1999 Country Assistance Strategy
Background Note

BURKINA'S REFORM EXPERIENCE

A Contribution to the Economic Development Strategy

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January 4, 1999

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INTRODUCTION

1. *Facts*. Burkina Faso has achieved a per capita real income growth of 1.6 % per year over the past seven years--since the first ESAF program was adopted. At its current pace, it would take 44 years to double the country's real per capita income of $145 in 1997 (using 1985 as a base year). With 45% of its 11 million inhabitants living under the poverty line (defined by the INSD as a yearly income of CFA 45,000, that is, US$ 89), it will take even more time to reduce poverty defined in material terms. At this rate and with life expectancy at 50, a 25-year-old student at the University of Ouagadougou could not expect per capita doubling during his lifetime. Two puzzling observations stand out in the data: (i) real per capita income in Burkina today is less than half its level twenty years ago ($302); (ii) resource booms and cycles in commodity prices only account for some, but not all, of these ups and downs. Shifts in macroeconomic policies also explain the country's performance.

2. *Purpose of the Study*. 1998-99 constitutes the third and last annual arrangement of the second three-year ESAF program in Burkina. In February 1999, a joint Bank-IMF mid-term review mission will travel to Ouagadougou to assess the current ESAF program and, hopefully, lay the ground of the course of action for the next few years. In parallel, the Bank is starting up the CAS discussion for a medium-term support to Burkina. These two events provide the opportunity to discuss the outcomes of stabilization and to analyze its effects on structural reforms and long-term economic growth.

3. The main challenge in policy design today is to enhance prospects for growth and development, rebuild the government capacity to operate effectively and efficiently, and forge an environment where the private sector can create opportunities and make the most of the country's natural geographic disadvantages. An important conclusion from this study is that trade policy can be an important factor to development. High levels of trade restrictions have been a major obstacle to exports, and their reduction is expected to stimulate foreign trade. The removal of export restrictions, dismantling of marketing boards, relaxation of quantitative restrictions on imports, and lowering of import tariffs will increase both traditional and non-traditional exports. But an open trade regime will not set the economy on a high and sustainable path on its own. Indeed, an increase in the share of national income that is exported will not, in itself, generate an increase in real GDP per capita. While trade restrictions are impediments to growth, the main fundamentals for long-term growth are macroeconomic stability, human resources, physical infrastructures, institutions, and the rule of law. Burkina would gain a lot by investing in those areas.

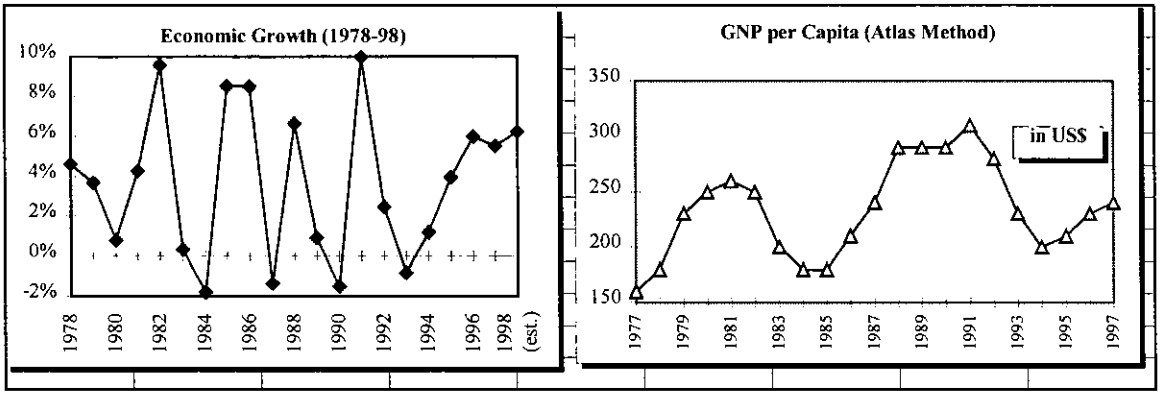
4. *Contents of the Paper*. The outline of the study is as follows. I begin by reviewing Burkina's growth experience in a historical perspective (Part I). Then I take a more detailed look at the outcomes of stabilization and structural adjustment policies implemented in Burkina since 1991 under Bank- and Fund-supported programs (Part II). Finally, I suggest some ideas for improving the macroeconomic framework (Part III).

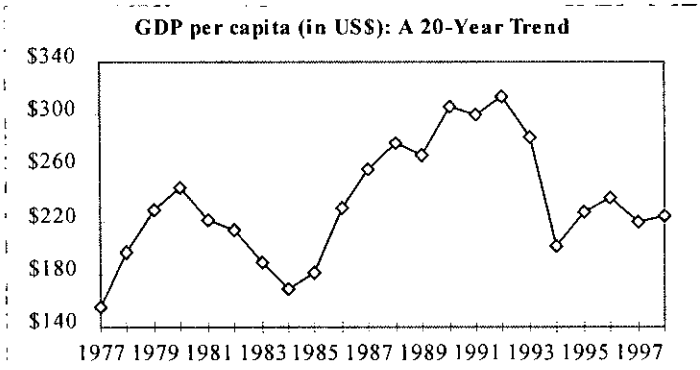
I-) ECONOMIC GROWTH IN A HISTORICAL PERSPECTIVE

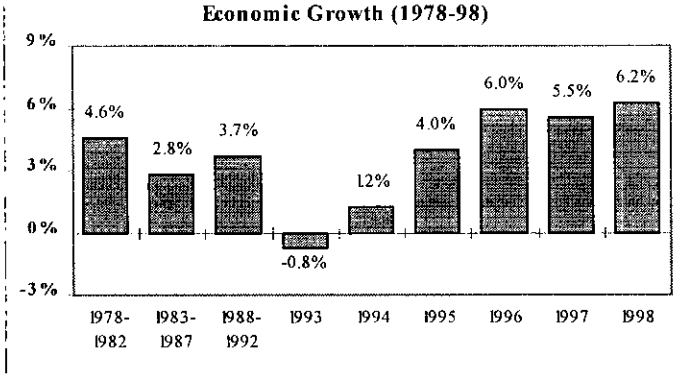
5. ***Approaches, Caveats, and Assumptions.*** In assessing the scope and nature of Burkina Faso's economic performance, one can conduct causal analyses at two levels. The first level is an investigation of ultimate causality that involves consideration of institutions; ideologies, pressure of socio-economic groups like trade unions, historical accidents, and economic policy at the national level. It would also involve consideration of the international economic factors, exogenous ideas, and positive and negative shocks. Indeed, such ultimate features are virtually impossible to quantify and thus, are legitimate scope for discussion and disagreement—especially among historians, political scientists, and sociologists. The second level of causal analysis is the proximate level where the relative importance of different influences can be more readily assessed. Here, one can use economic and statistical tools to understand growth of output, output per capita, or productivity by measuring inputs of labor and capital, availability of natural resources, factors affecting the efficiency with which resources are combined, and benefits derived from transactions with foreign countries. A crucial part of this approach is analysis of the role of technical progress, which interacts in many ways with other items, included in the growth accounts.

A-) Long-Run Economic Growth Performance

6. Burkina's growth record over the past thirty years has been uneven. After growing rapidly during the 1960s and 1970s, output declined during the first half of the 1980s and generally fell short of population growth rates. Economic growth has picked up since 1994 and was estimated at about 5.5% in 1997.







Box 1: Perceptions of Poverty in Burkina

According to a study by Walker and Ouedraogo (1994), the Burkinabé tend to associate poverty with the following characteristics: (i) the inability to help neighbors because of lack of savings or of food reserves; (ii) the lack of cattle, of decent clothes, and of food; and (iii), having too small an agricultural plot, without fruit trees. Falling into poverty often is described as resulting from old age, from the absence of support from the family, from becoming a widow, or from having some education but no job.

Poor people are always depicted as being marginalized; the poor person is not a full member of the village, he or she is not invited to celebrations and has no say in collective decision making. Migrant workers' remittances appear to be a crucial element of the Burkinabè individual household budget. Migrants who send money to their relatives are a powerful support, especially to the elderly.

People's perception of the benefits of education are mixed. While literacy and practical knowledge of basic nutritional or agricultural principles are seen as useful, there is a strong perception that formal education tends to drive young males away from agriculture to cities, where no job is available. Educated girls are seen as having difficulties finding a husband and, therefore, mothers are reluctant to send their daughters to school. Educated girls, in their view, are unwilling to do housekeeping, will not be regarded as desirable spouses, and want to marry educated boys, who face high risks of not finding jobs in the city. Girls emigrating to cities are in many cases seen as candidates for prostitution.

Income Distribution by Residence

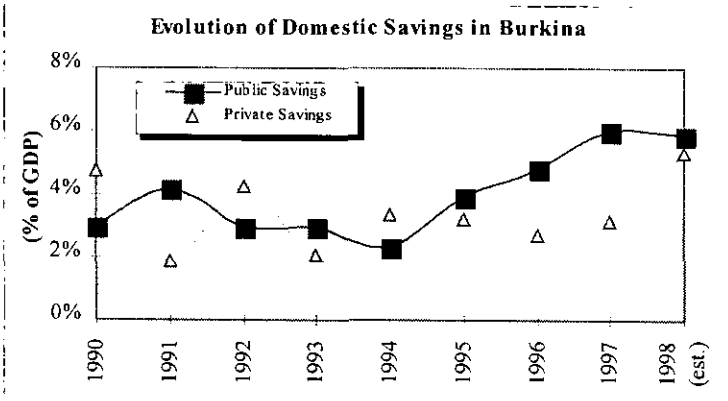
Maximum annual expenditure per head (in CFA francs)

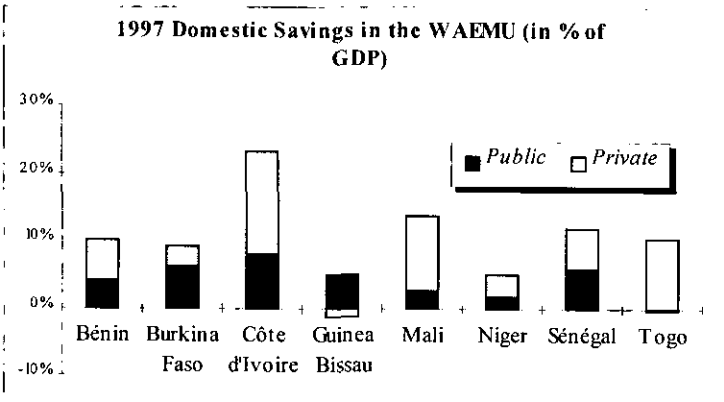
Share of Total Population (in percent)	Rural Households (84 %)	Urban Households (16 %)	Total (100 %)
20 percent spend at most:	26,400	56,300	27,600
40 percent spend at most:	35,200	91,200	38,500
80 percent spend at most:	72,600	222,500	92,300
Average expenditures	55,600	161,800	72,800

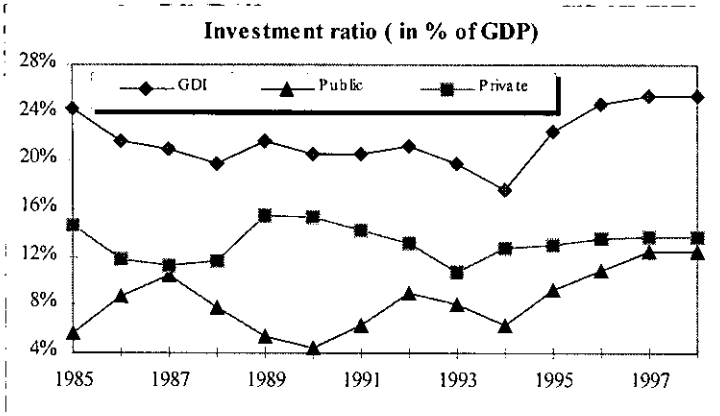
Source: INSD

B-) The Savings-Investment Picture

7. Sustaining high growth rates over the medium-term with the aim of alleviating poverty, improving living standards, and creating employment opportunities for the rapidly growing labor force are the main objectives of the authorities. The key to meeting that challenge is to maintain a high investment level to improve its composition and efficiency, and to ensure that it is financed in a sustainable manner. To this end, this section analyzes the linkages between growth, investment, and savings.







