BURKINA FASO: COUNTRY FINANCING PARAMETERS UNDER THE NEW POLICY FOR EXPENDITURE ELIGIBILITY

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Summary

1. This note describes the application of the Bank's new policy on expenditure eligibility in World Bank financing for Burkina Faso. The new financing parameters were discussed with the Government in December 2004 and comments have been incorporated. It is recommended that Burkina Faso should make full use of the greater flexibility in expenditure eligibility when and where appropriate. The Bank may finance project costs up to 100 %. The Bank may also finance recurrent and local costs in any proportion needed for individual projects. As of now, there are no excessive taxes and duties, and the Bank may finance taxes and duties in project costs. The changes are expected to remove obstacles to project implementation (including inadequate counterpart funds), allowing the Bank to assist the authorities in achieving PRSP and MDG objectives.

Background

2. Burkina Faso is a low income country. A key challenge for the country remains the need for a more diversified economy to strengthen resilience to external shocks (such as on cotton prices) and the vagaries of the Sahelian climate. However, Burkina has distinguished itself as a frontrunner in the design and implementation of Poverty Reduction Strategies. The World Bank portfolio performance is also one of the strongest in Sub-Saharan Africa.

3. With a CPIA of 3.6 in 2003, Burkina is a top-performer among Bank Clients. Based on its strong performance and its development needs, Burkina Faso qualifies as an IDA lending scale-up country and its IDA allocation for FY04-06 is set at SDR 301 million (approximately US$406 million equivalent). The country is also eligible for IDA grants. In FY05, 79% of IDA allocation for the country will be provided through grants.

World Bank Country Assistance Strategy and Portfolio

4. The Country Assistance Strategy (CAS)[1] prepared in 2000 and its progress report prepared in April 2003 CAS Progress Report (CAS-PR)[2] were designed to be fully aligned with the June 2000 PRSP[3]. The PRSP outlines and prioritizes the Government's poverty reduction strategy in four areas: (i) accelerating broad-based growth; (ii) ensuring that the poor have access to basic social services; (iii) expanding opportunities for employment and income-generating activities for the poor; and (iv) promoting good governance. The current portfolio, which comprises 13 projects, amounts to commitments of US$521 million, of which US$370 million is undisbursed. The sectoral repartition of the portfolio in terms of projects is: 23% for agriculture and environment; 15% for the urban sector, the social sector and the public sector; and 7.5% respectively for the transport, energy and private sectors, and for a Global Development learning center (capacity building for development). Burkina Faso was one of the first countries to move towards PRSC programmatic support and has successfully implemented program actions leading

[1] World Bank (2000) Country Assistance Strategy for Burkina Faso, Report No 21285-BUR, Washington D.C.
[2] World Bank (2003) Country Assistance Strategy Progress Report for Burkina Faso, Report No. 25458-BUR, Washington D.C.
[3] World Bank (2000) Poverty Reduction Strategy Paper for Burkina Faso, Report No. 21027, Washington D.C.

to approval of four successive PRSCs in August 2001, July 2002, July 2003 and May 2004. The PRSC 4, fully financed by IDA grants, was approved by the Board of Directors on May 11, 2004 for $60 million and fully disbursed on July 26, 2004.

5. A new results-based CAS is scheduled for Board presentation in May 2005. It will be aligned with the revised PRSP that was adopted by the Council of Ministers on October 27, 2004, and will seek to sharpen the focus on measurable results, while simplifying delivery mechanisms for Bank support. The new CAS is likely to have a three-pronged approach. First, the largest share of support will be channeled through the budget as PRSCs in support of PRSP priorities. Second, greater use will be made of pooled SWAPs and harmonized procedures in priority sectors. Third, the Bank will support Government in scaling up CDD operations nation-wide. The proposed lending pipeline for the next four fiscal years (FY06-09) will likely consists of: (i) one PRSC per FY to ensure support to the Government and close alignment of Bank support with the Government's budget cycle. Programmatic DPL is expected to represent an increased share of the country's yearly IDA allocations; (ii) a scaling-up of CDD approach in the agriculture sector to further support the diversification of the economy, and greater use of pooled SWAP; (iii) large scale urban/infrastructure projects with CDD activities and SWAP mechanisms; (iv) a follow-up project in FY06 to the Power Sector Development Project approved in November 2004 to permit the medium-term expansion of rural electrification in the poorest provinces in Burkina Faso; and (v) support to the health sector with the second phase of the HIV/AIDS Disaster Response. This sector will also be supported by the PRSC program. Improvement in the CPIA rating for 2004 is expected and therefore average yearly lending volume is expected to be around $150-175 million in a base core scenario. The new approach will imply greater reliance on country systems for financial management, monitoring and evaluation -- making strengthening of national, sectoral and community capacity in these areas critical. Government has been keen to move to simplified financing of IDA operations, as demonstrated during the discussions on country financing parameters since last September.

