REPUBLIC OF BURUNDI

Macroeconomic Framework

Introduction

In line with the process of consolidating peace and restoring security and with the support of its development partners, Burundi has initiated a program for economic recovery and for the implementation of important structural reforms aimed at supporting growth. New measures have also been adopted to improve the business climate, the transparent management of public finances, and the effective operation of monetary policy. In general, and despite the difficult environment resulting from a long conflict, results have been largely positive, in particular in terms of macroeconomic stabilization and the allocation of resources to programs focused on poverty reduction.

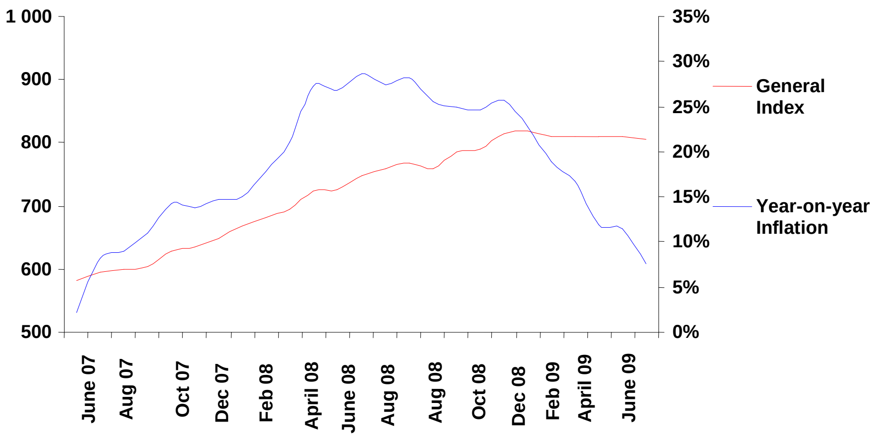
However, despite this progress, the negative impact of the global economic crisis risks compromising the reinforcement of the performance recorded so far, particularly in the area of the public finances.

1. The Real Sector

After the return to activity seen in a 4.5% growth rate for 2008, the trend in 2009 has been downward, with an expected rate of 3.2%, due to a coffee crop projected to be poor in 2009-2010, fluctuations in the price of coffee, a reduction in the transfer of remittances from the diaspora community to Burundi, and a reduction in direct foreign investment.

Inflation has been gradually brought under control. The first six months of 2009 have been marked by a lowering of prices since June 2008, thus announcing the end of the price rises experienced in Burundi.

Figure 1: Inflation June 2007 - June 2009



Source: Burundi Statistics and Economic Studies Institute (ISTEEBU)

After reaching a ceiling of 819 points, the consumer price index stabilized at around 810. The year-on-year inflation rate fell to 7.6% in June and to 5.6% in August, its lowest level in two years and considerably lower than the 28.6% of a year earlier. The objective of reaching the inflation level targeted by the government has thus been broadly achieved.

In the medium term, annual inflation is predicted to fall gradually to about 5.5% in 2012 (Table 1). These projections are based on a prudent monetary policy aimed at controlling inflationary expectations.

Table 1: Real Growth in GDP and Inflation, 2005-2012

-	2005	2006	2007	2008	2009	2010	2011	2012
		(Performance)				(Projections)		
Real Growth (%)	0.9	5.1	3.6	4.5	3.2	3.6	4.2	4.8
Inflation (%)	1.0	9.4	14.7	25.7	9.1	7.5	6.0	5.5

The macroeconomic projections depend on slightly higher sustained growth of the order of 3.6% to 4.8% from 2010 to 2012. The effects of the international financial crisis should continue to have repercussions on growth, which will probably not reach 5% per year. The hypotheses that justify this growth path are the continued structural reforms aimed at eliminating economic distortions, the reconstruction of the economic infrastructure, and the rebuilding of human capital to increase productivity.

