needed to reform the financial sector in Burundi, the urgent ones, that will be supported by the project, aim at improving governance, transparency, and efficiency. They are:

2. *Sub-component 1.1: The strengthening of supervision of commercial banks and MFIs.* Measures in this area are essential to increase governance and transparency. Project support will complement assistance already received by the BRB from AFRITAC in this area. The project will finance: (a) a resident expert/adviser at the BRB; (b) the training of inspectors; (c) the dissemination of the CoA for commercial banks and microfinance which are being prepared by a consultant under BRB financing, as well as training for users; (d) the establishment of electronic transmission of data from commercial banks to BRB, through technical assistance, and (e) the transformation of information centers at BRB into a credit bureau. This will include the introduction of a unique identifier and changing some rules, including rules of access. In addition, the project will fund training of microfinance staff to improve governance and efficiency of these institutions.

3. *Sub-component 1.2: The modernization of the payment system with a special focus on electronic clearing and a card payment system.* For the clearing system, the project will add an additional Fbu 2 billion to the Fbu 1 billon already budgeted by the government and cover the cost of consultant, equipment, and the visit to Rwanda to take stock of that country's progress modernizing its clearing system. It will also cover costs of improving the telecommunications system between commercial banks and BRB and between banks headquarters and their branches. For the card payment system, the project will finance consultants and the cost of seminars with operators. For the RTGS, the project will finance a consultant to design the system. Later on, as additional resources are made available, an automated RTGS will be put in place.

4. *Sub-component 1.3: The strengthening of non-banking financial institutions* through provision of technical advisory services, equipment and training, operating costs and capacity building activities, including strengthening and support to the operations and administration of the independent ARCA.

5. A strong insurance supervision mechanism is essential to introduce good governance and transparency in to the sector. The project will finance the cost of strengthening (consultants and equipment-furniture, computers, software, two cars) and of operations (including salaries, rents, and training for the first two years) of the supervisory authority. It will be an autonomous and independent unit with its own budget, the power to grant and revoke licenses and to impose sanctions. It will have the power to modify regulation. Its general manager and certain directors will be nominated by the government but will not be financed under the IDA grant. Only staff who are recruited by a competitive process according to World Bank procedures will be funded

under the project. The project will also finance the drafting of a chart of accounts and the training of users (consultant). The project will finance training of agency staff.

Component 2: Privatization and Public Sector Reform of selected Enterprises (US$5.2 million)

6. The project aims at supporting Burundi's efforts to revive and accelerate PE reform, mainly by: (a) providing assistance for the preparation and implementation of selected privatization transactions expected to have an important impact and a strong demonstration effect over the next two years; (b) enhance the capacity of Burundi's institutions, particularly SCEP to prepare and carry out further privatization operations; and (c) reinforce SCEP's capacity to monitor PEs, assess their performance and advice the GoB on further PE reforms.

7. *Sub-component 2.1: Privatization of ONATEL.* The objective of the GoB is to rapidly privatize ONATEL, within a transparent framework. To accomplish this, the project will finance a series of actions. In particular, the project will finance the fixed fee of the international privatization advisers to be recruited to carry out the due diligence of ONATEL, propose alternative privatization strategies to the GoB and recommend the most suitable for Burundi, prepare the tender documents, assist the authorities in launching the tender to select a strategic investors, analyze the bids, help in the negotiations with the successful bidder, and then finalize the transaction. Specialized advisers will be needed also to assist in the preparation and negotiations of ONATEL's staff retrenchment program. It is also possible that an additional financial audit of ONATEL will be needed if the work completed by the auditors recruited so far by ONATEL does not meet international best practices. Finally, the project will finance: (a) the technical assistance to support the GoB in the preparation and implementation of an optimal privatization program with a strategic partner, (b) complementary required physical asset audits, (c) the preparation of a social plan, and (d) the preparation of a communication plan.

8. *Sub-component 2.2: Privatization of the coffee sector washing stations.* The objective of the GoB is to rapidly privatize, within a transparent framework, the coffee washing stations. International privatization advisers had been recruited with financing of PAGE and carried out their work (up to the preparation of tenders for the coffee washing station and mills) in 2008 and early 2009. Additional work by them will be needed to complete the sale of those assets in 2009. In parallel, short-term[40] consultants will be urgently needed to: (a) lay out detailed environmental rules that the purchasers of the assets will have to abide by when modernizing and operating those, and (b) assist SCEP and the coffee sector reform steering committee in preparing the staff retrenchment program for OCIBU, the SOGESTALs and SODECO. In addition, the project will support the detailed preparation and implementation of the complementary measures[41] needed to reform the sector. These activities include: (a) the creation of a new regulatory body for the sector to which some OCIBU functions and staff would be transferred, (b) fostering the creation of a private inter-professional association which would provide services to the producers and eventually run the *Fonds de Stabilisation* after OCIBU will have been liquidated, and (c) initial support to individual coffee producers' groups/associations. Financing which may be needed to pursue implementation of those after 2010, particularly support to the coffee producers, could be

[40] About one man month each; to be financed under the project PPA.
[41] About one man month of consultant services would be financed under the PPA to define those in detail.

provided under a new IDA-supported agriculture project[42]. Financing of the retrenchment package (severance pay and training) of the sector PEs' staff would not be provided by IDA, but by budgetary sources. In addition, the project will finance technical assistance to support the GoB in the preparation of a social plan and communications strategy.

9. *Sub-component 2.3: Privatization of the sugar sector and preliminary work for the tea sector.* For SOSUMO, the project will finance[43] the fixed fee of the international privatization advisers to be recruited. S/he will propose alternative privatization strategies to the GoB and recommend the most suitable one for Burundi, prepare the tender documents, assist the authorities in launching the tender to select a strategic investor, analyze the bids, help with the negotiations with the successful bidder, and the finalize the transaction. In addition, the authorities would like the project to prepare a privatization strategy for the tea sector. This would include an additional audit of OTB and consultant services to propose alternative for divestiture and recommendation of the most suitable strategy[44].

10. *Sub-component 2.4: Privatization of financial institutions and commercial banks.* Bank Privatization and improvement of governance of the sector require the withdrawal of the GoB from the capital of commercial banks, as was indicated in the FSAP. The authorities would like to find international banking strategic partners for two public banks, *Banque Commerciale du Burundi* (BANCOBU) and *Banque Burundaise de Commerce et d'Investissement (BBCI).* The project will focus first on BANCOBU, because of its size, its role in the economy and the financial difficulties it is experiencing. However, if availability of funds permits it, the project will also support the privatization of the second bank. The project will finance the privatization adviser, the various administrative costs of the call for bids procedure (publicity in the media, data room, etc.).

11. *Sub*-component 2.5: *Support to SCEP.* The project aims at reinforcing SCEP's capacity and helping the service execute its work through training and advisory services. Training would include: (a) sessions in Burundi to train staff on selected topics (financial analysis of enterprises, valuation, privatization techniques, private-public partnerships, communication and outreach, regulatory matters, negotiation skills), and (b) study tours and ad hoc training sessions in other similar agencies to share the experience of other countries in privatizing, supervising[45] and restructuring PEs. This would also help SCEP build-up a capability in advising the GoB on private-public partnership matters and corporate governance of state enterprises, topics on which no experience and local skills currently exist in Burundi. Advisory services would include audits and services of specialized consultants to carry audits of other PEs and sectors, individual privatization/restructuring strategies of enterprises, communication campaigns, and preparation and supervision of labor retrenchment programs.

[42] Agriculture exports diversification and promotion project.

[43] SOSUMO itself has financed the work of auditors and consultants to prepare a detailed financial audit, a preliminary valuation of the company, and feasibility studies of possible capital investments to underpin a new business development plan.

[44] Financing of the privatization transactions per se in the tea sector would not be included under the project unless there were funds left under the contingency category and the first three privatization operations would be successfully completed.

[45] Particularly for enterprises like REGIDESO which may be expected to stay under majority state ownership for an extended period of time.

12. Building on the institutional study financed under PAGE, short-term consultant(s) paid under the PPA, will be assisting the GoB in preparing new amendments to the privatization law. In particular, the privatization decision mechanisms should be streamlined and simplified. Except for those amendments, the institutional set-up for PE reform is not expected to be modified until such time the coffee sector and ONATEL transactions are completed. It will then be opportune to review the performance of CIP and SCEP (as it will have benefitted from substantial capacity building efforts) and revisit the question of SCEPs' double role: privatization and monitoring/advising PEs remaining under state ownership. A possible option then could be splitting the tasks between two different unit/entities. The question should then also be addressed whether a sunset provision for the privatization entity would be warranted, as was done in other countries. These issues should be considered during the project MTR.

13. So far no significant staff retrenchment program has been implemented in Burundi in the context of privatization or PEs restructuring,[46] and there are no prior experiences to guide on how to best address that critical issue. The labor law provides for severance payments based on one month salary for every period of five years worked in the enterprise, with a maximum of six months' salary. On that basis, overall retrenchment costs, starting with the ONATEL privatization, could vary [47] from Fbu 0.6 billion to Fbu 1.8 billion (US$0.5 to US$1.5 million), to be financed out of budgetary sources or the enterprise cash flow (for example ONATEL).

Component 3: Improving the Regulatory Environment for Private Sector Enterprises (US$4.5 million)

14. As noted in Annex 1, there is much room for improvement in the business environment. The average time for completing the steps necessary for registering an enterprise and the costs involved are high. Many firms report that "unofficial payments" to government officials are often necessary "to get things done." There is also the need to improve the legal and regulatory framework, simplify the tax system for small businesses, improve the performance of the Commercial Court, revise the privatization code, and assess the financial position of public enterprises. It will also support public and private sector initiatives to improve the dialogue between the government and institutions representing private enterprises.