C-) Empirical Estimates of the Determinants of Growth

8. What can we learn about Burkina's growth record from empirical studies of the determinants of long-term growth? Three questions are addressed in this section: (i) we conduct a growth accounting exercise, using data averaged over the period 1967-97; (ii) we discuss whether Burkina's policy environment has been conducive to growth and investment, using cross-country estimates of correlation between macroeconomic and structural conditions on the one hand, and growth, investment, and productivity on the other hand; (iii) we examine the behavior of growth during Burkina's adjustment phase (1991-1997) after controlling for the long-run determinants of growth identified earlier.

9. ***(i) Insights from a Growth Accounting Exercise.*** This section sets forth the background for analyzing the relation between structural economic evolution and the growth of per capita income. Neoclassical economics usually postulates that GDP rises as the result of the long-term effects of labor force expansion, capital formation, and technical progress, which are assumed to take place under conditions of competitive equilibrium. The significance of changes in factor supplies and productivity is certainly an important aspect of the study; however, changes in demand and trade are equally important to sustained economic growth. Because economic growth is one aspect of the transformation of the structure of production over the past three decades, we adopt here a broader view. In the case of Burkina Faso, given the imperfect foresight and the numerous limits to factor mobility, structural changes are more likely to occur under conditions of disequilibrium. Thus, a shift of labor or capital from less productive to more productive sectors will yield higher economic growth rates.

10. (a) Supply Factors. Using the production function, we can examine the links between labor, investment, technical efficiency, and growth. An important question about the nature of growth in Burkina is whether the process is mainly extensive--that is, the economy grows because it uses new technologies and becomes more efficient, creating more output per unit of inputs-- or extensive-- meaning that the economy grows simply because it uses more resources as inputs. Every study of growth and productivity necessarily makes some assumptions about economic structure and relationships among a set of economic variables. But the building blocks of the exercise are always the same: it

starts with estimates of the growth rates of output, capital, and labor over a certain period of time; then factor shares are estimated; and the various sources of growth between the contribution of accumulation in the quantity of factors and the efficiency or intensity with which these factors are used can then be calculated.

Box 2: Using the Growth Accounting Framework

Despite its rigidities, the Cobb-Douglas production function is always a good starting point for a growth accounting exercise. It is defined as:

$$Y_t = A_t \; K_t^{\alpha} L_t^{1-\alpha} \qquad (1)$$

where Y is the amount of output, A, is a technological constant, K is the amount of capital used as input, L is the amount of labor used as input, t is a time subscript, and α is a parameter whose value is between 0 and 1. This production function, with a value of α of about 0.3 is often used to approximate the production possibilities of the economy (and the value of $1-\alpha$ to be 0.7). Dividing equation (1) by the population size, we get

$$y_t = A_t \; k_t^{\alpha} l_t^{1-\alpha} \qquad (2)$$

where y is the output per person, k is the capital per person, and l represents effective labor supply per person. From this static equation, which represents the amount of output, as a function of inputs, in any specific period t, we can derive a dynamic version that describes how output per person increases overtime:

$$\Delta y/y = (1-\alpha) \times \Delta l/l + \alpha \times \Delta k/k + \Delta A/A \qquad (3)$$

That is, Output growth = [labor share × labor growth] + [capital share × capital growth] × technical progress. We can then use equation (3) to analyze the determinants of growth. Decomposing the growth rate of output per person into those three elements has a very important empirical application: having a good sense of the magnitude of the parameter α, it is easy to measure the growth rate of output per person; it is also possible to measure the growth rates of capital per person and of effective labor supply per person; therefore, one can estimate the growth rate of technical progress or total factor productivity, and what proportion of output growth per person is accounted for by this technological progress. Obviously, factor shares vary by type of activity and over time. And a sensitivity analysis with respect to the values of the factor shares would help refine the results of the exercise. But since Burkina is not a fast-growing economy, it is unlikely that the magnitude of these shares would play a crucial role in the final results.

11. Studies that have been carried out for Burkina seem to point to the same conclusion: they all find that growth in physical capital has contributed strongly to output growth, and that the impact of human capital accumulation has not been important; they also conclude that the contribution of technical efficiency or technological progress (total factor productivity, TFP) was absolutely insignificant, if not negative.

Growth and Productivity

	1960-1973			1973-1980			1980-1988		
	Average growth rate	Average GDP per capita	Average GDP per worker	Average growth rate	Average GDP per capita	Average GDP per worker	Average growth rate	Average GDP per capita	Average GDP per worker
Mali	0.3	-2.1	-3.1	5.3	3.1	3.5	1.5	-0.9	-1.0
Burkina Faso	n.a.	n.a.	n.a.	4.4	2.1	2.6	5.2	2.5	3.2
Ivory Coast	7.7	3.7	4.7	5.7	1.4	3	0.0	-4.0	-2.6
Senegal	2.2	-0.2	-0.6	3.9	1.1	0.6	2.0	-0.8	0.1

Source: R. Summers and A. Heston (1991), *Penn Tables*.

12. A recent study by Emilio Sacerdoti et al. shows that despite its rather poor long-run performance, Burkina has done much better than many WAEMU contries:

Determinants of per capita income growth, 1970-96 (%)

			Contribution to the growth of GDP per worker				
	GDP per worker (actual)	GDP per worker (estimated)	Capital stock per worker	Terms of trade	Export growth	Budget deficit	TFP
Burkina Faso	1.4	1.43	1.42	0.08	0.14	-0.03	-0.18
Mali	1.07	0.98	1.46	-0.05	0.19	-0.01	-0.61
Ivory Coast	0.15	0.0	0.32	0.09	0.09	0.0	-0.51
Senegal	0.13	-0.03	0.39	-0.03	0.07	0.0	-0.46
Niger	-1.75	-1.99	-0.03	0.01	0.01	0.01	-1.99

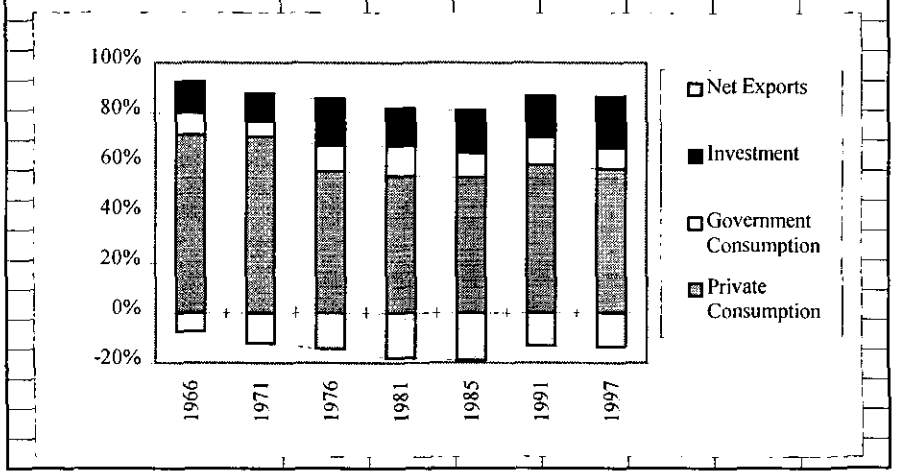
Source: IMF, 1998

13. The assumption behind such estimates is the efficient allocation of resources over time from the point of view of both the producers and consumers (Pareto optimality). That is to say that at any given moment it is impossible to increase aggregate output by shifting labor and capital from one sector to another because they have the same marginal return. Thus, reallocation takes place only as the economy expands. In contrast, a structural approach would assume that there might be systematic variations in the returns to labor and capital in different uses. How useful is the neoclassical methodology as applied to Burkina Faso? Which departures from the general equilibrium framework appear to be most significant? A more explicit analysis of the changing composition of demand and trade would be needed to fully answer those questions. It is beyond this analysis.

14. (b) Evolution of Demand. Let's consider a simple decomposition of the uses of GDP. The following table provides a thirty-year trend in the structure of demand.

Structure of GDP (in billions of CFA)

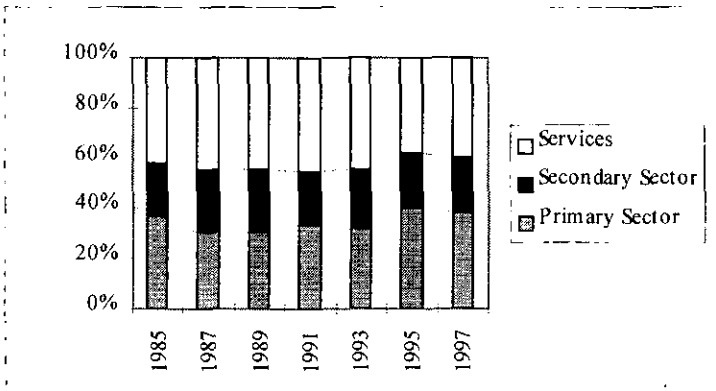
	1966	1971	1976	1981	1985	1991	1997
Private Consumption	48.9	94.6	118.9	278.7	411.9	663	1013.7
Investment	8.5	14.9	39.4	77.1	129	185.5	362.9
Government Consumption	6	8.5	21.2	60.9	72.6	122	143.8
Net Exports	-5.2	-16.4	-30.1	-92.5	-144.2	-148	-235.5
Gross Domestic product	58.2	101.6	149.4	324.2	469.3	822.5	1284.9



15. (ii) *Structural Changes over the Period 1985-97*[1]

Sources of Value-Added in Burkina (billions of CFA)

	1985	1987	1989	1991	1993	1995	1997
Primary Sector	236474	198193	230576	263163	261920	409929	468493
Secondary Sector	137139	161698	185313	167250	191457	223777	253886
Services	270538	290459	334527	352119	361834	388303	475866



[1] For a detailed decomposition of sectoral changes over the past decade, see the tables prepared by Y. Goetze for the CAS retreat.

II-) 1991-98: WHAT HAS BEEN ACHIEVED?
Assessing Stabilization and Structural Adjustment in Burkina Faso

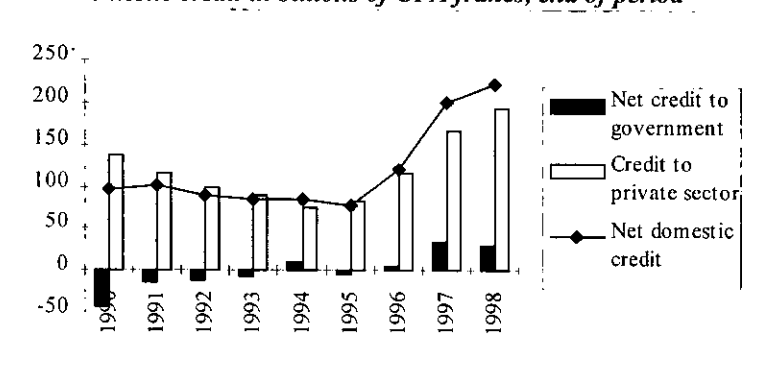
16. The usual criticism made by academic researchers and NGOs against Fund- and Bank- supported programs in Burkina and elsewhere is that rather than fostering growth, they tend to cause a slowdown in economic activity, increased unemployment, and a general worsening of living standards. The evidence used in this note is mostly indirect, since the studies from which it is obtained were not carried out with the express intention of assessing the results of the two three-year ESAF programs. Therefore, the conclusions drawn from the empirical evidence used here cannot provide definitive answers to the questions raised by stabilization and structural adjustment programs in Burkina.

17. A complete empirical analysis of the effects of stabilization and adjustment policies in Burkina would have to consider the following issues: (i) What are the immediate effects of these programs on economic growth?; (ii) Are these effects directly related to the implementation of these policies?; (iii) What would be a counterfactual scenario, that is, what would have happened in the absence of stabilization and structural adjustment policies?; (iv) How to take into consideration time lag issues and what are the effects of these policies in the long run? Unfortunately, empirical evidence is available only for the first of these questions. One can certainly use time-series data and statistical analysis techniques to determine the effects of specific policies. In this study, I simply adopt a "before-and-after" method, comparing the policy objectives to their outcomes.

18. ***A-) Outcomes of the Policies to Restrain Demand.*** The two main instruments used over the years for controlling aggregate demand are domestic credit policy and fiscal policy (tax and expenditures).

19. (i) Domestic credit. The relationship between domestic credit expansion and economic growth is important in assessing the impact of stabilization programs. The monetary approach to the balance of payments on which ESAF programs are designed suggests that in a small open economy operating under fixed exchange rate regime, a reduction in domestic credit will be completely offset in the long run by international reserve flows that restore the money stock to the level compatible with money demand. Consequently, a restrictive monetary policy would not have any long-run effect on the level of output relative to its normal trend. Yet, in the case of Burkina--which still cannot be considered an open economy in the traditional sense-- it appears, however, that during the first five years of the adjustment process, a decline in the growth of net domestic credit may have been associated with a reduction in capacity utilization and a rise in unemployment, since prices are not fully flexible downward. Since the adoption of the first ESAF program in 1991, net domestic credit decreased from CFA 105.3 billion to 77.1 billion in December 1995, before increasing by 190% over a three-year period (1995-1998).

