Key strategies to strengthen domestic resource mobilization: **Burundi.**

1. Introduction

« Akimuhana kaza imvura ihise ».

A Burundian proverb says: *"What comes from the neighbor comes after the rain"*.

The Burundian proverb corroborates the fact that no country can develop successfully without counting first on its own resources. The government of Burundi seems to have forgotten the wisdom of their ancestors. Strong external dependency and negative private savings are a feature of the sphere of financing development in Burundi. The recent financial and economic crisis is a reminder of the necessity and urgency of a determined policy of mobilizing domestic resources. The following measures, taken from an analysis paper on the issue, may help enroll such a policy. They address the areas of public, private and non-formal savings.

2. Public Savings: Increasing the tax yield by reforming the tax the administration

The increasing share of foreign assistance in Burundi's budget underlines the urgent necessity to mobilize additional public internal resources. Table 1 below shows the trend.

Table 1 : Revenue, expenditures and grants : 1997-2007

(In percentage of GDP)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Revenue	14,2	18,7	19,2	19,2	21,4	21,4	20,9	19,7	20	19,3	19,9
Expenditures	22,7	25,7	25,7	25,2	30,1	33,1	37,5	39,7	34,7	30,4	38,8
Grants	3,1	2,8	2,7	3,5	8.1	12,1	11,1	10,6	12,8	12,0	17,1

Source : Ministry of Finance

Given the current state of the constraints that hamper the mobilization of public resources, the main strategy to increase tax yield should focus on reforming the tax and customs administration. The primary objective of this reform is to increase public revenue without increasing the tax burden. Institutional and human factors largely explain the low level of public savings. Thus, the narrow tax base partially result from fraudulent custom exemptions and from profitable economic activities that are under taxed or even entirely exempted. Similarly, problems of organization and lack of equipment, the issues of skills, related to insufficient staff training, limit the effectiveness of the administration. Tax officials while in a position of high responsibility have very low financial incentives and this exposes workers to high temptations of corruption, already widespread in the upper echelons of the state. These factors greatly encumber the effectiveness of tax administration. The Government has committed to addressing this through a thorough reform of tax administration.

A reformed administration can broaden the tax base by eliminating tax exemptions and taxing untaxed sectors. An administration better organized, more competent and financially motivated is less likely to be seduced by corruption. Certainly, if, at the institutional level, overall, corruption is not addressed, the task remains arduous. However, it is always easier to fight corruption if the incentives are commensurate with responsibilities. This is possible if the tax authority emphasizes competence and merit, rewards performance and punishes deficiencies. The Burundi Revenue Authority has already been put in place by a law. A code of conduct has been adopted, and the Board of Directors of the Revenue Authority has already been appointed. These measures contain the necessary ingredients for successful reform and are signs of the Government's commitment to move forward. But they are not sufficient.

A highly critical condition for the reform to succeed is the strict observance by the Government of the autonomy of the new Revenue Authority. The Government must refrain from interference in hiring and managing technical files. Political appointments, outside the criteria of merit and competence condemn this reform to fail with, ultimately, the exceptionally high costs.

To mitigate this risk, it is essential that donors are heavily involved and specific mechanisms for verifying the implementation of the reform are in place and strictly followed. Two criteria could be set.

First, a qualitative criterion. One must first ensure that the conditions of autonomy of the Burundi Revenue Authority are met. Recruitment of management and staff must be made on the basis of criteria of competence and outside political considerations. The delay in the recruitment of the CEO, the recent appointments of senior executives from the Office raise much concern and suggest the existence of political interference. For example, the newly recruited Commissioner of Customs and Excise has a degree in mathematics, whereas the profile contained in the tender requires a qualification in economics, management or law. One must secondly ensure that the establishment and management of the Revenue Authority are conducted in order to guarantee the effectiveness of this new entity. To this end, special attention should be given to these areas: quality of staff recruited, equipment, establishment of systems and procedures that facilitate the recovery, training, communication with taxpayers, etc.