15. *Sub-component 3.1: Improving the legal and regulatory framework.* As noted in the main text and in Annex 1, a series of draft legislation has been prepared and adopted by the GoB. These include: (a) competition law, (b) investment code, (c) commercial code, (d) companies act, and (e) the mining code. The project will finance technical assistance to: (a) prepare the accompanying regulations, (b) print and disseminate (workshops) the laws, and (c) translate as needed. In addition, the project will support, through consultants and seminars, the amendment of certain texts of law (such as the land tenure act and the commercial code) and the development of new texts (for instance a law on means of payments) as well as some institutional strengthening. These include support to strengthen the Arbitration Center to

[46] So far, only liquidations of a few small to medium PEs have taken place.
[47] Depending on level of salaries (low in the coffee sector and high in telecommunications) and assuming 1,500 people out of 4,300 are covered under the program over four years.

develop Burundi's accession to the EAC. The project will finance a consultant to ensure the consistency of new laws and codes within the EAC framework and highlight areas where Burundi may be at a competitive disadvantage. In particular, the project will fund targeted activities to strengthen the National Bureau of Standards. Finally, the project will support the Commercial Court in its efforts to maintain the business registry, which is comprised of the companies' registry, outstanding guarantees and judgments.

16. *Sub-component 3.2: Support to the nation's accounting profession.* The project will finance activities for implementing the main policy recommendations of Burundi Report on the Observance of Standards and Codes: Accounting and Auditing (ROSC A&A) which was prepared in May 2007, under a joint Bank-Fund initiative on standards and codes. This would support the GoB's efforts to improve corporate governance in the financial sector and public enterprises, as well as to strengthen the institutional framework that underpins corporate financial reporting. The main focus of this component is to: (a) help strengthen the accountancy profession in Burundi, (b) ensure that there is a steady supply of qualified accountants and auditors for all sectors of the economy, and (c) properly regulate the members of the profession in a manner that they would contribute to enhancing transparency and accountability in both public and private sectors of the economy. The profession will be strengthened through a "twinning program" between the Burundi's professional accountancy body and a strong member body of the International Federation of Accountants (IFAC). The twinning partner will provide technical assistance over a period of four years, for turning the local professional body into a modern professional body, putting in place necessary arrangements for internationally comparable education and training in accounting and auditing, developing Burundi's own accounting technician and accounting professional qualification examinations, assisting development of national professional body's capacity to obtain membership of IFAC, enhancing capacities of the accountants and auditors to implement International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA), and assisting the local auditing firms to improve their capabilities for providing high quality auditing and assurance services.

17. *Sub-component 3.3: Support for activities to promote public-private dialogue and strengthen those private, para-statal, and public enterprises that are pivotal to private sector development and regional integration will be undertaken.* The project will provide some support to the Chamber of Commerce to organize their institution to be able to develop the necessary services to its members and the Association of Women, who play a major role in mobilizing women to contribute to Burundi's economic development. The project will provide support to the MoCIT to strengthen its capacity to support its effort to promote private sector development and ensure quality of exports. Finally, the project will finance two forums per year for three years to enable the private and public sector to meet and exchange ideas.

Component 4: Support for Project Implementation (US$1.8 million)

18. The project will, in substance, be implemented by the beneficiaries. However, overall project coordination will be carried out by an existing PCU that has a proven track record in project management. The PCU will oversee the financial management, procurement, reporting, monitoring and evaluation, audit, public information and related functions, as well as manage some cross-cutting issues.

19. The PCU will be further strengthened with an additional accountant, procurement officer, and private/financial sector specialist. Whenever necessary, technical assistance will be sought to strengthen the team. This will enable it to continue to transfer skills from one project to another, including procurement and disbursement expertise.

20. Since the project will use an existing PCU, some expenditures will continue to be financed under PAGE for the first two years of the project. This includes: operational expenditures, including internet service and the salaries of the coordinator and some of the key staff. The project will finance the last two years. In addition, the project will finance: (a) the private sector specialist (b) accountant; (c) procurement specialist; (d) the communication program, which is a weekly program highlighting various economic and social topics of interest to the Burundi population; and (e) some goods and equipment which may be needed to supplement the office.

Annex 5: Project Costs

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

Project Cost By Component and/or Activity	Local US$ million	Foreign US$ million	Total US $million
1. Modernizing the Financial Sector	0	7,100,000	7,100,000
2. Privatization and Public Sector Reform of selected Enterprises		5,300,000	5,300,000
3. Improving the Regulatory Environment for Private-Public Partnerships	500,000	4,050,000	4,550,000
4. Support for Project Implementation	1,050,000	800,000	1,850,000
5. Unallocated		200,000	200,000
Total Financing Required	1,550,000	17,450,000	19,000,000

Annex 6: Implementation Arrangements

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

1. The project will be implemented over four years. PCU currently has a full fiduciary team which will continue to work for the proposed project and will be paid for the next two years under that project. The proposed project will recruit an additional accountant, an additional procurement specialist, and a private sector specialist to provide the necessary additional support.

2. However, as institutional development and capacity building is at the core of the proposed operation, it is necessary that the responsibility for the implementation of the respective reforms be vested to the concerned ministries and BRB. The BRB will be responsible for technical implementation of all activities related to financial sector modernization. The Ministry of Good Governance and Privatization will be responsible for the second component dealing with improving the governance structure and privatization of selected PEs. The MoCIT, in coordination with other respective ministries, will be responsible for activities related to the improvement of the business environment and private sector development, including strengthening the Bureau of Norms and Standards, further developing the Arbitration Center which started under PAGE and preparing regulations to accompany recent commercial legislation.

3. Under PAGE, an implementation structure is already in place which has: (a) technical focal points that meet on a regular basis, (b) a technical committee which is responsible for following the project and meets on a quarterly basis, and (c) a steering committee that is responsible for national planning and meets on a semi-annual basis. The steering committee is comprised of the key ministries, but will add the Governor of the BRB who is not currently a member of the steering committee.

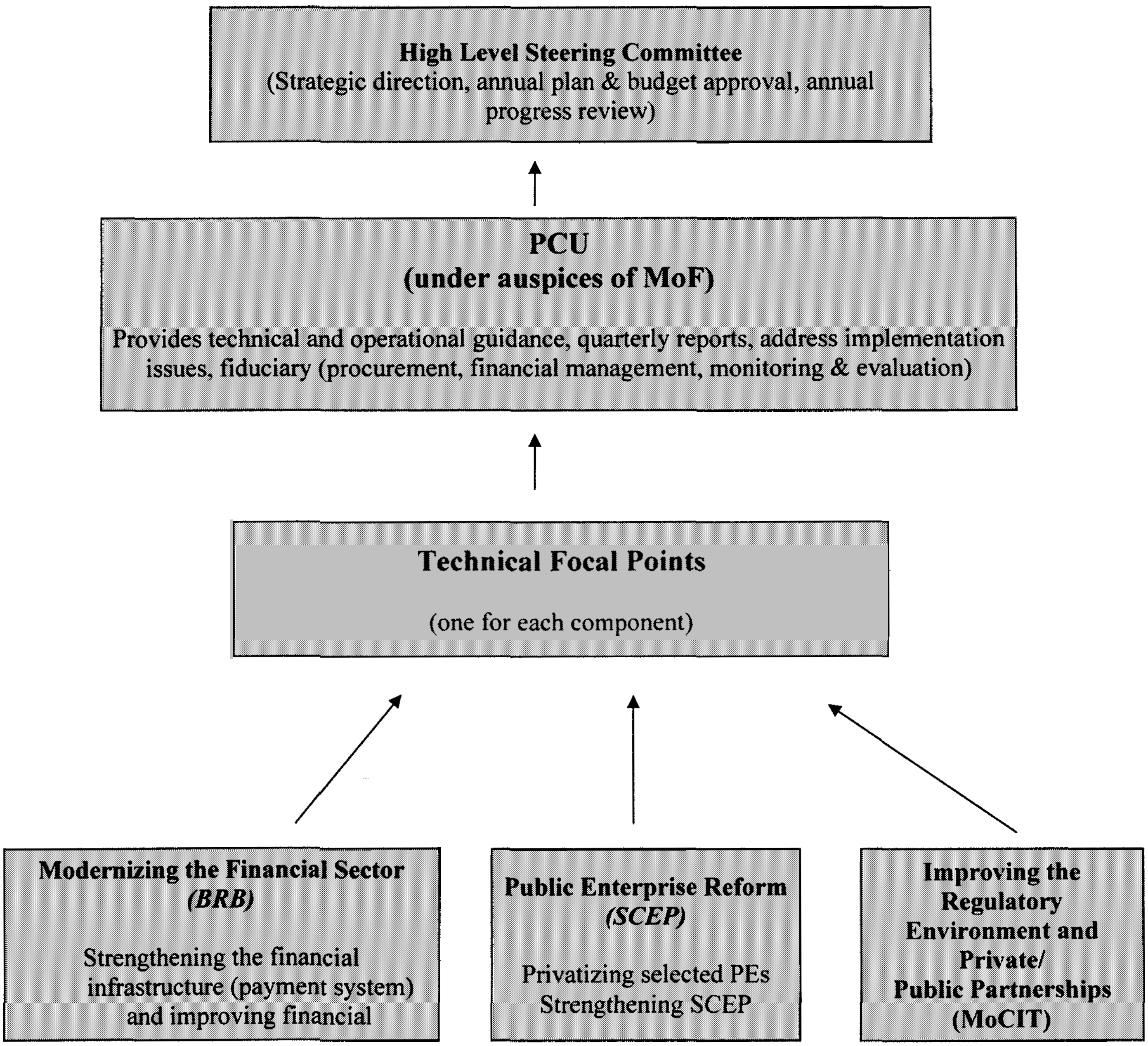
4. The project has recruited a private/financial sector specialist who will be dedicated to the implementation of the new project. He will work closely with the Coordinator of PCU, who will be responsible for the fiduciary functions of both projects, namely procurement and financial management, where there is substantial experience. The private sector specialist will report directly to the Minister of Finance, or whoever she delegates the responsibility.

5. To maintain the bottom-up approach that began under PAGE, each implementing agency will prepare the ToRs for consultants, including required qualifications of consultants and technical specification for the procurement of goods. Executing agencies will implement their respective components and report to the PCU on a quarterly basis, including any modifications to the procurement plan and/or training plans. This approach will be underlined in the PIM.