Domestic credit in billions of CFA francs, end of period



20. The estimated size and duration of the deflationary effect that might have been created by the very restrictive monetary policy of the period 1990-95 depends on several factors, including the speed with which the initial credit restriction was offset by international reserve movement, the effect on private investment of the reduction in the availability of credit, the evolution of price levels in response to the excess demand for real money balances created by the credit restraint policy, etc. These factors interact in complex ways. The net outcome is an empirical question.

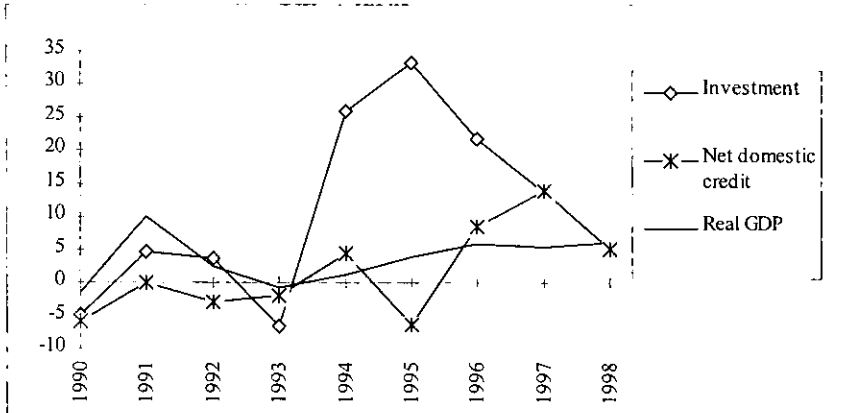
Credit and growth, annual percentage change

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Net domestic credit	-5.8	0.0	-3	-1.9	4.5	-6.3	8.5	14.0	5.1
Credit to the private sector	-2.0	-14.9	-9.6	-5.6	-8.3	3.4	11.0	6.2	7.1
Net credit to Government	-5.4	25.0	1.2	2.7	8.5	-6.2	3.8	9.5	-1.1
Investment	-4.9	4.6	3.8	-6.5	25.9	33.2	21.8	13.7	
Real GDP	-1.5	10.0	2.5	-0.8	1.2	4.0	6.0	5.5	6.2

21. Simply looking at the data without carrying out a sophisticated statistical analysis for causation, it is more than likely that the monetary contraction did indeed exert a deflationary effect on domestic output in the early nineties, although the effect is difficult to quantify. Because monetary policy affects growth mainly through its impact on investment, further indirect empirical evidence on the effect of changes in domestic credit on output should be deduced from an analysis of investment behavior. A major problem, however, is the lack of transparency in investment data, which certainly includes large sums of current expenditures generated by investment projects.

Credit and growth, annual percentage change

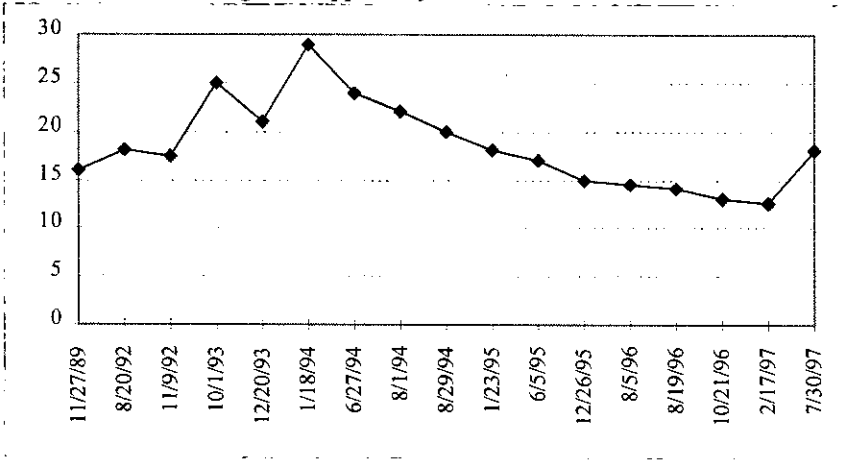
	1990	1991	1992	1993	1994	1995	1996	1997	1998
Net domestic credit	-5.8	0.0	-3	-1.9	4.5	-6.3	8.5	14.0	5.1
Credit to the private sector	-2.0	-14.9	-9.6	-5.6	-8.3	3.4	11.0	6.2	7.1
Net credit to Government	-5.4	25.0	1.2	2.7	8.5	-6.2	3.8	9.5	-1.1
Investment	-4.9	4.6	3.8	-6.5	25.9	33.2	21.8	13.7	
Real GDP	-1.5	10.0	2.5	-0.8	1.2	4.0	6.0	5.5	6.2



22.

23. Clearly, investments picked up after the 1994 devaluation in parallel with decreasing maximum lending rates on commercial banks credit. Yet, the larger share was financed by the Government, and many investment projects with low rates of return have received priority over other higher-yielding investments. Constraints on investments in Burkina include the availability of financial resources and their cost. When adjusted for risk, the rates of return on most capital investment operations are usually lower than real interest rates on loanable funds, which are *de facto* regulated by the limited number of modern financial institutions. Moreover, in spite of the 1994 restructuring operation, commercial banks still face the dilemma of having to fund medium- and long-term investment projects with their short-term resources. The Abidjan Regional stock exchange is supposed to offer new financial instruments for all West-African economies. Yet, because of its low start, there is still a chronic excess demand for capital in countries like Burkina, in spite of the existence of a rather liquid banking system.

Maximum lending rates applied by commercial banks--Credit to SME



24. Fiscal Policy. Evidence on the relationship between changes in government spending or tax policy and economic growth in Burkina is quite weak, especially when compared with evidence on the links between output and domestic credit discussed above. In theory, one would expect an active fiscal policy (tax reduction or increase in public spending) to have a multiplier effect on the level of real income, at least in the

short run. Most studies found the effect to be statistically insignificant in Burkina. Indeed, the effects of government deficits on growth are difficult to measure here because of the linkage between fiscal policy and monetary policy, which is very tight in CFA countries. Changes in the money supply are, by definition, changes in credit to the government, changes to the private sector, and variations in international reserves. Because the financial market in Burkina is underdeveloped, the government relies heavily on bank credit for its financing needs, which explains the close link between the fiscal deficit and changes in the supply of domestic credit. In fact, the close linkage between the government deficit and the evolution of money supply is important in understanding the limitations on the use of monetary and fiscal policies as independent instruments in a country like Burkina.

25. If one only takes snap shots of the fiscal deficit situation in 1990 and 1998, the positive outcomes of the various stabilization programs are not quite obvious:

Public Finance Indicators, 1990-98

In percent of GDP	1990	1991	1992	1993	1994	1995	1996	1997	1998
Overall fiscal balance*	-7.3	-8.2	-9.1	-10.4	-11.0	-9.3	-8.9	-9.8	-11.0
Primary balance**		1.9	-0.3	-1.5	-0.9	1.1	1.7	1.2	-0.8
Current account balance	-9.4	-11.3	-8.9	-9.7	-8.7	-11.3	-13.4	-12.6	-11.0

(*) Commitment basis, excluding grants; (**) idem, also excluding foreign-financed investments

26. One also needs to consider the fact that fiscal policy can influence output through the effects of public sector investment on private investment. The relationship between public and private investment takes on a greater importance in Burkina because of the larger role played by the government in the overall process of capital formation. Since the Burkinabé authorities have not recently carried out an in-depth analysis of their public investment program (PIP), there is some uncertainty as to whether public sector investment has raised or lowered private investment over the past ten years, all things considered. One can only assume that in broad terms, public sector investment has not caused much of a crowding out because of its sources of financing: neither through taxes (domestically-financed investments represent less than 20% of the PIP), nor through issuance of debt instruments, nor through inflation; but mostly through grants and borrowing on concessional terms. Yet, it does not appear that public investment really enhanced the possibilities for private sector investment, or raised the productivity of capital, or stimulated private output by increasing the demand for inputs and ancillary services--a study of these various effects is probably needed for more conclusive results.

27. ***B-) Outcomes of Policies to Stimulate Supply***. One can regroup supply-side policies into two broad categories: policies to improve resource allocation and policies to increase the level or rate of growth of capacity output in the economy.

28. (i) Assessing improvements in resource allocation mechanisms.

29. What is the outcome of the various measures in Bank programs that were devoted to improving resource allocation through the elimination of distortions in Burkina? Here

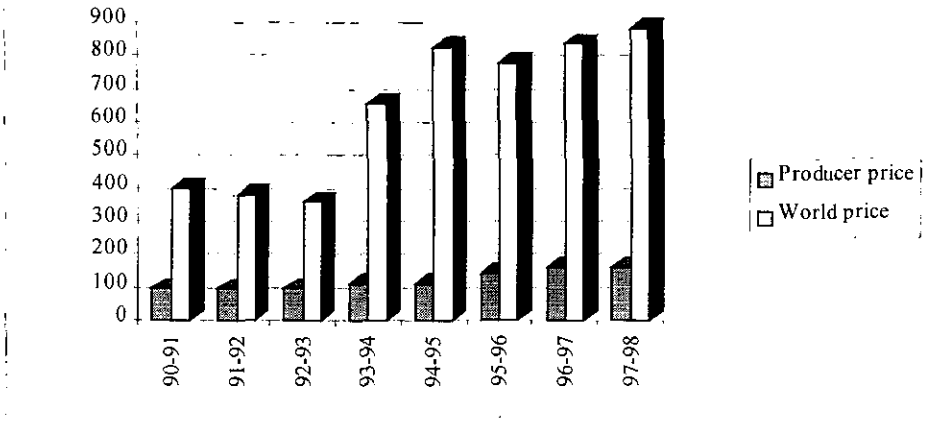
again, empirical evidence seems to suggest that the results are mixed. While progress was made in liberalizing the economy, it seems that we overlooked the fact that attempts to remove distortions very often caused unemployment and even reduced welfare, at least in the initial phase--that is what happened in the case of Burkina. Furthermore, because the country had a large number of distortions, the elimination of only some of them did not necessarily result in the desired gain of efficiency.

30. When the first Bank program started eight years ago, there were three main sources of distortions in the Burkinabé economy: (a) trade-related distortions, which included various types of taxes, subsidies, tariffs, quotas, and non-tariff barriers; (b) distortions in agricultural pricing policies; (c) public sector pricing and other forms of imperfect competition. Let's briefly consider each of them in turn.

31. **Trade-related distortions**. Substantial trade and price liberalization began in 1993 with the consolidation of tariff rates into three categories (11, 14 and 37%). Regulations on profit margins for imported goods were removed. Burkina is part of the new common external tariff (CET) of the WAEMU, which is gradually being implemented since July 1998. The new customs tariff that will be in force on January 1, 2000, provides for a simplified tariff structure of four rates (0, 5, 10, and 20 %), plus a statistical tax of 1%. However, recent discussions about complementary measures to the common external tariff and the WAEMU investment code seem to aim more at "correcting" the CET. An illustration of this trend is the decision at the December WAEMU meeting in Ouagadougou to accept pre-established lists of activities eligible to the *Taxe Dégressive de Protection* and the TCI. Another matter of concern is the rather confused debate about the provisions on customs duty in the investment code under consideration--which makes the idea of a maximum tariff in Burkina fuzzy, in any case well above 45% for many widely distributed products. Finally, there is still some important export restrictions on skins and hides.

32. **Agricultural pricing**. In Burkina as in many African primary-producing countries, it was observed that government policies caused prices of agricultural commodities--especially cotton-- to deviate from prices in competitive markets. Starting in 1993, the government eliminated public marketing and stabilization schemes on traditional cereals, oil seeds, and livestock. Price controls on locally produced goods were eliminated in 1993-1996 and remain in effect only for rice. However, the booming cotton sector remains a monopoly from product marketing to exports. The estimated price elasticity for cotton being about .50, there is reason to believe that a pricing policy to increase the return to producers would tend to stimulate output. (The question remains, however, whether higher levels of production would translate into higher incomes for farmers in the context of a depressed world market for cotton and a relatively weak dollar/CFA exchange rate).