Recently, with the help of its partners, the government has carried out a series of studies to identify the main directions to follow so as to accelerate the country's economic development. The next stage involves the rapid implementation of the main conclusions and recommendations of this work. These studies show that the sources of growth are still predominantly the agricultural sector, essentially food products, with the aim of increasing national consumption, and the traditional export sectors of coffee and tea, with the aim of developing foreign trade and foreign currency earnings. The main development priorities of the agricultural sector have been adopted by the new national agricultural strategy, which has the general objective of "contributing in a sustainable way to poverty reduction and supporting Burundi's economic growth by increasing productivity, maximizing production, diversifying income opportunities, and conserving and maintaining natural and environmental resources." Three other sectors have been identified as having high potential and could soon make a significant contribution to economic growth and government revenue. These are horticulture, tourism, and mining. In the current context of public and private infrastructure reconstruction, the construction and public works sector is also growing significantly. Finally, although this is difficult to measure at the moment, the spread of networks for information and computer technology (NICT) should have a positive impact on the productivity of the service sector, including its informal component.

Despite difficult conditions, significant efforts have led to appreciable results in initiating the early development of these sectors. Yet growth in food production remains insufficient given the rate of population growth, and it has not contributed to economic growth as much as was predicted by the Poverty Reduction Strategy Paper (PRSP). However, the government has the measure of the problem and is already benefiting from significant support from its partners in modernizing the country's agriculture.

Reform of the coffee sector (the most important sector, in which about 800,000 families – or close to half the country's population - earn their living and which contributes about 5% of GDP) aims to increase export income and the income of agricultural producers, particularly in rural areas, through the privatization of production plants to increase productivity and better positioning on the international market due to the stimulus provided by competition and transparency in marketing channels. The process of selling the first washracks is now under way and a new regulation for the sale of coffee in compliance with best international practice is now in force.

As regards tea, an audit of recent years has been completed. Reform of the sector aims to: (i) restructure the Burundi Tea Agency (OTB) and rehabilitate and liberalize production structures, (ii) privatize the sector and increase the tea industry's competitiveness, and (iii) consolidate the capability of those involved and organize a communication campaign.

The government is also focusing on the horticulture sector and plans for developing it are being worked out with support from the country's partners. The same is true of the tourism sector, which should once again receive attention with the return of peace and security throughout the country. The government believes in the rapid development of mining and in its positive impact on the rest of the economy. To prepare the way for future mining operations, the government recently started revising the Mining Code, which dates back to the colonial era (1962) and was last revised in 1976. A complementary study on small-scale mining operations is also being prepared.

Using as a basis the lowest level of global competitiveness as shown in the latest World Economic Forum and Doing Business indices, Burundi wants to provide itself with the means of attaining the level of its main regional partners. Stimulating the private sector and improving the business environment have progressed appreciably. A new investment code in conformity with best international practice was promulgated in September 2008 and should help improve the business climate. The Council of Ministers has adopted plans for business codes and private and public company regulations in conformity with international standards.

A participatory process has been implemented for formulating these codes and has involved not only representatives from the government ministries and institutions involved but also representatives from the private sector. The government has also committed itself to revitalizing the framework for public-private sector dialogue in order to better prepare the private sector to profit from the opportunities presented by Burundi's accession to the East African Community (EAC). Leaving nothing to chance, the government is actively preparing the launch of a project for the development of the private and financial sectors, which takes account of all relevant aspects.

In line with this, the government has made a significant investment in improving the management of the petroleum sector. It has approved a bill transforming import tariffs and the former tax on transactions into specific tariffs (a law revising the fuel tax system was introduced in July 2009). A memorandum reflecting the conclusions and recommendations of a technical assistance project on the mechanism for setting prices in the domestic petroleum sector has been finalized. Subsequently, a ministerial decree was signed in May 2009 confirming the practice of a quasi-automatic monthly review of gasoline prices at the pump contingent on fluctuations in global prices and stabilizing margins at an appropriate level (subject to annual review contingent on the development of operators' net costs).

Burundi's accession to the EAC was a turning point in the history of the development of the country's economy. Burundi officially joined the EAC in July 2007 and formally joined the community's customs union in July 2009. To accomplish this, a series of studies were necessary, especially on tax issues, to harmonize fiscal instruments with those of the community and to reduce the potentially negative impact of accession to the union on government revenue.

With the participation of development partners, work is now in progress, and to date the following projects have already been completed: (i) a study of the fiscal impact of Burundi's accession to the EAC; (ii) a study of the introduction of Valued-Added Tax (VAT) (the law on VAT introduction came into effect on February 17, 2009, replacing the Tax on Transactions); (iii) the adoption of the EAC's Common External Tariff (CET); (iv) the computerization of the Tax Department; (v) the revision of the Tax Code; (vi) the revision of the Customs Code, and (vii) the establishment of the Burundi Revenue Agency (OBR).