6. Burkina has successfully implemented key reform in the areas of public expenditure management, including: (i) budget formulation, to ensure a close link between the budget and PRSP objectives. Significant progress was made in mastering the preparation of global MTEFs. Their full integration into the budget preparation cycle in 2002-03 led to increasing realism of revenue targets and improved the budget arbitration. Moreover, program budgets linking PRSP objectives with budget allocations were established in all key ministries; (ii) budget execution, to make service delivery more effective. In 1999-2000, Burkina Faso fully operationalized a computerized expenditure management system. The system captures all domestically financed expenditure at the different stages of the expenditure process and allows to closely monitor the execution of the budget and the level of payment obligations. To improve efficiency a new procurement code was adopted in May 2003, new procurement manuals and forms were drafted, and a capacity building plan was drawn up and is being implemented; and (iii) budget reporting and good governance, to ensure efficiency of spending and fight corruption. To strengthen external controls, an independent Supreme Audit Court was created and made fully operational in 2002. The government caught up with its legal obligation to submit budget execution reports to the audit court for the years 1996-2003. Moreover, the CFAA was finalized and its recommendations were integrated into the new budget management reform plan (*Plan d'action pour le renforcement de la gestion budgétaire* or PRGB) adopted in July 2002. A good governance plan was prepared and a High Authority for the Fight Against Corruption was created in 2002 and staffed in 2003.

7. As a result of the prudent fiscal policies, the Government has maintained the fiscal deficit at level that can be supported by resource inflows from abroad. The overall fiscal deficit –

including grants – was 2.9% of GDP in 2003. In addition to grants, net external assistance was 3.3% of the GDP in 2003. When they have occurred, revenue shortfalls have been compensated by appropriate cuts in non-priority expenditures. Allocations to the social sector have increased steadily since 2002 with an acceleration of spending financed with HIPC debt relief. Domestically-financed priority spending also increased from 4% in 2001 to 5% in 2003.

A. Cost Sharing

8. Current arrangements: The Bank has established a minimum Borrower cost sharing of 10%. Actual decisions regarding the financing percentage are made on a case-by-case basis during project preparation. For instance, in the case of the ongoing CDD project, Bank has set a 20% contribution in cash and kind from beneficiary communities.

9. Government's ownership and commitment to its development program is strong. The political leadership in Burkina Faso has shown a firm commitment to a vision for poverty reduction, macroeconomic reforms and a strategic development plan that addresses poverty. It has also empowered other leaders and institutions within the government to design and deliver on strategies for poverty eradication[4]. Burkina Faso was among the first countries to present a full PRSP in 2000. The public debate on poverty studies leading to PRSP was recognized as "best practice" in using participatory dialogue to reach consensus among the different actors[5]. Progress in implementing the PRSP has been satisfactory as laid out in three PRSP progress reports to date[6] [7] [8].

10. The Government has revised its 2000 PRSP. The PRSP revision, based on a participatory process, includes the development of regional poverty reduction strategies and emphasizes selectivity through the development of a Priority Action Plan. However, domestic resources are limited and the Government has not been able to match a strong ownership with financial contribution. Donors finance 75% of investment and 50% of all public expenditure[9]. Government's difficulty in mobilizing counterpart funds has been a major impediment to project implementation. Bank-financed projects are well aligned with the country's PRSP, especially those projects approved after FY00 and Bank financing is integrated into the national Budget.

11. Conclusion and recommendation: In view of Burkina Faso's strong commitment to poverty alleviation, and the limited domestic resources, the Bank may finance, on a selective basis, up to 100% of project costs. Allocations of the Bank's overall financing envelope to projects will be determined by: (i) the availability of the IDA financing envelope; and (ii) the prioritization outlined in the revised PRSP and the new CAS. In evaluating cost-sharing during project preparation stage, contributions from other sources than Government (notably community contribution to local development programs) and potential co-financing by other donors will be taken into account. In such cases, Borrower's contribution will be encouraged. Cost sharing will

