CLASSIFICATION: UNCLASSIFIED

PD-ABF-042

80282

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 695-T-601B	2. Country: Burundi
3. Category: Sector Grant (695-0125)	4. Date: August 1992
5. To: Glenn G. Slocum, Director, USAID/Burundi	6. OYB Change Number: N/A
7. From: David Leong, USAID/Burundi/PDO	8. OYB Increase: N/A To be taken from: N/A
9. Approval Requested for Commitment of: $ 10,000,000	10. Appropriation Budget Plan Code: 72-112/31014, GSS2-92-31695-KG39
11. Type Funding: ☐ Loan ☒ Grant 12. Local Currency Arrangement: ☐ Informal ☒ Formal ☐ None	13. Estimated Delivery Period: January 1993 14. Transaction Eligibility Date: August 1992

15. Commodities Financed

None

16. Permitted Source		17. Estimated Source	
U.S. only	N/A	U.S.	N/A
Limited F.W.	N/A	Industrialized Countries	N/A
Free World	N/A	Local	N/A
Cash	N/A	Other	$10,000,000
Multilateral Debt	$10,000,000		

18. Summary Description

The purpose of the Burundi Enterprise Promotion Program (BEPP) is to foster the growth of private enterprise in Burundi, in particular through the development and expansion of small and medium enterprises (SMEs) and exporters, in Bujumbura and in secondary towns. This is being accomplished in tandem with the Burundi Enterprise Support and Training Project (BEST): BEST is financing technical assistance, studies, training, and related costs to identify and help implement a phased series of policy reforms, while BEPP is providing dollar resources to support adoption of the required reforms. The dollars will be used by the Government of Burundi to service eligible multilateral debt.

19. Clearances	Date
USAID/B/PROG:AFerrara	8.28.92
USAID/B/CONT:JDuVall	8/29/92
USAID/B/A/APED:AFleming	8-28-92
REDSO/ESA/LEG:AVance (subs)	8/28/92

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: Glenn G. Slocum

Date: August 31, 1992

Title: Glenn G. Slocum, Director, USAID/Burundi

AID 1120-1 (5-82)

CLASSIFICATION: UNCLASSIFIED

ACTION MEMORANDUM FOR THE DIRECTOR, USAID/BURUNDI

FROM: S/PDO, David Leong

DATE: August 28, 1992

SUBJECT: Project Authorization Amendment (Facesheet) and Program Assistance Authorization Document: Burundi Enterprise Promotion Program (BEPP, 695-0125; PAAD No. 695-T-601B)

1. Action Requested: Your approval is requested to approve the attached Program Assistance Authorization Document Amendment Number Two for the Burundi Enterprise Promotion Program (BEPP, 695-0125; PAAD No. 695-T-601B) in order to:

(a) Increase LOP funding from $21.0 million to $31.0 million; and

(b) Define the policy conditionality required for the Government of the Republic of Burundi to meet in order to effect disbursement of the cash transfer.

2. Justification/Notification to Congress: A Congressional Notification was submitted on August 10, 1992. The waiting period expired without objection on August 25, 1992.

3. Authority: Pursuant to A.I.D. Handbook 5, Delegation of Authority and Section 4 of Africa Bureau Delegation of Authority 551, as amended, you have the authority to authorize project modifications less than ten years and with a LOP cost of less than $20 million. Additionally, an ad hoc Delegation of Authority to approve subsequent amendments to the BEPP Program for a life-of-program amount not to exceed $35.0 million was approved on July 26, 1991.

4. Recommendation: That you sign the attached facesheet to the Program Assistance Authorization Document Amendment No. 2 thereby approving and authorizing the third-year amendment to the Burundi Enterprise Promotion Program.

Attachments:
Program Assistance Authorization Document Amendment No. 2

Draft:CWTHagelmanIII/DLeong:PDO:8/4/92:BEPPAAD2.ENG:DL
Clearance:DLeong:S/PDO: (draft) Date: 8/28/92
AFerrara:PROG: (draft) Date: 8/28/92
AFleming:A/APED: (draft) Date: 8/28/92
DHart:PRE: (draft) Date: 8/28/92
JDuVall:CONT: (draft) Date: 8/29/92
SOverall:REDSO/ESA/LEG: (draft) Date: 8/4/92 (TDY)
AVance:REDSO/ESA/LEG: (draft) Date: 8/28/92

Acronyms

AEPRP	Africa Economic Policy Reform Program
A.I.D.	Agency for International Development
A.I.D./W	Agency for International Development, Washington, D.C. Headquarters
APEE	*l'Agence de Promotion des Echanges Exterieur* (Burundian Export Promotion Agency)
APEF	Africa Private Enterprise Fund Project
APEF	*Association pour la Promotion Economique des Femmes* (Association for the Economic Promotion of Women)
BEPP	Burundi Enterprise Promotion Program
BEST	Burundi Enterprise Support and Training Project
BUHRD	Burundi Human Resources Development Project
CCIB	*Chambre de Commerce, d'Industrie, d'Agriculture et d'Artisanat du Burundi* (Chamber of Commerce and Industry of Burundi)
CIP	Commodity Import Program
CLUSA	Cooperative League of the USA
CRED	Center for Research and Economic Development, University of Michigan
ESOP	Employee Stock-Option Plan
EPZ	Export Processing Zone
FED	European Development Fund
GRB	Government of the Republic of Burundi
HBCU	Historically Black Colleges and Universities
HIE	Household Income and Expenditure (Baseline Survey)
IBRD	International Bank for Reconstruction and Development (World Bank)
IES	Impact Evaluation System
IESC	International Executive Service Corps
LOP	Life of Project
LTTA	Long Term Technical Assistance
M&E	Monitoring and Evaluation
MCI	Ministry of Commerce and Industry
MIS	Management Information System
MPIS	Mandatory Pre-shipment Inspection Service
NCBA	National Cooperative Business Association
NPA	Non-Project Assistance
OCIBU	National Coffee Office of Burundi
ONI	Africa Bureau, Office of New Initiatives
PASA	Participating Agency Services Agreement
PC	Peace Corps
PCV	Peace Corps Volunteer
PDP	Public Expenditure Program
PFP	Policy Framework Paper

PIO/C	Project Implementation Order/Commodities
PIO/P	Project Implementation Order/Participants
PIO/T	Project Implementation Order/Technical Assistance
PIP	Public Investment Program
PSC	Personal Services Contract
PSO	Project Support Office
PW/IPG	Price-Waterhouse/International Privatization Group
REMODRA	*Le Projet pour la Revision et Modernisation du Droit des Affaires*
SCEP	*Service Chargé des Entreprises Publique* (Service in Charge of Public Enterprises)
SFSR	Small Farming Systems Research Project
SOE	State-Owned Enterprise
UNDP	United Nations Development Programme
USAID/Burundi	United States Agency for International Development, Mission to Burundi
USG	United States Government
USPSC	United States Personal Services Contract

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I. BACKGROUND

A. General

The Burundi Enterprise Promotion Program (BEPP, 695-0125) is a planned four-year, $35 million non-project assistance activity which is being implemented in tandem with the five-year Burundi Enterprise Support and Training Project (BEST, 695-0124). The BEST Project is being amended in FY92 to expand its activities and to add an additional $2.35 million. This PAAD Supplement No. 2 presents the third-year policy reform agenda which is being supported by a cash disbursement of $10.0 million under BEPP.

The BEPP and BEST activities share the same purpose: to foster the growth of private enterprise in Burundi, in particular through the development and expansion of small and medium enterprises (SMEs) and exporters, in Bujumbura and in secondary towns. BEST is financing technical assistance, studies, training, and related costs to identify and help implement a phased series of policy reforms, while BEPP is providing cash to be used for debt repayment, to support adoption of the required reforms.

The original Project Paper/Program Assistance Approval Document (PP/PAAD) was approved and authorized on April 26, 1990. BEST was authorized for the $5.0 million life-of-project (LOP) amount while BEPP was authorized only for the first year amount of $13.0 million. The original PAAD prescribes annual amendments, using input provided by the BEST-financed studies and the long-term technical assistance (LTTA) team to formulate each year's policy reform agenda, upon which each year's policy conditionality is based. The BEPP PAAD was first amended in August 1991 with expanded policy conditionality to support the second year tranche of $8.0 million. This second PAAD amendment further expands the policy conditionality which is supported by the third-year tranche of $10.0 million, bringing the total amount disbursed under the sector grant to $31.0 million.

As was the case in 1991, it is important to reiterate that BEPP supports, but by its very nature is subsidiary to, the structural adjustment reforms of the GRB. It complements the IBRD/IMF efforts in macroeconomic reform: fiscal and monetary stabilization; a flexible exchange rate policy; decontrol of most domestic prices; elimination of most import restrictions; and reduction of the role of the government in the productive sectors of the economy. This reform agenda includes regulatory and legislative changes leading to market-driven economic decisions underpinning these reforms needed to allow the private sector to develop and expand. The IBRD is the lead donor on the macroeconomic elements of the reform agenda. Two Structural Adjustment Loans (SALs) have been approved since 1986, and a third SAL is currently being negotiated in 1992. The monetary and stabilization goals have been largely achieved, but public sector budgetary and privatization reforms are being achieved at a slower and more difficult pace, due largely to the political implications inherent in achieving budget cutbacks and privatization of parastatals.

USAID is the primary donor focusing a comprehensive, sustained program of policy-based assistance on the attitudinal, procedural, administrative, and legal obstacles that limit and restrain development of the private sector in Burundi. The PAAD identifies a number of impediments to Burundi's achievement of a market-driven economy. The first level of constraints being addressed under BEPP is in the domain of rules, regulations, and practices which have hindered efficient domestic and international trade and day-to-day business operations. This definition has been further expanded in 1992 to include the study or promulgation of legislation, regulations, or implementing measures that facilitate private sector activity, e.g., leasing legislation, corporate law, etc. Nevertheless, the rank order of constraints being dealt with remains essentially unchanged:

1. Removal of barriers to entry to the formal sector;

2. Alleviation of constraints to doing business; and

3. Facilitation of international trade and promotion of exports.

The second level of constraints is the insufficient data base and analytical capacity within Burundi to examine, understand, and make adjustments to the reform agenda as the economy matures, but also to measure both positive and negative impacts the reform measures may have. These factors will be looked at more closely under the BEST Project.

B. Specific - The BEPP/BEST "Enabling Environment" Approach

BEPP and BEST were conceived to systematically and in tandem, research and eventually facilitate the removal of sectoral policy constraints to private enterprise development in Burundi. This so-called "enabling environment" approach was chosen because there were, apart from the macroeconomic adjustments being addressed by the IBRD/IMF, numerous regulatory, administrative, and procedural constraints which were better addressed under a BEPP/BEST-type instrument. Nevertheless, the primary objective of creating an enabling environment for private enterprise growth has frustrated and baffled those desiring empirical proof and hard statistics supporting the assertion that the program's impact has been positive. Obviously, it has also been impossible to quantify the degree of impact within the program's current timeframe.

Additionally, enabling environment programs are feared to be seemingly never-ending processes. An appropriate analogy used in the past within the Africa Bureau is that enabling environment policy reform programs are not unlike the multi-layered onion - removal of one constraint or series of constraints invariably reveals yet other layers which then become binding. Also, the constraints are not always, or only, policy-related. Thus, by its very nature, it has been difficult to articulate exactly where BEPP/BEST was going.

The past two years' experience under BEPP has both pleased and frustrated critics of enabling environment programs. The analogy of the onion has proven prophetic: the range of constraints which face Burundi's private sector has expanded substantially since the original PAAD was prepared. Nevertheless, the paradox is that the nature of BEPP has given USAID the opportunity and flexibility to weigh in on issues which it otherwise would not. Thus, USAID/Burundi has emerged as not only a preeminent voice in private sector development in Burundi, but is also seen as a donor which is proactive and unafraid of taking development risks. Furthermore, USAID has earned uncommon respect among Burundians by speaking out against proposals made by former colonial partners which are clearly not in Burundi's best interests. Because of USAID's aggressive and vocal stance on a wide range of issues, it has become a major force in private enterprise development in Burundi. It is a characteristic which is, for all its value, difficult if not impossible to quantify. The companion BEST Project will develop a series of impact indicators to translate, insofar as possible, apparently impalpable achievements into measurable results.

II. PROGRESS TO DATE

A. The 1990 Reform Agenda

The first-year reform agenda was a discreet entry into the policy arena in Burundi and has been discussed in detail in the 1991 PAAD Supplement. Along with other conditions precedent, including authorization for the conduct of baseline surveys and studies, it comprised the following prerequisites:

- Decentralization of customs clearance at Kayanza
- Decentralization of related import/export procedures
- Provision of easier access to foreign exchange for business travel

This agenda clearly reflected the emphasis on export promotion and secondary towns explicit in the purpose statement of BEPP. While currency control was not intended to be among the policy targets of the program, access to foreign exchange nonetheless became the focus of one of BEPP's earliest reforms. At this point in the program, minor alleviation of stringent Central Bank control over hard currency was seen exclusively in the context of promotion of foreign trade through easier business travel abroad. But the foreign exchange question would grow rather than vanish, and the present document will follow its development into the third year of BEPP.