Then, a quantitative criterion: It would set quantitative targets for recovery over a period of 2 to 3 years. For example, increase the government revenue level by 1.5% of GDP in the first year by eliminating fraudulent duty exemptions is a realistic target.

Donors could link the disbursement of budget support to the achievement of these objectives, as well as provide arms length oversight of the reform process.

If such reform bears fruit, public revenue could increase significantly. In Rwanda, the implementation of this reform has resulted in a tripling of revenue in seven years. The revenue to GDP ratio has doubled in ten years (from 7 to 14%). The same ratio stands at 18% in Burundi and therefore may not show a dramatic increase. But according to estimates made by sources inside the administration, it is realistic to expect an increase of 5 % over a period of 3 years. This would increase the ratio to 24% of GDP, a level above the African average (21%).

3. Private savings in the formal sector: Generalizing Social Security and strengthening competition in the banking sector

Table 2 and 3 below give some indicators on the economy and private savings.

Table 2 : GDP growth rates, Inflation and Interest rates

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
GDP growth rates	0,3	4,8	-1,0	-0,9	2,1	4,5	-1,2	4,8	0,9	5,2	3,6
Inflation	31,1	12,5	3,4	24,3	9,3	-1,3	10,7	8,3	13,2	2,7	8,3
Credit rates	16	17,6	17,7	20,4	20,9	20,3	21,1	20,8	20,6	18,0	17,5
Deposit rates	8,8	9,1	9,4	11,3	12,1	13,3	13,7	12,8	9,6	8,9	8,3
Real deposit rates	-22,3	-3,4	6,0	-13,0	2,8	14,6	3,0	4,5	-3,6	6,2	0,0
Intermediation margin	7,2	8,5	8.3	9,1	8,8	7,0	7,4	8,0	11,0	9.1	11,2
Ratio M2/GDP	17,9	15,3	20	18,5	19,8	24,1	26,7	28,9	29.9	31,9	32,5

Source: Central bank of Burundi

In order to increase savings in the formal financial sector, two areas need to be explored, namely extending the social security system and strengthening competition in the banking system.

The niche most likely to mobilize more private savings in the short term is undoubtedly the extension of the social security system to target populations that are not yet covered. The current coverage is limited to approximately 10% of the total population. Formal private sector employees enjoy a pension and accident insurance cover but do not benefit from a contribution-based health scheme. Public servants on the other hand have a health coverage but did not contribute for their pension until very recently. A recent decision has just set up “L’ Office des Pensions et des Risques Professoinnels”(pension and accident scheme) for the benefit of civil servants with effect from January 2010. Health coverage should be extended to the private sector and the wider population. Moreover, as regards pensions, insurance companies, some companies and some unions have developed systems of voluntary contributions to supplement low pensions paid by the system established by the state. It is the responsibility of the Government to take appropriate measures with the partners to establish health coverage for the formal private sector and non-formal sector. Neighboring Rwanda has done this so there is no reason that this can not be done in Burundi. To boost retirement savings initiatives already launched by the private sector the Government should introduce tax incentives but also and especially make available plots for construction on affordable terms.

These measures could raise an annual savings of between 1 and 1.5% of GDP.

Furthermore it is necessary to strengthen competition in the banking sector.

Table 3 : Evolution of deposits and credits (in billion BIF)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Deposits	38,0	37,7	58,3	62,6	74,9	96,8	127,7	159,9	183,4	231,4	245,8
Credits	66,2	87,1	117,4	129,8	162,7	183,6	215,3	278,7	289,7	364,5	372,4
Public	23,3	29,4	4,9	23,9	46,2	31,5	46,0	106,5	120,9	157,9	156,8
Private	42,9	57,7	75,5	105,9	116,6	151,9	169,3	172,1	168,8	206,6	215,6

Source: Central bank of Burundi

Despite a strong growth of deposits and credits, financial services remain concentrated in the urban areas and credits flow mainly to trade activities, accounting for 60% of the total. It is therefore necessary to extend the geographic and sectoral cover in order to bring financial services to uncovered areas.

