Deepening Regional Integration to Address Burundi’s Trade Challenges and Support Economic Growth

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Introduction

This note explores the role of regional integration in addressing Burundi’s trade and development challenges. It presents Burundi’s main export and import challenges and discusses the role of regional integration in reducing the country’s current high transport costs, diversifying its trade flows and attracting foreign direct investment. The note provides concrete policy recommendations to deepen Burundi’s integration with neighboring countries, improve its trade performance and increase its competitiveness. In addition, the note gives some practical guidance regarding the implementation and sequencing of these recommendations based on Lesotho’s successful experience in addressing typical trade challenges facing landlocked LDCs.


Key messages:

• Export diversification is critical: Burundi’s export base is narrow and undiversified, making the country vulnerable to external shocks and dependent on foreign financing

• Services can play a key role: There is a strong need to raise awareness about the crucial role of services and trade in services for Burundi’s export diversification and development. Services such as telecommunications, energy, transport, and business services are important inputs into the production of goods and other services and hence influence productivity and competitiveness. Increasing the availability, affordability and quality of services is crucial for export diversification, economic growth and poverty reduction in Burundi.

• Regional integration needs to be more effectively pursued: There are two main issues that need to be addressed (i) Burundi needs to coordinate EAC and COMESA integration and address the large deficit of technical and institutional capacity; (ii) deeper integration to remove non-tariff barriers (NTBs) and integrate services. The
lesson from successful regional integration experiences elsewhere in the world is that tackling tariff barriers is not enough to enhance trade. Burundi must also aim to facilitate regional trade by addressing NTBs, such as restrictive product standards or complex rules of origin. In the services area, Burundi needs to put special emphasis on the behind-the-border reform and regulatory agenda. There is a strong need to coordinate regulatory reform with liberalization of explicit trade barriers.

- **Attracting FDI is crucial for export diversification.** Opening up to foreign direct investment can be an effective mechanism to increase competition and efficiency in the provision of goods and services in the domestic economy.

- **Key structural constraints must be addressed to move ahead with the trade agenda.** A key message from experience in other LDCs such as Lesotho is that when moving forward in designing and implementing effective policies for export-led growth and development, it is important for Burundi to focus on improving its business regulation and investment climate. Furthermore, reaching out to private sector partners, both domestic and foreign, and ensuring that high quality infrastructure and a better functioning financial system are in place can help attract FDI and improve the country’s trade performance. Finally, it is important for Burundi to put in place the necessary institutional arrangements to coordinate, monitor and evaluate the implementation of these trade and trade-related reforms.

**Burundi’s Trade Challenges: Narrow and Undiversified Export Base and High Dependence on Imports**

Burundi’s very narrow export base (averaging only about 10 percent of GDP) has not changed notably in the last 20 years. Compared with most of the other EAC members, Burundi has a relatively high level of export concentration. Burundi’s economy is highly dependent on primary products, predominantly coffee followed by tea, Burundi’s export structure is characterized by very low use of technology. Burundi has been only partially successful in introducing high-value primary products, such as cut flowers and the income potential of Burundi’s export basket remains low.

The expansion of coffee faces severe challenges. Some 600,000–800,000 households (perhaps one-third of the population) grow coffee. Though Burundi has the agricultural conditions to produce high-quality, high-value coffee, the sector underperforms with declining production and quality partly because inadequate official measures do not stimulate production. Unlike Rwanda, Burundi has been slow to match the latest developments, such as the increased importance of specialty coffees or the marketing of high-quality coffee.

Imports play a major role in the Burundian economy. The country imports a wide variety of goods, with manufactures representing about two-thirds and fuel about 15% of Burundi’s goods imports. The import composition largely reflects the lack of a domestic manufacturing industry and fuel resources as well as the limits of a small domestic market that prevents economies of scale.

As a small, landlocked country Burundi confronts significant difficulties and costs in accessing global markets. High trade costs, poor infrastructure and underdeveloped services sectors limit Burundi’s ability to attract FDI, develop competitive higher-value activities for export and pursue export-led growth. The internal obstacles are compounded by high costs in the ports of Dar es Salaam (Tanzania) and Mombasa (Kenya), through which Burundi trades. The following factors can further explain Burundi’s poor trade performance:
First, Burundi has one of the most unfavorable business environments worldwide. The World Bank’s 2010 *Doing Business* survey ranked Burundi 176 out of 183 countries surveyed in their Ease of Doing Business Ranking, near the bottom relative to other countries assessed in the areas of dealing with permits, getting credit, protecting investors, trading across borders, and enforcing contracts. Another cross-country assessment of business conditions ranked Burundi 133 out of 133 countries surveyed in its Global Competitiveness Index. Survey respondents highlighted corruption, political instability, inefficient government bureaucracy, and crime and theft among their top concerns.