Cotton prices in Burkina (in CFA francs)



33. **Public sector reform**. The first phase of the public enterprise reform was completed with the privatization or liquidation of 19 enterprises between 1991 and 1996 and the elimination of large budgetary subsidies. But the second phase launched in 1994 and concerning 20 entreprises is only slowly being implemented. Indeed, at this point, the macroeconomic outcome of privatization seems to be negligible. An illustration is the case of the sugar company SOSUCO: a year after its rather controversial privatization, the company has hired some new employees, which is an important socio-economic signal in the politically important Banfora region; but the price of sugar for consumers sugar remains well above CFAF 500 per kilogram, which makes some bank critics say that the operation merely replaced a public monopoly with a private monopoly.

34. Price controls are still in effect for generic drugs, petroleum products and utilities that are still entrusted to public monopolies. There are heavy inefficiencies related to energy pricing, which makes Burkina one of the most expensive countries in the WAEMU, as far as factor costs are concerned. According to a comparative study, Burkina was in 1996 the most expensive country in the WAEMU:

Some Key Competitiveness Indicators (in CFA francs)

	Construction cost for a square meter in the capital (land)	Construction cost for a square meter in the capital (office building)	Water (over 100 m3)	Electricity costs (KW/h, excl. VAT)	Telecommunication costs for a one-minute call in the WAEMU	Telecommunication costs for a three-minute long distance call	Transport costs (CFA per Km) Roads	Transport costs fret to the USA (CFA per Kg) Air	Transport costs Rail (CFA per Km)	Social Charges paid by firms (in % of salary)	Montly minimum wages
Benin	12,500	250,000	293	66	481	642	33.5	2,470	33.7	16.4-19.4	20,200
Burkina	**6,000**	**120,000**	**1,026**	**70**	**924**	**780**	**55**	**3,150**	**52.5**	**18.5**	**24,944**
Ivory Coast	3,000	330,000	396	65.93	580	535	31.2	2,350	26.6	9.9-12.9	36,607
Mali	3,000	125,000	315	82	716	705	33.6	3,095	28.9	17.4-20.4	20,965
Niger	5,000	175,000	386	70.71	600	529	42.4	3,170	26.6	15.4	18,989
Senegal	7,800	180,000	614	107.18	250	375	33.6	2,580	28.9	18.2-22.2	34,850
Togo	3,500	120,000	257	62.4	139	583	31.6	3,100	40	18.1	13,757

Source: Pigato et al. (1997)

35. The policy of subsidizing energy for urban social groups tends to slowdown the necessary shift to less energy-intensive production techniques and patterns of consumption. In the case of electricity for example, failure to set the domestic price at its international opportunity cost leads to important adverse effects on resource allocation.

36. By and large, Bank programs succeeded in pushing for some key reforms aiming at improving resource allocation mechanisms in Burkina. Yet, the net economic outcome of these reforms is difficult to measure. But clearly, there is still a lot of work ahead to eliminate distortions.

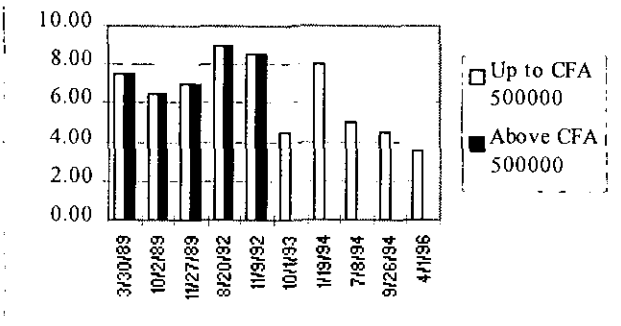
(ii) Assessing Policies to Increase Capacity Output.

37. Burkina's potential economic growth rate is a function, among other factors, of decisions about the proportion of current real output to be invested in productive capital rather than consumed, as well as the quality of the additional capital stock. That is why supply-side policies to increase savings and incentives for private capital formation, that are supposedly at the heart of Bank and Fund programs, should be assessed.

38. Interest rates to stimulate the expansion of savings. In ESAF programs implemented in Burkina, policies aiming at increasing savings have focused primarily on increasing the return on bank deposits. Under the assumption that financial savings are interest rate sensitive, interest rates on the larger fraction of small bank deposits (savings accounts up to CFA 500,000) were raised during the first stage of the program (1990-92) up to 9% before decreasing to 3.5% in 1996. Indeed, during the period 1990-98, average interest rates on those savings deposits were below the average inflation rate. The discrepancy can be explained by the 1994 devaluation; but the fact remains that in

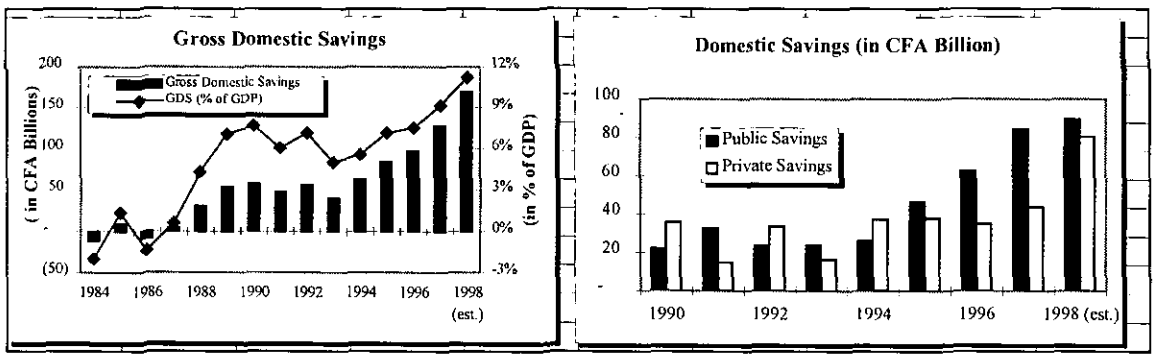
general, ceilings and other restrictions on nominal interest rates offered on savings deposits by the banking system have often led to extremely low or even negative real interest rates on financial savings. The BCEAO decided in 1993 to only liberalize interest rates on savings deposits above CFA 500,000.

Interest Rates Applied by Commercial Banks on Savings Deposits: A Ten-year Trend (%)



Source: BCEAO. N.B.: Above CFA 500,000, deposit rates on savings are no longer fixed by the BCEAO

39. There seems to be no correlation between the decreasing trend of interest rates and the evolution of domestic savings in Burkina Faso, at least over the last decade. As shown on the graphs below, domestic savings have increased over the past ten years (from 4.3% of GDP in 1988 to an estimated 11% in 1998). But their level is still extremely low, compared to international standards and to the requirements for sufficient capital formation.



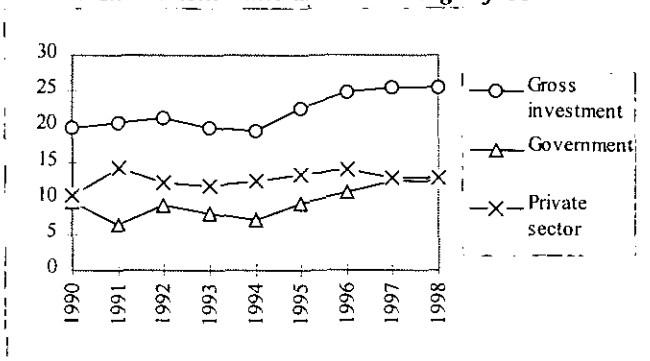
40. But the expectation that the increase in savings would raise domestic investment and thereby capacity growth did not materialize. Even if investment has also increased over the last ten years--assuming that everyone believes the accuracy of the official data[2]-- it was heavily financed by external borrowing and grants.

41. Effect of Increased Investment on Growth. As shown in the growth accounting exercise, the long-run trend of the rate of growth in Burkina is related to increases in the

[2] In the absence of detailed information about the Burkinabé public investment program, one can assume that an important share of what is officially considered "investment' to be reccurent charges.

various factors of production--capital stock of both domestic and foreign origin, the labor force, the use of imported inputs, and technical progress. Therefore, it was natural that policies designed to increase the long-run rate of growth of per capita income included measures to increase the rate of capital formation. The ratio of gross investment as a percentage of GDP has increased from 19.8 to 25.5 between 1991 and 1998. But private sector investment has not yet reached its 1991 level.

42. Investment Ratio as a Percentage of GDP



43. Most empirical studies using official data would estimate the incremental capital-output ratio (ICOR) for a country like Burkina to be about 5, which would imply a marginal productivity of capital of 20%. Clearly, it is necessary to improve the impact of investment on growth.

Box 3: Challenges of a Participatory PER Process in Burkina

Background. A participatory public expenditure review (PER) started in 1995 with the Government taking the lead. But the 1995 PER draft, prepared by a team of government experts, was never finalized. Instead, a public expenditure incidence analysis was carried out in 1996-1997 for the education, health, and water sectors. While it provided many interesting insights on equity issues, it did not lead to a comprehensive assessment of the rationale and efficiency of expenditures in those sectors.

Progress Made. Following the Board adoption of the HIPC final document in November 1997, a seminar was organized in Ouagadougou in January 1998 to resume the PER process. During that seminar: (i) a set of monitoring indicators were discussed and adopted; a *Tableau de Board* is now issued by the authorities every six months during the ESAF mid-term review and the PFP negotiations; (ii) a calendar for regular consultation between the Bank and the authorities on all budgetary issues was adopted; (iii) a series of studies on PER-related matters was defined and the Government committed itself to carry them out with help from the Bank team. (The Bank provided substantial comments on the three-year rolling public investment program, with recommendations for improvements). A national interministerial committee was set up by the Minister of Economy and Finance to coordinate the work on the PER process. Reflecting substantial progress was the fact that the 1999 budget guidelines issued in May 1998 took into account many recommendations from Bank missions in December 1998 and February 1999: in conformity with the HIPC targets, indicative sectoral ceilings for health (12 percent) and education (13 percent); objective based budget were prepared for the ministries of Health, Finance, Interior, Defense, Primary Education and Secondary/Technical education.

Remaining Issues and Next Steps. In spite of the slow pace of the PER process, some progress was made in 1997. After holding several meetings over the past months, the PER national committee chose decentralization as the topic for the next study (decentralization). But there are still some unresolved issues to be addressed: (i) the terms of reference of the ongoing study on decentralization do not reflect the Bank's first order priority with the impact of public expenditures in social sectors (education and health); (ii) it is not clear whether the timetable of the PER process fits the budget cycle; (iii) there is a need for a clearly formulated multi-year PER program, that is, a more cohesive framework that would bring together the various ongoing PER-related tasks; (iv) the nature of the involvement of other donors in this exercise has not yet been defined.

The Government committed itself to a series of different actions which are all part of a broader PER program: budgeting by objectives in some ministries (PFP); the preparation of a partial Medium-Term Expenditure Framework (SAC II); the HIPC indicators; and a study on the public investment program. All this cannot be done at once--there is only a limited number of experts in the Ministry of Finance who are familiar with modern budget management techniques. To address the remaining issues, the burkinabe authorities have agreed to:

- Develop and implement a result-oriented MTEF based on sectoral policies and fiscal discipline;
- Increase and maintain share of education sector in GOB budget to 13 percent in 1999-2000;
- Set sectoral spending targets based on standard cost-analysis and consultations with beneficiaries/donors;
- Prepare sectoral financial envelopes consistent with macroeconomic projections;
- Improve budgetary planning, control and monitoring systems;
- Develop system of ex-post evaluation of outcomes.

A Bank team is scheduled to travel to Ouagadougou within the next weeks to prepare a multi-year framework with the government and other donors.

C-) Outcomes of the Switching Policies

44. (i) Assessing the Use of the Exchange rate. The discussion of exchange rate policy here concerns itself solely with whether the 1994 devaluation achieved its clearly defined straightforward immediate goals (restoring growth, improving the current account, and changing trade flows). No attempt is made either to measure the quantitative impact of the devaluation or to assess its inflationary consequences. Moreover, because the change in the nominal exchange rate was accompanied by a number of other policies, it should not be considered in isolation. And somehow, the measured overall effects would be at best suggestive of orders of magnitude.