However, the government realizes that in addition to the necessary harmonization of fiscal policies, the budget calendar, and phytosanitary standards as well as the negotiation of the most appropriate terms for a mutually profitable membership of this regional economic environment, it must develop a global strategy. Within this framework, studies are being carried out with significant technical and financial support from donors on regional integration within the EAC with the aim of clarifying decisions taken by the government.

Implementing the economic policy recommendations of all these programs requires significant contributions from donors. Sustained technical and financial assistance is critical in carrying out the measures designed to stimulate growth so as to achieve the EAC standard, make the most of the growth potential outlined above, and profit from the opportunities offered by joining this new economic group while controlling the related risks. The government is highly aware of the importance of this transitional phase toward an integrated and dynamic economy. It is committed to accelerating the implementation of all these reforms in order to maintain an annual growth rate exceeding population growth, and it calls for the permanent support of its development partners so that it can better handle this historic turning point.

2. Monetary Sector

Burundi's monetary policy remains focused on price stabilization. The Central Bank (Bank of the Republic of Burundi – BRB) aims to keep the growth of the money supply within boundaries compatible with economic activity and the objectives of the balance of payments. The monetary authorities are predicting a growth rate in the money supply of 14.4% in 2009. This objective translates into an increase in the monetary base of 13.5%. This rate was raised slightly during 2009 to help Burundi's economy adjust to the effects of the financial crisis. However, this easing should not have a negative impact on the rate of inflation thanks to the downward trend in petroleum and food product prices.

The Finance Ministry and the Central Bank have agreed to coordinate their fiscal and monetary policies in order to reach the target rate of inflation, improve the cash resource predictions of the BRB, and ensure the absorption of foreign aid funds through appropriate foreign exchange tenders. In addition, the BRB has committed itself to strengthening banking supervision to minimize risks linked to the financial sector. In particular, the minimum amount of capital required by commercial banks has been raised to BIF 5 billion.

After the promulgation of new statutes confirming the independence of the Central Bank, the Bank has implemented important measures focused on internal and external control, including risk management.

As far as exchange rate policy is concerned, after several years of constant depreciation, the BIF/US$ exchange rate has finally stabilized at around BIF 1,230 to US$1. This stabilization is the result of prudent monetary policy as well as reforms implemented by the BRB on the foreign exchange market.

The depreciation of the national currency in relation to the dollar at the end of 2008 was due to higher inflationary pressures than in partner countries as well as foreign exchange market dysfunction. Despite a comfortable level of foreign exchange reserves and regular sales of foreign currency on the foreign exchange market by the BRB, the Burundi Franc continued to depreciate. This depreciation was mainly the result of the floor rate mechanism. On January 1, 2009, the BRB abolished this floor rate and in April 2009 decided to establish a symmetrical exchange market. These reforms had a positive effect on the market and contributed to stability in the exchange rate.

3. Public Finances

The budget deficit is expected to remain at 4.3% of GDP in 2009, above the 3% initially envisaged, because of the relaxation of budgetary policy to enable the Burundi economy to face the impact of the international financial crisis. The increase in the budget deficit is the result of losses in tax revenue due to the contraction of international trade. This deficit will be financed through additional budgetary assistance from donors as well as by increased advances by the BRB to the government.

In the medium term, government revenue should reach close to 20% of GDP, although it will only reach 18% in 2009. The government will therefore have to broaden its tax base by reducing tax exemptions and strengthening the Revenue and Customs services. The introduction of VAT on July 1, 2009 and the establishment of the Burundi Revenue Agency go in this direction.

Essentially, revenue should continue to consist of tax revenue, mainly in the form of taxes on goods and domestic services (45% of revenue), income tax (25%), and foreign trade taxes (20%).

The level of expenditure in 2009 was revised upward from 44.6% to 46.1% of GDP to allow the government to mitigate some of the effects of the economic crisis on the most vulnerable population. However, this should be gradually reduced to less than 42% of GDP. Expenditure in priority sectors will increase from 8.8% of GDP in 2008 to 9.9% in 2009 and this trend will continue in the medium term in conformity with the PRSP. The resources obtained after the cancellation of foreign debt will be concentrated on the agriculture, water, rural infrastructure, health, and education sectors.