[4] OED (2003), CDF Evaluation Working Paper: Burkina Faso Case Study.
[5] OED (2000), Burkina Faso – Country Assistance Evaluation, Report No 20704-BUR.
[6] World Bank (2001), Burkina Faso: PRSP Implementation progress report, Report No 23190-BUR, Washington D.C.
[7] World Bank (2002), Burkina Faso: PRSP Annual progress report, Report No 24809-BUR, Washington D.C.
[8] World Bank (2004), Burkina Faso: Poverty Reduction Strategy Paper Annual Progress Report and Joint IDA-IMF Staff Assessment of the PRSP PR, Report No.27655-BUR, Washington D.C.
[9] World Bank (2004), Burkina Faso: The Budget as Centerpiece of PRSP Implementation, Public Expenditure Review, Report No. 29154-BUR, Washington, D.C.

likely be the rule for projects with contributions from other sources than Government, co-financing by other donors, and with revenue generating and SWAP mechanisms. It should be noted that, as the Bank portfolio in Burkina will shift increasingly towards CDD and SWAP approaches, the overall IDA financing will become a smaller part of a program's total costs. For operations supporting regional HIV/AIDS programs and reform efforts, 100% of the project costs may be envisaged.

B. Recurrent Cost Financing

12. Current Arrangements: Bank has been financing fairly significant share of recurrent project costs in Burkina, notably capacity building programs, maintenance costs in infrastructure programs, and operating costs of Project Implementation Units (salaries and materials).

13. Burkina Faso's financial situation is fragile. Burkina Faso reached the completion point under the enhanced HIPC initiative in April 2002. At that date, Burkina also received a topping–up of debt relief to bring the NPV of debt-to-export ratio to 150%. Most recent Debt Sustainability Analysis[10] indicate that the combined effect of discount rates, exchange rates, disbursement profile and export performance, will improve the outlook for debt sustainability. Overall, NPV of debt-to-exports ratio would decrease to less than 150% by 2012, earlier than anticipated at completion point.

14. While the fiscal situation is fragile, the government of Burkina is implementing a comprehensive reform program articulated in the PRGB (*Programme de Réforme de la Gestion Budgétaire*). The PRGB is underpinned by a strong body of analytical work, including CFAA, PER, CPAR, and an HIPC Expenditure Accountability Assessment and Action Plan jointly undertaken by the Bank and IMF. Performance under PRGB is a key element of the donors' harmonization framework for budget support. Burkina has a solid track record of prudent fiscal policy as evidenced by a successful implementation of an IMF program since 1994. In fact, actual and projected new disbursements in 2002-2006 are lower than anticipated at completion point. Budget preparation takes into account the recurrent cost implications of new capital spending, and of new recurrent cost spending on social sectors in the country's fiscal and debt analysis and target. Overall fiscal and debt situation is being monitored during the semi-annual review of the PRGF-supported program when a DSA is carried out. All Bank financing are integrated into the government's finances, and therefore taken into consideration in fiscal and debt analysis and targets.

15. Burkina Faso will remain dependent for the medium term with regard to financing costs. The future recurrent expenditures impact of foreign-financed capital investment is substantial and beyond the capacity of Government to finance them out of its own resources. Assuming a R-coefficient of 0.035[11], the annual incremental impact is about CFAF 6 billion, equivalent of 0.23% of GDP. Given the greater emphasis on social sectors in the PRSP and MDGs context, an even higher impact is expected as these sectors require relatively significant recurrent inputs than infrastructure projects. Availability of grants or highly concessional loans – including recurrent costs – will be critical for the Burkinabé authorities to reach their development objectives.

[10] IMF (2004). Burkina Faso – First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion. EBS/04/34.

[11] Ron Hood, David Husband, and Fei Yu (2002) – Recurrent Expenditure Requirements of Capital Projects: Estimation for Budget Purposes. World Bank Working Paper Series No 2938.

16. In the next CAS under preparation, the Bank may adopt SWAP approach[12] in providing project support. The basis for Bank financing of SWAPs will be a satisfactory sector sustainability framework including relevant sector financing and institutional aspects, and therefore financing of recurrent costs will not likely be an issue. In addition, there is evidence that the emphasis on capital expenditures in development assistance may not be quite valid[13]. Using data from 43 developing countries over 20 years, Devarajan, Swaroop and Zu show that an increase in the share of current expenditure has positive and statistically significant growth effects. By contrast, the relationship between the capital component of public expenditure and per capita growth is negative. They concluded that developing-country governments have been misallocating public expenditures in favor of capital expenditures at the expense of current expenditures. Their conclusions clearly fit Burkina's circumstances. Lastly, Burkina's track record on sustainability of previous projects is good. Of the projects evaluated in FY00-03 —the sustainability of 82% of them was rated as likely. In addition, there are evidence that the emphasis on capital expenditures in development assistance may not be quite valid[14.]