6. Details of the implementation arrangements have been agreed and described in the PIM. The PCU will be responsible for: (a) reviewing project proposals prepared by the executing agencies to ensure conformity with World Bank Guidelines, (b) undertaking quality control for ToRs once a project proposal has been agreed, (c) overseeing project implementation activities, and (d) administering project funding and procurement processing (including the employment of consultants).

7. Details of financial and disbursement arrangements are provided in Annex 7. The financial unit of PCU will also be responsible for financial management, maintaining overall records, and managing disbursements of the project. There is currently a financial management system in place which has the capability to account for multiple projects.

Chart 2. Implementation Structure



Annex 7: Financial Management and Disbursement Arrangements

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

A. Executive summary

1. The financial management (FM) of the proposed project will be carried out by PCU of PAGE. Thus, a FMA was carried out of the existing financial management arrangements in accordance with the Financial Management Practices Manual issued by the Financial Management Sector Board on November 2005.

2. The objective of the assessment was to determine whether: (a) PCU has adequate financial management arrangements to ensure funds will be used for purposes intended in an efficient and economical way, (b) PCU's financial reports will be prepared in an accurate, reliable, and timely manner, (c) arrangements exist for an independent audit of the sources and uses of funds, and (d) the entities' assets will be safeguarded. The assessment also included the identification of key perceived financial management risks that may affect project implementation in achieving its intended development objectives and proceeded to develop mitigation measures against such perceived risks and outlined in the risk matrix below.

3. Based on the assessments conducted, the proposed financial management arrangements put in place by the project meet the Bank's minimum requirements for project financial management as per OP/BP 10.02.

B. Country issues

4. The Country Financial Accountability Assessment (CFAA), concluded in 2004, documented the evaluation of the Public Financial Management (PFM) environment in Burundi. It revealed several weaknesses in the PFM system attributed to years of civil war. Notable areas of weaknesses included budget formulation and execution, financial reporting, oversight systems as well as weak linkages between agreed policies, budgeting, planning, and execution. However since then, significant progress has been made in a number of areas, notably:

- A fully operational interim Financial Management Information System (FMIS) which generates standard quarterly budget execution reports and reports on poverty-reducing expenditure and/or HIPC expenditure execution;
- The adoption and implementation of a new unified functional and economic budget classification system and a double-entry accounting system which has served to improve budget monitoring process while also addressing the weak treasury controls and thus the closing of government's extra-budgetary accounts is successfully on track; and
- The *Cour des Comptes* (Audit Court), established in 2004, has been an important step toward the strengthening of jurisdictional control over public financial management.

5. The GoB is committed to implementing additional reforms and is preparing an integrated medium-term reform action plan, on the basis of the recently completed (2008) joint government–Bank PEMFAR report, covering the legal framework, budget formulation, budget execution, public procurement, financial management and reporting, internal control and audit, external oversight, and control over the wage bill.

C. Risk assessment and mitigation

6. The following are necessary features of a strong financial management system:

- The PCU should have an adequate number and mix of skilled and experienced staff financial management (FM) staff;
- The internal control system should ensure the conduct of an orderly and efficient payment and procurement process, and proper recording and safeguarding of assets and resources;
- The integrated information system should support the PCU' s requests for funding and meet its reporting obligations to fund providers;
- The system should be capable of providing financial data to measure performance when linked to the output of the project; and
- An independent, qualified auditor should regularly review the project's financial statements and internal controls.

7. The risk assessment and mitigation table below shows some of the key perceived risks the project may face in achieving the intended project objectives and provides a basis for determining how management should address the identified risks using the mitigation measures outlined.

Inherent Risk	*Preliminary/ residual Risk Rating*	*Risk Mitigation measures*	*Condition of Negotiations, Board or Effectiveness (Y/N?)*
Country Level CFAA conducted in 2004 revealed weaknesses in PFM systems attributed to years of civil war. CPIA assessment of Q13 and Q16 show a high FM risk.	H/S	The government has embarked on a revision of its legal and regulatory framework for budgetary and financial management in order to update it and strengthen compliance with the principles of efficiency and effectiveness of public finances management.	
Entity Level The capacity in government institutions to carry out the oversight remains weak, a fact exacerbated by the unclear roles and responsibilities for each one and the	S/M	The creation of an Audit Court (Cour des Comptes) in 2004 was an important step toward the strengthening the jurisdictional control	

possibility of resulting duplicated functions: Burundi has a generally weak audit environment without a proper regulatory mechanism		over public finance management.	
Project Level Weak PCU capacity and related internal controls may affect the project financial management.	M/L	PCU's core accounting, financial reporting and auditing has been satisfactory in the previous projects . Involvement of few sectors, less spending units and previous experience in bank financed projects keeps the risk to manageable levels.	
Control Risk			
Budgeting The existing budgeting procedures as described in the Administrative, Budgeting, Accounting and Financial Procedures Manual are not suitable for the project.	M/L	The specific budgeting arrangements have been well documented in the updated/new procedures manual, developed under PPA.	
Accounting The accounting procedures being used by the PCU may not respond to the requirements of the new project.	M/L	A project specific Financial Management Manual has been developed and has been reviewed, and will be updated and approved by IDA to take into account the specificities of the project as implementation is being undertaken.	
Internal Control The principles of segregation of duties may be jeopardized due to insufficient staff. PCU does not have an internal audit function.	M/L	The PCU has hired an accountant who will be handling specifically the accounting of the project. The project internal controls will include all the means by which the implementing unit will ensure that its operations are carried out efficiently and effectively and that appropriate segregation of duties exists.	
Funds Flow Even though the PCU personnel have sufficient experience in Funds flow management from experience in implementing World Bank projects, there may be delay in submitting WA. There may be a risk of mixing funds for different projects.	L/L	An additional accountant was hired and will be specifically in charge of following through the funds flow of the project's account. A segregated designated account (DA), denominated in US dollars, was opened under terms and conditions acceptable to IDA.	

Financial Reporting There may be financial reporting delay even though the project has adequate experience in preparation of IFRs complying with IDA requirements as the PCU has still a running project.	L/L	The newly recruited accountant will focus on the financial reporting of the project. IFR formats were agreed with the PCU during negotiation	N
Auditing Burundi has a weak audit environment and the capacity of the audit sector to follow acceptable International Auditing Standards is low.	S/M	PCU will recruit independent external auditors acceptable to IDA whose terms of reference will include the need to follow ISA.	Within three months after effectiveness
Overall Risk Rating	**M**		

H: High; S: Substantial; M: Moderate; L: Low

(a) Strengths and weaknesses of the Financial Management System (FMS)

8. The PCU's financial management is strengthened by the following salient features:

(i) PCU has a strong experience in managing IDA-financed projects together with an experienced work force.

(ii) A project specific Financial Management Manual (FMM) has been developed and has been reviewed, and will be updated and approved by IDA to take into account the specificities of the project as implementation is being undertaken.

(iii) The specific budgeting arrangements have been well documented in the updated/new procedures manual developed under the PPA.

(iv) An additional accountant was recruited and will be specifically in charge of following through the funds flow of the project's account.

(b) Financial management action plan

9. The action plan below indicates the actions taken by the PCU to strengthen its financial management arrangements and the dates that they are due for completion.

	Action	Date due by	Responsible
	The PCU will recruit independent external auditors acceptable to IDA.	Within 3 months after effectiveness	PCU

D. Institutional and implementing arrangements (see Annex 6)

10. The PCU will be responsible for the overall implementation of project. It will, during project execution, coordinate the project implementation by:

(a) Project monitoring, reporting, and evaluation;

(b) Contractual relationships with IDA and other co-financiers;

(c) Financial management and record keeping, accounts, and disbursements; and

(d) Handling project procurement matters.

E. Budgeting arrangements

11. The budgeting arrangements have been well documented in the updated procedures manual. The director of finance has sufficient experience drawn from their previous engagement with an IDA-financed project and will take the lead role in budgetary preparation. Budget analysis will be conducted to ensure budget variances are addressed in an adequate and timely manner.

12. The budget format will be based on project components and will be integrated into the project accounting system. The budget will be used as a management tool. Expenditures will be authorized in accordance with agreed budgets.

13. The specialists of the different components of the project will first discuss the budget with the technical focal points for activities to be done. After this discussion, the PCU will consolidate the budget and submit it to technical committee for analysis before being approved by the steering committee. The approved budget will then be submitted to IDA for no objection.

F. Accounting arrangements

(i) Books of accounts

14. Adequate books of accounts which include ledgers, journals, and the various registers, will be maintained by the PCU. The accounting system described in the updated Financial Management Manual will be used to track, record, analyze, and summarize the project's financial transactions. The PCU accounts will be prepared on a cash basis in accordance International Public Sector Accounting Standards (IPSAS), the grant agreement, and the laws and regulations in Burundi. The accounting system will allow for the proper recording of project's financial transactions, including the allocation of expenditures in accordance with its components, disbursement categories, and sources of funds. Appropriate controls over the preparation and approval of transactions should be put in place to ensure that all transactions are correctly made, recorded, and reported upon. In this regard, the PCU will ensure proper books of account are maintained, a revised and updated CoA has been adopted.

(ii) Staffing arrangements

15. The overall responsibility over the PCU's financial matters will remain with the director of finance assisted by the chief accountant and the assistant accountant. The chief accountant will be responsible for the preparation of payments to be reviewed and approved by the director of finance. The director of finance will oversee the preparation and submission of IFR and audited financial statements to IDA.

16. The accounts department has currently three units with clear job descriptions for each one of them: the director of finance, the chief accountant, and the assistant accountant. However, the additional project will require an additional assistant accountant to be specifically handling all accounting matters of this project. This will help the PCU to preserve segregation of duties and to ensure that funds of different projects are not mixed.

(iii) Information systems

17. The PCU is currently using an integrated information management system TOMATE to maintain its books of accounts. The software is designed to account for multiple projects. Therefore, it is anticipated that the same software will be used to maintain its books of accounts under the new project.