Civil service salaries still absorb more than 40% of current expenditure. Since 2007, the total wage bill for the army has been increasing less rapidly than that of the rest of the civil service and has been progressively reduced to 2% of GDP thanks to the implementation of the demobilization program. This program proved onerous in the early years but it is beginning to bear fruit. Similarly, police salaries, after an initial increase following the integration and training of former rebel movements, have been decreasing since 2007 as a percentage of GDP. As regards the priority sectors, education has benefited from an initial increase in salaries following the implementation of free primary education, but much remains to be done. In the health sector, salaries had to be raised to insure adequate human resources for the sector. These are today the only sectors in the civil service that are still recruiting.

The total wage bill will have to be controlled below the level of 11.2% of GDP in 2009, a rise of 0.5% of GDP having been decided to respond to the increase in salaries in the health sector, and this will be balanced by budget cuts in non-priority sectors. The aim is to gradually reduce the size of the government's wage bill to below 10% of GDP. To achieve this, civil service reforms are under way with support from technical and financial partners. The payroll has already been re-integrated into the Finance Ministry and an audit of this expenditure is taking place. This audit will also be used as a basis for civil service wage reform, for which a commission has been created. Control over the wage bill will gradually be strengthened after completion of the census of civil servants and the publication of the results of the census of army and police personnel.

Table 2: Government Financial Operations (BIF billion)

	2005	2006	2007	2008	2009	2010	2011	2012
	(Performance)				(Projections)			
Total Domestic Revenue	**172.1**	**178.8**	**197.6**	**256.7**	**307.4**	**350.7**	**401.7**	**449.4**
Tax Revenue	158.9	163.4	182.6	229.8	277.7	316.8	364.1	407.7
Non-tax Revenue	13.2	15.4	15.0	26.9	29.7	33.9	37.5	41.7
Net Expenditure and Loans	**316.4**	**361.0**	**407.9**	**608.0**	**789.6**	**860.7**	**873.2**	**952.9**
Current Expenditure	200.6	221.5	261.2	354.5	421.5	478.4	530.6	591.9
Salaries	72.6	93.9	114.0	154.7	192.2	209.6	225.3	248.2
Of which: Health	1.8	2.8	3.8	6.7	14.6	…	…	…
Education	26.5	41.0	53.2	55.1	72.2	…	…	…
Army	24.0	22.9	28.0	29.4	33.6	…	…	…
Police	6.7	15.1	18.2	19.8	21.5	…	…	…
Special programs financed from foreign resources	33.2	23.5	12.2	45.2	90.0	57.0	18.0	18.0
Net equipment expenditure and loans.	82.6	116.0	134.5	208.3	278.1	325.3	324.7	343.1
Variations in Arrears (reduction = –)	-10.2	-13.7	-21.9	-11.0	-3.5	0.0	0.0	0.0
Overall Balance (occupational fund)	-154.5	-195.9	-232.3	-362.3	-485.7	-510.1	-471.6	-503.5
(grants included)	-64.3	-30.8	-16.3	-21.6	995.9	-75.0	-38.9	-29.5
Financing	**165.2**	**199.8**	**237.7**	**366.8**	**485.1**	**490.8**	**449.7**	**479.2**
Foreign Contributions	100.8	169.0	221.5	345.2	1 480.9	415.8	410.8	449.7
Domestic Debt	8.5	21.3	25.4	19.0	21.7	23.2	-26.0	-16.0
Residual Financing Requirement and Errors and Omissions	-10.6	-3.9	-5.4	-4.5	0.7	19.3	21.9	24.3

Source: 2nd Poverty Reduction and Growth Facility (PGRF) Review, IMF Services, September 2009

It should be noted that since compilation of this information, interest charges, particularly those due abroad, have been greatly reduced following the cancellation of Burundi's debt by its creditors in 2009.

At present, investments are anticipated to reach their maximum level in 2010, or 17.2% of GDP. However, the condition of the country's infrastructure demands more sustained investment and the government should commit itself to increasing the portion of the national budget devoted to investment and make greater demand on foreign resources. Indeed, the country is still dependent on foreign aid for almost 80% of its investment expenditure.