Only by tracing related as well as direct consequences of the reforms can one arrive at a just appreciation of their impact. The 1991 Supplement concluded that the three reforms had little, if any, measurable effect on business promotion in secondary towns. But policy reform is a cumulative process: for reasons of political sensitivity as well as intellectual preparedness, it must often commence more demurely than the imperatives which drive it would seem to demand. Thus, policy reforms must be assessed in the light of deeper reforms they engender as well as by direct impact from their implementation. Because the 1991 BEPP agenda pushed further towards decentralization and relaxed control over foreign exchange, it is useful to evaluate the impact of the 1990 reforms in the context of the 1991 proposals.

B. The 1991 Reform Agenda

1. Development of the Agenda

During the first year of BEPP, USAID's understanding of the Burundian economy greatly deepened and its approach to policy reform matured commensurately. The second year agenda addressed fully the purpose statement of the program and the three broad areas for reform identified in the PAAD: barriers to entry; obstacles to doing business; and constraints upon foreign trade. It also dealt with the microenterprise sector, SMEs, and labor markets, and it continued to support decentralization of customs clearance and easier access to foreign exchange for importers. In a somewhat abridged form, the 1991 agenda was as follows:

- Legal protection for itinerant traders
- Decentralization of customs clearance to Gitega
- Linking tax incentives for exporters to their level of gross export receipts
- Simplification of duty restitution (drawback)
- Raising the allowable ceiling of importation without license of equipment and spare parts for SMEs
- Lengthening the validity of import licenses
- Elimination of double work authorizations required of foreign nationals
- Authorization of private placement services

2. Impact of the Reforms

Annex I provides documentation that each reform was implemented by the GRB as required for release of the second tranche cash transfer.

The philosophic intentions behind the 1991 agenda were to encourage a regulatory environment that (i) respected the *a priori* right of all individuals to engage in private entrepreneurship; (ii) created incentives to engage in exporting; and (iii) promoted a modern, fluid labor market benefitting both workers and management.

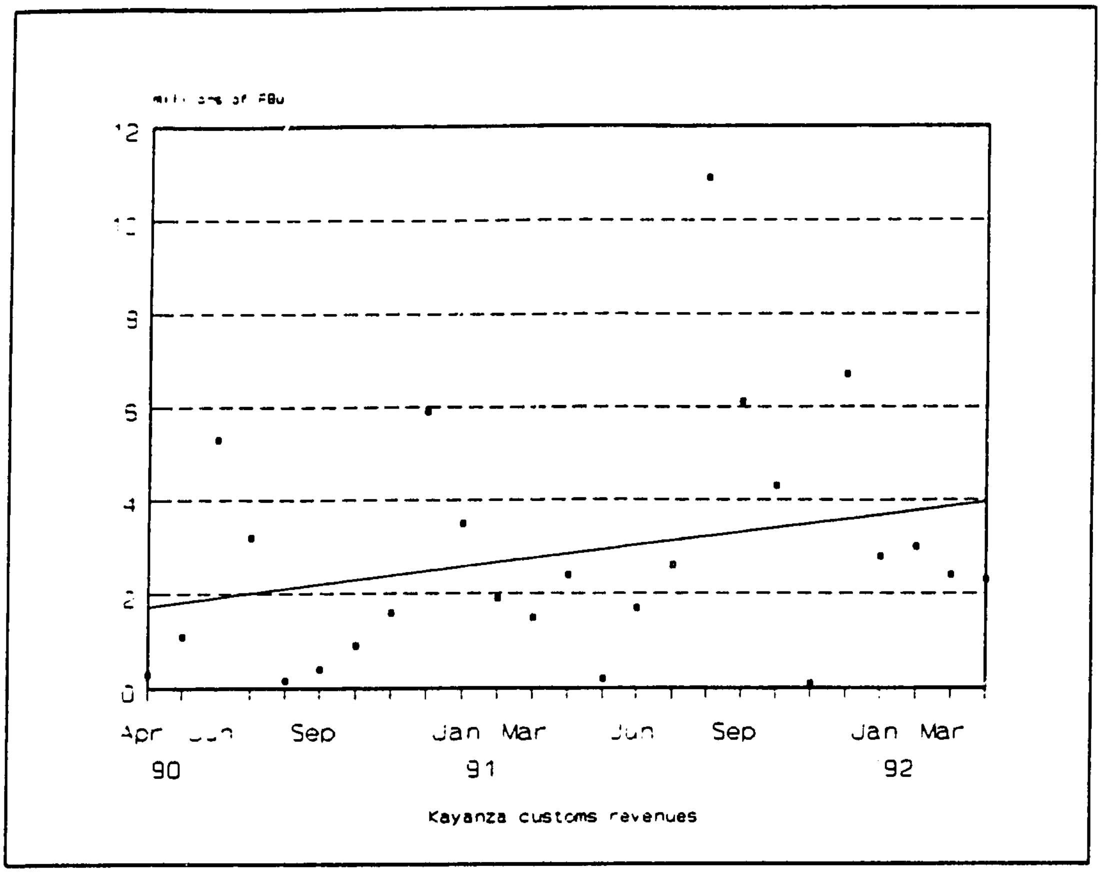
itinerant trade

Because peddlers already operated in a *de facto* environment of tolerance since 1986, a quantitative measurement of the impact of the new legislation would be meaningless. Nevertheless, the impact of this reform can be assessed in three ways. First of all, the GRB has given formal recognition to the right to entrepreneurship at its most basic level: street vending. Second, the revision of this brief text of commercial legislation was the first step towards major revisions of commercial law to be undertaken by the GRB and supported by BEPP/BEST in 1992-93. Third, the value of enacting a law which legalized what was formerly a tolerated practice contributed towards improved governance: in November 1991, soon after the new legislation was enacted, the mayor of Bujumbura was obliged to retract a prohibition issued on peddling. USAID believes that the mere fact the law was on the books served as a powerful instrument to protect the powerless against arbitrary and capricious treatment.

customs decentralization

USAID has made site visits to Kayanza in 1991 and 1992 and to Gitega in 1992 to analyze the impact of the new customs operations. Despite curtailed commerce with Rwanda, the Kayanza bureau's revenues are increasing. The graph on the next page presents a trend-line analysis which conceals seasonal irregularities but which indicates the degree of growth.

For the Gitega bureau, it is clear that there was pent-up demand for local clearance facilities. While some of this demand flowed from development assistance projects, which enjoy exoneration from customs duties, the majority was strictly commercial. From July 1991, the effective start-up of customs operations in Gitega, through March 1992, the Gitega customs had cleared FBu 525,865,399 (over $2 million) and received revenues from duties of FBu 79,518,729 (around $400,000). This compares to FBu 302,593,313 and FBu 19,046,333 for Kayanza for the same months during the preceding year. Even subtracting the total value of all



petroleum imports to Gitega (which already enjoyed special rights to clearance there), FBu 239,449,406 remain of cleared goods.

The decentralization of customs may be read as a success; however, the degree of success should be interpreted with some caution. It is not at all clear that the decentralization has promoted foreign trade where none existed or where none would have existed. It is also very difficult to ascertain that the measure has been cost-effective: the new bureaus are inefficient and over-staffed, and businessmen probably have not reduced their travel to the capital as a result of the new facilities. It is also not evident that there is any decrease in actual transport mileage. For these reason, BEPP is not proposing further customs decentralization until need for such a facility at a third point in the country is clearly established.

exporters' tax incentives

It is still premature to evaluate even the direct impact of this measure, since tax declarations for 1991 have only recently been submitted. As of this writing, however, five exporters have benefitted from the new, clearer incentives proposed under this measure. A rapid survey proposed for late 1992 should reveal more concerning the efficacy of this incentive.

duty restitution

BEPP's conditionality changed only the efficiency of the drawback instrument, not the principle of the incentive itself. The GRB's good will to render the incentive meaningful translated into immediate implementation of the reform. The positive results are reflected in the data below. The 1990 totals reflect three years of cumulative data, and the 1992 total reflects only six months. If one averages the amount reimbursed per year, with a multiplier of 1.5 for 1992, the growth becomes more apparent as seen in the last row of the table.

YEAR	VALUE IN FBU	FIRMS	AVERAGE/YEAR
1988-90	127,966,852	17	42,655,616
1991	86,716,713	14	86,716,713
1992 (6 mos)	70,222,465	11	105,333,697

One can tentatively conclude that the drawback mechanism is working with improved efficiency and is being solicited by an increasing number of exporters.

While the above reforms were approached by BEST as export incentives rather than for their fiscal impact, they nonetheless stand as BEST's first interventions in the area of tax revision. Insofar as they foreshadow future activity, they also suggest the nature of intervention BEST may take in the realm of taxation, i.e., a practical, problem-solving approach to urgent needs for change in tax structure.

raising the ceiling for import of spare parts

lengthening validity of import licenses

The Open General Licensing (OGL) system proposed by the World Bank and the IMF went into effect in May 1992. USAID was aware that the OGL was being negotiated and felt that the BEPP proposals served both to support the move towards elimination of export and import licenses as well as to offer a certain protection to small businesses in the event that the negotiations or the OGL's subsequent implementation stalled.

Because the OGL provides hard currency to exporters and importers on a first-come, first-served basis, the impact of the above two provisions were overtaken by events before their effect could be evaluated. Nevertheless, frequent discussion of these measures improved the palatability and desirability of eliminating licensing; in this way, USAID believes that the BEPP policy dialogue played an important behind-the-scenes role in the GRB's ultimate acceptance of the OGL.

elimination of double authorizations for alien workers

authorization for establishment of private placement services

Unfortunately, labor statistics are not sufficiently current to evaluate the effect of the simplified procedures for foreign workers. In regard to private placement services, however, impact was virtually immediate.

One entrepreneur, knowing of BEPP's support to the latter reform, had prepared a business proposal and secured assurance of financing prior to the abrogation of the existing proscription upon such agencies. The firm opened for business in February 1992 and has served to date only as a recruiter for permanent positions. The firm has received 882 *curricula vitae* from unemployed persons of all professional categories and has received 56 requests from 40 firms for placement. The firm has concluded 25 contracts as of the present writing. USAID feels that this response testifies to market demand and vindicates the many discussions held with the Ministry of Labor on the subject.

These two reforms in labor regulations were the focus of protracted debate with the responsible authorities. The guiding objective behind both is the creation of a more fluid, responsive labor market. But BEST had two further objectives in exhorting these changes: first was to establish closer working relationship with the Ministry of Labor at a time when the revision of the Labor Code was soon to begin; second was to raise the sensitive subject of foreign workers, which would become increasingly important as foreign investment was courted for partnerships, off-shore production, and for the privatization program. In the discussion of the 1992 agenda below, it will become evident that the strategy bore fruit.

3. Other 1991 Issues

One reform proposal was dropped from the 1991 agenda despite having been strongly advocated by all members of the BEST Technical Committee except the Central Bank. This proposal urged authorization for non-traditional exporters to retain 25 percent of their hard currency earnings in foreign exchange retention accounts (FERAs) for unrestricted use. Because of lingering concerns expressed by the Central Bank and the IMF, the 1991 BEPP Supplement and the subsequent ProAg Amendment No. One relegated this reform to a program covenant, with the intent that it would be pursued during the coming year by BEST.

The 1991 PAAD Supplement also described USAID's analysis of the Investment Code and the general critique from the donor community that ensued after USAID provided written comments on the revision of the Code. As will be seen below, concern over the Investment Code and concern over foreign exchange control issues began to create an emphasis on all policy factors affecting investment, especially direct foreign investment. This emphasis in turn engendered a vision of a fully liberalized system which would render competitive not just Burundian products, but Burundi as a favorable country for taking investment risks.

C. FY 1991 Dollar Use

As was the case with the first-year (1990), $13.0 million sector grant under BEPP, the $8.0 million grant for the second year was to be used to service debt owed by the GRB to the U.S. Government (USG) and multilateral lending institutions. An "order-of-preference" was established for utilization of the funds, so that debt owed to the USG received priority attention, debts to multilateral lending institutions which the USG was a member (e.g., IBRD, AfDB, AfDF, IMF) received second priority attention, other debts acceptable to A.I.D. received third priority attention, and such uses received last priority attention. An analysis of multilateral and bilateral debt conducted during the development of the first BEPP Supplement revealed that there was no debt to the USG, but more than sufficient debt owed to multilateral lending institutions which the USG was a member, to account for the $8.0 million sector grant.

One condition precedent to disbursement of the second-year tranche was that the GRB would submit a schedule of debts for which it would use the $8.0 million sector grant. That schedule was submitted and approved prior to initiation of the documentation pursuant to which the cash transfer would be made.

Several factors, however, resulted in delayed disbursement of the $8.0 million sector grant. First, the civil unrest experienced in Burundi in late-November 1991 virtually shut down GRB operations the latter part of November and the beginning of December 1991. Any momentum of the GRB to meet the policy conditionality suddenly ground to a halt. Because of this - and realizing that the GRB was a victim, not the cause, of the unrest - the deadline to meet the conditions precedent was extended an additional sixty days, to February 20, 1992.