G. Financial monitoring and reporting

18. The PCU, under the previous bank financed project prepares Unaudited Interim Financial Reports (IFR) in the format complying with World Bank guidelines on the preparation of IFRs for Borrowers and submitted on a quarterly basis to the World Bank for review. This will be adopted for the new project to ensure that they provide quality and timely information to the PCU, and various stakeholders monitoring the project performance. A separate IFR for this project will be submitted to the World Bank within 45 days after the end of the quarter being reported will comprise of:

- A DA activity statement;
- A source and uses of funds statement;
- A statement of uses of funds by project activity/component; and
- The accounting policies and procedures adopted and notes to the financial statements will be disclosed in the report.

H. Audit arrangements

19. The PCU, under an ongoing bank-financed project, provides satisfactory audits to IDA and in compliance with the provisions of the grant agreement. The project annual financial statements will be audited by independent external auditors recruited under terms and conditions acceptable to IDA. A separate annual audit report including a management report will be submitted to IDA within six months following the end of each financial year. The auditors will provide a single opinion on the project financial statements, the DAs and statements of

expenditures. They will be required to carry out a comprehensive review of the internal control procedures and provide a management report outlining any recommendations for their improvement. ToRs containing the audit scope to ensure the efficient use of funds for intended purpose and state whether the audit has been conducted in accordance with ISA was agreed with IDA at appraisal will be given to the appointed auditors.

I. Internal control and internal audit

(i) Internal audit and controls

20. The project internal controls will be documented in updated PIM complemented with a FMM. The accounting systems, policies, and procedures employed by the PCU in accounting for and managing project funds will thus be documented in the updated PIM and FMM. The accounting policies will specify the accounting treatment for the PCU's financial transactions and will constitute basic principles designed to ensure that the accounting records are complete, relevant, and reliable and that accounting practices are followed consistently. The revised PIM and FMM will be used by: (a) IDA to assess the acceptability of the PCU's accounting, reporting, and Internal Control Systems; (b) staff as a reference manual; and (c) by the auditors to assess its accounting systems and controls and in designing specific project audit procedures.

21. Specific procedures will be documented for budgeting, accounting systems, internal controls, funds flow, reporting, and auditing, depicting document and transaction flows, the appropriate filing of project documents, management approvals, and organizational duties and responsibilities. The accounting system will consist of the methods and records established to identify, assemble analyze, classify, record and report the transactions of a project, and to maintain accountability for the related assets and liabilities. The aspects to be covered in the updated manuals will include: (a) flow of funds, (b) financial and accounting policies, (c) accounting system (including centers for maintenance of accounting records, CoA, formats of books and records, accounting and financial procedures), (d) procedures for authorization of transactions, budgeting, and financial forecasting, (e) financial reporting (including formats of reports, linkages with CoA and procedures for reviewing financial information), (f) auditing arrangements, and (g) aspects of human resources.

23. The PCU does not have an Internal Auditor to exercise an oversight function, review the financial monitoring reports and carry out regular internal audit reviews. However, the project internal controls will include all the means by which the implementing unit will ensure that its operations are carried out efficiently and effectively.

(ii) Flow of funds: IDA funds

24. *Disbursements arrangements and methods.* The basis of disbursements from IDA will be transaction based. Upon grant effectiveness, an initial advance up to the ceiling of the DA ("Advance" method) will be disbursed from the proceeds of the IDA grant and will be deposited into a PCU DA to expedite its implementation. The PCU will submit withdrawal applications (at least monthly) supported by statements of expenditures (SOEs) or records, as the case may be, to report actual eligible expenditures paid from the DA, and at the same time may request a new

advance up to the ceiling amount. The PCU may also submit requests for reimbursement of eligible project expenditures which the recipient has pre-financed from its own resources. The PCU will also use the direct payment method, whereby payments may be made directly to third parties (e.g., a supplier, contractor, and consultant) at the Recipient's request. Another acceptable method of withdrawing from the proceeds of the IDA grant is the special commitment method. Under this method, payments may be made to third parties for eligible expenditures under special commitment entered into, in writing, at the recipient's request and on terms and conditions agreed between IDA and the Recipient.

25. The DA ceiling is set at US$1.0 million, calculated to represent approximately four months of eligible project expenditures. Monthly bank reconciliations will be prepared by the Chief Accountant, reviewed by the Director of Finance. PCU payments of project transactions regardless of the currency will be done through the bank and converted at the day's mean exchange rate.

26. *Supporting documentation and Use of Statements of Expenditures* (SOEs)- applications to request reimbursements or to report eligible expenditures paid from the DA should be submitted with records evidencing eligible expenditures (e.g., copies of receipts, supplier invoices) for payments against contracts of (a) goods valued at US$100,000 or more, (b) services of consulting firms valued at US$100,000 or more, (c) services of individual consultants valued at US$50,000 or more, and (d) SoE for all other expenditures / contracts.

27. The project will finance 100 percent of eligible expenditures inclusive of taxes consistent with the Country Financing Parameters (CFPs) for Burundi.

28. The account signatories for the DA will be updated as necessary in the Accounting and Financial Management Procedures Manual. Authorized signatories will be designated in accordance with their positions. The current signatories include:

- The Project Coordinator;
- The Director of Finances.

(iii) Flow of funds: counterpart funds

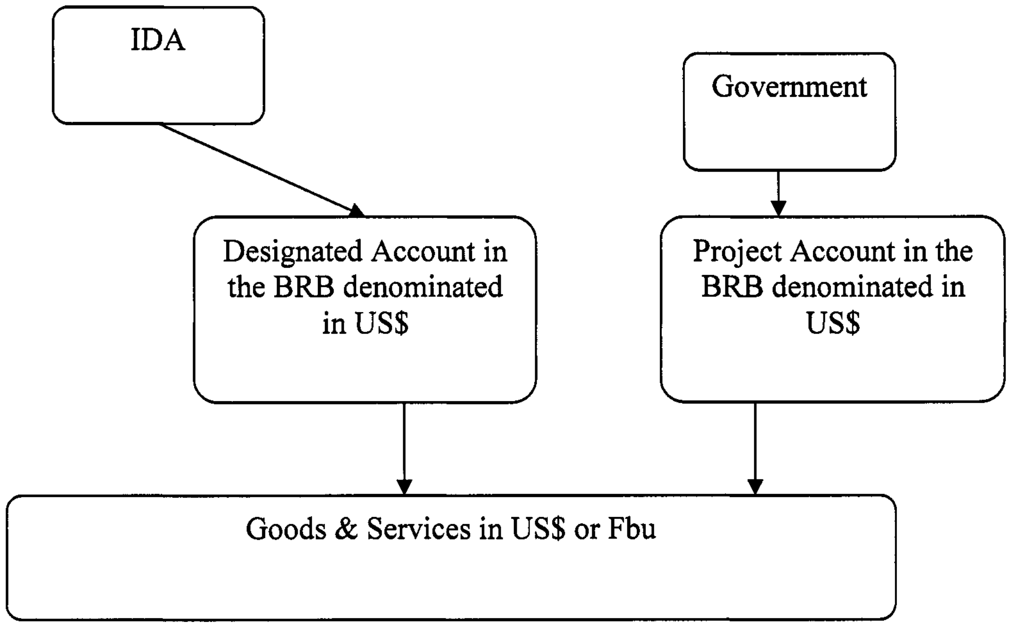
29. The government will deposit its contribution of US$1 million to the project in a Project Account to be opened at the BRB and denominated in US dollar. The first installment of US$500,000 equivalent will be deposited by June 15, 2011 and a second amount of US$500,000 equivalent no later than June 15, 2012 or such other amounts as may be required and agreed to by IDA.

J. Supervision plan

30. *Since the current overall FM risk rating of the project is moderate* a minimum of one on-site supervision visit will be conducted each year to commensurate with the risk levels. The objective of the supervision missions will be to ensure that strong financial management systems are maintained for the credit throughout the life of the project. Reviews will be carried out

regularly to ensure that expenditures incurred by PCU remain eligible for IDA funding. The Implementation Status and Results Report (ISR) will include a FM rating for the FM component and will be arrived at by the financial management specialist after an appropriate review.

CHART 3. FLOW OF FUNDS



Annex 8: Procurement Arrangements

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

A. General

1. Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004, revised October 2006; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, revised October 2006, and the provisions stipulated in the Legal Agreement. The general description of various items under different expenditure category is described below. For each contract to be financed by the grant, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and IDA project team in the procurement plan. The procurement plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

2. **Procurement of works**: No procurement of works is foreseen under this grant.

3. **Procurement of goods**: Goods procured under this grant will include software, hardware, information system required to modernize the banking system and the insurance sector. Goods will also include vehicles, offices supplies, and furniture. The above mentioned goods will be procured using a combination of the following procures: (a) International Competitive Bidding (ICB) for contracts estimated to cost more than the equivalent of US$500,000, (b) National Competitive Bidding (NCB) for contracts of value amounted more than the equivalent of US$50,000 but less than US$500,000, and (c) shopping for contracts estimated to cost less than the equivalent of US$50,000.

4. In situations and circumstances that are in compliance with the provisions of paragraph 3.6 of the Guidelines for procurement direct contracting may be used with Bank prior review. For ICB, the procurement will be done using the most updated and relevant versions of Bank's Standard Bidding Document. For NCB will be carried using the standard bidding documents developed by the government.

5. **Procurement of non-consulting services**: Non consulting services under this grant are limited to office and equipment maintenance, rental expenses for facilities to deliver training activities. Non-consulting services will be procured following shopping procedures as described in the project implementation manual.

6. **Selection of consultants**: The consultant services under this grant will include technical assistance to the BRB and the insurance regulatory agency. The services will include various studies aimed at designing, supporting and implementing the modernization of bank and insurance sector. Contracts estimated to cost the equivalent of US$200,000 or more, will be procured through Quality-and Cost-Based Selection (QCBS). The contracts for services estimated to cost less than the equivalent of US$200,000 per contract may be procured under contracts based on Consultants' Qualifications in accordance with the provisions of paragraphs 3.1 and 3.7 of the Consultant Guidelines.