Foreign grants should cover more than 75% of the primary deficit in 2009 and more than 90% in 2012, the rest coming from loans at concessionary rates from financial and technical partners. Domestic indebtedness to the banking system remains limited and is due to reverse itself from 2011. Over the next four years, budget support alone should finance 26% to 30% of the budget deficit, and project-related support should finance another 30% to 50%.

Meanwhile special programs, which are now dominated by demobilization, elections, and cyclical support measures to confront the economic crisis, should decrease from 20.5% to 13.6% of the budget deficit.

The privatization process will produce some additional – though very small – gains for the government's coffers. Even if Burundi completes the process, it is not in a position to borrow on capital markets, which is why the government has made a commitment to its partners to seek only grants or loans at highly concessionary rates.

The government has committed itself to reforming the management of public finances with the implementation of an organic law regarding financial regulation that also includes general regulation and the strategy and action plan for reform of public finance management. Ordinary and extraordinary budgets have been merged. Furthermore, the closure of the government's accounts with commercial banks and the consolidation of its sole account with the treasury are on course.

Box 1: Review of National Accounts
Realizing the importance of reliable official statistics for appropriate macroeconomic management and assessment of public policies, Burundi has started to produce national accounts using a methodology that conforms to international standards. The new base year, 2005, has already been completed and published. This reveals a favorable deviation of 35% compared with the figures used today. The public finance ratios discussed above need therefore to be adjusted and, consequently, it is probable that the percentage of the tax burden is still too small and that the level of civil service salaries is lower than 10% of GDP. ISTEEBU is currently redoubling its efforts to finalize data collection for 2006, 2007, and 2008 to create a coherent series and to adjust current estimates.

4. Foreign Sector

With the reconstruction of its economic and social infrastructure, the county has become increasingly dependent on imports over recent years, and the current external balance should deteriorate further from US$156 million in 2008 to US$236.3 million in 2012, or almost 15% of GDP.

Table 3: Selected Balance of Payments Indicators, 2005-2012 (US$ million)

	2005	2006	2007	2008	2009	2010	2011	2012
Current External Balance	-9.7	-133.5	- 153.4	- 155.9	- 134.6	- 153.7	- 206.0	- 236.3
(excluding official transfers)	-232.7	-333.4	- 364.4	- 372.0	- 333.6	- 350.2	- 380.6	- 397.9
Balance of Trade	- 132.8	- 186.0	- 242.1	- 284.5	- 174.3	- 197.6	- 225.0	- 249.9
Exports	57.2	58.6	52.9	57.7	57.5	73.0	78.3	81.1
of which, coffee	*40.5*	*39.7*	*32.6*	*38.0*	*41.2*	*56.7*	*61.3*	*63.2*
Imports	-190	-244.6	- 295.0	- 342.2	- 231.8	- 270.6	- 303.3	- 331.0
of which, petroleum products	*-38.3*	*-57.5*	*- 58.4*	*- 105.2*	*- 62.0*	*- 82.0*	*- 95.6*	*- 105.8*
Services (net)	-99.9	-167.6	- 145.6	- 159.1	- 189.0	- 181.6	- 186.0	- 188.1

Source: 2nd Poverty Reduction and Growth Facility (PGRF) Review, IMF Services, September 2009

However, 2009 is an exception, with a significant reduction in import costs being due to a fall in the cost of imports, particularly petroleum products, which represent almost 25% of imports. Although the financial crisis has also had a negative impact on the level of exports and on private transfers, this year the current external balance deficit will not exceed 10% of GDP.

In the medium term, exports, which only covered 17% of imports in 2008, should reach 25% in 2012 thanks to the resumption of international trade, the diversification of the export base, efficiency gains from the implementation of structural reforms. The balance of trade should therefore deteriorate only slightly, from 10% of GDP in 2009 to 11% of GDP in 2012.

Burundi will remain highly dependent on foreign financing. However, official transfers are projected to decrease from US$216 million in 2008 and $199 million in 2009 to only $161.6 million in 2012. The current account should therefore deteriorate from a negative balance of 9.5% in 2009 to 15% of GDP in 2012.

Official gross reserves will consequently be reduced from 6.6 months of imports in 2008 to 4 months of imports in 2012.