Second, the private sector in Burundi faces several major constraints. The Burundian private sector is underdeveloped - it includes a large number of small enterprises, most of which operate in the informal sector. Furthermore, Burundi’s economy is dominated by public enterprises, several of which face financial problems.

Third, the financial sector is small and not well developed; and access to finance is a major obstacle for companies in the formal and informal sectors.

Fourth, lack of infrastructure raises the costs of Burundi’s isolation. The country lacks roads, bridges, ships, rails, power, communications, water and sanitation. The poor coverage and state of infrastructure create costs in time and money that lower the return to work, discourage domestic and foreign investment, and constrain economic growth. High transport costs, caused by absence of infrastructure, hinder internal trade and reduce Burundi’s trade opportunities with East Africa and the world beyond.

Finally, the limited availability of skilled workers and the low labor productivity of labor is another explanatory factor for Burundi’s poor export performance.

There is consensus among policymakers and private sector stakeholders that the country’s goods export expansion will have to be driven by a combination of quality improvements of its traditional products (such as coffee and tea) and exports diversification. Several products have been identified as potential export products: cotton; mining; fisheries; tourism; handicrafts; and nontraditional exports, such as fruits and vegetables, flowers, ornamental plants, aromatic and medicinal plants, and palm oil.

By contrast, policy makers tend to neglect the role of services as a source of export diversification, with trade policies focusing solely on goods.

The provision of clean water, effective sewerage, a stable supply of energy, and access to education and health services is critical to increasing welfare and alleviating poverty. Services such as telecommunications, energy, transport, and business services are important inputs into the production of goods and other services and hence influence productivity and competitiveness. Furthermore, distribution services are important in addressing food security issues. Increasing the availability, affordability and quality of these services is crucial for economic growth and poverty reduction in all developing countries. There is a strong need to raise awareness about the crucial role of services and trade in services for Burundi’s development.

But Burundi cannot move ahead with the trade agenda without addressing the structural constraints facing its economy. The process of catching up will involve addressing (i) a non-conducive business environment, including the lack of an encouraging statutory framework for a favorable investment climate and poor governance; (ii) the lack of dynamism and competitiveness of the domestic private sector; (iii) a weak financial system; (iv) the poor physical and energy infrastructure; and (v) skills issues. Addressing these challenges will require
both national reform and international cooperation, including increased regional cooperation within the EAC.

**Burundi’s EAC Membership: Benefits and Risks**

Burundi belongs to several and often overlapping organizations including the COMESA and the East African Community. A recent and important development in East Africa has been the commitment of the five East African countries, including Burundi, to establish progressively the EAC Common Market Protocol that provides for the free movement of goods; the free movement of persons; the free movement of labor; the right of establishment; the right of residence; the free movement of services; and the free movement of capital.

Burundi authorities have shown strong commitment to EAC membership. Since Burundi was officially admitted as a member of the EAC on July 1, 2007, efforts have been made by the authorities to align with the EAC requirements, especially in political, institutional, and economic areas. Burundi signed the treaty, ratified the protocols and the conventions, and developed (relatively late) a communication campaign aimed at sensitizing the population to support the integration initiative. An institutional structure has been put in place to further the integration agenda—a full ministry was created in charge of EAC affairs, as practiced within the other EAC member-states. It is critical for Burundi to develop a strategy that ensures successful participation in the EAC.

Burundi’s EAC Membership opens opportunities for the country’s goods and services trade. Furthermore, the regional physical and regulatory infrastructure that can help link Burundi to a larger regional market and the rest of the world. The EAC agreement can also create a push for economic and structural reforms and strengthen political and regional stability. Box 1 describes in more detail the potential benefits resulting from Burundi’s EAC Membership.