Perhaps a more immediate impact of the civil unrest was that it coincided with the commencement of an assessment of the GRB's financial management capacity, conducted by the independent auditing firm of Price-Waterhouse. Contained in the Program Grant Agreement Amendment Number One were two related conditions precedent to disbursement: 1) that the GRB agree to the terms of reference for a financial assessment of the GRB's capacities to manage the sector grant (to be carried out by an independent accounting firm and funded under the BEST Project); and 2) that the financial assessment be completed and, in the event any weaknesses were found, the GRB agree to undertake remedial steps prior to the release of the funds.

When the civil unrest occurred on November 23-24, 1992, the two-person team from Price-Waterhouse/Nairobi had just begun its work. The disruption, accompanied with uncertainty as to when the security situation would allow continuation of the assessment and the unavailability of French-speaking consultants to conduct the study on short notice, caused additional delays of several months. By the time the assessment was completed, translated, and transmitted to the GRB, it was already mid-May 1992.

Notwithstanding receipt of the transmittal in satisfaction of the CPs for disbursement from the GRB on February 19, 1992, the cable requesting disbursement of the $8.0 million sector grant was not sent until July 14, 1992. USAID/Burundi was only able to confirm on August 20, 1992 that the disbursement was made on July 23, 1992, and even then the GRB's U.S. bank (Citibank) had not yet officially informed the GRB that the deposit had been made (it only learned so indirectly when it was advised that an interest payment had been made on the account). The GRB will now proceed to disburse these funds in accordance with the original debt schedule, although USAID anticipates that there may be some modification to the schedule due to the inordinate passage of time since the debt schedule was originally submitted for USAID's approval and the actual disbursement of the funds was made into the GRB's U.S. bank account.

D. FY 1991 Local Currency Use

Revised Agency guidance modifies the requirements for deposits of local currency when sector grant dollars are used for debt service, for agreements signed after June 30, 1991. Such was the case for the second-year tranche under BEPP. Although there is no requirement that local currency be deposited into a special account, USAID retains the right to negotiate an amount to be deposited, if it determines that this is the most expedient means to secure local currency to meet ongoing obligations, such local currency costs associated with ongoing projects, or the USAID Trust Fund.

During negotiations for the second-year tranche under BEPP, USAID obtained the GRB's agreement to deposit the equivalent of $2.37 million into the special local currency account, which would then be transferred in its entirety into the USAID Trust Fund account. The figure was arrived at by calculating the estimated costs of USAID operating expenses, including major office renovation/rehabilitation and procurement of up to two residences to defray long-term, recurrent expenses. Because of substantial deposits made to the BEST and Small Farming Systems Research Projects from the first-year tranche under BEPP, there was not an immediate need for local currency deposits for these projects from the second-year tranche.

E. The BEST Project

1. BEST Activities

A detailed description and commentary of the BEST Project is furnished in the companion to the present document, the BEST Project Paper Supplement No. 1. To avoid duplication between the two amendments, only such commentary is given in this section to illumine the process through which BEPP has evolved and through which it will be implemented, supported, monitored, and finally evaluated. At the time of the PAAD Supplement, BEST's three-person, long-term technical assistance team has been in place for ten months. Working in close collaboration with USAID's Agriculture and Private Enterprise Development Office, as well as with USAID's Small Farming System Research Project economists, the Team has made development of the 1992 reform agenda the chief thrust of its work.

The challenging dimension of the agenda grew out of extensive policy dialogue during the course of several activities. These include a two-day retreat by the BEPP/BEST Technical Committee, a monitoring and evaluation consultancy, the free zone legislation consultancy, participation in seminars on essential oils and land tenure, participation in the REMODRA Project, and the drafting of terms of reference for various studies to be performed during 1992 and 1993. All of these activities are described in the BEST Supplement, but two deserve further amplification here, as they are playing a determinant role in the shaping of BEPP.

2. The REMODRA Project

Urged to advance the pace of legal and regulatory reform under SAL III, and encouraged by the technical and financial resources available through BEST, the GRB created *Le Projet pour la Revision et Modernisation du Droit des Affaires - REMODRA*. USAID had long pressed for involvement in the revision of legal texts governing commerce and corporations based on the conviction that U.S. law had much to offer to a country wishing to modernize its business regulations. The BEST Team pushed engagement further, to the point where USAID is the formally acknowledged leader among donors in the REMODRA effort.[1] The GRB's acceptance of USAID's role bears witness to the confidence established during the life of BEPP/BEST and confers both opportunity and solemn responsibility on the Mission. BEPP/BEST has become a powerful instrument to shape the entire legal environment for the establishment and conduct of business in and *with* Burundi.

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1 See the World Bank's "Staff Appraisal Report: Private Sector Development Project," Report No. 10184-BU, March 31, 1992, p.25.

3. The Free Zone Regime

The 1991 PAAD Supplement stated,

> "The issue of free zones has quite properly not been laid to rest. . . . Through BEST, USAID will explore ways in which certain free zone incentives can be established on a country-wide basis."

In May 1992, BEST brought a consulting team to Burundi to draft the legislation for a free trade regime that would confer free trade status administratively rather than geographically: free trade status could be obtained by any businesses exporting one hundred percent of its goods or services. The consultants also prepared the outlines of a promotional program to attract investment.

Because the work demanded continual consultation with both public and private sectors, the consultancy yielded a heightened awareness in Burundi of the need for foreign investment, and the conditions required to attract it. In great measure thanks to the intensification of the policy dialogue through the work on the free trade regime, BEST was able to produce the very challenging 1992 reform agenda discussed in Section IV below. The free trade consultancy also lent contours to a dimension into which BEPP was already growing: reform that not only promotes entrepreneurship within Burundi to reform that promotes Burundi as a place to do business.

F. Related Activities

1. General

Related activities are not funded through BEST but support the Mission's private sector initiative. These activities are normally coordinated by the Agriculture and Private Enterprise Development Office. They include the Export Development Consultancies, the Private Sector Round Table, work on privatization, and consultancies on rural enterprise development and on agriculture investment strategies. As the BEST Supplement discusses each of these activities, it is unnecessary to explore them further here, except for the subject of privatization, whose influence on BEPP may be felt in the near-term.

2. Privatization

At the request of the GRB in 1991, USAID brought a highly qualified consultant to assess the state of the privatization program in Burundi and the feasibility of assistance from USAID.

That consultancy convinced the Mission that assistance to privatization cannot be segregated from the broad private sector development effort. Success in privatization means many things that directly support the Mission's private sector work:

- diversification of private sector activities
- attraction of foreign investment
- decrease in financial burdens to the State through alleviation of direct and indirect subsidies to unprofitable businesses
- improvement in governance through a recognition of the proper roles of the State in regulation and promotion
- indirect support of the democratization process through diversification of shareholding via auctions and Employee Stock-Option Plans (ESOPs)

The Mission's carefully considered approach to privatization is thoroughly pragmatic. Prolonged discussions with the GRB and with the donor community, especially the World Bank, convinced USAID that sufficient studies had been done, and that it would be more efficient to contract for technical assistance to carry through a divestiture. To this end, the Mission subscribed to the centrally-funded Privatization and Development Project managed by A.I.D.'s Private Enterprise Bureau. Coordinating on the scope of work with the prime contractor, the Price-Waterhouse/International Privatization Group (PW/IPG), the Mission identified three phases leading to a transaction. The first phase - selection of one enterprise for sale from a short list provided by the GRB in coordination with the World Bank and USAID - is complete at the time of this writing.

USAID believes that more will be learned about the realities of privatization in Burundi from carrying through a single divestiture than from conducting additional analyses of the privatization environment. Expecting results from the first transaction around the beginning of CY 1993, USAID has elected to reserve sufficient funds in the amended BEST Project to complete a second divestiture during that year (see the BEST Supplement, Section III.E.3.c.). Thus the Mission's assistance to privatization will, in 1993, be incorporated into BEST, while continuing to be directly managed by the Agriculture and Private Enterprise Development Office.

III. BURUNDI IN 1992

A. Macroeconomic Overview

1. General

In comparison to its small demographic size (10,747 square miles), Burundi has a relatively large population base of some

5.3 million inhabitants - 94 percent of which live in rural areas - growing at a rate of 2.7 percent per annum (1990). This translates into a population density of 494 per square mile - the second highest in Africa.

The economy, now entering a phase of transition from subsistence to monetized, has historically been characterized as "natural resource-poor" and "rural-based" (the primary, i.e., agricultural, sector amounts to 56 percent of GDP and employs over 94 percent of the economically-active population). As a consequence of the above, and given the low traditional technological basis of most agricultural production, it has exhibited limited growth - and employment - prospects. Nevertheless, it has thus far enabled the country to be barely self-sufficient in foodcrop production. The state-dominated secondary sector (15 percent of GDP), due to its relative inefficiency and small size, is equally limited in its capacity to provide employment opportunities to a burgeoning population, which is providing 63,000 new entrants into the labor force per year.

The single most striking feature of the productive economy is its overdependence on a single agricultural export crop - coffee - which in most years brings in over 80 percent of foreign exchange earnings. The second major source of hard currency, tea, accounts for an additional 11 percent. Mining and manufacturing represent only 6 percent of GDP and 4 percent of export earnings. Although the private sector plays a major role in the production of both export and food crops and transport, it is the public sector that enjoys a quasi-monopolistic position in the processing and export of primary commodities, manufacturing, energy, and infrastructure. The public sector also generates half of the country's formal employment.

The combination of a rural economy which is extremely dependent on the international price of coffee, and an overall economy skewed by excessive public involvement and erroneous government policies, caused mounting distortions and a pattern of erratic growth which marked most of the period from the early 1960s until 1985. Recognizing its failure to correct the recurring domestic and international disequilibria by the previous "*dirigiste*" measures, the Government embarked in 1986 on a program of comprehensive economic reform under the sponsorship of the IMF and the World Bank.

Ever since, the macroeconomic environment of the country has been conditioned by four Policy Framework Papers (PFPs) elaborated by the Government in consultation with the Bretton Woods institutions. These were followed by two major Structural Adjustment Loan (SAL) facilities conditional on the satisfactory implementation of reforms and performance: SAL I (approved in May 1986) for a total of $50 million, and SAL II (approved in June 1988) for a total of $155 million, each financed by World Bank/IDA and a group of co-financiers. Although the balance sheet of the 1986-1991 reforms shows some successes in the areas of economic management capacity and policy reform - notably exchange rate, tariff reform and interest rate policy - there was very meager progress in other areas considered cornerstones of the reform program: privatization and private sector promotion, restructuring of public spending, export and investment promotion, and liberalization of the labor and financial markets.

Economic growth performance continues to be erratic and less than satisfactory in terms of sustainability, indicating little improvement in the absorptive capacity of the economy and a lack of private sector supply response. There was little change in the structure of the traditional "one-crop" export agricultural economy and in the public sector's share of GDP; there was also no change in the historical pattern of chronic deficits both in the budget and external balance of payments. Massive inflows of foreign aid served mainly to boost foreign exchange reserves and, to a lesser extent, to continue the subsidization of inefficient public enterprises. These shortcomings, compounded by bureaucratic resistance to change, have seriously hampered the success of the structural reforms.

The inescapable conclusion is that both SALs I and II have fallen short of the needed result of diversifying the productive base of the economy; both programs were far too optimistic about the speed at which the diversification reforms, namely privatization, could be attained. The present absence of any significant changes in the structure of the economy and the non-existence of new sources of growth effectively argue for the continuation of a structural adjustment program for the Burundian economy until at least the end of the decade.

Observation of the GRB's performance in structural adjustment, as well as the response of the economy to the reforms, argues that donors' programs should be structured to support the diversification process over the long-run. In the short run, efforts should be directed towards maximizing value-added in the traditional agricultural and related sectors. Simply put, the Burundian economy --given the vital importance of agricultural activities in the productive economy at the present-- cannot expand satisfactorily in the last decade of the twentieth century without a vibrant and efficient primary sector.

Equally important, an expanding primary sector is a *sine qua non* for critically needed improvement in intersectoral links and transfers of wage-goods and capital from agriculture to the secondary sector, be it in agribusiness or other industry. This so-called "agricultural transformation" is of crucial importance to the establishment and maintenance of competitive industrial wages and to finance capital purchases for small and medium-scale industrial enterprises.

The following sections summarize the status of key factors affecting the economy, namely the GRB's fiscal and monetary policies, the role of foreign aid in the structural adjustment process, other factors, and projections for the medium term.

2. Fiscal Policies

a. General Characteristics

Historically, while the lack of strong fiscal adjustment has had an adverse effect on the pace of the adjustment program, good fiscal management has been complicated by exogenous factors resulting primarily from Burundi's reliance upon fiscal revenues generated from the coffee sector.

Fluctuations in coffee export receipts compounded by rapidly increasing expenditures have caused the overall fiscal shortfalls to vary correspondingly. For example, the budget deficit (excluding foreign grants) as a percentage of GDP between 1987 and 1989 showed a decline from 17 percent to 9 percent, but the trend was reversed in 1990 when the deficit climbed to 13.4 percent. Between 1986 and 1989, these shortfalls were in good part met by foreign concessional aid and, particularly from 1988 on, by the auctioning of treasury certificates. As a result of the latter innovation, the GRB has managed to reduce its net indebtedness to the domestic banking system by nearly 50 percent between end-1987 and end-1990. With the recent reform measures on coffee taxation, revenue stability from coffee will be significantly enhanced.