7. Financial and technical audit estimated to cost less than the equivalent of US$100,000 may be procured under Least Cost Selection (LCS) in accordance with the provisions of 3.1 and 3.6 of the Consultant Guidelines Consultant for services meeting the requirements of section V of the consultant guidelines may be selected under the provisions for the Selection of Individual Consultants, i.e., in essence through the comparison of the curriculum vitae of at least three qualified individuals. No civil servant can be hired as consultant. Single source selection may be used exceptionally in accordance with paragraph 3.9 to 3.12 of the Consultant Guidelines.

8. Most of these services will require international expertise and experience. However to ensure that priority is given to the identification of suitable and qualified national consultants, short-lists for contracts estimated under US$100,000 equivalent may be comprised entirely of national consultants (in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines), provided that a sufficient number of qualified individuals or firms (at least three) are available at competitive costs.

9. **Training, workshops, conference attendance, and study tours** will be carried out on the basis of approved annual work programs that would identify the general framework of training or similar activities for the year, including the nature of training/study tours/workshops, number of participants, and cost estimated.

10. **Operational costs:** These will include operating costs of the PCU and the Participating Institutions on the basis of the annual work plans and budgets and attributable to per diem, supervision cost and salaries of locally recruited staff, office and equipment maintenance, and rental expenses, and excluding salaries, bonuses, and fees for government civil. These expenses will procure using procedures acceptable to IDA and that will be described in the PIM and in the project financial and administrative manual.

B. Assessment of the agency's capacity to implement procurement

11. Procurement activities under the project will be carried out by the PCU of PAGE which is an IDA financed operations. The PCU will be responsible for: (a) selecting and recruiting consultants in charge of technical studies and technical assistance, (b) managing bidding process and awarding contracts for goods, (c) supervising quality of studies and supervising contracts of goods, (d) approving invoices, and (e) receptions of goods and services. Since most of the services will not be furnished to the PCU but rather to the institutions involved in the reforms and activities financed by the grant, these institutions will be closely involved in the key step of the procurement process.

12. An assessment of the capacity of the Implementing Agency to implement procurement actions for the project has been carried out by the Procurement Specialist of the Bank Country Office. The procurement assessment started in April 2009 to end in August 2009. The assessment reviewed the organizational structure for implementing the project, procurement procedures, staffing, and the interaction between the PCU and the other institutions involved in the implementation of the grant.

13. Most of the issues and risks concerning the procurement component for implementation of the project have been identified and include:

- Division of responsibilities might be difficult in a project that has to work with many institutions that are not all very familiar with the requirement of an efficient procurement planning and with the Bank guidelines for the selection of consultants;

- Procurement filing needs to take in consideration of requirement of about advertising that are new for the project since the ESMP is governed by directives of May 2004 as revised in October 2006, only since February 2009;

- Drafting of ToRs and the preparation of technical specifications for assignment and the supply and installation of software that are not known in Burundi; and

- Contract management is often overlooked, disputes, when occurred, are rarely resolved promptly.

14. To address the issues above mentioned the following corrective measures which have been agreed with the PCU are:

- Training for staff of the institutions associated in the implementation of the project on selection and employment of consultant using Bank guidelines and in the drafting of ToRs;

- Adoption of a project implementation manual that will provide detailed information about role and responsibilities of the various institutions associated to the project in the preparation of work program, procurement planning, and preparation of ToRs and bidding documents; the PIM will also detail the role of the commissions (evaluation and award of contract) in order avoid the misunderstanding about their relationships; and

- The ToRs and the technical specifications and bidding documents of complex activities will be prepared with the support of qualified consultants; if needed the consultants will assist the client during bid evaluation and during the implementation of the contract.

15. The overall project risk for procurement is high before mitigations but can be judged substantial after mitigations in particular training activities concerning procurement filing, the selection of the consultant and the drafting of ToRs were conducted during the first and second quarter of 2009.

C. Procurement plan

16. The Borrower, at appraisal, developed a procurement plan for project implementation which provides the basis for the procurement methods. This plan was agreed by the Borrower and the project team on October 22, 2009, and is available at the office of the PCU (SOGEAR Building). It will also be available in the project's database and in the Bank's external website. The procurement plan will be updated in agreement with the project team annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

D. Frequency of procurement supervision

17. In addition to the prior review supervision to be carried out from the World Bank office, the capacity assessment of the implementing agencies has recommended at least two supervisions missions to carry out post review of procurement actions.

E. Details of the procurement arrangement involving international competition

(i) Goods and works and non-consulting services.

(a) List of contract packages which will be procured following ICB and direct contracting:

1	2	3	4	5	6	7	8	9
Ref. No.	**Contract (Description)**	**Estimated Cost US$**	**Procurement Method**	**P-Q**	**Domestic Preference (yes/no)**	**Review by Bank (Prior / Post)**	**Expected Bid-Opening Date**	**Comments**
G 1.3.1	Electronic Clearing: Equipment & Telecom	2,100, 000	ICB	No	no	Prior	February, 2011	

(b) ICB contracts estimated to cost above US$500,000 per contract and all direct contracting will be subject to prior review by the Bank.

(ii) Consulting Services.

(a) List of consulting assignments with short-list of international firms.

1	2	3	4	5	6	7
Ref. No.	**Description of Assignment**	**Estimated Cost (US$)**	**Selection Method**	**Review by Bank (Prior / Post)**	**Expected Proposals Submission Date**	**Comments**
Component 1- Modernizing the Financial Sector						
	Sub-component 1.1. Strengthening of supervision of banks and microfinance institutions					
1.1.1.	Resident adviser BRB	540,000	ICS	Prior	March 2010	Hired under PPA
1.1.2	Consultant to disseminate microfinance chart of accounts and train users	200,000	CQS	Prior	January 2010	
	Sub-component1.2. Establishment of insurance supervision					
1.2.4	Consultant for chart of accounts	200,000	QCBS	Prior	Febuary,2010	
	Sub-component 1.3. Modernization of Payment Systems					
1.3.1	Consultant for	200,000	ICS	Prior	January, 2010	

	Electronic Clearing					
1.3.2	RTGS/Card system/telecom/ Legal	700,000	QCBS	Prior	January 2010	
Component 2 – PE Reform						
	Privatization of ONATEL					
2.1	Privatization advisers for ONATEL transaction	1,000,000	QCBS	Prior	March, 2010	
2.2	Audits(financial & operations)	300,000	QCBS	Prior	March, 2010	
	Privatization of coffee					
2.11	**Adviser to re launch process of working station**	200,000	**ICS**	Prior	December 2009	PPA
	Privatization of sugar					
2.13	Privatization of SOSUMO	300,000	QCBS	Prior	April, 2010	
	Preparation of tea					
2.14	Preliminary Studies /privatization of tea	300,000	QCBS	Prior	February, 2010	
	SCEP					
2.15	Privatization advisers	200,000	ICS	Prior	December 2009	PPA
2.21	The privatization of banks	700,000	QCBS	Prior	February, 2011	
Component 3 Improving the Regulatory environment and Private-Public Partnerships						
	Sub-component 3.1Regulations					
3.17	Three ICs for regulations	300,000	ICS	Prior	February 2010	
	Sub-component 3.4 Support to national norms and standards					
3.4.2	TA for norms	200,000	QCBS	Prior	February 2010	
	Sub-component 3.5 Support to the ministry of commerce					
3.5.1	EAC integration activities	500,000	QCBS	Prior	January, 2010	
	Sub-component 3.6 support to the accounting profession					
3.6.1	ROSC implementation	200,000	QCS	Prior	January, 2010	
	Sub-component 3.7 Support to the MoF					
3.7.1	IT system for MoF	1,000,000	SSS	Prior	October 2009	PCU

(b) Consultancy services estimated to cost above US$200,000 per contract and Single Source selection of consultants firms and individual consultants for assignments estimated to cost above US$100,000 will be subject to prior review by the Bank.

(c) Short lists composed entirely of national consultants: Short lists of consultants for services estimated to cost less than US$100,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Annex 9: Economic and Financial Analysis

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

1. The link between the development of the financial sector and economic growth is well established in the literature. In addition, the recent turmoil on the international financial markets has clearly demonstrated this link.

2. Improving governance, strengthening supervision, priatization banks, microfinance institutions and insurance companies and modernizing the payment system will strengthen the environment for enterprise creation and growth and the investment climate.

3. Similarly, the rationale to undertake reform in the pension sector is primarily to diminish the budgetary impact of the recurrent deficit of INSS and develop long term resources.

Annex 10: Letter of Sector Policy

BURUNDI: LETTER OF FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

NON OFFICIAL TRANSLATION

REPUBLIC OF BURUNDI Bujumbura, November 16, 2009

To
Mr. John McIntire
Director of Operations of the World Bank
For Burundi, Tanzania and Uganda
Dar-es-Salaam

Subject: Letter of Development Policy for
the Private and Financial Sectors

Dear Mr. McIntire,

I am pleased to transmit by the attached annex, the letter of development policy for the private and financial sectors.

This policy letter of will serve to orient the negotiations for the financing of a grant for the Private and Financial Sector Development Project. I take this opportunity to remind you that on March 27, 2009, IDA provided the Government of Burundi with a project preparation advance for US$1.2 million.

I would like to inform you that the activities to be implemented with the advance are being satisfactorily implemented.

We count on your continued collaboration.

Clotilde Nizigama
Minister of Finance

Letter of Development Policy for the Private and Financial Sectors

I. Introduction

1. Burundi is confronted with a number of diverse and important challenges. The challenges include: economic diversification, the improvement in agricultural productivity, the growth and diversification of exports, infrastructure development, and increased access to financial services. In addition, the country needs to support the improvement of enterprise productivity. The Government is committed to implement structural and financial reforms, which include the state divesting from the productive sectors of the economy, the liberalization of the foreign exchange market, the reduction of tariff and non-tariff barriers, and the modernization of the tax regime.

2. Burundi is committed to economic and financial structural reforms supported by the IMF and the World Bank through a new agreement approved by the IMF, under the Poverty Reduction and Growth Facility (PRGF) arrangement and the Economic Sector Reform Program (ESRG). In this context, an action plan to implement the reforms is underway. Prudent management of resources is being implemented and the country attained the HIPC completion point.