45. Effects on demand, supply, and growth. Obviously, the devaluation increased the level of foreign prices measured in CFA francs and thus the price of tradable goods relative to nontradable goods. On the demand side, the effect on absorption was negative as expected: there was a reduction in private sector wealth and expenditure, owing to the impact of the rise in the overall price level --the inflation rate was 24.7% in 1994 and 7.8% in 1995-- on the real value of private sector financial assets, and on real wages whose nominal values did not rise proportionately with the devaluation. These

contractionary effects were outweighed by expansionary effects on the supply side: because the prices of most domestic factors of production, especially labor, were almost maintained to their 1993 level, the devaluation had a stimulative impact on aggregate supply. (A more detailed analysis would explain what was due to the increase of world prices for cotton and gold, and to the evolution of the CFA/dollar exchange rate.) Clearly, the net effect of the 1994 devaluation on domestic output was expansionary: Burkina went from a negative growth rate of -0.8% in 1993 in real terms to 1.2% in 1994, 4% in 1995, 6% in 1996, and 5.5% in 1997.

Box 4: Tradables versus Nontradables.

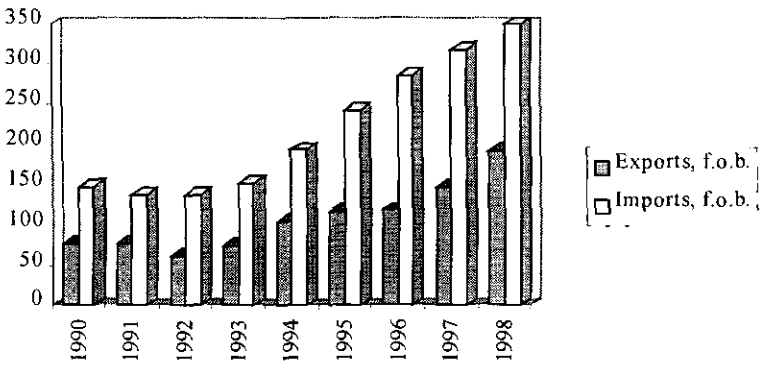
Among the various factors to be taken into account when analyzing the effects of a devaluation, one needs to pay attention to the relative sizes of the price elasticities of imports and imports, and the relative shares of tradable and nontradable goods in total production. In Burkina, the data to estimate these indicators is scarce, and the national accounts do not yield a clear distinction between tradable and nontradable goods. However, a back-of-the-envelop calculation, using the information provided by the INSD in the recently published 1993 final report on the national accounts, yields the following results:

Sectoral Classification (in % of total value added)

A. Tradables	**47.20%**	**B. Nontradables**	**52.80%**
Agriculture	17.2	Agriculture	2.2
Livestock & Related	14.4	Electricity, gas, and water	1.3
Mining	0.8	Construction	5.6
Food processing and tobacco	9.3	Trade	14.7
Textiles	2.8	Hotels, Bars, and Restaurants	1.7
Paper and printing	0.2	Transports	4.4
Chemicals	0.5	Financial sector	1.5
Nonmetallic minerals	0.5	Market services	10.2
Metal and wood products	1.5	Other services	11.2

46. Did the devaluation improve the current account of Burkina's balance of payments? Burkina's trade deficit has worsened over the past decade, going from CFA 62.3 billion in 1991 (82% of exports) to 171 billion in 1997 (117% of exports). The current account deficit, excluding official transfers, evolved the same way: from CFA 89.2 billion in 1991 to 186.5 billion in 1997.

Exports and Imports, 1990-98 (in billions of CFA)

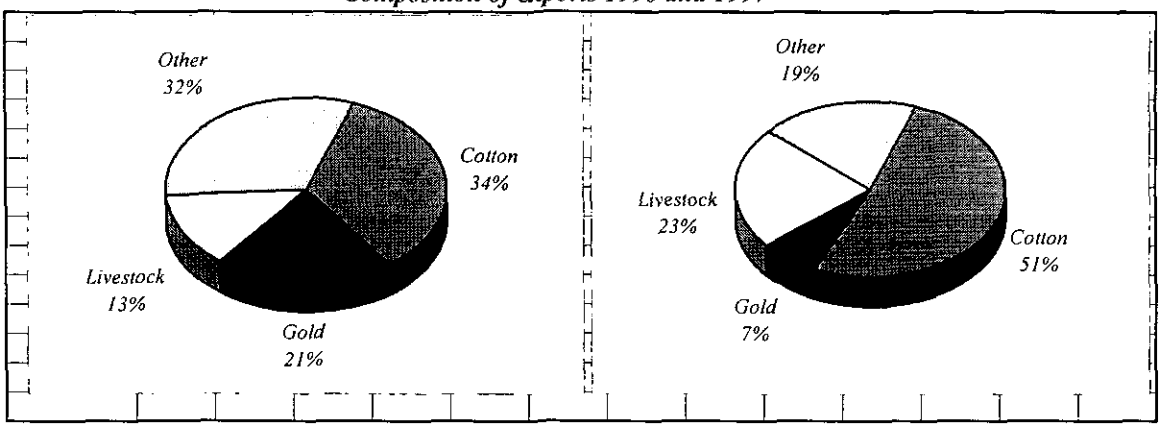


47. A detailed analysis would probably lead to more contrasting results. Some Burkinabé economists suggest that the 1994 devaluation redistributed income to some social groups with relatively low propensity to consume (cotton farmers in the South-West region for instance); as a consequence, there was a reduction in aggregate domestic demand which had a depressing effect on domestic supply, and this did offset the increase in Burkina's exports. The empirical evidence does not fully support that proposition. On the other hand, a much more powerful argument is the fact that the aggregate supply function in Burkina is probably backward bending, for two reasons: first, distortions in the credit market and restrictions in monetary policy (credit to the private sector decreased from CFA 137.9 billion in 1991 to 82.4 billion in 1995) -- even today, most banks have excess liquidity, while entrepreneurs trying to take advantage of the opportunities created by the devaluation still cannot access credit; and second, the increase in the domestic-currency prices of many imported inputs whose demand is inelastic --this led to a decline in production in many industrial firms.

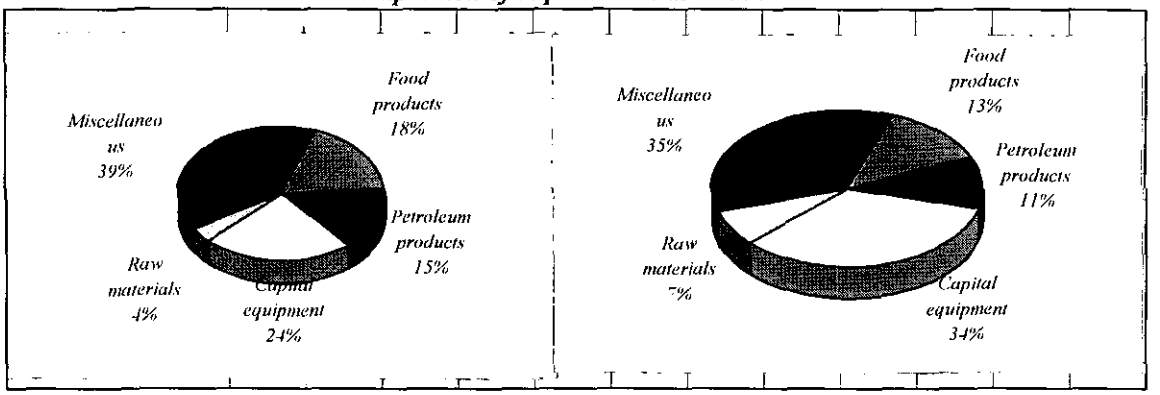
48. Could Burkina have done better? One would expect appropriate exchange rate and interest rate policies in the context of comprehensive stabilization and structural adjustment programs to attract private capital inflows by creating a climate of confidence in the economy, especially with a fully liberalized capital account. Yet, the increase in foreign savings over the past decade has been through public capital inflows or remittances, which raises puzzling questions about the attractiveness and the competitiveness of the Burkinabé economy nearly ten years after the first Bank- and Fund-supported program.

49. Was the devaluation effective in changing trade flows? In terms of the composition of exports, the dominant feature is the boom recorded in the cotton sector over the past years: from 34% of exports in 1990 to 1991. Indeed, the diversification of exports so often advocated simply has not been observed yet.

Composition of exports 1990 and 1997



Composition of imports 1990 and 1997



50. In terms of destination and origins, it is important to mention the increasing importance of Asian customers for Burkina's exports and the still negligible share of exports to the Western Hemisphere. Exports to Asia have increased substantially between 1990 and 1996.

Destination of Exports and Origin of Imports (in %)

Exports to	1990	1996	Imports from	1990	1996
EU countries	41.6	23.9	EU Countries	45.3	47.8
France	*23.1*	*14*	*France*	*27.5*	*27.1*
Other Europe	11.5	17.7	Other Europe	3.8	1.2
Africa	22.6	26	Africa	28.2	29.4
Ivory Cost	*11.3*	*11.6*	*Ivory Cost*	*14.5*	*17*
Taiwan	7.5	0.8	United States	6.3	5.7
Japan	1.3	0.1	Japan	4.2	5.7
China	7.8	0.2	China	0.9	1.1
Other	7.7	30.6	Other	11.2	9.1
Total	100%	100%	Total	100%	100%

51. Wage policy. Wage policy is not a crucial factor in Burkina, where wage earners represent less than 4 % of the labor force.

Evolution of Wages and Salaries

	1990	1991	1992	1993	1994	1995	1996	1997
In percent of GDP	7.6	6.9	6.4	6.6	5.7	5.3	5	4.8
In percent of total expenditure	38.7	31.9	30.8	28.6	25.7	25.1	23.4	21.2

Box 5: The Labor Market Rigidities in Burkina

As Burkina prepares for the new phase of regional integration, the possibility to use of domestic stabilization policies in responding to exogenous shocks is almost inexistant. Therefore, the efficient and flexible functioning of the labor market is of particular importance in this regard and could become an important determinant of the economy's growth prospects. Data on employment in Burkina is utterly scarce and often unreliable. Estimates of the unemployment rate vary: from 19.5 %, according to the results of a 1996 survey in Ouagadougou by AFRISTAT, to 35 % from one academic study, depending on the definition and methodology used. The rates have deteriorated over the past decades, with aggregate rates masking enormous disparities across regions, sectors, and demographic groups. According to the latest available statistics, 92 % of the labor force is employed in the agricultural sector, while 2 % is in the industrial sector, and 8 % in services.

Burkina's labor market is characterized by extremely low levels of labor force participation and employment in the formal sector. It is certain that formal employment has diminished over the period 1991-1998 as a result of structural adjustment measures. Official employment statistics are difficult to find for recent years and difficult to use because they do not adequately capture the very large share of employment in the informal sector. The available data show a rise in the share of the informal sector in the overall non-agricultural employment: it provides about 25 % of the overall GDP and 40 % of non-agricultural GDP.

For the first three decades of independence, the wage formation process in the public sector was dominated by a de facto indexation of nominal wages to inflation and a centralized bargaining structure. Real wage growth was positive throughout the 1970s and 1980s, irrespective of aggregate business cycle conditions. Starting with the 1993 labor code reform, the indexation of wages was eliminated, and a new income policy changed real wage formation. Even the 1994 devaluation did not really feed into wages, in spite of some symbolic increases. A comprehensive reform of the civil service, which provides for the staffing of government jobs by contractual hires, a merit-based promotion system, decentralization of recruitment, and improved transparency of performance, was adopted in April 1998. If promptly implemented, it would accelerate the liberalization of the labor market.

Wage Earners represent 3.6% of the Labor Force

	1986	1991	1994	1997
Labor force (in millions)	4,5	5	5.3	5.7
Civil service	25,437	36,985	41,723	47,777
Wage bill (in millions CFA)	37,240	57,100	63,315	76,579
Average annual salary	1,464,009	1,543,869	1,517,508	1,602,842
GDP per capita in CFA (curr)	81,718	88,356	97,394	121,439

III-) WHERE DO WE GO FROM HERE?
Outline for a Development Strategy

A-) The Medium-Term Outlook

52. To raise the income levels of the population and foster the development of human resources and productive potential, the government has formulated a medium- and long-term strategy within the framework of the letter of policy on sustainable human development. The major objectives from the present to 2005 may be summarized as follows: (i) increase per capita GDP by at least 3 percent a year; (ii) double the literacy rate from 20 percent to 40 percent; and (iii) raise life expectancy by about 10 years to 57 years. According to the Policy Framework Paper, the macroeconomic objectives for the period 1998-2000 are to: (i) maintain a real GDP growth rate of about 5.5 percent on average between 1998 and 2000; (ii) limit inflation to 2.5 percent per annum; and (iii) reduce the external current account deficit, excluding grants, to 9 percent of GDP by 2000.