Equally important, in the effort to stabilize revenues and curtail waste, the country has created institutional mechanisms for a more rational expenditure allocation. A Public Investment Program (PIP) and a Public Expenditure Program (PDP) are now in place, the latter under the guidance of the World Bank. However, some major issues of resource allocation persist: excessive military expenditures (an estimated 3-4 percent of GDP), underfinancing of recurrent costs, continuation of direct and indirect subsidies to public enterprises, and inadequacy of cost recovery and distorted pricing for some public utilities. Also, the needed rationalization of public expenditures is still adversely affected by a lack of consistency in approach and implementation deadlines with the recently enacted but still not all-inclusive - "Consolidated Budget" for 1992. In this budget, foreign grants still account for over 29 percent of total fiscal receipts. Equally important, total fiscal receipts are still much below the level of irreducible expenditures (i.e., those expenditures which are absolutely necessary), effectively denying any possibility for the mobilization of public savings for investment purposes.

b. The Predominant Public Role in the Economy and Its Impact on Development Prospects

The GRB, given its predominant role in the economy, is both the largest consumer and investor in the country and its resource allocation is crucial to economic growth. However, as noted above, the track record of such resource allocation has been disappointing. Rather than decreasing during the adjustment program, government demand has actually increased, accumulating ever-larger opportunity costs for undertaking critically-needed reforms, and making it increasingly difficult to free up scarce resources for more economically-efficient uses. The excessively large non-developmental expenditures, e.g., massive subsidies to unprofitable industrial and commercial enterprises functioning in a quasi-monopolistic environment and reinforced by bureaucratic resistance to change, have combined to negate any significant contribution to the critically-needed diversification of the economy. As a result, the structural fragility and narrowness of the underlying economic base have actually increased during SALs I and II.

3. Monetary Policies

The stated objectives of the GRB's monetary policy were to reduce inflation, strengthen the external balance of payments and produce an efficient mobilization of resources via the maintenance of real interest rates. Money supply growth, as measured by M2, although occasionally exhibiting the effects of some of the historical "brakes on, brakes off" policies of the past, was generally held back, contributing to a moderate average inflation of some 6.5 percent during 1986-1990. On the other hand, the share of credit available to the private sector shrunk commensurately with the higher government borrowing needs brought about by the persistence of high budget deficits. With the sole exception of 1989, when there was a big jump in inflation (12.1 percent), interest rates - both in terms of deposits and borrowings - remained positive. As a result, term savings deposits, bolstered by an excellent performance of rural savings cooperatives, expanded, albeit from a low base, by over 800 percent between 1986 and 1990. Unfortunately, the balance of payments, exclusive of foreign aid inflows, still exhibits chronic deficits in good part the result of the vagaries of the international coffee markets and a rising import bill.

4. The Role of Foreign Aid

Another disturbing trend relates to the country's ever-mounting dependency on foreign aid, which now finances about 80 percent of the Public Investment Program. This degree of dependency, as measured, *inter alia*, by the ratio of the total annual foreign aid flow to GDP, just about doubled from 1983 to 1990 to stand at over $169 million (15 percent of GDP) in 1990. To a large extent, this supply-driven foreign support - which due to the lack of absorptive capacity of the economy was also the main cause for the nearly quadrupling of the level of foreign exchange reserves to $141 million between end-1985 and end-1991 - has also had a deleterious role in undermining the structural adjustment process. This is so because of lack of coordination among the donors' programs, often in terms of often conflicting objectives. The latter may also be in conflict with the targets of the overall adjustment program in that they may discourage support for public enterprises. This in turn may enter in conflict with certain donors which have given long-term support to the same enterprises. Also, large inflows of funds may cause a slowing of the privatization process, as they may cause a postponement of tariff reform, effectively acting as barriers to entry to potential private investors.

Optimally, these one-way flows should have been gradually replaced by direct investment flows. Unfortunately, the direct investment indicators are equally grim in that they are equally revealing of the economy's fragility and of, perhaps, the concomitant lack of confidence of foreign investors. (For example, in this country with a GDP amounting to some $1.12 billion, direct investment amounted to a negligible $1.2 million a year!)

Clearly, direct investment mobilization and enhancement measures ought to be urgently enacted and made part of the economic restructuring program as one important weapon aimed at economic diversification. New foreign investment will bring in considerable additional benefits such as skilled jobs creation, "know-how" in terms of western managerial practices, and a much-needed familiarity with the modus operandi and the required standards of international markets.

5. The External Debt Situation

The debt strategy followed by the GRB since 1986 is to borrow only on highly concessional terms. However, Burundi's external debt, as per World Bank figures, nearly doubled between 1985 and 1990 to over a reported U.S. $900 million (end-1990), due both to an acceleration in concessional borrowing and the impact of successive exchange rate devaluations. As a percentage of GDP, outstanding debt went from 45 percent to 80 percent, between 1985 and 1990. In 1990, multilateral institutions accounted for 48 percent of the debt service.

For its part, the debt service ratio, notwithstanding France's cancellation of $105 million in official debt, still amounted to over 40 percent at year-end 1990. (Belgium also cancelled about $12 million in July 1991). Although these debt-forgiving measures by foreign creditors are bound to spell some relief for the balance of payments, particularly in 1992, the debt-service ratio is still projected to exceed an onerous 35 percent in the years ahead. To put the situation in perspective, 1990 World Bank statistics indicate that the debt service ratio for Sub-Saharan Africa averaged 20.6 percent in 1990.

6. Other Factors

a. Privatization

Privatization of State-Owned Enterprises (SOEs) has been a concern of the World Bank during the entire course of SAL II. The GRB has endorsed the need for near-term action in this area, emphasizing the urgency and requirement to disengage th State from unproductive investments.

The GRB privatization program rests within the *Service Chargé des Enterprises Publiques* (SCEP), the agency designated to monitor public enterprises which has been supported by the World Bank. In the previous SAL II, the World Bank had earmarked some 30 companies for privatization or liquidation. The program targets were far too optimistic about the speed a which the privatizations could be completed.

These shortcomings were in large part due to the delicate socio-political environment, but also because the privatization program --the cornerstone of public enterprise reform-- was flawed because it lacked, *inter alia*, an effective financing mechanism.

Early on, USAID recognized privatization as a necessary but insufficient condition to promote diversification of the economy. Nevertheless, it was initially reluctant to fully engage in the process due to lingering sentiments within the donor community, notably the World Bank, that direct interventions in privatization were outside USAID's domain (see Section II.F.2. above). Excellent collaboration among the GRB, the World Bank, and USAID - buttressed by USAID's support to concrete, pragmatic activities (e.g., the free trade regime consultancy) - has served to overcome many of these concerns. Today, the GRB and the World Bank welcome USAID's involvement in the program. At the time of this writing, Price Waterhouse is returning to Burundi to initiate the second phase of their assistance, which includes final selection of an enterprise for divestiture, valuation, and preparation of an information memorandum for buyers.

b. Democratic Initiatives/Political Analysis

In March 1992, Burundian voters approved a new multi-party democratic constitution, which went into effect immediately. Given the delicate ethnic situation which has existed since independence (1962), and the correspondent authoritarian rule exercised by three military Presidents since 1965, this was a step of no small significance.

Of even more import, however, is the Charter of National Unity, which was approved in a national referendum in February

1991. The Charter is the document to which even the Constitution defers; it defines and prohibits a variety of discriminatory and divisive activities, and it invokes the unity and harmony of a precolonial Burundi. Its impact cannot be overstated as it initiated a national discussion on the long-simmering ethnic issue: for the first time, Burundians were encouraged by their government to openly acknowledge the tragic events of the past three decades and collectively commit themselves to getting along. While it is true that in November 1991 there was a week of violence set off by the invasion of outside extremists, many Burundians feel strongly that without the Charter, events would have escalated far beyond what they in fact did. It has set the parameters for what is acceptable dissent for the foreseeable future.

It should be said that democracy is not a foregone conclusion in Burundi, nor will it necessarily bring equity to what has traditionally been a very stratified society. It does seem, however, that Burundians are willing to give it a chance, because they believe it is the key to achieving harmonious ethnic relations.

The Charter of National Unity seeks to unite Burundians on the basis of their nationality, not ethnicity; the Constitution provides for equal treatment and protection of individuals under the law. It guarantees a variety of basic freedoms, including freedom of conscience, association, expression, movement and religion. The freedom of the press is recognized, as is the independence of the judiciary, and the presumption of innocence. Property rights are guaranteed, as are equal pay for equal work and equitable access to educational opportunities. The Constitution also calls for equal access to the country's social and economic resources, which, in a country with per capita incomes of $210 and a very small but well-entrenched elite, may be the most difficult guarantee of all. Yet, it is <u>this</u> issue - equity - upon which the ultimate success of Burundi's democratic experiment may depend.

7. Projections for the Medium-Term

The revised PFP macro targets of the World Bank call for: 1) average real GDP growth of 4 percent (which, accounting for population growth implies a per capita GDP growth of about 1 percent per annum); 2) maintenance of the inflation rate at 5 percent by 1992; 3) stabilization of the current account deficit, excluding transfers, at about 15 percent; 4) stabilization of net foreign exchange reserves at no less than four months of imports of goods and services; and, 5) a reduction in the budget deficit, excluding grants, from 12 percent of GDP in 1990 to 5 percent in 1992.

For 1991, USAID's estimates (based on IBRD/IMF statistics) suggest a good economic performance - bolstered by foreign aid - of around 5 percent in real growth. Favorable weather boosted the output of food crops and tea. Inflation is reckoned to have gained some momentum at over 8 percent, in good part the result of the lagged erratic impact of the "on-again, off-again" monetary policy. Given the above fundamentals and assuming coffee export receipts at about the same level as 1990, the current account balance would have benefitted from larger aid transfers and shown a deficit entry lower than the $56.4 million registered in 1990. Thus, although any improvement would be welcomed, the negative historical pattern persists in that chronic trade and services account shortfalls continue to be offset entirely by large foreign aid inflows.

USAID forecasts that the modest gains of 1991 are not going to be repeated in 1992. For this year, the target of an annual real growth rate of 4 percent and inflation of 5 percent, as well as the hoped-for improvements in the external accounts and budget deficits, will probably not be achieved. This opinion is formed in view of the 22-year record lows for coffee prices as well as the potential effects of adverse weather. The most likely end result will be a widening of both the internal and external deficits, higher financial aid from the donors to close the balance of payments financing gap, and/or a reserves drawdown. The net effect will be that the state of the fragile Burundian economy will become even more precarious.

In view of the present absence of any significant changes in the structure of the economy, the absence of new sources of growth, and the potential impact of exogenous factors (coffee prices and weather), it would appear that Burundi will remain a candidate for continued structural adjustment efforts for the near to medium term.

IV. FY 1992 REFORM AGENDA

A. Development of the Agenda

While the development of the 1992 reform agenda has been described in the amendment to the BEST Project, an overview of the consultative nature at this point will help to elucidate the process through which it matured and was negotiated.

It was only for this third year of conditionality that BEPP enjoyed the full support of the three long-term technical assistants that comprise the BEST Project Team. This increase in personnel meant that, with USAID's Private Enterprise Office, six qualified professionals, including four expatriate contractors, now carried primary responsibility for extending and deepening the policy dialogue. Focus on this dialogue, and approbation of the reform conditions, was then the work of the BEST Technical Committee, which is chaired by the GRB's BEST Project Manager.

When a plenary session of the Technical Committee was called to debate the agenda, sustained exchanges during the foregoing six months had permitted agreement on a broad range of proposals in the areas of legal reform, labor legislation, foreign trade, taxation, and agriculture. Matters gathering around currency control and foreign exchange remained unresolved at that time, but they had been widely discussed with public authorities, commercial bankers, and the business community. The agenda presented in section IV.C below was accepted by the Technical Committee on July 31, 1992.