In order to do this, barriers to credit must be reduced. In the absence of adequate mechanisms for risk assessment, banks require collateral so high that many potential clients are un-served, and extension of credit is very low. Donors could assist in the establishment of information systems such as "credit reference bureaus" which would get around this obstacle and expand the number of eligible borrowers. Similarly, mismanagement of institutions charged with the protection of private property and the enforcement of commercial contracts constitute additional risks faced by the banking sector. Improving the effectiveness of these institutions could increase the risk appetite of banks and widen coverage.

The establishment of a capital market (bonds) could also stimulate competition within the banking system. This market would be a cheaper alternative source of funding for the State and a number of quality borrowers. The development of this market would push banks to reduce their margins but also to seek other revenue streams. A crucial issue for success is to provide a secondary market to ensure liquidity.

Competition is also encouraged by the recent establishment of banking institutions by new African investors wishing to increase their geographic coverage. These are mainly Nigerian and Kenyan institutions. Their market presence is already being felt through the double effect of lower borrowing rates and higher deposit rates. Some have set up in areas not already covered by the banking sector. Although it is too early to assess the effects on savings mobilization, it is clear that these efforts indicate a willingness of operators to bring new potential applicants.

The increase in banking competition also calls for increased vigilance of the authorities responsible for banking supervision.

4. Microfinance institutions (MFI): Non-formal savings

Microfinance institutions have recently experienced an annual growth of 40% in Burundi(table 4). They are a response to the plight of low-income people access to financial services. The attractiveness of microfinance institutions lies in their proximity, but also in the fact that the financial conditions of access (minimal requirements to open an account for example) are affordable.

Table 4: Some indicators of the Microfinance Institutions (in BIF)

Variables	31/12/2004	31/12/2005	31/12/2006	31/12/2007
Clients Or members	272.340	311.094	365.074	309.945
Amount of credit	9.603.149.000	8.704.138.000	14.172.283.643	20.622.337.797
Client	52.955	63.051	115.997	112.422
Average credit	181.000	138.050	122.178	183.437
Aggregate deposit		12.067.087.787	13.443.118.223	17.657.582.439
Outstanding credit		13.897.427.000	14.173.075.189	18.930.603.801

Source: RIM (Microfinance Institutions Network)

The development of microfinance institutions is the appropriate strategy for mobilizing private non formal savings. To materialize, it will require combining the efforts of the private sector (operators), the Government and donors.

The Government's role is to implement a supervisory structure and to enact the legislative framework. In Burundi a framework for microfinance already exists, the challenge is to ensure proper implementation. The Government must also combat the pyramid schemes which may undermine the public confidence in savings institutions. There is evidence of recent cases where investors have been cheated.

Donors could play a key role in strengthening and extending the existing network of microfinance. They could assist in four major areas.

1. Improved management through technical assistance and training of management and staff of the microfinance institutions: MFIs face deficiencies in management (risk analysis, accounting, and computer science). Providing technical assistance and training could overcome these weaknesses.

2. Provision of lending resources during the first years of set up and pending the mobilisation of deposits. This could help generate revenue necessary to cover the operationnal costs until the deposits increase. Such support must be limited in time (eg. 3 years).
3. Guarantee fund for small traders and farmers. Experience shows that these categories of operators face the greatest difficulties in accessing credit, lack of conventional guarantees (property titles, salary guarantees etc). It is therefore appropriate to establish a guarantee fund for them.
4. Grants for equipment and access to essential infrastructure (like electricity). Given the low level of capital required to start MFIs and the fact that these operations are often mounted far from the centers equipped with electricity, it would be useful that subsidies be provided in particular for access to computer equipment and electricity.