53. Agriculture and the rest of the primary sector will most likely continue to be the main source of growth in Burkina Faso, as well as the main revenue-generating and job-creating activity, accounting for about 30 percent of GDP. Maintaining the economy's competitiveness will facilitate development of the growth potential of such exports as cotton and livestock products and promote the production of nontraditional exports crops, such as fruits and vegetables. The mining sector is also expected to expand, given the recent renewed interest in gold exploration and extraction. Current estimates indicate that gold output could increase at least fivefold in the next decade, up from the current level of 1.5 metric tons a year.

54. The government intends to continue to pursue its macroeconomic and reform strategy, the main elements of which are the following: (i) maintaining macroeconomic stability and consolidating the recent competitiveness gains; (ii) improving the efficiency of the public sector by further strengthening tax and customs administration and budgetary procedures, and by stepping up the reform of the civil service and public enterprises; (iii) reforming the judicial system to ensure appropriate protection and incentives for private investors; (iv) further reducing the state's role in agriculture and mining; and (v) improving human resources development. This strategy requires moderation of population growth, implementation of policies directed at promoting job creation and income growth, and at providing women with a greater role in the development process, and greater access to social services, especially education, health, safe drinking water, and sanitation services. It also requires a better management of natural resources through enhanced security of land ownership and training of the general public in environmental protection techniques.

55. The targeted rate of economic growth will be sustainable only if it is supported by an increase in saving and investment. For this reason, the government's fiscal policy will seek to increase public saving; such an increase, combined with the expected inflow of

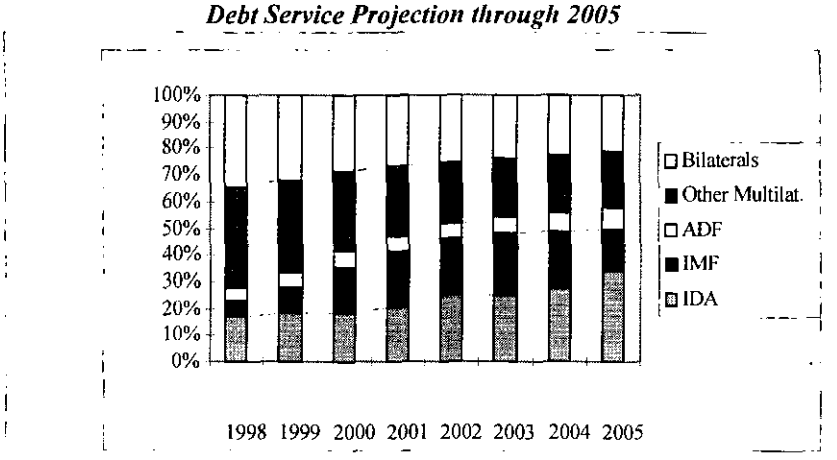
external assistance, will permit the financing of an adequate level of investment, which, in turn, needs to be effectively allocated. The overall investment ratio is expected to remain at about 25 percent of GDP during the 1998-2000 period. At the same time, private sector saving and investment will be fostered by a more favorable business climate.

56. The government has adopted a strategy aimed at developing and diversifying the country's export potential, and it will complete the liberalization of the export and import sectors. This strategy should lead to the sustained growth of exports, which are projected to rise by an average of 19 percent in value annually in 1998-2000, and by 13 percent in volume, owing mainly to the continued increase in cotton production. The external current account deficit, excluding grants, is projected to decline to 9 percent of GDP by 2000; this decline, together with the reduction in external debt under the HIPC Initiative, should reduce the debt burden to a sustainable level.

Selected Indicators 1997-2000

(Annual percentage change)	1997	1998	1999	2000	*(In percent of GDP)*	1997	1998	1999	2000
GDP at constant prices	5.5	6.2	5.7	5.6	Gross investment	25.4	25.5	25.3	25.3
GDP deflator	2.0	2.0	2.2	2.6	Gross domestic savings	9.2	11.2	11.7	12.3
CPI annual average	2.3	2.5	2.5	2.5	Government revenue	13.0	13	12.5	12.0
Net domestic assets (banks)	21.4	5.1	4.5	...	Domestic primary expenditure	11.9	12.2	12.0	11.8
Credit to the government	8.3	-1.1	0.8	...	Overall fiscal balance	-10.1	-10.3	-10.1	-9.9
Credit to the Private sector	15.5	7.1	4.4	...	Exports of GNFS	13.8	16.1	16.8	17.0
Broad Money (M2)	14.1	10.4	9.2	...	Imports of GNFS	30.1	30.4	30.5	30.0
Velocity (GDP/M2)	3.8	3.7	3.7	...	Debt-service ratio (Exports)	15.2	12.6	11.9	12.1

Debt Service Projection through 2005



B-) Why Burkina Needs a New Economic Strategy

57. ***(i) Beyond Stabilization: A Rationale.*** What emerges from previous analyses is the relative success of Burkina's stabilization program over the past five years, and the rather disappointing performance on structural reforms. Yet, what is striking in the

current economic agenda is the fuzziness of a long-term vision shared by the authorities and the donor community, a vision that is necessary to tackle structural issues and the heavy challenges facing Burkina Faso.

58. Today, the traditional objective of an ESAF program--to provide for a more orderly adjustment of the imbalance between absorption and aggregate supply so as to achieve a viable external position within a reasonable period of time-- would not fit Burkina's current economic conditions. The fiscal deficit is still very high, and in spite of the reallocation of resources towards social sectors over the past five years, there is a structural budgetary gap (about 10% of GDP) which is funded with aid and borrowing on concessional terms. Compared to its 1990 level, the external balance has deteriorated: the current account deficit for 1998, excluding official transfers, will represent about 13% of GDP. On that basis, it appears necessary to rethink the policy content of the Fund- and Bank-supported programs and to move beyond stabilization.

59. Typically, the need for a stabilization program arises when a country experiences an imbalance between aggregate domestic demand and aggregate supply, which is reflected in a worsening of its external payments position. While it is true that at the end of the eighties Burkina was having some difficulties on the external front, with net foreign assets averaging 8.8% of GDP (CFA 66 billion) and 44% of imports in 1990, other macroeconomic indicators were not worse than they are today. The current account deficit, excluding official transfers, was 9.4% of GDP in 1990, compared with an estimated 11% in 1998; the overall fiscal deficit on a commitment basis, excluding grants, was 7.3% of GDP, compared with an estimated 11% in 1998; the debt service ratio was 12% of exports of goods and nonfactor services, compared with 16% in 1997; inflation was 1.4 % in 1990 (measured by GDP deflator), compared to 2% in 1997.

60. In fact, in hindsight, it seems that Burkina did not really suffer the kind of deep demand-supply imbalances that brought many other francophone African countries to adopt stabilization programs in the eighties. However, some external factors such as the deterioration of terms of trade and inappropriate policies had created distortions in relative prices and inefficient resource allocation, which in turn led to a very slow increase of the productive capacity of the economy. The country was loosing its international competitiveness because of its low levels of domestic productivity and the overvaluation of the CFA exchange rate. Foreign financing was still available, especially from multilateral sources, but the relative expansion of domestic demand could have persisted in an unsustainable manner throughout the nineties.

61. Macroeconomic policy in Burkina needs to be expanded beyond the traditional focus on inflation and government deficits. The country needs a financial program and a development program overlapping with each other, but having with different focuses and objectives. The reasons are as follows:

62. *A financial program,* including the Government budget and a credit program should be prepared in spite of the fact that the country is not currently facing a financial

crisis. It should allow for an allocation of resources on the basis of the Government's priorities. The Government budget in the current macroeconomic framework certainly is a form of financial programming, inasmuch as public revenues are devoted to the financing of priority expenditures and objectives.

63. *The stabilization program* was initially designed to yield quick results --to solve the crisis caused by the large fiscal deficit of the early 1990s and to organize follow-up measures in the aftermath of the 1994 CFA franc devaluation. The current program is the third-year arrangement of the second three-year ESAF; therefore, it probably is neither appropriate, nor realistic to expect that its content will address all the major economic problems identified in Burkina. Furthermore, since the circumstances and objectives of the stabilization program would be different from those of the long-term development program, attention may be given to measures that are expected to yield medium- and long-term, rather than short-term results.

64. *A Development program* is necessary to achieve Burkina's long-term objectives: sustained economic growth, structural changes, and poverty alleviation. Obviously, there would be some points of overlap among the three forms of program. But an economic program focusing on the development of supply factors, and not only on demand factors, is required if the country is to move quickly to double-digit growth rates. In principle, the current ESAF program involves all these three different programs since the Article IV consultation mission normally focuses on projections and financial programming. However, the achievements of the past five years only represent a first step in the right direction. Besides, given the limited number of economic instruments available to policymakers in CFA zone countries, it seems that the plan is trying to achieve too many objectives with, basically, one single instrument: fiscal policy.

65. There are at least two other reasons why Burkina needs a new economic development strategy: first, the necessity to take into account current economic circumstances and the challenges ahead on the external front; second, the domestic constraints on competitiveness and the political economy factors that impede policy design and policy implementation.

66. ***(ii) Indicators of External Vulnerability.*** Although export-led growth policies have rightly been advocated as a key-feature in Burkina's structural programs since 1991, we must keep in mind that they are only part of several ingredients in a successful development strategy. Some countries have been able to sustain high economic growth rates with an emphasis on productivity or with an efficient use of their natural resources. Indeed, the prospects of slower growth of world trade, intense recession in Asia, and more intra-european trade after the adoption of a single currency should cause strategies of export orientation to be improved. In the particular case of Burkina Faso, one should recall that there are limits to what the government can do. That is, the strong and active role played by Asian states during the takeoff phase cannot be advocated here given the human, political, institutional and financial resource constraints facing the Burkinabé authorities, especially if the decentralization program moves forward as one might

expect. Also, unfavorable human resource endowments (an educated labor force and a critical mass of highly qualified civil servants) and the rather gloomy international environment of the late 1990s are negative features that limit the transferability to Sahelian economies of the Asian superexporters's experience.

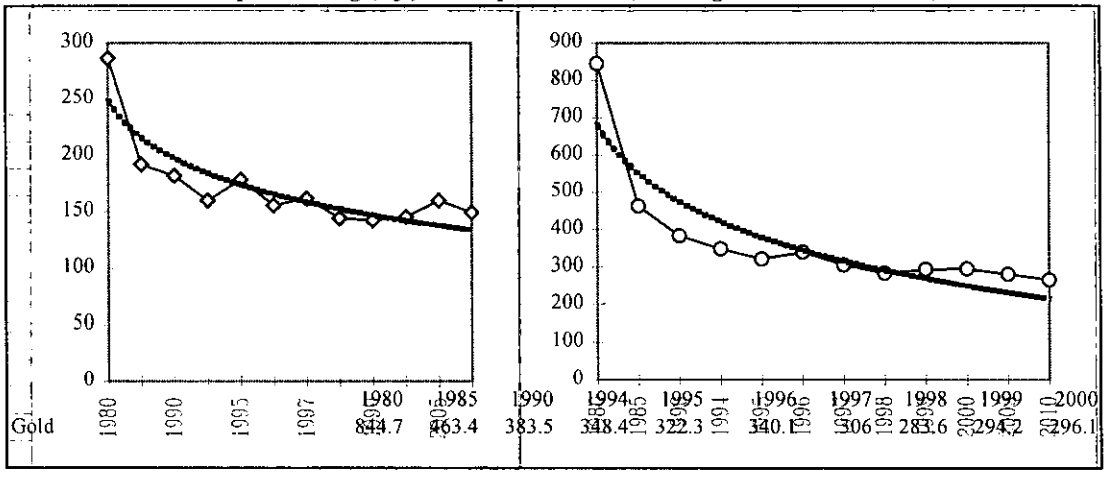
67. *Implications of Gloomy World Economic Prospects.* In the aftermath of the East Asian crisis, the short-term outlook for the world economy is less optimistic than it was a few months ago. Even in a relatively favorable base-case projection, world growth in 1999 is expected to register only 1.9 %. Sub-Saharan Africa is expected to grow by 3.2 % in real terms in1999 (from an estimated 2.8 % in 1998), 3.8 % in 2000, and an average 4.2 % in 2001-2006.