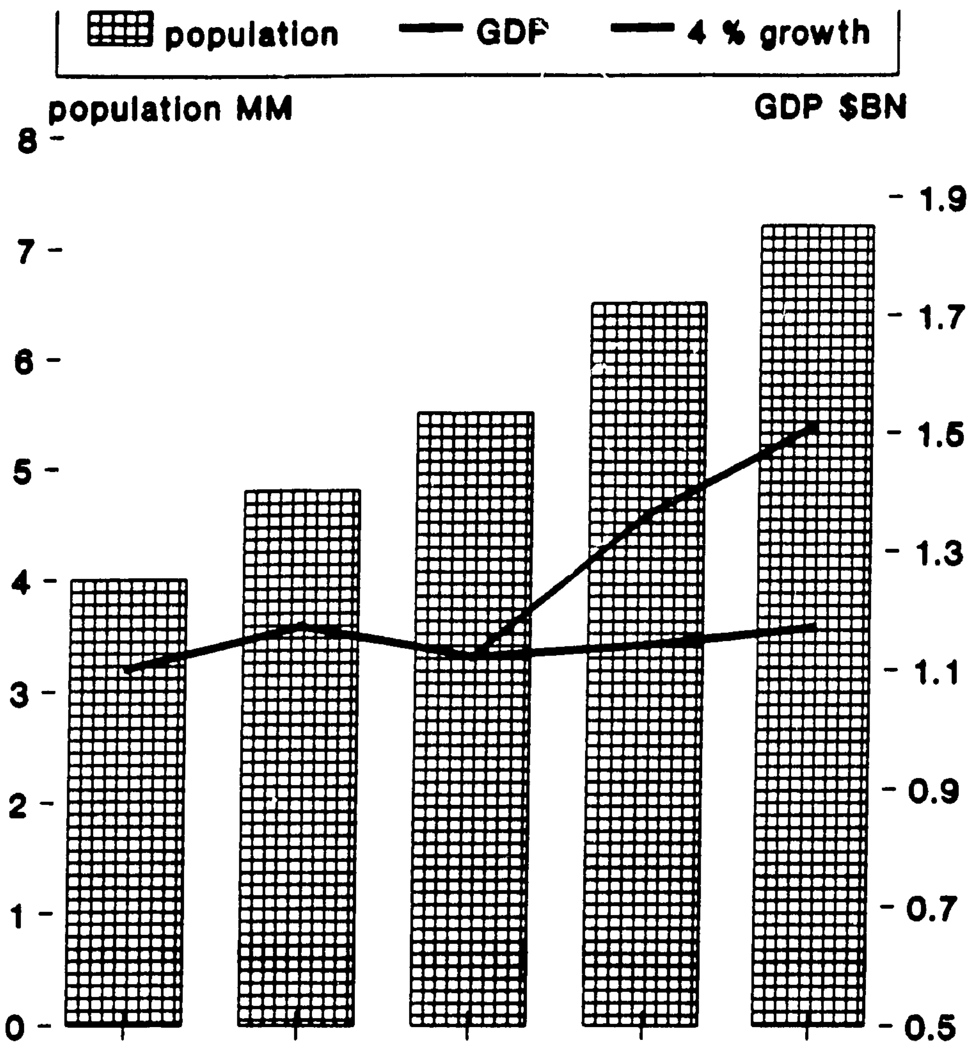
B. The Developmental Objectives of the 1992 Agenda

USAID believes that Burundi enjoys a moment of opportunity to become a center of economic strength in the region. Sections above have described the political and economic context of this opportunity, both for the region as well as for the nation itself. The choices are real, and the time span for making them is brief. Its known and suspected mineral deposits notwithstanding, Burundi cannot depend on its natural resource assets for rapid economic growth. If the country is to meet even the basic needs of its population by the end of the century, it must break with an intellectual tradition of self-sufficiency based on internal resources. Burundi's per capita GDP is only slightly over $200 and average land holdings are under one hectare per family; the graph on the following page portrays some idea of the developmental problem. It shows population growth projections at current rates, GDP in real terms based on the ***average exchange rate of the U.S. dollar***, and two projections of GDP, also based on real growth in dollar terms. The first projection posits a two percent annual growth rate and the second a near four percent required to maintain real GDP per capita - in dollar terms - until the end of the century. Even two percent is optimistic under current conditions.

In retrospect, USAID believes that the objectives presented and constraints identified in 1989 in the PAAD were correct. The purpose remains unchanged: through BEPP/BEST USAID will continue to foster growth of private enterprise in Burundi, and BEPP will give special emphasis to non-traditional exports and to the growth of private entrepreneurship in the interior in the marketing and processing of agricultural produce and inputs.

But research under BEST has revealed the diminutive size of the formal private sector in Burundi in relation to the economy. There are only about 25,000 salaried employees in the formal private sector of Burundi. The modern private sector of Bujumbura, which represents over half of total employment and the bulk of the private sector's value added, contributes about seven percent to GDP. Any activities undertaken or supported under BEPP must necessarily take into consideration this fact, and must also take into consideration the predominant role of the rural sector in the economy.

Non-traditional exports brought in under $4 million in 1991, while exports from the purely private sector remain around $1



million. Total manufacturing accounts for less than five percent of GDP. The domestic private sector lacks the financial and technical strength to effect broad-based impact through economic growth. Perceiving this weakness, the 1991 PAAD Supplement stated: "Burundi has no choice but to develop business links outside its borders. It must do serious research that will help define innovations where it can gain preeminence in some economic activity in this part of Africa. Such innovations will inevitably require courting foreign investment."

To attract foreign investment, policy reform in this resource-poor country must be creative and bold. It must make Burundi competitive on a world-wide scale for off-shore production or commercial re-export; it must make Burundi competitive at least in the region for hard-currency deposits. If Burundi can achieve such competitiveness, through policy reform and public relations, it can indeed attain specialized preeminence in this part of Africa, and it can offer hopes of real gain in the standard of living of its people.

It is this conviction, along with a sense of urgency, that has driven the formulation of the 1992 reform agenda. Thus BEPP has transformed a relatively limited concept of promotion of SMEs into promotion of Burundi. The policy dialogue has shown that senior authorities and business people of the country share USAID's perceptions and agree with the developmental expansion of BEPP/BEST.

C. The 1992 Reform Program

The 1992 reform agenda builds upon structural achievements that have been enacted and comprises the seven categories listed below. One additional area, taxation, is covered under a special covenant (see Section IV.D.).

- The Legal and Regulatory Environment
- Labor and Employment
- International Trade
- Foreign Exchange and Currency Controls
- Financial Services
- Agriculture
- Other

The conditionality in the agenda is of two general sorts: that which proposes specific changes in regulations; and that which asks authorization to perform a study. The specific language from the Program Grant Agreement Amendment Number Two is provided below and is preceded with a preamble which states:

> "Prior to the disbursement by A.I.D. of the Dollar Grant (Total U.S. $10,000,000) provided in this Amendment Number Two to the Agreement or to the issuance by A.I.D. of documentation pursuant to which such disbursement shall be made, the Grantee, acting through the Ministry, Council, Office, or other such entity responsible for such action will, except as the parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D., documentation confirming that the actions described below have been taken:"

A third category, that which requests the establishment of a consultative mechanism, is covered in the special covenants section. In requesting this consultative mechanism, USAID seeks the opportunity to review and provide input in areas where it does not play a lead donor role, but which impact upon the overall objectives of BEPP. Such is the case for revisions of the investment, labor, and tax codes.

Each of the conditions in the 1992 reform agenda has been thoroughly researched and widely discussed. Furthermore, each item was the object of discussion at plenary sessions of the BEST Technical Committee. Rather than embarking on comprehensive exegesis of each proposal, this PAAD Supplement will approach the agenda by category, entering into specific detail only where judged necessary for justification or to elucidate the impact expected.

1. The Legal and Regulatory Environment

a. Grantee has promulgated revised General Provisions to the Commercial Code (*Code de Commerce*) which address, *inter alia*, the legal status of traders, the legal requirements for the operation of commercial establishments, the rights and obligations of business persons, and the governmental structure regulating commerce. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

b. Grantee has promulgated a law permitting the privatization or creation of legal professions, e.g., notaries public, process servers, auctioneers, surveyors, and the like. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

c. Grantee has agreed in writing to authorize consultants selected through the BEST Project to begin work on a revision of the Grantee's Corporate Law (*Code des Sociétés*). A.I.D. expects that such work shall begin on or about January 1, 1993.

d. Grantee has issued, under the auspices of the Grantee's Council of Ministers, a declaration enunciating the Government of Burundi's formal commitment against nationalization of private enterprises and assuring protection of all private investment in the territory of Burundi, whether domestic or foreign. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

e. Grantee has agreed in writing to authorize USAID to undertake a study on the land code (*Code Foncier*). The expectation of such a study is that it would result in recommendations concerning the acquisition and transfer of property rights in rural areas and thus create an appropriate legal framework for good land use and improved access to credit.

Revision of legal codes addresses the sort of constraints identified in the PAAD as general impediments to doing business.

Reform of the Commercial Code has been long deemed necessary and in fact was mandated under SAL I by the World Bank in

1986. The Code is based upon *fin de siecle* Belgian commercial law and has become a patchwork of provisions attached on an as-needed basis during six decades. USAID, recognizing the necessity for a major overhaul of the Code, originally proposed that U.S. assistance help draft certain portions, e.g., the laws regulating corporate registration and bankruptcy. Negotiations between the GRB and the World Bank for SAL III led to a formal invitation to USAID to assume the lead donor role in the revision of the Commercial Code as well as the laws governing legal auxiliaries.[2]

At a time when Burundi has made major advances towards the creation of a favorable business climate, a fully contemporary commercial code becomes a necessity. This code should reflect the increasing "Americanization" of business practice throughout the world, including in the European Community. The existence of this code will serve as a protective seal for much legislation enacted during the past four years and will be a further assurance to domestic and foreign investors that the basic rules of commerce are transparent and stable.

Notaries and process servers are public professions in Burundi. There is only one notary in the country, and this represents a blockage for a plethora of legal transactions. There is no objection from any quarter regarding this reform.

Other reforms in this category are designed to encourage investment - both domestic and foreign - as well as to promote a more efficient (and appropriate) use of land resources. A study of the land code is proposed to see if there is a means to facilitate registration of property that could subsequently serve as collateral for commercial loans. This could have another beneficial effect on the equitable distribution of wealth, insofar as it may eventually lead to the private ownership of land by women.

2. Labor and Employment

a. Grantee has agreed in writing to authorize USAID to undertake a study on the possibility of eliminating the discriminatory three percent tax levied on all salaries of alien workers.

b. Grantee has promulgated a law, regulation, or operating procedures increasing the maximum allowable validity of a work contract from two to five years. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

c. Grantee has promulgated regulations redefining the temporary permit as follows:

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[2] See footnote 1.

The temporary work permit issued to foreigners with special technical competencies will have a period of validity corresponding to the maximum period of validity allowed for temporary residency visas. It will be automatically renewed as often as necessary as long as there is a lack of Burundian capacity in the technical area under consideration.

d. Grantee has promulgated declarations, regulations, or other such documentation confirming and assuring the right of employers to negotiate or renegotiate salaries freely with their employees without prior governmental approval, while respecting the minimum wage limits established by the Salaire Minimum Interprofessionel Garantie ("SMIG"). This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

e. Grantee has agreed in writing to begin, by December 31, 1992, a study on a new health insurance system for private business, and, based on the recommendations of this study, to make a decision by April 1993 on the type of health care system to be adopted.

The 1992 agenda has greatly expanded BEPP's intervention in the domain of labor regulation. The agenda is the result of over six months of frequent dialogue with the Ministry of Labor and careful review of the proposed revision of the labor code. USAID has studied labor legislation in Burundi since 1988[3] and identified it as an outstanding target of reform in the original PAAD. Guided by the objective of promoting self-sustaining increases in employment generation, USAID has focused on two areas: equitable means of reducing the cost of labor to employers; and enhancing mobility in the labor market.

3. Foreign Trade

a. Grantee has promulgated the Free Trade Regime Law, the related implementation decrees, and the customs regulations relevant to the free trade legislation. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

b. Grantee has agreed in writing to initiate, both nationally and internationally, the GRB's Free Trade Regime promotion program, and that it will generally respect the guidelines proposed by the BEST-financed consultants on the Free Trade Regime.

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[3] Sylvie Chantal, "Policies, Procedures, and Institutions Affecting Employment in Burundi," prepared by Robert Nathan Assoc., Inc., December, 1988.

c. Grantee has agreed in writing to authorize USAID to undertake a study on pre-shipment inspection services used for imports to Burundi. This authorization will specifically include guarantees that the following information will be made available by the Central Bank to the consultants:

(1) a copy of the contract(s) between the GRB and the firm(s) currently providing pre-shipment inspection services to Burundi;

(2) import statistics since 1978;

(3) correspondence between importers and the BRB;

(4) correspondence between the Central Bank and the firm(s) that provide, or have provided, pre-shipment inspection services since 1978; and

(5) other information determined indispensable to the proper conduct of the study.

d. Grantee has agreed in writing to authorize USAID to undertake a consultancy to assist in the organization of the newly created Burundian Bureau of Norms and Standards (*Bureau Burundais de Normalisation et de Contrôle de la Qualité*, BBN).

The work of BEST in drafting legislation for a free trade regime in Burundi has been amply discussed in the BEST Supplement for 1992. The legislation is an improvement on the Mauritian model and permits free zone activity anywhere in the territory of Burundi; it also allows for commercial as well as for industrial enterprises to qualify for free zone status, as long as the enterprises export 100 percent of their goods or services. Expected to be passed into law in the coming weeks, this legislation will figure among the most modern and liberal in the world, certainly on the continent. BEPP's conditionality reinforces the urgency felt not only by USAID but by many of the most eminent private and public figures in Burundi.

Two other topics specifically related to foreign trade which have captured the attention of USAID during the course of 1992 are pre-shipment inspection requirements and the establishment of a bureau of norms and standards.