While Burundi’s potential benefits from EAC Membership are compelling, the country has a large deficit of technical and institutional capacity and the challenges posed by a regional integration policy are enormous. Chief among those challenges and concerns are:

**Capacity issues**—Weak technical and institutional capacity may delay or compromise the implementation of the agreed program. In this regard, a capacity-building program is being developed with assistance from the U.K. Department for International Development (DFID); but permanent technical assistance will be needed, at least in the first years. In addition, although the working language in the EAC is English; most Burundians speak only French. This language misalignment has consequences in terms of common understanding and follow-up on agreed decisions.

**Loss of revenue resulting from adoption of the common external tariff**—A study of the fiscal impact estimated a loss of 1.7 percent of total revenue. This is not a substantial loss, given existing alternatives of compensation, mainly through tax reform (expanding the tax base, eliminating exemptions) and the mechanisms of compensation agreed between COMESA and the EAC for Burundi and Rwanda.

**Indirect costs**—Indirect costs of regional integration are related to the capacity of regional hubs to attract and combine the best opportunities (research, education, employment, and so forth). Other indirect costs are related to the likelihood of criminal activity taking advantage of free movement in a fragile area. The first problem is a political economy issue and needs to be addressed on the community level. The latter poses a security problem and
Box 1: Burundi’s EAC Membership - Potential Benefits

**Trade Gains from Burundi’s EAC Membership**
While Burundi is likely to reap larger traditional gains from trade from the Economic Partnership Agreement with the EU than through the EAC as Burundi’s export structure is very complementary with the EU import structure, and vice versa, trade with the EAC has enabled Burundi to move into differentiated goods, which it does not export to Europe. Regional trade agreements among natural trading partners are also more likely to facilitate deeper integration involving differentiation and diversification, which further expands welfare gains. The EAC offers a good opportunity for Burundi to export new products. Burundi, however, needs to implement a number of reforms in order to be able to successfully maintain and grow new exports.

**Benefits for the Industrial and Services Sectors from Regional Foreign Direct Investment**
Strategic regional partnerships aimed at attracting regional FDI can help Burundian firms increase profitability resulting from economies of scale generated by a bigger market and better supporting services. Also, Burundi’s low wages and the availability of (unskilled) labor constitute potential incentives to relocate regional production centers to the country. The regional partnerships could take the form of joint ventures with local small and medium enterprises, equity participation in the shareholder, or subsidiaries from which the economy would take the maximum benefit.

**Benefits from Regional Public Infrastructure**
As a landlocked country, Burundi depends on Dar es Salaam and Mombasa for most of its external trade. EAC membership does not guarantee progress, but it gives Burundi a forum to advocate for better infrastructure management in regional ports, rails, and roads that it does not operate directly. Public infrastructure plays a critical role in promoting economic growth. More efficient regional transport, telecommunication and energy infrastructure can help firms in Burundi to their lower transport and transaction costs and reduce their fixed and variable costs. In addition, a regional integration process also provides gains through regional commitment mechanisms.

**Benefits from Political Stabilization and Improved Security**
Burundi could benefit considerably from a ‘regional’ political stabilization effect. Furthermore, regional integration mechanisms tend to strengthen an individual country’s bargaining power as well as the credibility of its policies. In addition, they tend to seriously lower security risks through regional agreements and other common arrangements. Moreover, there is a hope that the land issues that are a permanent source of conflict in Burundi could be addressed at least partially through the establishment of the EAC common market.

**Benefits from Accelerating Burundi’s Economic and Structural Reforms**
Regional integration can help Burundi accelerate its ongoing reforms in the following areas: implementation and harmonization of fiscal instruments, financial sector reform on the basis of EAC standards and norms, reduction of tariff and non-tariff barriers affecting goods and services, reform of the business environment on the basis of EAC regulation. Regional agreements such as the EAC Common Market Protocol may also make it possible to reap scale economies in regulation and supervision, particularly where national regulatory agencies face skill constraints; they could also reduce scope for the capture of national regulation by private sector interests and reduce regulatory heterogeneity.

**Looking Ahead: Can Burundi Become a Regional Transport Hub and Exploit Additional Gains from Regional Integration?**
Because of its geostrategic location, the port of Bujumbura has the potential to return to its former role as traditional gateway to providing goods and transport services to countries bordering on Lake Tanganyika, especially to the eastern portion of the DRC. In the context of regional integration, development of intense mining and other economic activities in Burundi, eastern DRC, and Rwanda could efficiently use the services of the port of Bujumbura. In addition to its location, it is adequately equipped and currently operating at less than 50 percent of its capacity, according to statistics from the port authority. The future role of the port of Bujumbura, however, primarily depends on developments regarding the Tanzania Railways Corporation.
also needs to be addressed at the community level; it further requires the setting up of a monitoring mechanism and the establishment of regional security.