World Economic Prospects through 2007

	1981-90	1991-97	1997	1998	1999	2000	2001-2007
Real GDP in G-7 countries	2.8	1.9	2.6	1.7	1.8	1.8	2.4
Real GDP in Sub-Saharan Africa	1.9	2.2	3.5	2.4	3.2	3.8	4.1
World Trade	4.6	6.8	9.5	5.3	6.0	6.0	6.2
Nominal LIBOR (6 months, US$)	10	5.1	5.8	5.5	5.5	5.5	5.9
Price index nonfuel commodity	-5.4	0.2	5	-14.6	-0.4	0.4	0.3
Import growth (Sub-Saharan Africa)		3.5	5.8	4.7	5.9	5.9	5.3
Export growth (Sub-Saharan Africa)		2.6	7.7	3.7	4.5	4.7	5.1

68. Price projections for commodities have fallen substantially. Burkina's export prospects will be affected by the decline in cotton and gold prices.

Cotton prices, c/kg (left); Gold prices, $toz (with logarithmic trendlines)



69. *Real Exchange Rate.* According to the schedule, the European Monetary Union (EMU) was formally created on January 1, 1999, and the Euro was launched. For the eleven members of the Union, the single currency is expected to bring substantial productivity and growth benefits through decreased transaction costs, increased allocative efficiency, elimination of exchange rate risk premia in interest rates, and improved investment demand. To the extent that it also serves as a catalyst for prudent fiscal policy and structural reforms, growth prospects will be enhanced.

70. It is generally expected that the Euro will appreciate relative to the dollar, in line with the larger current account deficit in the United States, and the respective cyclical positions of the euro zone (early recovery) and the United States (maturing).[3] The Euro is also expected to gain strength over the medium term as reserve portfolios are rebalanced away from the dollar. While the Euro will provide an opportunity to increase external trade to Europe for CFA countries, the implications of an exchange rate pegged to a possibly strong currency will need to be assessed.

Box 6: The Euro/CFA Exchange Rate

The CFA is currently pegged to the French franc and to the Euro. As of January 4, 1999, the exchange rate was: 1 Euro = 656.690 CFA (or 1 CFA = 0.00152 Euro). In trying to predict the evolution of the CFA real exchange rate in Burkina, one needs to take into consideration two ideas that are not mutually exclusive: the possibility of a *strong* Euro, and the possibility of a *volatile* Euro. The first assumption is embodied in the Maastricht Treaty, which provides for price stability as the main objective of the European Central Bank. The concern that the Euro will be volatile is based on at least two observations: (i) foreign trade will be a smaller share of Europe's GDP than it is in individual European countries; therefore, European governments and the European Central Bank may be less inclined to intervene about exchange rate swings. In fact, because the ECB's mandate is to maintain domestic price stability, one can expect the Euro exchange rate to be a secondary matter of concern for policymakers in Europe; (ii) a more unified bond market in Europe will probably make investors' behavior more uniform across the union--that is to say, they would move in and out the market simultaneously. The banks providing liquidity to the currency markets are currently being consolidated, which reduces their willingness to take foreign-exchange risk. Because the diversification benefits derived from positions in eleven national currencies will vanish after January 1, 1999, liquidity in the Euro is likely to be low and the currency might then become more volatile.

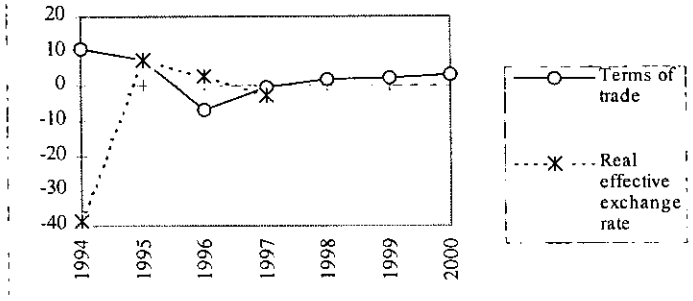
The implications of a possibly strong Euro for CFA countries like Burkina are obvious. A strong Euro would mean an appreciation of the real effective exchange rate, that is loss in competitivness, especially with respect to the 30-to-40% depreciation of Asian currencies that occurred in 1997-98. Also, a strong Euro-CFA would mean higher interest rates that will lower credit demand and investment. A volatile Euro would worsen the burden of asymmetric shocks to which the CFA countries will be subjected relative to the EMU, as well as among themselves. Fluctuations in the Euro-CFA/dollar exchange rate will affect the predictability of financial flows and the debt amortization schedule. They may also negatively affect the current account balance. All these risks reinforce the need to accelerate structural reforms so as to encourage the diversification of the export base, and to foster regional integration.

71. *Terms of Trade.* According to IMF projections, Burkina's terms of trade are expected to improve slightly over the next three years: 1.9% in 1998, 2.4% in 1999, and

[3] Cf. The recent issue of the World Bank Global Economic Prospects.

3.4% in 2000. But a careful analysis, taking into account the impact of the East Asian crisis, shows a slight deterioration, at least in the short run.[4]

External Vunerability: IMF Projections (% change)



Terms of Trade: Bank Estimates

% Change 1998 TOT		
Bank		
Best	-1.7%	
Expected	-10.8%	
Worst	-18.9%	
TOT Impact on 1998 GDY	Dadush	Other Formula
Bank		
Best	-0.10%	-0.06%
Expected	-0.62%	-0.39%
Worst	-1.09%	-0.69%

(iii) Some Domestic Challenges Ahead

72. The following domestic constraints could be serious impediments to any economic development strategy.

73. *Natural constraints.* As an arid, Sahelian, landlocked country, Burkina is likely to suffer recurrent droughts, limited land available to productive farmers, and demographic pressure (population growth is 2.7 per year). The proportion of young farmers has been decreasing over the years; but the yield in cultivable areas is still rather low, which leaves room for improvement.

74. *Limits to Domestic Competitiveness.* Because of the slow pace of structural reforms due itself to political economy issues, the market structure is not likely to change soon. The exogenous variables that determine the number of firms in the Burkinabé modern economy (barriers to entry, level of technological advance in the dominant primary sector, etc.) are unlikely to evolve quickly. Furthermore, with a privatization program still lacking credibility, Burkina will remain a high factor costs country --

[4] The formulae used here, and suggested by U. Dadush and D. Addison, capture changes in gross domestic income (GDY).

electricity, water, telecommunications, and transports-- for the near future. Also, one might assume that some of the administrative and institutional constraints would not be removed soon.

75. *Limits to the use of Policy Instruments.* Monetary policy, one of the most powerful instruments of economic policy, is to be ruled out, at least for now. Ideally, a study such as this one would genuinely recommend the use of any economic policy instruments that makes sense given the issues identified in Part I. Yet, for non-technical reasons, we must rule out monetary policy as a possible tool to cope with changes in demand. This means that our economic strategy will rely exclusively on fiscal policy and some kind of structural reforms. Yet, the problem with fiscal policy in the CFA countries is that the room for maneuvering is limited. Furthermore, in an open economy like Burkina, where imports represent over 20% of GDP, the multiplier effect which is traditionally attached to fiscal policy is very difficult to estimate. In any case, given the huge overall budget deficit (about 10% in Burkina), we cannot even envisage any kind of "active" fiscal policy. Indeed, our focus should be to assure an orderly financing of the deficit, and the efficient use of public funds. Also, since tax and expenditure policies have various effects on economic efficiency and equity, we may want to look into these.

C-) Suggested Changes in the Macroeconomic Framework

76. The following suggestions are based on three principles. We need to: broaden the economic development agenda in Burkina by including a new set of objectives; design a different mix of demand-side and supply-side policies, one which places more emphasis on the latter; and explore the microeconomic foundations of macroeconomic performance, notably by focusing our work on labor productivity which, in the long run, will improve Burkina's competitiveness and economic welfare. Designing a set of policies that simultaneously satisfy those principles would require hard work and a candid assessment of what options are available. Here are some ideas for discussion:

77. *Setting Higher targets for Economic Growth and Moving Beyond.* It is worth repeating here the basic fact that we are confronted with: at its current rate (-1.7 % over the past twenty years if measured in dollar terms), Burkina's GDP per capita will not change substantially over the next decades. Given the magnitude of poverty across all social groups and all geographical areas in Burkina, it is important to achieve higher growth rates if we want to really help the country reduce its poverty rates. In spite of its natural constraints-- a landlocked country, poorly endowed in natural resources, and with very limited rainfall-- Burkina could count on its hardworking and entrepreneurial people, provided that an ambitious strategy to develop human capital is promptly designed and implemented. At the same time, one needs to acknowledge that growth should not be an end by itself when its short-run determinants can be "artificial" (that is, temporary increase in world prices of commodities for instance, instead of improvements in the way the factors of production are used).

78. *Broadening the Macroeconomic Agenda.* A typical stabilization program in Burkina really has only three objectives: a short-term economic growth, an inflation target, and a fiscal deficit target. The various measures in the program are adopted to achieve those objectives. It is fair to say that Burkina has been relatively successful in achieving macroeconomic stability. But the country has now moved beyond the point at which stabilization alone defines economic policy. To address the main challenges ahead, the government needs to accelerate structural reforms and develop prospects for sustained growth. Given the rather limited growth prospects and the variability of output, Burkina should consider a larger macroeconomic agenda and the possibility of using if necessary some countercyclical monetary and fiscal policies that would allow automatic stabilizers to operate more effectively. The government may also want to consider some microeconomic policies that would focus on productivity improvements. They could include the following objectives: (i) promoting employment through the the simplification of the tax system and the reduction of employment taxes, especially on small and medium size firms; (ii) promoting equity in economic policy either by providing basic infrastructures and incentives to the private sector to operate in all densely populated areas of the country, or by encouraging greater labor mobility across the country and across the UEMOA--in that regard, and given the relative importance of rural households (84 %), a comprehensive rural development strategy aiming at creating conditions for private sector development is urgently needed; and (iii) accelerating institutional development through the implementation of the civil service reform and the decentralization laws.

79. *Rethinking the Architecture of Bank's and Fund's Programs.* The current framework of the ESAF program in Burkina Faso was catalyzed by the experience of the country during the 1970s and 1980s. At the time, markets were functioning very poorly, mostly because of bad public policies rooted in socialist-type ideologies. With a population growth rate fluctuating around 3 % a year, GDP growth per capita was insignificant, if not negative. Budget deficits were always high, reaching 15.2 % of GDP in 1989. And the spending underlying these deficits was being used for subsidies to a very large state sector. With many incentives for a selected group of politically powerful importers and little support to exporters, there was no reason for the handful number of firms that constituted the modern sector in Burkina to increase productivity and efficiency or to maintain international quality standards. Also, the budget deficit was financed mainly by borrowing abroad, including some substantial borrowing from bi-lateral creditors that raised the burden of interest payments. Fortunately, the CFA Zone institutional arrangements prevented Burkina from turning to seignorage to finance the gap between the high level of public spending and the limited tax base. Inflation was controlled (8.7 % in average over the past five years), but real economic growth was lower.

80. We need to rethink some aspects of the ESAF program because the economic conditions described above, which determined its current framework, no longer prevail. Burkina's record can even be seen as a case of relatively successful stabilization. Yet, *the macroeconomic situation is still fragile and projected rates of real GDP growth are*

clearly insufficient to alleviate poverty. Indeed, the time has come to reassess the medium-term strategy and to design a more ambitious development approach that can generate robust economic growth. In focusing on deficit reduction, trade liberalization, simple financial sector restructuring, and privatization, the ESAF program has neglected other important features that are crucial for achieving higher growth. I now consider some of them.

81. *Relaxing Some Assumptions about Inflation.* Because inflation changes the relative prices in the economy and hurts everyone, especially the poor, controlling its rate of increase is a crucial element in any stabilization package. Yet, focusing on inflation will not lead to macroeconomic policies that are conducive to sustained economic growth. In fact, recent studies suggest that low levels of inflation may even improve economic performance relative to what it would have been with zero inflation. Empirical evidence from all over the world shows that most low-inflation countries (defined as countries with inflation rates of less than 40% a year)[5]. Such an argument may seem strange in the case of CFA countries where inflation, by the virtue of the existing institutional arrangements, has to be almost zero. But Burkina, like most countries, could probably afford moderate inflation (in the range of 10-20% a year) as a better trade-off to the current situation of limited growth rates, high unemployment, and poverty levels--provided that the current discussions of the sustainability of the CFA zone arrangements lead to substantial changes in monetary policy.