Burundi has maintained a contract for over ten years with a single firm to provide verification of goods and prices for products to be exported to Burundi. During the Private Sector Round Table in October, 1991, local businessmen expressed their dissatisfaction with this service and identified the requirement as a cost for products in Burundi, a drain on hard currency reserves, and an impediment to business.[4] USAID has agreed to undertake a disinterested evaluation of the service. The conditionality is proposed in order to assure full cooperation from the BRB, without which the evaluation could not proceed.

Establishment of a bureau of norms and standards is a project which was to enjoy financing from the UNDP. USAID had discussed the project with some of the parties involved in the original design and feared that a staff-heavy agency would be created that could, through a misguided concept of the prerogatives of the service, create obstacles to efficient export from Burundi. The conditionality will allow USAID to ensure that the service fulfill its legitimate role.

4. <u>Foreign Exchange and Currency Controls</u>

a. Grantee, acting through the Central Bank, has promulgated regulations, operating instructions, or other such documentation allowing the time period for deposit into the Central Bank of Burundi of hard currency earnings from the export sales of non-traditional products to be determined by the exporter's commercial bank. The determination of the time period for deposit of foreign exchange earnings from non-traditional exports shall be made on a case-by-case basis, taking into consideration the sales contract, the terms of the documentary credit, and other factors that could clearly influence the period of payment. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

b. Grantee, acting through the Central Bank, has clarified the regulation relative to the authorization given non-resident foreigners to open convertible accounts at local commercial banks. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

c. Grantee has agreed in writing to complete, before April 1993, a study on the implications of authorizing resident foreigners to open convertible accounts in Burundi.

d. Grantee, acting through the Central Bank, has promulgated regulations, operating instructions, or other such documentation authorizing exporters to retain in foreign exchange accounts in Burundi thirty (30) percent of their hard currency earnings from export sales of non-traditional products. This must be made public knowledge through publishing the information in the national

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[4] see cable Bujumbura 04248 of Oct 31, 1991.

newspaper or otherwise making such information available to the general population. Grantee shall confirm in such publications that access to deposits in foreign exchange accounts shall have no effect on the access of exporters of non-traditional products to foreign exchange made available through the Open General Licensing ("OGL") System.

e. Grantee, acting through the Central Bank, has promulgated regulations, operating instructions, or other such documentation authorizing Burundian nationals resident abroad to hold foreign exchange accounts in commercial banks in Burundi. This must be made public knowledge through publishing the information in the national newspaper or otherwise making such information available to the general population.

f. Grantee has authorized USAID to undertake research and to promote tours abroad, to include public and private Burundian nationals, to study the operations of foreign exchange bureaus and to determine whether the foreign exchange regulations in Burundi are dynamic and competitive for investment as compared with exchange regimes functioning elsewhere in the region.

Interventions in the area of foreign exchange and currency controls were not foreseen in the PAAD, even though numerous issues had been identified in certain baseline studies used by the design team.[5] They were, however, twice foreseen in the 1991 PAAD Supplement in the section on special covenants, for FERAs for exporters and for the foreign exchange allocation system. As this is the generally acknowledged realm of the World Bank and the IMF, it is of paramount importance that USAID's reasons for positing conditionality in the domain of currency control be clearly understood.

The Mission feels that by the end of BEPP it will be driving enabling environment reform to the limit. During the course of 1993, USAID expects to complete revision of the Commercial Code, including the company, bankruptcy, and administrative codes. BEST work this year will lead very soon to establishment of perhaps the most liberal free trade regime on the continent. And USAID is now embarking upon a very pragmatic form of assistance to the privatization program, from which positive results should emerge within the next few months. But it is clear to the Mission, as it is to other donors and to high-ranking Burundian authorities, that this economy will not respond to the most enlightened of reform measures without a significant rise in direct foreign investment. In other words, the measures needed to make a success of privatization, free zone production, and even SME development are still inadequate.

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[5] E.g., Phillips and Nicampaye, "Doing Business in Burundi," World Bank, 1989.

Although the Open General Licensing mechanism discussed earlier is an excellent instrument warmly welcomed by the local business community, it does little to entice new levels of investment or to capture hard currency afloat in the marketplace and in the region. The parallel market remains hardy and capital flight has not been deterred by progress under structural adjustment. Burundi must become - very soon - globally competitive for off-shore investment and at least regionally competitive for foreign exchange deposits. The country need not look far for sources of remittances. Conservative calculations, based upon reasonable supposition and anecdotal evidence, suggest that as much as $25 million could become available as deposits and as investment from Burundians and long-term residents of Burundi.

The proposals encompassed by this rubric are of two sorts: those targeting foreign exchange issues affecting the sector of non-traditional exports; those encouraging a modern, liberal notion of foreign exchange retention by individuals *when the hard currency does not originate from the sale of goods or services from Burundi*. USAID has insisted on continuing dialogue with the authorities on the latter sort of reforms. When remittances are secure and access to them by their private owners is automatic, businessmen will confront one less obstacle as they ponder the risks and inconveniences of investment in Burundi. If the banks can become competitive for foreign exchange deposits, Burundi's recognizably well-managed financial system can become a regional repository for hard currencies. The proposals in the present agenda represent a compromise of earlier recommendations which were challenged by the more conservative Central Bank. The Mission believes, nonetheless, that acceptance of the final agenda has opened the door to truly pivotal reforms in the near future.

The proposals targeting exports in this category aim, on the one hand, to rationalize an improperly conceived regulation and on the other to provide an additional incentive to a sector that is in fact losing ground. In the first instance, the period for repatriation of foreign exchange from export sales (currently one month if shipment is by air) should not be fixed by arbitrary concept but by the terms of the sales contract. If Burundi succeeds in developing the non-traditional export sector, it will have to adapt to generally accepted standards of international negotiations. It should be noted, however, that BEST continues to support the requirement for repatriation, given the growing trade deficit of the country.

The proposal for retention of 30 percent of hard currency earnings in FERAs should be understood in the present context of absence of export financing or export insurance. It should also be understood as a further incentive towards entrance into the sector. The amount of hard currency involved would have been inferior to $1 million in 1991, when gross sales from non-traditional exports stalled at $3.5 million. This proposal was made during the 1991 negotiations though conserved only as a covenant. Its retention this year is further testimony to the continuity of the policy dialogue under BEPP.

5. Financial Services

a. Grantee has agreed in writing to promulgate legislation on leasing of real property, equipment, and other physical assets, and related implementation measures, by April 1, 1993, and has agreed in writing to make this information public knowledge through publishing the legislation in the national newspaper or otherwise making such information available to the general population.

b. Grantee has agreed in writing to authorize USAID to undertake a study on commercial credit in Burundi, with the intent that such study would result in recommendations concerning the legal and regulatory steps necessary to be taken by the Grantee in the short term to make credit more accessible to small and medium enterprises and exporters.

The 1991 PAAD Supplement discusses the Mission's hesitant position in regard to business credit, a subject it has followed closely since 1989. Access to monies available for term lending is impeded for an array of reasons, none of them unique to Burundi: high interest rates, a non-competitive banking system, lack of collateral, lack of equity, lack also of sound projects. Given the managerial soundness of the banking system in Burundi, USAID has been unwilling to contribute to the abundant rhetoric blaming the banks for excessive conservatism. Although USAID remains unconvinced that lack of access to commercial credit is the major constraint upon private sector growth in Burundi, the Mission agrees that it is a serious problem which merits closer review and understanding. Both a study on leasing and research on commercial credit were foreseen in the PAAD.

Leasing is a credit mechanism which can assume various forms that may serve as alternatives to traditional term loans. In fact, the Meridien Bank of Burundi has already established a leasing company in light of governmental assurances that legislation will be enacted in the near future permitting and regulating this sort of credit. The work proposed by USAID reaches beyond the original intent of a study: BEST will produce a draft of all the required legal texts for leasing operations, much as it did for the free zone regime.

The work proposed under a credit consultancy remains in the scope of pragmatic research. Some of the questions the consultant must answer are:

- Is there scope for a genuine venture capital project? (if so, how should it be capitalized, by whom should it be managed, etc.) Is there any other form of equity lending which might be appropriate?

- Should small business credit be funneled through the banks or avoid the formal institutions? If the former, how can a project circumvent the obstacles inherent in the banking system itself?

- How can seizure of pledged assets be rendered more efficient?

- What can be learned from the failure of the World Bank's APEX Project and the weaknesses of the National Guarantee Fund in constructing proposals for innovative credit activities?

- Is there a place for USAID/Burundi in minimalist credit activities (e.g., extremely small seed-money grants or loans to rural women)?

6. Agriculture

a. Grantee has promulgated legislation, regulations, or related implementing measures guaranteeing for importers and distributors of agricultural and livestock production inputs (seeds; veterinary, phytosanitary, and soil amendment products), as well as tools, equipment and machinery destined for agricultural or livestock use, the same tax and duty benefits already accorded to importers and distributors of chemical fertilizers.

b. Grantee has promulgated national seed legislation allowing and encouraging the full participation of the private sector in seed production, importation, and distribution. This law will include a voluntary seed certification and validation procedure, available on demand, under the auspices of the National Seed Service. It will also assure patent protection for new seed varieties.

The 1992 BEPP reform agenda includes for the first time reforms that fall under the purview of the Ministry of Agriculture and Livestock. This reflects the growing conviction at USAID that, in order for BEPP to fulfill its mandate of sustainable, broad-based impact, efforts must be intensified to stimulate private enterprise development within the agricultural sector through policy reforms (as well as other interventions) which directly affect the vast majority of Burundi's population who are small farmers. It also conforms to the GRB's general strategy, stated succinctly in its Framework for Economic and Financial Policy for 1991-1994 (August 1991), to liberalize agricultural markets and transfer a major proportion of agricultural production and commercial activities from the public to the private sector.

The two specific agricultural reforms included in the 1992 BEPP agenda relate directly to liberalization of the input supply and distribution system. Liberalization of agricultural input markets is already included in general terms in the conditionality of SAL III, but the GRB has requested U.S. assistance in developing a plan to assure continued supply and distribution of inputs to Burundian farmers as the GRB phases out of direct intervention. An April 1992 report by a USAID-sponsored consulting team, and reinforced by a REDSO/ESA report summarizing agricultural development support for Burundi, proposed a development strategy for USAID which focuses on agricultural input supply and distribution - largely because of the potential for growth in this market to lead to economic benefits for a broad segment of the Burundian population. The technical assistance team of the Small Farming Systems Research (SFSR) Project has been conducting economic and marketing research and analyses since 1991 which have been leading to similar conclusions and which are beginning to feed into the BEPP mechanism of conditionality through policy reform.

The two reforms on this year's agenda listed above reflect in large measure the collaborative work of the SFSR and BEST teams in their ongoing analyses of constraints to, and opportunities for, increased efficiency in agricultural input markets - including seed. The first reform seeks to apply liberalization of prices and elimination of sales taxes and import duties, which were accorded to fertilizers via a Ministerial Ordinance in May 1992, to all other agricultural inputs. The second reform, which has been elaborated in draft form with the long-term assistance of the SFSR Project, is already under GRB review. Once enacted, this law will provide a needed legal framework, including incentives for developing or introducing improved crop varieties, which should encourage further participation of the private sector (both domestic and international) in the Burundian seed industry. Neither of these reforms is seen as an end in itself, but rather they are important points of departure for establishing a functional, market-driven input supply and distribution system.

7. <u>Other</u>

a. Grantee has agreed in writing to authorize USAID to perform follow-on surveys of the three baseline surveys already completed under the auspices of the BEST Project: the Household Income and Expenditure Survey; the Informal Sector Survey; and the Formal Sector Survey.

b. Grantee has agreed in writing to authorize USAID to contract, locally or abroad, for services to execute rapid surveys and polls in order to determine the efficacy of any or all reforms proposed under BEPP since 1990.

c. Grantee has agreed in writing to permit annual financial audits of the books and records and the

Grantee's financial management procedures for Dollar Grant funds released pursuant to the original and subsequent amendments to the Agreement. Furthermore, Grantee has agreed in writing to permit audits of local currency funds resulting from dollar funds disbursed pursuant to the original and subsequent amendments to the Agreement. Audits will be done in accordance with the Inspector General Act and Office of Management and Budget Circular A-73.

d. Grantee has provided to A.I.D. a written schedule of multilateral debt for which the Dollar Grant will be used. At a minimum, this schedule should include the name of the multilateral lending institution, the names and purposes of the loans to be serviced with Dollar Grant funds, and a list of the anticipated payments by month, by amount, and by multilateral lending institution. Additionally, the Grantee should ensure that the above written schedule covers anticipated debt payments sufficiently in excess of the $10.0 million, in order to account for proposed ineligible debts which Tranche Number Three of the Dollar Grant cannot finance and for anticipated interest which will be earned once Tranche Number Three of the Dollar Grant is deposited in the Grantee's U.S. bank account.

This final category appropriately addresses the monitoring and evaluation of the present, as well as past, reform agendas. Annual updates of the three baseline surveys had been projected in the original PAAD. The Mission's subsequent deliberations suggested that biennial updates would suffice for the purpose of monitoring economic and sectoral change. Acceptance of this conditionality constitutes definitive authorization for the performance of these large-scale activities.