Other risks related to persistent insecurity in Burundi and the possible focus on the electoral agenda— Although the recently established technical committees for monitoring and evaluation and donor support should mitigate such risks, the Government needs to remain focused on its regional commitment to keep the momentum.

Timing of the implementation of priority measures—The timing is considered very ambitious for the newest member-states—especially for Burundi. Negotiations based on the variable geometry principle should help address this issue.

To sum up, in order to be able to maximize the benefits from the regional integration process, Burundi needs to implement reforms in the following areas: capacity building, institutional reforms, increased cooperation with and involvement of the private sector in the reform process, and a clear coordination and communication mechanism.

Recommendations for Policy Action

Burundi needs to implement a comprehensive approach to regional integration, prioritizing and sequencing actions in order to be able to benefit from EAC membership and address the trade challenges. Most importantly it needs to address economic reforms and institutional constraints.

Key recommendations are the following:

Economic Reforms:

1. Trade policy reforms

Multilateral vs. regional liberalization: While barriers to goods and services trade would ideally be liberalized on a non-preferential basis, such liberalization may not always be technically feasible or politically acceptable, especially when impediments arise from differences in regulatory requirements. Deeper regional integration through regulatory cooperation with neighboring partners, which have similar regulatory preferences, can usefully complement non-preferential trade liberalization. Deeper regional integration would also enhance competition between providers of goods and services, allow these providers to exploit economies of scale, and produce a wider variety of goods and services. Regional integration brings further benefits in that a larger regional market is able to attract greater domestic and foreign investment, and regionalization may help to take advantage of scale economies in regulation, particularly where national agencies face technical skills or capacity constraints.

Regarding goods trade, key challenges refer to NTBs. NTBs in Burundi remain a serious concern for intraregional trade—especially customs and administrative procedures, including the length of the clearance formalities and the high number of institutions involved in control operations at the port in Bujumbura.

Proposed measures to remove Burundi’s NTBs within the EAC are:

- Establishing a mechanism for identifying and monitoring the disposal of NTBs. Preferably, this mechanism would include both public sector and private sector representatives concerned with issues of trade facilitation.
- Consolidating institutions in charge of customs clearance and administrative control at the port of Bujumbura in a one-stop window to streamline the transit and customs formalities.
- Improving layout and equipment of border posts.
• Introducing competition in the selection of companies for preshipment inspection.
• Gradually establishing an infrastructure for quality control and certification.

Regarding services trade, key challenges relate to the coordination of regulatory reform with the removal of explicit trade barriers.

Liberalizing services trade is typically more complex than liberalizing goods trade and can require considerable technical capacity. The complexity arises from the necessity for many services sectors to be regulated in order to ensure that they operate efficiently in the face of market failures. The challenge is one of integrating domestic services markets with regional and global markets, while promoting a regulatory environment that delivers competitive services sectors and allows public policy objectives, such as universal access, to be met efficiently.

Coordinating services trade liberalization with regulatory reform to make them mutually reinforcing can be vital in mobilizing and sustaining support for reform. Domestic regulatory reform includes the easing of entry requirements and the elimination of disproportionate restrictions on competition and on the operation of firms in various services sectors. Furthermore, deeper regional cooperation to decrease regulatory differences between Burundi and it neighbors in areas such as licensing requirements or standards needs to be pursued. This emphasizes the importance of developing the capacity to define and implement sound regulatory policies for services sectors, capacity that is limited in Burundi. The DTIS update will provide detailed guidance on these largely unexplored issues in Burundi.

Policies on trade and diversification need to be complemented by reforms to improve the business environment and by an effective and practical support to the promotion of the private sector and the improvement of its competitiveness by enhancing the framework for private-public dialogue.

2. Business environment

Burundi needs to implement reforms of the legal and regulatory frameworks to address the poor regulatory framework that is characterized by cumbersome administrative and bureaucratic procedures, high tax rates, outdated legislation, and weak capacity to enforce contracts. Furthermore, it needs to reinforce incentives for growth in private investment, and disengage the government from the productive sector and privatization of public enterprises.