II. The financial sector

II.1 Current status

3. The financial sector normally contributes to economic growth, the development of the private sector and the reduction of poverty through the mobilization of savings, an efficient payment system, availability of credit and the diversification of risks.

4. Despite the progress realized, there is a need for additional improvements in banking supervision. The current regulatory framework does not address the fundamental principles directed by the Basel Committee concerning banking supervision nor the implementation of risk-based supervision. Although the overall situation of the commercial banks appears satisfactory, the sector is vulnerable to credit risks.

5. The payment system is archaic, check clearing is manual and the card payment system is under-developed. The microfinance sector is facing major challenges and their lack of supervision reflects the constraints facing the Bank of the Republic of Burundi (BRB).

6. The insurance sector is outdated, and has a very limited product range. The financial health and solvency of companies fall below regulatory requirements and international standards. The regulations, accompanying the sector, have many gaps and supervision is non-existent.

7. Access to financial services is a serious problem for the majority of the population and for the SMEs.

II.2 Reforms realized

8. The Government, conscious of the fundamental role of the financial sector : (a) requested the IMF and the World Bank to carry out a review of the sector under the framework of the Financial Sector Assessment Program (FSAP) which was completed in January 2009, and (b) launch a comprehensive reform program.

9. Certain reforms have been launched. New statutes have been approved for the (BRB) providing it with increased independence to put into place important reforms relating to, in particular, monetary policy, foreign exchange regulations and banking supervision.

10. In the meantime, the microfinance sector is governed by a new decree regulating its activities by the BRB. In this regard, it is underscored that a supervisory structure has already been put into place for microfinance institutions that are operational.

11. Under the framework of monetary policy, the central bank has an intermediate objective to consolidate its monetary policy into a framework of flexible exchange rates, the final objective being to stabilize the currency price. The central bank intervenes in the money market. In this aspect, the BRB uses both direct and indirect instruments to ensure sufficient the liquidity for the banking system.

12. However, despite the progress, many actions remain to be implemented to ensure a more robust monetary policy.

II.3 The reform program

13. Following the FSAP, the Government would like to elaborate a financial sector development strategy, with an accompanying action plan in an effort to ensure stability and improvement of penetration of the financial sector. A request has been addressed to the Financial Sector Reform and Strengthening Trust (FIRST) in an effort to obtain the necessary funding to carry out this activity.

14. However, the Government has judged certain reforms to be very urgent and cannot be attained until the financial sector strategy is prepared and adopted. The Government therefore asked the World Bank to provide technical and financial support for these selected activities. The principle reforms that are envisaged are the strengthening of supervision of commercial banks and microfinance institutions, the divestiture of the state from the capital of the commercial banks, the modernization of the payment system, the regulation and supervision of insurance companies, and measures to rapidly improve the governance of the financial sector. With respect to the comittments taken at the level of the East African Community, there is an urgency to finalize the financial market plan.

15. At the level of banking supervision, the BRB will implement a risk management program and take measures to bring the commercial banks to a level of risk conducent to reduce their vulnerability to external shocks.

Specific to the BRB

- Closely monitor banking risk-management practices, condition of credit delivery and the financial performance;
- Take appropriate measures to manage emerging risks (commercial sector, coffee, concentration of credit)
- Carry out stress tests on a regular basis and engage in dialogue with the commercial banks about the results
- Instruct the banks to take the necessary measures to manage market risks
- Put into place a new chart of accounts and insure that they are implemented in the commercial banks.

16. At the level of microfinance, with the intention of developing a sector based on a solid foundation, the Government intends to put into place a regulatory framework that will facilitate its growth in a sound and professional manner. This would include the best human resources, the appropriate management tools, modern methodology and good governance. All of these actions will be accompanied by a strengthening in supervision of the sector. Thus the decree that regulates these activities will be amended to take into account, the recommendations of the FSAP and the suggestions from the respective profession. The chart of accounts was completed on July 7, 2009 and the microfinance institutions are receiving training on its utilization.

17. At the same time, an integrated computer system will be put in place at the BRB and the supervision department will be strengthened with the acquisition of equipment and training of inspectors.

18. Certain banks and financial institution may have difficulties with the competition in the pan-African network, unless they can find respectable partners who can bring the latest technology, financial skills and marketing benefits. In the first place, efforts will be brought to the banking and financial institutions where the state is a shareholder. The disengagement of the state which can be through a sale of shares or an increase in capital (dilution of shares) will permit external partners to invest and contribute to the development of their activities.

19. The Government considers the modernization of the payment system and the implementation of a real time settlement system (RTGS) urgent. In this context, putting into place an electronic compensation system and the development of the card system, a high priority. In view of the importance of the payment system, the BRB will put into place, a department that is dedicated to: (a) the modernization of the payment system (in all aspects), management of the system and supervision of the operators.

20. The work on its modernization began with the implementation of a legal and judicial framework (including the standardization of instruments) harmonized with the work underway at the EAC and the strengthening of the telecommunication's system. The implementation of electronic compensation will follow. In parallel, the BRB will contribute to the development of

the card system and insure its inter-operatability of the systems put into place by the various commercial banks.

21. The Government considers that the insurance sector should be modernized and restructured to ensure financial stability, a dynamic and international competitiveness. In this context, it is urgent to put into place an efficient supervisory mechanism. An independent regulatory and supervisory authority will be created by amendment to the insurance law number 1/012 of November 29, 2002. There will be a new decree modifying the decree number 100/121 of October 27, 2001 which provided the organization of the regulatory agency and the control of insurance.

22. The Agency will be an autonomous and independent unit with its own budget, the power to grant and revoke licenses and to impose sanctions. It will also have the power to develop the prudential standards. The insurance companies will have one year after the law becomes operational to conform with the prudential norms. A chart of accounts will also be elaborated and put into place for insurance companies.

23. With respect to the financial markets in Burundi, a development plan is currently being elaborated. The Government is conscious that the emergence of a bond and equities market in Burundi is not feasible in the short-term due to the low number of enterprises that could enter the stock market and mobilize long-term resources.

The privatization and reform of public enterprises

24. Facing the challenges of economic growth that is based on the development of the private sector, poor governance and the performance of the majority of the public enterprises, the Government has undertaken a reform program to divest itself from productive economic sectors, starting with the coffee sector. The Government is adopting a privatization plan taking into account the list of enterprises it wishes to privatize and a multi-annual action plan for the coffee reform. The first privatization steps have been launched. Their implementation is conforming with the privatization law of February 2009 which revised the privatization law of 2002 is performed by the Interministerial Privatization Committee supported by the Service Chargé des Entreprises Publiques (SCEP).

Recent Progress

25. With respect to public enterprise reform, the recent actions should be highlighted. Conscious of the need to improve the institutional framework and to strengthen the institutional capacity in charge of privatization, the Government has undertaken a feasibility study that analyzes the institutional needs, provides recommendation for modifications of the legal framework and suggests actions to strengthen the institutional capacity. There after, the decree authorizing the privatization of para-statals, including ONATEL, was signed in 2009.

26. With respect of the disengagement of the state from the coffee sector, a detailed action plan was adopted by the Govenrment on December 17, 2008. These steps have been followed by the signature of a decree creating the new sector regulatory agency on June 1, 2009 and the sale by international tender of 117 coffee washing stations and two coffee hulling and processing

plants. Thanks to these important first steps, 13 washing stations have been transferred to private owners. OCIBU should be liquidated and a new the regulatory agency (ARFIC) should be effectively operational before the end of 2009.

27. The following steps will be implemented without delay. This will necessitate feasibility studies, advisory services and multiple technical assistances which will result in capacity building actions to strengthen these institutions. The Government would like to obtain the Bank's support in this endeavor. This support will be complemented by actions to strengthen the analytical capacity of SCEP to management the Government's public enterprise portfolio.

Next Steps

28. Based on the recommendations of the study to improve the institutional framework and the capacity building of public institutions in charge of implementing the privatization programs, the Government intends to: (a) revise the privatization law in order to make it more flexible and favorable to the implementation of the privatization process, according to international best practices, and (b) modify the decree of SCEP, which will permit SCEP to play a more pivotal role.

29. With respect to the privatization of ONATEL, the Government's strategy is to open the capital to private economic operators including strategic investors. To this end, the transaction will be conducted transparently by international tender.

30. The Government also intends to pursue the divestiture of the state in the coffee and other sector reforms, notably by: (a) relaunching the process of selling the remaining washing stations, and (b) implementing the accompanying reform measures, with respect to AFRIC and the support to launch of the new inter-profession.

31. Additionally, the Government decided to privatize SOSUMO, principally by an increase in capital. The main objective is to provide SOSUMO the means to implement its ambitious modernization and expansion program. The process will also be conducted transparently by international tender. Particular attention will be given to environment protection. The private owners will be required to respect international environmental standards. At the same time, the best practice will be followed with respect to the social protection plan for the reduction of staff in any enterprise that is privatized or liquidated.

32. Important and targeted communication actions on the reform program, notably on the privatization program, will be for civil society and particularly, the staff of the respective public enterprises in order to allow them to better under the objectives, the effects and the implementation of specific actions of the privatization reforms.

33. The Government intends to implement measures that permit the reform preparation of another group of public enterprises, notably, the tea sector.

Improvement of the business environment and strengthening of the private – public dialogue.

34. Burundi has had several years of political crisis and during this period, has been unable to take the necessary steps to improve the investment climate and business affairs in general. Consequently, investments (national and international) in the country dropped drastically and the overall private sector and did not evolve significantly. Certain instruments of the legal framework pertaining to the commercial environment dated back to the early 1990 and merited updating.

35. The last Doing Business Report 2010 ranked Burundi 176th out of 183 countries in the ease of doing business. The Government recognizes that private sector development requires a better business climate in order to conduct its affairs.

36. After the crisis, the Government established a number of democratic institutions and defined their strategic vision where the private sector is recognized as the engine of growth for economic development. In this context, the Government has engaged in regional economic integration, notably in the EAC.