17. Conclusion/recommendation: No country-level limit is proposed on recurrent cost financing. However, given the country's fragile public finances, the Bank will continue to monitor the aggregate fiscal and debt situation, and its implications for recurrent cost financing. The Bank may finance recurrent costs as needed in individual projects. In all cases, recurrent cost financing will be applied after consideration of sector and project sustainability issues including: (i) institutional arrangements to allow for greater emphasis on sustainability through result-based M&E systems, and strengthening of capacity at national and local level; and (ii) implied future budget outlays.

C. Local Cost Financing

18. Current arrangements: In Burkina Faso, the Bank has typically supported 100% of foreign expenditures while it has financed local expenditures at 79% during FY99-03. The Standard Disbursement Percentage (SDP) for consultant services is 100% for foreign individual consultants and 80% for local individual consultants, and local and foreign consultant firms. A major proportion of Bank disbursements have been for local costs: these accounted for 74%, 87%, 72% and 83% of Bank disbursements in investment projects in FY01, FY02, FY03 and FY04 respectively.

19. According to IMF estimates[15,] total external financing requirement for Burkina Faso's development program is about US$1.8 billion[16] over the period 2004-2006. After accounting for anticipated grants (US$1 billion), loans (US$0.3 billion), and HIPC debt relief (US$0.2 billion), there would still be a financing gap of US$0.3 billion that would need to be met with additional external borrowing and/or external grants. While desirable, a significant increase in domestic resources mobilization is not realistic in the short to medium term. A large informal sector and weak capacity in the financial administrations are key impediments to tax collection in Burkina. Membership in the West African Economic and Monetary Union (WAEMU)[17] and

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[12] Provided a good implementation of the latest CFAA and CPAR for Burkina Faso.

[13] Shantayanan Devarajan, Vinaya Swaroop, and Heng-Fu Zou (1997) – The composition of Public Expenditures and Economic Growth. Journal of Monetary Economics 37 (2, April): 313–44, 1996.

[14] Shantayanan Devarajan, Vinaya Swaroop, and Heng-Fu Zou (1997) – The composition of Public Expenditures and Economic Growth. Journal of Monetary Economics 37 (2, April): 313–44, 1996.

[15] IMF (2004) Burkina Faso – First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria. EBS/04/34.

[16] Using an exchange rate of CFAF550 for US$1.

[17] Banking financing is being phased out in WAEMU from its initial ceiling of 20% of tax revenue.

underdeveloped private capital markets limit the extent to which the Government can have recourse to domestic borrowing.

20. For projects in the current portfolio or in the pipeline, Bank's financing of foreign expenditures alone would not be sufficient to help these projects meet their development objectives. This is obvious for the Community Driven Development (CDD) projects which entail a high share of local costs at the community level. It is worth mentioning that CDD will be scaled-up in the next CAS, in parallel with larger share for PRSC and the adoption of SWAP in sectoral investment. In addition, there are specific skills, local knowledge and capacity that are critical to project development objectives, and which are not available in external markets.

21. Conclusion/recommendation: Burkina Faso meets the two criteria for Bank financing of local expenditures. Therefore, the Bank may finance local costs in any proportion needed in individual projects.

D. Taxes and Duties

22. Current arrangements: Financing of taxes and duties are prohibited.

23. Taxes in Burkina cannot be considered excessive. Since 2000, Burkina Faso has been applying the WAEMU common external tariff. The average customs duty under the CET is 12% while the highest customs duty rate is 20%. The index of trade policy restrictiveness compiled by Fund Staff is estimated at 5 on a scale of 1 to 10, with 1 indicating complete openness and 10 indicating complete restrictiveness[18]. A Value Added Tax was introduced in 2001 at a single rate of 18% Corporate income taxes range from 10 to 35%. Burkina has a set of income taxes on individuals based on the source of the income. The rates for the single progressive tax on wages and salaries range from 2 to 30%. Noncommercial profits taxes range from 10 to 35%. Tax on real estate capital gains is 15% of the capital gain and taxes on rental income range from 0 to 25%. There are no discriminatory taxes for Bank-financed projects/activities.

24. Conclusion/recommendation: There are no taxes and import duties that are unreasonable or discriminatory. Therefore, the Bank may finance all taxes and duties associated with project expenditures. At the project-level, the Bank would consider whether financing taxes and duties constitute an excessively high share of project costs.

[18] IMF (2004). Ibid.