Burundi has made some progress in terms of promoting an environment conducive to business: it has recently drafted several business instruments that take into account harmonization with regional tools. However, a number of issues remain on the agenda: for example, the duty exemptions, the tax incentives to export procedures, customs regulations, and transit cargo regulations have not yet been harmonized at the EAC level; and limited progress has been made in harmonizing standards.

3. Infrastructure

To provide the private sector with the necessary means to operate and increase productivity, it is essential to close the main infrastructure gaps in Burundi. Burundi’s proposed infrastructure action plan aims at addressing weak infrastructure in the following sectors: power, transport, and communications.

• One of the objectives of the program for the power sector is to ensure, through increased investments in domestic and regional generation capacity, that the business community and households have access to reliable power supply 24 hours a day.
• The key objectives of the proposed action plan for the transport sector are to lower the costs
of transport for the entire economy and to improve access to local and international markets. The proposed program focuses on road transport and civil aviation, and investigates the possibility of a rail extension from Tanzania into Burundi.

- The proposed communications program aims to improve access to the international communications network substantially and to lay the foundations for a national communications grid that will provide communities and business through Burundi with low-cost voice and data communications. A high priority is attached to the immediate development of a national communications grid of fiber-optic cable and digital microwave that would be linked to the regional network.

4. Finance

Burundi needs to strengthen its financial sector, improve access to financial services, and lower their cost. Over the next five years, the country must focus on domestic issues and view the EAC as a benchmark that guides regulation, supervision, and institutional strengthening.

Key recommendations include the following: (i) increased stability covering the privatization of state-owned banks and improvement of supervision; introduction of a clearing and real-time gross settlement system; strengthening supervision and institutions dealing with microfinance, establishment of an independent regulatory/supervisory agency in insurance; and changing management structure, internal restructuring, and parametric reform of pension systems; and (ii) improved access by developing new products and lending mechanisms for small and medium enterprises and rural areas and building the capacity of the Banque Nationale de Développement Économique (BNDE) to lend in rural areas.

Development of an integrated financial market is important. The Central Bank of Burundi needs to accelerate the financial sector reform to comply with EAC standards and norms. Specific actions would include promoting market access for investors from the EAC, setting up a specific unit responsible for systems and methods of payment, and defining a strategy and policy modernizing the payment systems and necessary infrastructure in line with the plans of the EAC.

5. Skills

To address the limited availability of skilled workers and low labour productivity the following could be pursued: joint programs between public institutions and private firms to improve technical and professional skills; facilitation of English language programs; reexamination of labor market regulations, increased access to education by making schooling available to a larger part of the population, providing more opportunities for technical and professional education, and strengthening existing skills;

Additional guidance regarding the implementation and sequencing of these recommendations can be obtained from Lesotho’s successful experience in addressing typical trade challenges facing landlocked LDC.

It is important for Burundi to focus more strongly on the factors it can influence, namely: policy reforms to attract new and better FDI and to ensure foreign investments provide positive spillovers to the wider economy. Moreover, Lesotho’s experience confirms that implementing reforms to improve business regulation and investment climates; ensuring that high quality infrastructure is in place to facilitate foreign investment and domestic growth; increasing exports by streamlining customs procedures and upgrading border crossing infrastructure; and, reforming immigration regulations to ease the entry of skilled workers into the market are essential elements of a successful trade strategy.
A key message is that when moving forward in designing and implementing effective policies for export-led growth and development based on attracting FDI, Burundi should place particular emphasis on improving its business regulation and investment climates. LLDCs that do not have Lesotho’s proximity advantage will have to focus even more on these policy issues if they are to succeed. Within this process, the role of the private sector is crucial. Reaching out to private sector partners, both domestic and foreign, can help attract FDI.

**Institutional Reforms:**

It is essential that the Ministry of East African Community Affairs (MEACA) is staffed with competent personnel, and the necessary institutional arrangements need to be in place, requiring extensive capacity building. It is important to implement a coordination, monitoring, and evaluation mechanism for all EAC-related issues. A coordination mechanism is critical at this stage. It should include the Government, the donor community, the private sector, and civil society. It can clarify the roles of the potential actors and help maximize their contributions. Furthermore, a communication campaign aimed at sensitizing the population to support the integration initiative should be implemented.

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