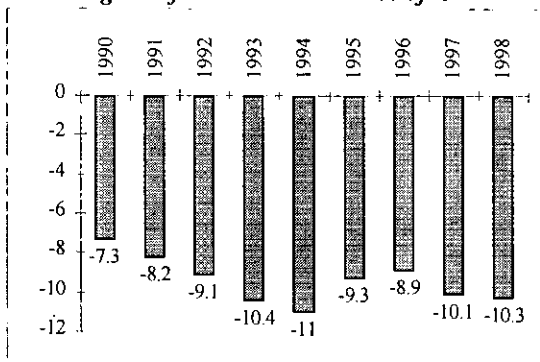
82. *Avoiding a Pre-Conceived Level of Budget Deficit.* In preparing the financial programming framework, the BCEAO and the IMF usually start by reviewing recent and expected trends of different variables such as production, prices, exports and imports; then, they set a budget deficit target to a level consistent with the monetary requirements. That approach seems reasonable. However, in the case of a country like Burkina where the deficit is essentially financed with grants (71 % of the overall budget deficit in 1997) and borrowing on concessional terms (23 % in 1997), and where donors are prepared to make high and predictable aid flows available to the government, the rationale for maintaining such an orthodox approach is unclear. Especially because money supply is only considered a function of the economic growth rate and the target inflation rate--little consideration is given to the demand for money. A different view would be to start from the accounting identity which equates money supply to credit to the government, credit to the private sector, and foreign reserves, and to: (i) determine what should be the appropriate level for money supply (based on a clear understanding of money demand and a sound assessment of the capacity of the Burkinabé financial system to manage higher levels of credit to the private sector without creating bad loans and inflation); (ii) determine what should be a reasonable level of net foreign assets for a CFA country with little to worry in terms of foreign exchange; (iii) determine the optimal level of credit to the private sector, and (iv), use the fiscal deficit as the residual variable of the identity.

[5] This important yet ignored fact is reported by numerous studies, and endorsed by Joseph Stiglitz in some of his recent speeches.

Box 7: Burkina's Optimal Budget Deficit

What is the "right" size of the budget deficit in a country like Burkina? There is no easy answer to that question. The sustainable deficit depends on several factors, including circumstances, the state of the economy (business cycles and trends), prospects for future growth, the efficiency of public expenditures, the state of financial markets, and the levels of savings and investment. Before making any judgment, one should also take into consideration the use of the various sources of budget financing.

Budget Deficit in Burkina in % of GDP



Over the past ten years, Burkina has run an overall deficit (on a commitment basis, excluding grants) of about 10% of GDP (see graph). During recent Board discussions, some Executive Directors in the Bank and the IMF have expressed the view that Burkina should lower its deficit. But one can also make the case that because the deficit is financed steadily by predictable inflows of grants and concessional foreign assistance, it may be legitimate for the government to treat foreign aid as a regular and stable revenue base to be included in the budget.

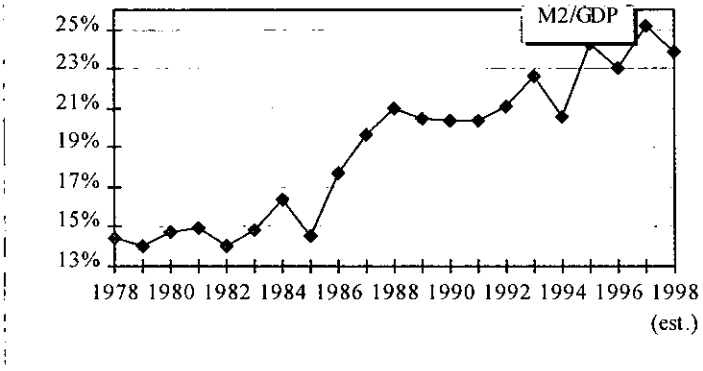
The only key concerns with the current situation are: (i) external financing seems to be driven by the necessity of filling a structural budget gap, instead of funding public expenditures in social sectors and basic infrastructures with high rates of return that are carefully planned; and (ii) huge inflows of foreign money change the relative prices, affecting the real exchange rate and the competitiveness of the economy in a way that is not fully studied and understood by policymakers. Further empirical research should be carried out on this topic.

83. *A More Flexible Approach to the Current Account Deficit.* Burkina's current account is due to the fact that the country has been investing more than it saves. Until we have a full picture of the quality, efficiency, and return of the public investment program, it is impossible to determine whether the current deficit is intrinsically good or bad. Because it is an exogenous variable, determining whether it is too high depends, first, on its origins. According to official statistics, Burkina's high current account deficit is not due to excess consumption, but to high levels of imports of capital equipment and intermediate goods, which are indispensable to build the infrastructures that the country needs. It will continue to be so for some time. The rigidities of the exchange rate policy might be a source of concern for the level of the current account deficit. But the situation does not seem likely to evolve substantially in the sort term. Assuming that externally-financed investments have rates of return above the cost of international capital, we

should shift the focus to the form of financing. Burkina's advantage is that the current account is financed mostly through large and substantial amounts of external grants, not in the kind of short-term, hard currency-denominated debt that creates problems in other countries with high current account deficits. However, as a matter of long term economic policy, the country would gain more from higher levels of foreign direct investment, which not only brings stable capital but also knowledge spillovers and productivity improvements.

84. *Designing A Second Generation of Financial Reforms.* An important instrument in promoting employment and equity in Burkina would be a well-functioning financial system. While the 1994 rehabilitation operation helped balance the books of the financial institutions--by and large, all commercial banks in Burkina seem to be in line in terms of prudential ratios--, recapitalize banks and liberalize the sector, it did not address the fundamental problem of weak financial intermediation, which is still low in spite of the rising trend of the ratio M2/GDP.

85. Financial Sector Depth (1978-1998)



86. There is a need to revive the financial system so that it can perform its three main functions: collecting savings, allocating funds to the most productive investments, conveying information and monitoring the economy. These activities are essential to promoting transparency in financial transactions, creating wealth, improving corporate governance, and increasing total factor productivity. A second generation of financial sector reforms in Burkina could focus on: (i) developing regulations to foster competition among banks and insurance companies so that customers have abroader array of bank and insurance products at their disposal; and (ii) opening up the financial system to small, specialized banking institutions.

87. *Linking Competitiveness to Trade and Productivity.* Despite its almost ten-year reform experience, Burkina still lacks competitive markets. Trade liberalization reforms that started in 1993 and accelerated in 1998 with the adoption of the new WAEMU common external tariff (to be fully implemented in 2000) are not yet yielding the efficiency of a market economy. And recent discussions about temporary protection for certain industries have led to the adoption of new protective taxes that will not encourage competition among domestic firms, at least for the next four years. The process whereby

privatization leads to enhanced productivity and domestic competitiveness is not taking place in Burkina. In many industries, trade liberalization and privatization have simply replaced a public monopoly with a private monopoly--it's the case notably with the cement and sugar industries. Rents are simply transferred from the government to the new monopolists, with even higher prices for consumers. Clearly, the new economic strategy should aim at fostering competition and promote the use of new technology. And the Bank should move beyond the discussion of owernship of firms to the issue of regulation (tackling imperfect competition, predatory pricing, implicit collusion, control over the main distribution systems, etc.).

Box 8: Regional Integration, Competitiveness, and Productivity

In January 1994, the government of Burkina ratified the WAEMU Treaty which transformed the former WAMU into a true economic union. The new organization is already operational, and its institutions have been set up. Its aims include (i) the free movement of people, goods, and capital; (ii) the creation of a customs union among the eight member states; (iii) the convergence of macroeconomic policies; (iv) the harmonization of sectoral policies; (v) the harmonization of government finance statistics; and (vi) the harmonization of indirect taxes. For the three-year period 1998-2000, the measures include the preparation of a regional investment code; effective harmonization of government finance statistics; implementation of the common accounting system (SYSCOA); implementation of the CET; and multilateral surveillance with application of penalties. Finally, Burkina Faso is actively moving to integrate its transport system through the joint operation, with Côte d'Ivoire, of a private railroad company, as well as exploring the potential for subregional operation of air transport services with several neighboring countries.

While it is true that the WAEMU poses some short-term challenges to Burkina--the decrease in tariffs will initially lead to lower public revenues--, the country needs to be more productive to expect an increase in its standards of living. This would be true even if there were no regional integration process ongoing. The argument here can be summarized in two propositions:

By most recent estimates, Burkina's productivity rates (across the board) are currently lower than that of its main competitors in the union. But from a macroeconomic standpoint, it does not matter much. Indeed, the opportunity for Burkina to trade with more productive partners within and outside the WAEMU mitigates rather than exacerbates the consequence of its very low productivity rates. Why? Because a country with lower productivity than its competitors usually also have lower wages--otherwise, they would go bankrupt, which never happens to whole nations. But wages in Burkina cannot be too much lower than in Ivory Coast, since it would then be cheaper to produce everything there in spite of its poor productivity performance. So the wage ratio between countries is usually somewhere between the productivity ratios in the industries under consideration. In industries where there is a large productivity gap, it will remain cheaper to produce goods in Ivory Coast, in spite of the higher wages. But in spite of its absolute disadvantage in certain sectors, Burkina will still manage to export goods and services for which it has a comparative advantage.

The rate of productivity growth in Burkina relative to that of other WAEMU countries is not a determinant of Burkina's economic health. What is important to the country's standards of living is labor productivity in Burkina; it does not matter whether workers are concentrated in the tradable sector. Since about 40 % of the value added takes place in agriculture while only 15 percent takes place in industry, a percentage point gain agricultural

productivity is worth about 40/15 times as much an equal gain in manufacturing.

88. *Identifying New Sources of Growth.*[6] Burkina's growth prospects are limited over the medium-term given its underdeveloped human resource base and its poor natural resource base. While there are opportunities for increased production of some varieties of crops, agricultural production is not expected to grow by 10 % a year as officially announced by the government. Exports of traditional grains, fruits, vegetables, and livestock to regional markets offer good growth prospects, but they are subject to soil and rainfall conditions.

89. However, despite its natural constraints, Burkina could obtain much more from its factor endowments, which are not yet maximized by:

- establishing a tax-friendly environment so that the country can attract foreign direct investment, in spite of the tax competition that would probably take place in the WAEMU shen the regional integration process is more advanced;

- building human capital to stimulate labor productivity across sectors, and facilitating labor migration across the WAEMU region and outside the region (workers' remittances represented CFA 56 billion in 1997, which equals almost 40 % of export revenues);

- promoting Burkina's geographic location in a global economy. Ouagadougou has one of the closest airports to the major European capital cities and commercial centers. One can assume that if airline transport were to be fully deregulated, some carriers could established commercial flights allowing the development of non-traditional exports;

- diversifying the economy through the promotion of fast-growing, high value-added, labor intensive, low transportation cost activities that could be exploited by the private sector.

90. Over the medium-term, the mining sector could become a significant source of growth. Gold has yielded encouraging results and important international companies are considering heavy investments in Burkina, provided that international prices are above the threshold of about $325 an ounce.

91. *A Supervisory Role for the Government.* To insure that the proposed economic strategy is properly implemented and that an adequate environment allows the private sector to create opportunities, it is important that the government be focused on the economic fundamentals: a stable macroeconomic framework, the institutional and

[6] Most ideas presented in this paragraph are from my discussions with Paul Collier and Jeffrey Sachs.

regulatory environment, the basic infrastructures, and the social policies. Burkina's government should focus on those activities that make the market work better.

92. *Sequencing:Taking into Account the political economy aspects of reforms.* Besides its economic specificity, Burkina has no large domestic private sector or strong political opposition that would make it impossible for the government to change its policies. However, the violent history of the quest for political power by different social groups, and the silent but permanent political confrontations between the predominant Mossi and other major social groups (Peuhls, Bobo, Gourmantche, Bissas) led to a particular distribution of power: most stakeholders from politically powerful social entities are represented in high levels of the ruling coalition (CDP), the government and the Parliament. Indeed, when he came to power eleven years ago, President Compaore's smartest political move was perhaps to express his willingness to accommodate all key constituencies previously undermined by the Sankara regime (the Mooro Naaba and other traditional rulers from the Mossi society, religious leaders, leaders of the main corporatist associations, trade unionists, etc.).

93. Clearly, such a strategy has helped maintain the political stability that the country has enjoyed since 1987. On the other hand, it did set the pattern for difficult policy changes: any major structural reform --privatization, civil service, agricultural policy-- has to go through an informal path of hard battles with representatives from the above groups. Indeed, some of the toughest opposition to economic reforms may come from within the government and its implementing agencies. Moreover, the ideological shift that was implied by the move from a revolutionary type of regime to a market economy did not really occur within the ruling elite. Therefore, some policymakers who are major stakeholders are not fully committed to reforms...

94. In sum, the weakness of the private sector and the opposition groups may favor a different sequencing of the reform program, with emphasis given to consensus building before implementation.