The bland appearance of this conditionality fails to disclose the vigorous intentions behind it. USAID is keenly aware that policy signifies no more than the real intentions to back it. Beyond any concern to justify the actions taken under BEPP/BEST, the Mission is eager to launch effective monitoring of the implementation of BEPP's proposals. This follow-through is a component which, largely for lack of sufficient management resources in the past, has been insufficiently enforced. One of the major initiatives of BEST in late 1992 will be the institution of a program to secure the implementation of each reform, to disseminate ample information on each reform to all potential beneficiaries, and to measure the influence of each reform in its practical context.

The latter two CPs put in place appropriate financial management and audit mechanisms to ensure proper accounting and use of the dollar grant. The latter condition - first used under the second-year disbursement under BEPP - was put in place to allow the GRB to specify which debts it would service and obviate the need for another round of approvals by USAID.

D. Special Covenants

In addition to the above reforms, the Program agreement will include several special covenants to address areas which USAID believes should have particular attention, or which will facilitate program implementation.

1. Representation on BEST Technical Committee

The BEST Technical Committee was constituted in January, 1991 as a vehicle for developing the annual reform agenda through open discussion with representatives of the agencies and organizations directly concerned with the reforms under consideration. The Committee also offers a forum in which agencies may bring new proposals to the table. The organizations and agencies permanently represented are: the Ministry of External Relations and Cooperation; the Ministry of Planning; the Ministry of Commerce and Industry; the Ministry of Agriculture and Livestock; the Ministry of Labor; the Central Bank (BRB); the Chamber of Commerce of Burundi (CCIB); and the Export Promotion Agency (APEE). For the Committee to function properly, it is essential that each agency be represented by persons invested with sufficient authority to take policy positions for their respective organizations.

The proposed special covenant concerning the BEST Technical Committee, therefore, will be:

> **The Grantee covenants to designate permanent representatives to the BEPP/BEST Technical Committee from the relevant technical and economic ministries and the Central Bank who shall attend all scheduled meetings of that Committee and who are vested with authority to represent and make policy decisions on behalf of their respective agency.**

2. Monitoring Information

As BEPP has completed half of its LOP of four years, monitoring of the economy and the reforms must intensify. The BEST Project needs to receive data on a regular basis from the technical ministries concerned with BEPP's reform areas.

The proposed special covenant that will facilitate access to required data is:

> **So as to monitor the progress of the policy reforms supported under the BEPP Program, the Grantee covenants that the Ministries of Planning, Commerce and Industry, Agriculture and Livestock, Labor, Finance, and the Central Bank (BRB) shall each designate, in writing, an office or special representative who will transmit, at**

minimum on a bi-monthly basis, such statistical information as is regularly compiled in the respective ministries to the Grantee's BEST Project Manager (the Permanent Secretary to the Structural Adjustment Monitoring Committee (PS/CS/PAS)).

3. Investment Code Revision Consultations

USAID's concern with the Investment Code revision was expressed in the 1991 PAAD Supplement, and while USAID has in the past made formal comments on the Investment Code, it has not been invited to work directly on the document. Given its importance, USAID is requesting in this special covenant the opportunity to review and provide input on any revision process of the code.

The proposed special covenant that will facilitate this process is:

> **The Grantee's Ministry of Plan (MOP) covenants to establish a mechanism through which it will keep USAID regularly informed of progress, deliberations, and decisions made under the Investment Code Revision project. Such a mechanism should be structured to allow USAID sufficient time to review and comment on the work being made on the revision of the Investment Code, so as to give USAID the opportunity to have its comments considered by the Ministry of Plan prior to promulgation of a new Investment Code.**

4. Labor Code Revision Consultations

USAID is not considered, and has not tried to make itself, a major partner in the revision of the labor code. Nonetheless, since the subject deals with one of the primary factors of production, the Mission has maintained continual oversight on matters affecting employment. The Mission's work in this area dates from 1988. Without insisting upon a major role in labor law revision - which might prove cumbersome to the process - USAID asks that a right to oversight and commentary be formalized.

The proposed special covenant that will facilitate this process is:

> **The Grantee's National Labor Council (Conseil National de Travail, CNT) covenants to establish a mechanism through which it will keep USAID regularly informed of progress, deliberations, and decisions made under the Labor Code Revision project. Such a mechanism should be structured to allow USAID sufficient time to review and comment on the work being made on the revision of the Investment Code, so as to give USAID the opportunity to have its comments considered by the Ministry of Labor prior to promulgation of a new Labor Code.**

5. Tax Code Revision Consultations

Although a study of the fiscal system was foreseen in the original PAAD, and USAID has received requests from various quarters to finance research on tax reform, the Mission has hesitated to make a commitment in this area. The IMF is currently studying the fiscal system with a view towards major reform, and in the above conditionality the BEPP is asking that the Ministry of Finance make available to it the work completed thus far.

While USAID, given the scope of its present engagements, would prefer to eschew direct involvement in fiscal reform, BEPP/BEST shoulders a responsibility to ensure that real progress is made towards alleviating the tax burden on private enterprise. In nearly every general forum for dialogue with the private sector, the tax system is cited as the number one constraint on the growth of private initiative.

The proposed special covenant that will facilitate this process is:

> **The Grantee's Ministry of Finance (MOF) covenants to establish a mechanism through which it will keep USAID regularly informed of progress, deliberations, and decisions made under the Tax Code Revision project. Such a mechanism should be structured to allow USAID sufficient time to review and comment on the work being made on the revision of the Tax Code, so as to give USAID the opportunity to have its comments considered by the Ministry of Finance prior to promulgation of a new Tax Code.**

E. Revisiting the PAAD Economic Analysis

1. Background

As stated in the first PAAD Supplement, the PAIP and original PAAD make numerous points regarding the economic benefits arising from the policy reforms undertaken under BEPP. The PAIP notes that "it is the responsibility of all governments to establish basic infrastructure and social and economic rules and regulations (preconditions for development) that are fair and equitable to its citizenry and allow individuals to prosper economically and socially." The impact of the kinds of policy change envisioned under the BEPP, and others that may follow, fall into this basic, precondition or environmental category.

The PAIP also notes that "studies funded... by USAID/Burundi and other donors have already identified a long series of policy constraints that need to be alleviated. Some are minor and non-controversial, while others represent major, politically sensitive changes. Taken individually, many may have only a small economic impact. When considered as a group, however, they will create a new positive attitude and environment for the private sector. This new environment will have economic consequences beyond those of the individual policy reforms, and will be an important factor in attracting new investment and in increasing domestic and international trade."

The above concepts were expanded upon in the original PAAD, which stated, "Burundi has learned through painful experience that development led by the public sector cannot generate the employment and income opportunities needed to keep pace with its growing population. It has responded to this lesson by committing itself to the development of a market-oriented economy... [the *dirigiste* years and the reliance upon public enterprises have] combined to leave Burundi with laws, procedures, and practices that are archaic, often arbitrary, and generally not known or understood by the public. Thus, the private sector is still hindered by the lack of an adequate set of regulations that are fairly and impartially applied in a manner that facilitates trade and provides positive atmosphere for business." The PAAD goes on to note that, "if the private sector is to assume its envisioned leading role as the source of increased employment and income for Burundi's poor, the country will have to reform these practices."

Thus, the major thrust of the policy reform program for the PAAD designers was to concentrate on those policies that inhibit or have the potential to inhibit the establishment of a viable private sector whose role is to provide the stimulus to greater and steadier economic growth than has existed previously. While the expression was not used, the intent of the program was to establish an "enabling, market-based environment" within which the private sector could flourish.

2. Estimating the Benefits and Costs

During the PAAD preparation period, the issue of measuring benefits and costs of policy reform programs had not been thoroughly vetted within the Africa Bureau. In fact, there was considerable disagreement over the issue. In some quarters of AID/W there was particular concern with the assertion that it was difficult if not impossible to quantify the economic impact of "enabling environment" reforms. In addition, even if benefits would be identified, there were divergent views on the definition of what the costs were. Within this milieu, no formal rate of return analysis such as a benefit/cost or internal rate of return was developed for the PAAD. In their place was put a present value analysis (discounted at 10 percent) of the benefits that we anticipated would be derived from all the policy reforms that were anticipated would be undertaken as a result of the **full four-year policy reform package as described in the PAAD** (see Annex II for further details). The present values of the anticipated amounts of the yearly policy reform grants were also included as costs. As a result, the presentation provides all the information needed to judge the efficiency of the program by each and all schools of thought.

The difficulty of measuring the benefits of an enabling environment policy reform program continues to be recognized at the senior levels of the Bureau. This issue was discussed at the May 1991 Mission Director's conference, where USAIDs were charged with descriptively tracing the linkages with future economic growth if "standard" benefit-cost analyses could not be conducted.

3. Estimating the Benefits for the Second PAAD Supplement

As noted above, the benefit analysis for the PAAD was conducted for the entire presumed four-year PAAD period, using present value analysis (discounted at 10 percent) of the benefits that we anticipated would be derived from all the policy reforms that were anticipated would be undertaken as a result of the **full four-year policy reform package as described in the PAAD**. While the benefit numbers are somewhat subjective, they are best estimates for the kinds of benefits identified in the PAAD that would occur over the 13-year period as a result of the policy changes during the first four years. Thus, in principle, if there had been no changes in the anticipated amount of grant in the second year, there would be no need to conduct any additional analysis for this Supplement or third year of the program. However, since there have been increases in the grant amounts for FYs 1991 and 1992, an update is required. Also, the benefits from the four new policy changes that were not anticipated in the original PAAD analysis should also be added to the original analysis. The causal relationship between the policy reform set negotiated with the GRB and accelerated economic growth have been described earlier and will not be repeated here since no value can easily be placed on them. Although it is impossible to place any value on these new policy changes, it must be assumed that they have been captured by the "efficiency" or "business cost savings" benefits in the original analysis. To the extent the reforms are additional, it can be safely assumed that the benefits would now be understated. Several tables are presented in Annex II. Table 1 shows the original present value analysis; Table 2 shows the updated analysis for year 2 under BEPP, and Table 3 shows the figures based on amounts projected to be disbursed to date under BEPP, as well as adjustments for additional expenditures contemplated under BEST, which is being amended in FY 1992 to include new activities and add an additional $2.35 million in funding.

These tables reveal that the present value of the total costs amounts to just over $44 million, which, while significant, is still considerably less than the $119.8-121.0 million present value of net benefits estimated to occur over the 14 years covered by the analysis. If the actual benefits realized over the period were only one-half of the *ex-ante* estimate of

$119.8-121.0 million of net benefits, the investment would still produce a rather robust return.

4. Estimating the Benefits for the Future

The designers of the original PAAD implicitly assumed that results from the various studies outlined in the four-year reform program as well as others suggested by the BEST team would lead to the identification of specific sector policy changes that would produce quantifiable changes in economic growth. Lack of information made it impossible to identify which sector or sectors. Thus, there was an implicit sequence of events assumed by the designers that began with the very clear need to begin to "get right" the basic rules and regulations which governed the operation of the private sector. What was uncertain was how soon it would be possible to begin to identify policy changes that would lead to clear and definable economic changes which would not be inhibited by an as yet inadequate "enabling environment."

As discussed in more detail elsewhere, free zone or bonded warehouse concepts, as well as privatization, may allow some leap-frogging ahead of the enabling environment policy strategy. Work by the BEST TA team should begin to transform the policy reform agenda from one of merely "enabling environment" to one with a combination of "necessary" enabling environment and "necessary and sufficient" policy reforms that will produce identifiable and measurable economic change.

F. 1993 and Beyond

1. Policy Development

To a considerable degree, the policy agenda for 1993 is implicit in the 1992 reforms. Each of the seven designated categories contains the beginnings for future conditionality. Rather than attempt to anticipate specific 1993 reforms, however, this section will treat those areas which are most challenging, which are new, and which point in the direction which a fully-amended BEPP is likely to pursue.

Foreign Exchange Regulations

USAID believes that Burundi should adopt exchange regulations that are very attractive to foreigners for investment or deposit, that encourage remittances from Burundians, and that facilitate tourism. In recent weeks the BRB has authorized establishment of an off-shore bank in Bujumbura. While this represents a bold step forward, Burundi lacks regulatory mechanisms for off-shore financial services. BEPP may, therefore, support the following measures, among others:

- creation of a legal framework for off-shore banks;

- authorization for fully accessible foreign exchange accounts for anyone declaring hard currency at customs;

- establishment of foreign exchange (FOREX) bureaus;

- repeal of the unenforceable law prohibiting Burundians from possessing bank accounts overseas; and

- authorization for Burundian nationals to hold internationally valid credit cards.

Tax Reform

USAID believes that fiscal reform cannot be delayed indefinitely. It is academically interesting to design a tax system which will conserve or increase revenues to the State while simultaneously reducing the imposition on businesses. But it is privately acknowledged everywhere that fraud on the side of business as well as on that tax collection contributes largely to the penury of revenues. The Mission is already exploring ways in which certain almost unanimously revindicated changes can be introduced while awaiting completion of the new Tax Code.