37. The enterprises face a number of difficulties in terms of regulatory environment, which is the framework in which they conduct their business. A number of key laws which drive their activities have been prepared, however, the regulations that accompany these laws, are missing. In addition, Government is aware of various gaps in the legal framework. Conscious of the urgency of adopting competitive measures in the region, the Government has undertaken a series of actions to modernize the business environment.

38. To implement its policy, the Government will address these issues on several strategic fronts: (a) continue to revise certain legal commercial instruments, elaborate the regulations that accompany the laws, translate into English, certain legal textes for better understanding by foreign investors, (b) disseminate the legal texts to the private sector and to civil society, and (c) improve the private-public consultation process in order to strengthen the private-public partnerships.

39. The country has a weak implementation capacity to implement laws, to enforce commercial contracts and obtain fair legal decisions foreseen by the commercial tribunals (court). It plans to finalize the strategy and action plan for the legal and judicial framework. In addition, the Government will support the commercial court, notably with respect to the baseline data of the commercial registry, the judgements and guarantees. Finally, they will strengthen the capacity of the the arbitration and mediation center to accelerate the treatment of commercial disputes.

40. The Government will support the efforts to improve the governance structure of the public and private sectors. In this context, on one hand, it will organize high level training of the Accountant Profession and the other hand, they will organize regular forums between the public and private sector, with an emphasis on the competitiveness of the private sector in the sub-region. This will help the country to have a sufficient pool of qualified accountants and auditors

in all economic sectors. This will also contribute to improving transparency and financial responsibity in the sectors.

41. We should highlight in the framework of promoting exporting and protecting consumers, the Government will take measures to modernize the Burundi Bureau of Norms and Standards (BBN) and will force the economic operators to respect the quality norms and standards and the applications of the phytosanitary measures.

42. The BBN will be reinforced by providing the necessary technical and logistical means to strengthen its capacity comparable to those in the sub-region. Particular emphasis will be put on the capacity to improve insection and certification of products.

Annex 11: Safeguard Policy Issues

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

1. A number of project components are expected to lead to favorable social outcomes. There are numerous benefits to the project. Economic development will be supported on several fronts, namely by stronger financial, legal, and regulatory systems that will help to facilitate enterprise access to finance and allow firms to operate within a more transparent business environment. The GoB has aggressively liberalized the telecom sector and this is showing positive results through increased network coverage and lower prices. It has also made a public commitment to privatize ONATEL which is also very positive. With respect to privatizing the coffee stations, the GoB, on June 5, 2009, began the process by launching a tender for the sale of 117 washing stations and sold 13 washing stations (without support of the project). Steps will be taken to modernize them and will ultimately improve the quality of the coffee and generate more business for the farmers.

2. The project has been classified as Category C because it is only financing technical advisory services that are unlikely to result in significant adverse environmental impacts. With respect to the coffee sector, the privatization of the coffee sector was started (and initially supposed to be completed) under PAGE. During the implementation of PAGE, an environmental impact assessment was commissioned and is currently underway for the purposes of assessing potential environmental impacts of activities under the coffee sector. PAGE is currently financing the consultant fees of the privatization advisers. The proposed project will finance additional work needed to support the ongoing coffee privatization process; and specifically it will cover: (a) the additional work the privatization consultants have been doing over the last couple months, since PAGE is running out of money, (b) the fees for a consultant to prepare environmental and social guidelines, and (c) the remaining funds are for complementary measures (regulatory agency, professional association of coffee growers). Thus, under the PPA, the government, as part of its due diligence to strengthen the coffee sector, recruited a consultant to prepare an environmental and social impact assessment of the potential run-off and will put into place an ESMF.

3. The privatization of coffee washing stations may have environmental implications, in terms of potential water pollution. However, as the washing stations are privatized, the project would help ensure that the environment-related practices followed do not deteriorate. In fact, it would be expected that the practices would improve. Thus, an environment impact assessment is currently being carried out and as part of the negotiation of the sale, it is anticipated that the purchaser of the coffee washing station will be required to put into place measures to minimize any negative environmental or social impact using the ESMF and the Retrenchment and Consultation.

4. With respect to SOSUMO, the project is only financing a transaction adviser for an increase in capital (or dilution of government shares). This transaction will not have an environmental consequence, however, it is anticipated that the consultants financed by our project who will work on the preparation of the capital increase of SOSUMO will examine the environmental and social aspects, using the ESMF. The World Bank is supporting the

agricultural sector in Burundi and the World Bank's group is preparing a follow-up, agriculture development project. The development of the coffee sector will be one pillar of that big investment project, and the two operations will work together to strengthen the environmental and social safeguards of the relevant institutions.

5. The third PE, which will be supported under this project, is the sale of shares of ONATEL, the telecom company. It is unclear at this time, what percentage of the company will be put on the market. There are currently six telecom operators in the sector so it's anticipated that the change of ownership of ONATEL will not have any significant safeguards impacts on the sector which cannot be mitigated. The ESMF will provide the mitigation measures required for potential safeguards impacts in telecoms and the installations of towers (noise from generates, radio signals from base stations – albeit minimal). The ESMF will also guide the client with regard to mitigation measures and the need for development of any further safeguard tools needed. Normally, the operators run under national regulations for environment and health and safety which are enforced either by the sector regulator or by the environmental agency (or both). With the ESMF in place the project will provide guidance to these agencies.

6. There may also be some social impact due to retrenchment of workers at ONATEL and/or the coffee washing stations. While the magnitude of such an activity is uncertain at this stage, the government has already begun consultations with the workers and the labor unions to ensure a smooth sale and agreement on a comprehensive retrenchment and social action plan prior to any sale. The government has its own laws pertaining to retrenchment of workers. It will be important, however, to provide technical support in the implementation of the retrenchment/social action plan and public consultations strategy.

7. The government has already launched its efforts to address safeguard policy issues. Government began the process of carrying out an environment impact assessment of the coffee sector and has finalized the ToR to recruit an adviser to prepare a social plan. During project implementation (or perhaps sooner, since an environmental impact assessment is already underway), a consultant will (a) review the existing environmental (water pollution-related) practices (good and bad) of the existing facilities, (b) provide recommendations regarding good environmental practices that the washing station operators could feasibly be expected to follow, and (c) lay out detailed environmental rules that the purchasers of the assets will have to abide by. The appropriate environmental requirements would then be reflected in the tender and sale documents for the washing stations that remain to be sold.

8. The plan is anticipated that based on the recommendations of this study, to prepare an ESMF, which will be jointly implemented by the Ministry of Good Governance and Privatization and the sector ministry. Government will ensure that the sale of these entities is conditional on the private sector purchaser putting into place measures to mitigate potential negative environmental and social impacts including the retrenchment plan/public consultation strategy.

9. It was further agreed with the Government that the drafting of the mining regulations will take environmental considerations into account, including how any possible overlaps or legal ambiguities between the mining code and Burundi's environmental laws are to be interpreted. It will also be agreed that an environmental specialist will be part of the team to draft of the mining regulations to ensure that any environmental aspects are adequately addressed. The terms of

reference for the technical assistance to prepare the mining regulations will specify the need for attention to potential environmental implications.

SAFEGUARD POLICIES THAT MIGHT APPLY

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP 4.01)	[ ]	[X]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Physical Cultural Resources (OP/BP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OP/BP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP 7.60)	[ ]	[X]
Projects on International Waterways (OP/BP 7.50)	[ ]	[X]

Annex 12: Project Preparation and Supervision

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

	Planned	Actual
PCN review	02/12/2009	0/12/2009
Initial PID to PIC	02/15/2009	11/05/2009
Initial ISDS to PIC	02/15/2009	11/05/2009
Appraisal	10/16/2009	10/16/2009
Negotiations	11/05/2009	11/16/2009
Board/RVP approval	12/17/2009	
Planned date of effectiveness	04/01/2010	
Planned date of mid-term review	09/17/2012	
Planned closing date	02/28/2014	

Key institutions responsible for preparation of the project: IDA

Bank staff and consultants who worked on the project included:

Sherri Archondo	Sr. Operations Officer (TTL)	AFTFE
Andre Ryba	Consultant (Lead FSD Specialist)	AFTFE
Yves Duvivier	Consultant (Lead PSD Specialist)	AFTFE
Josephine Ngou	Program Assistant	AFTFW
Alexander Pankov	Sr. Private Sector Specialist (peer reviewer)	ECSFI
Eduado Urdapilleta	Sr. Private Sector Specialist (peer reviewer)	LCSPF
Michael Wong	Sr. Private Sector Specialist (peer reviewer)	SASFP
Eric Mabushi	Lead Economist	AFTP2
Sameena Dost	Sr. Counsel	LEGAF
Adrian Di Giovanni	Counsel	LEGAF
Sylvain Rambeloson	Sr. Procurement Specialist	AFTMG
Aissatou Diallo	Financial Officer	CTRFC
Mazen Bouri	Sr. Private Sector Specialist	AFTFE
Emmanuel Sinzohagera	Financial Management Specialist	AFTBI
Yeshareg Dagne	Program Assistant	AFTFE

Bank funds expended to date on project preparation:

1. Bank resources: US$176,794
2. Trust funds: 0
3. Total: US$176,794

Estimated Approval and Supervision costs:

- Remaining costs to approval: US$ 30,000
- Estimated annual supervision cost: US$125,000

Annex 13: Documents

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

1. Financial Sector Assessment (2009),
2. Investment Climate Assessment (2009)
3. Doing Business, 2009 and 2010
4. Privatization reports on coffee
5. Diagnostic Study of the Legal and Judiciary *(Etude Diagnostique du système juridique et judiciaire du Burundi, December 2008)*
6. Source of Growth Study (2007)
7. Environment Impact Study on the Coffee Washing Stations
8. Public Expenditure Management and Accountability Review