Agriculture and Land Tenure

As has been described elsewhere in this document, the extension of BEPP's reform agenda to include agriculture-related issues (including land tenure) is a natural outgrowth of: a) USAID recognition of the need to address issues of direct consequence to the vast rural majority if BEPP (and, in fact, the USAID program as a whole) is to have any chance at achieving broad-based impact during the next 5-7 years; b) the evidence that among the most important policy areas affecting private initiative are those under the control of the Ministry of Agriculture and Livestock; c) the explicit GRB medium-term strategy, reflected also in SAL III conditionality, of initiating reforms in the agricultural sector which will liberalize input and product markets; and d) the identification of particular areas where a USAID intervention could be opportune.

Although USAID's strategy for the agricultural sector is not yet fully elaborated, and the exact nature of future years' BEPP reforms is not yet known, some observations may already be made regarding key policy realms in which USAID (and BEPP) should be able to concentrate its efforts productively.

- Increasing access to agricultural inputs and technologies:

  USAID/Burundi will probably devote the greatest share of its attention and resources within the agricultural sector in the next few years to a broad range of issues which may be grouped under the general rubric of increasing farmers' access to agricultural inputs, including newly developed technologies such as improved crop varieties. BEPP may be expected to play an expanded role as a vehicle for helping to formulate policies related to these issues and activities, including:

--Ongoing collaborative studies (undertaken to date by SFSR, BEST, MOAL, and CCIB) aimed at helping to make the transition to private input supply and distribution systems will be continued and new studies begun as information needs are identified. An appropriate, permanent locus (or loci) for these and other economic, marketing, and policy research functions is yet to be determined.

--USAID will explore the possibility of initiating a Commodity Import Program (CIP), possibly in conjunction with the current cash transfer method used under BEPP, as a direct means of increasing the supply of inputs (and perhaps eventually other non-agricultural commodities as well) available in the country.

--The amendment of the BEST Project includes funding for a pilot twelve-month rural enterprise development activity which will test the feasibility of developing farm-level cooperative enterprises, which could, among other things, fill an important role in making inputs available in rural areas. This activity (which will be expanded in next year's BEST amendment if proven successful) could provide a means to extend BEPP policy reform benefits to the rural population and also provide feedback on the effectiveness of policy changes.

--An effective agricultural research and technology transfer system which continuously makes improved crop varieties and agronomic practices available to Burundian farmers is critical to both the maintenance of national food security and the development of more diversified commercial agricultural production. USAID clearly has an important role to play in this area, both by its comparative advantage (*vis-à-vis* other donors) in food crops research and the concentration of other donors on the traditional, large-scale, commercial export crops.

Given the declining productivity of their relatively scarce land resource base, Burundian farmers have no alternative but to intensify their production techniques (i.e., increase yields per hectare) through adoption of improved technologies and farming practices. Without such changes, further degradation of the soil will inevitably force most farmers to devote additional resources to food crops, at the expense of existing or potential cash crops - including non-traditional exports. There is thus a direct relationship between improving the productivity of resources devoted to food crops and the development of alternative private agricultural enterprises. USAID also has a key, but as yet undefined, role to play in making agricultural research more responsive to market forces and involving the private sector directly in the process.

- Assistance in privatizing key agro-industries:

  This will be a natural area for inclusion in future BEPP amendments as USAID further defines (and extends, if successful) its approach to helping GRB privatization efforts. A number of large agro-industrial operations have already been targeted for privatization, and USAID's direct assistance in accomplishing any of these transactions could make a real contribution. BEPP and BEST may also provide a means of helping the GRB formulate policies regarding appropriate functions for the (agricultural) public versus private sector, and of assisting newly privatized enterprises by providing commercial information, technical assistance and training.

- Land tenure:

  Land tenure is a serious problem in Burundi in that current regulations and customary practices related to land ownership, acquisition, and transferral often lead to an inefficiency in land use which Burundi can ill afford. Farmers with insecure land tenure have few incentives to undertake long-term improvements of their parcels (such as tree planting or other fertility-enhancing or anti-erosion measures) which could increase the parcels' economic productivity. Furthermore, the potential economic activities of certain farmers (particularly women) are severely constrained because their lack of access to land is compounded by an accompanying inequitable access to credit. The GRB, in recognition of these problems, has requested USAID assistance in formulating a modern land tenure code which will promote increased efficiency in land use and also encourage additional investment in agricultural enterprises by both Burundian and expatriate entrepreneurs. The initial activity to be undertaken towards achieving this end will be a study conducted by a University of Wisconsin Land Tenure Center team, in conjunction with the resident research program of the AFRENA agroforestry research network of the International Center for Research in Agroforestry (ICRAF). USAID will undoubtedly be called upon to provide additional assistance to follow up on the findings of this study and finalize the land tenure code.

• Feasibility studies, market information and market development assistance to agricultural entrepreneurs, particularly for select non-traditional exports:

The BEST Project has already established links with, and provided some assistance to, a few local entrepreneurs interested in developing or expanding their agribusinesses - particularly for non-traditional export crops. BEST helped sponsor a workshop on essential oils, oleoresins, and medicinal plants, which has generated interest on the part of both local businessmen and U.S. and European firms in establishing a small-scale Burundian processing and export capability for certain of these products. This type of market development activity, in addition to financial feasibility studies, for select agricultural enterprises, will be continued under the BEST Project. However, the resources devoted to these efforts should be commensurate with the perceived potential for creating a broad-based impact.

Privatization

USAID's approach to privatization in Burundi is discussed above in section II.F.2. It is incontestable that the public enterprise sector represents a constraint to greater and more diversified investment in this country. It is premature to identify the policy questions which will issue from the experience of putting state-owned enterprises on the auction block. The experience is likely, however, to lead to a rich policy vein for BEPP. Conversely, it is nearly certain that BEPP will, as early as 1993, prove to be a welcome and respected instrument for the proponents of privatization. As the funding for privatization is subsumed under BEST, it is logical that BEPP will serve as a vehicle for furthering the initiatives.

2. Monitoring and Evaluation

As manifest in both the final category of reforms and in the section on special covenants, BEST is preparing to launch a major effort in following through on its reform agenda. This means that USAID, the BEST Team, and the BEST Technical Committee will ensure that there is adequate dissemination of information on the reforms and that they not just promulgated or authorized but effectively implemented. Evidence is accumulating that such is not always the case.

The implications of this effort are that BEST must develop a framework with verifiable indicators - where applicable - for the reforms and must create mechanisms for continual collection and analysis of information. The creation of the framework will be the object of a consultancy; the mechanisms will largely be devised in country. They will include analysis of the follow-up surveys, formal transmission of statistics, and polls and rapid surveys conducted by the BEST Team and by local experts.

USAID is also preparing to contract for the mid-program evaluation of BEPP in late 1992/early 1993.

V. DOLLAR USES

The $10.0 million cash sector grant will be used by the GRB for the same purposes as the original and amended grant, i.e., for servicing of external debt. Although some consideration has been given to using future-year cash grants for other purposes, e.g., a commodity import program, a tied open general licensing (OGL) arrangement, or a foreign exchange auction system, USAID has determined that these options are either too labor intensive, too new, or that the current banking system is not sufficiently sophisticated to allow for such an arrangement. In May 1992, the GRB adopted an OGL system to finance imports; eventually, USAID may find the OGL an appropriate mechanism through which the cash grant may be channeled, but did not elect to do so this year as it has only been in operation a short while.

As before, approval to use the sector grant for debt servicing will be based on an order-of-preference, as follows:

A. Debt to the U.S. Government;

B. Debt to approved multilateral donors; and

C. Debt to approved bilateral donors.

Since the GRB does not have any outstanding debt to the U.S. Government, USAID anticipates that the entire sector cash grant will be used to repay multilateral debt in category "B" above. Such was the case for the first two years under BEPP, where debt to the following organizations was serviced: the International Development Association (IDA), the African Development Bank (AfDB), the African Development Fund (AfDF), and the European Bank for Investment (BEI).

A revision of the debt servicing schedule for the above lending institutions indicates that $16.5 million in foreign exchange will be required during calendar year 1993, as shown in the table below:

Debt Servicing Schedule, Selected Lending Institutions
(1/93 - 12/93)
(in $000, or equivalent)

Lending Institution	Total
IDA	$6,207
AfDB	7,089
AfDF	2,304
IFAD	907
Total	$16,507

Source: National Bank of Burundi, GRB Ministry of Finance

VI. LOCAL CURRENCY USES

Under the conditions of the original Program Grant Agreement, local currency in the amount of $13.0 million was deposited by the GRB into a separate, non-commingled account at the National Bank of Burundi upon disbursement of the $13.0 million in the GRB's U.S. Bank Account. The local currencies were used for three primary purposes: USAID's OE Trust Fund; USAID Project Support; and GRB Ordinary Budget Attribution. In FY 1991, revised guidance concerning local currency deposits eliminated the requirement that local currency be "generated" and deposited when dollar grants were used for debt servicing. As this was the case in FY 1991, USAID only required the GRB to deposit the equivalent of $2.37 million in local currency into USAID OE Trust Fund to finance planned operating expense costs, including renovation of the USAID office complex and procurement of two residences to defer long-term recurrent OE expenses.

The above-mentioned guidance similarly affects the FY 1992 disbursement: as the funds will be used to service external debt, USAID is only requesting local currencies it determines necessary to fund local currency project support costs. The local currency equivalent of $2.0 million is being requested, of which the equivalent of $1.15 million will be deposited into the BEST Project account, and the equivalent of $850,000 will be deposited into the Small Farming Systems Research Project account.

VII. AUDIT REQUIREMENTS

A. Financial Assessment - 1991/92

One of the conditions precedent to disbursement of the second-year tranche under BEPP was the GRB's approval of the terms of reference for an assessment of the GRB's financial management capacities, in particular as they pertained to the management of the first-year disbursement under BEPP. The assessment was eventually conducted by the independent auditing firm of Price-Waterhouse/Nairobi using BEST Project funding. The financial assessment revealed that adequate financial controls existed, but that some of the procedures used were either cumbersome (e.g., too many signatures and/or countersignatures required) or were not executed in a timely fashion (e.g., reconciliations were effected several months after they should have been). The assessment report addressed these minor deficiencies and the GRB has satisfactorily responded to how they will improve or address these deficiencies.

B. Revision of Program Grant Agreement Language Concerning Audits

Language will be incorporated into the Program Grant Agreement Amendment to make it consistent with revised audit guidance for project assistance. This will ensure conformance with (1) the Inspector General's Act of 1988, as amended, and (2) OMB Circular A-73, as amended, which provides that primary responsibility for audits rests with recipient organizations and that federal agencies will rely on recipient audits provided they are in accordance with U.S. Government auditing standards and otherwise meet the requirements of the federal agencies.

The language will be incorporated into ProAg Amendment Number Two as follows:

"Section 5.5 of the original Agreement, Reports, Records, Inspections, Audit, and as amended in Section 5.5 of Amendment Number One to the Agreement, is deleted in its entirety with the following substituted in its stead:

'A. The Grantee will maintain, or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, such books and records relating to this Amendment Number Two to the Agreement as are necessary to show adequately, without limitation, deposit into and withdrawals from the Special Dollar Account and compliance with this Amendment Number Two to the Agreement. Such books and records will be audited annually and in accordance with generally accepted auditing standards, and shall be maintained for three (3) years after the date of last disbursement under this Grant.

B. The Grantee will provide quarterly reports as to deposits into and disbursements out of the Special Dollar Account, monthly bank account statements, and such additional information as A.I.D. may request from time to time relating to the activities financed from the Special Dollar Account. These reports will contain such information and include such supporting documentation as may be required by A.I.D. The Grantee shall also arrange to have copies of bank statements on the Special Dollar Account sent directly from the bank to A.I.D. In addition, the Grantee shall furnish to A.I.D. such further information and reports relating to this Amendment Number Two to the Agreement as A.I.D. may reasonably request.

C. The Grantee will afford authorized representatives of A.I.D. the opportunity at all reasonable times to inspect the books, records and other documents relating to this Amendment Number Two to the Agreement and to all uses of the Dollar Grant made pursuant to this Amendment Number Two to the Agreement.

D. The Grantee agrees to perform an annual audit of the Special Dollar Account established pursuant to the original Agreement, Amendment Number One to the Agreement, and Amendment Number Two to the Agreement, using the services of an international public accounting firm agreed to by A.I.D. Such annual audits shall be continued for each year during which there was activity in the Special Dollar Account since the last audit or during which any funds remained undisbursed in the Special Dollar Account. A.I.D., at the request of the Grantee, may assist in arranging these audits. In cases of continued inability or unwillingness to have an audit performed in accordance with the terms of this paragraph, A.I.D. will consider appropriate sanctions which include suspension of all or a portion of disbursements until the audit is satisfactorily completed or until A.I.D. performs its own audit financed by the Dollar Grant or by other sources of funds.'

VIII. ANNEXES

Annex I:	GRB's Transmittal to USAID in Satisfaction of Conditions Precedent for BEPP ProAg Amendment No. 1 (1991)
Annex II:	Revised Economic Analysis Tables
Annex III:	Approved OPS Memo re: NPA Obligation for USAID/Burundi