Annex 14: Statement of Loans and Credits

BURUNDI: FINANCIAL AND PRIVATE SECTOR DEVELOPMENT PROJECT

			Original Amount in US$ Millions						Difference between expected and actual disbursements	
Project ID	FY	Purpose	IBRD	IDA	SF	GEF	Cancel.	Undisb.	Orig.	Frm. Rev'd
P113235	2010	BI - ERSGIII-Dev. Policy Loan DPL3	0.00	25.00	0.00	0.00	0.00	25.40	0.00	0.00
P113506	2009	BI: Emerg Demob and Transitional Reint.	0.00	15.00	0.00	0.00	0.00	15.69	0.00	0.00
P112998	2009	BI:Public Works and Urban Management	0.00	45.00	0.00	0.00	0.00	46.63	2.09	0.00
P101160	2009	BI-Health Project (FY09)	0.00	25.00	0.00	0.00	0.00	25.96	-0.73	0.00
P109964	2008	BI-Second HIV/AIDS MAP (FY08)	0.00	15.00	0.00	0.00	0.00	10.56	0.70	0.00
P097974	2008	BI-Multisectoral Water & Electricity Inf	0.00	50.00	0.00	0.00	0.00	46.54	2.63	0.00
P064557	2007	BI-Educ. Sector Reconstr. (FY07)	0.00	20.00	0.00	0.00	0.00	9.01	2.25	0.00
P095211	2007	BI-Community and Social Dvpt SIL (FY06)	0.00	40.00	0.00	0.00	0.00	31.93	4.96	0.00
P064558	2005	BI-Agr Rehab & Sustain Land Mgmt (FY05)	0.00	50.00	0.00	0.00	0.00	10.69	-5.43	2.24
P078627	2004	BI-Econ Mgmt Supt SIL (FY04)	0.00	26.00	0.00	0.00	0.00	12.45	10.35	0.00
P064876	2004	BI-Road Sec Dev SIM (FY04)	0.00	51.40	0.00	0.00	0.00	17.97	16.87	0.00
P065789	2001	Regional Trade Fac. Project - Burundi	0.00	15.00	0.00	0.00	0.00	5.84	-2.28	3.42
		Total:	0.00	377.40	0.00	0.00	0.00	258.67	31.41	5.66

BURUNDI
STATEMENT OF IFC's
Held and Disbursed Portfolio
In Millions of US Dollars

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic.	Loan	Equity	Quasi	Partic.
	Total portfolio:	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic.
	Total pending commitment:	0.00	0.00	0.00	0.00

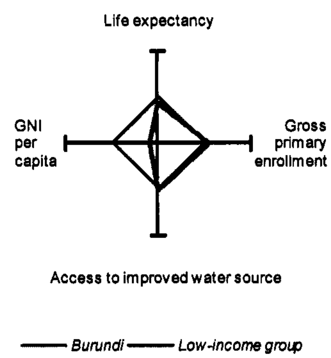
Annex 15: Country at a Glance

Burundi at a glance

9/24/08

POVERTY and SOCIAL	Burundi	Sub-Saharan Africa	Low-income
2007			
Population, mid-year *(millions)*	8.5	800	1,296
GNI per capita *(Atlas method, US$)*	110	952	578
GNI *(Atlas method, US$ billions)*	0.92	762	749
Average annual growth, 2001-07			
Population *(%)*	3.6	2.5	2.2
Labor force *(%)*	4.7	2.6	2.7
Most recent estimate (latest year available, 2001-07)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	10	36	32
Life expectancy at birth *(years)*	49	51	57
Infant mortality *(per 1,000 live births)*	109	94	85
Child malnutrition *(% of children under 5)*	..	27	29
Access to an improved water source *(% of population)*	71	58	68
Literacy *(% of population age 15+)*	..	59	61
Gross primary enrollment *(% of school-age population)*	103	94	94
Male	108	99	100
Female	98	88	89

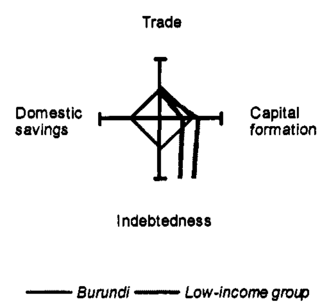
Development diamond*



KEY ECONOMIC RATIOS and LONG-TERM TRENDS	1987	1997	2006	2007
GDP *(US$ billions)*	1.1	0.97	0.90	0.97
Gross capital formation/GDP	22.6	6.1	15.7	..
Exports of goods and services/GDP	9.7	9.8	10.9	..
Gross domestic savings/GDP	6.6	1.5	-20.2	..
Gross national savings/GDP	..	5.1	..	..
Current account balance/GDP	-11.4	-1.0	-6.3	-9.9
Interest payments/GDP	1.4	0.9	1.0	..
Total debt/GDP	68.0	109.9	156.2	..
Total debt service/exports	41.3	29.4	49.1	..
Present value of debt/GDP	..	..	88.9	..
Present value of debt/exports	..	..	996.6	..

	1987-97	1997-07	2006	2007	2007-11
(average annual growth)					
GDP	-1.6	2.0	5.1	3.6	..
GDP per capita	-3.5	-1.0	1.1	-0.3	..
Exports of goods and services	2.7	..	..	..	..

Economic ratios*



STRUCTURE of the ECONOMY	1987	1997	2006	2007
(% of GDP)				
Agriculture	55.1	49.2	..	..
Industry	17.1	15.8	..	..
Manufacturing	11.5	7.6	..	..
Services	27.8	35.0	..	..
Household final consumption expenditure	83.7	81.7	90.9	..
General gov't final consumption expenditure	9.7	15.8	29.3	..
Imports of goods and services	25.7	14.4	47.8	..

	1987-97	1997-07	2006	2007
(average annual growth)				
Agriculture	-1.2	-1.7	..	..
Industry	-2.8	-4.7	..	..
Manufacturing	-5.1	..	..	..
Services	-0.8	9.1	..	..
Household final consumption expenditure	-1.8	..	..	..
General gov't final consumption expenditure	0.8	..	..	..
Gross capital formation	0.6	..	..	..
Imports of goods and services	0.8	..	..	..

Note: 2007 data are preliminary estimates.

This table was produced from the Development Economics LDB database.

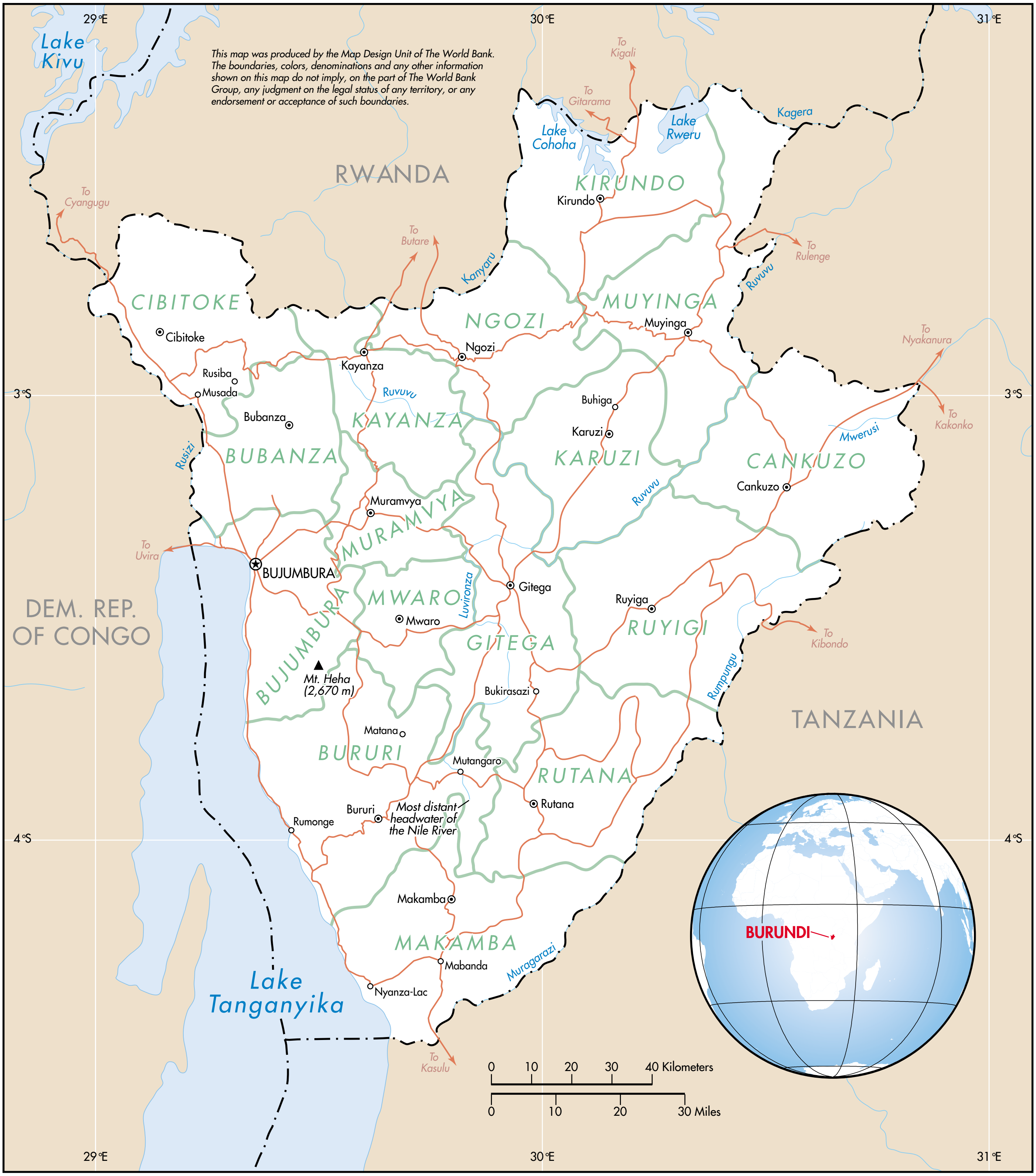
* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Annex 16: Map BDI 33380

IBRD 33380

BURUNDI

SELECTED CITIES AND TOWNS
PROVINCE CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
PROVINCE BOUNDARIES
INTERNATIONAL BOUNDARIES



SEPTEMBER 2004