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## II. PROSPECTS FOR ECONOMIC DIVERSIFICATION<sup>1</sup>

### A. Introduction

1. A central challenge for Burkina Faso's medium-term growth prospects is the diversification of the economy. This paper examines the extent to which economic diversification is justified and how the Burkinabè authorities are addressing the challenge. In particular, it reviews the main diversification objectives contained in the authorities' poverty reduction strategy paper (PRSP), analyzes the main activities that have been implemented or that are programmed in near future, and attempts to identify the weaknesses and remaining constraints to the successful implementation of the strategy. After an analysis of the rationale for diversification, the following four sections of the paper focus on the principal areas of economic activity on which the authorities rely to generate new sources of income. In addition to identifying new income-generating activities, another essential aspect of the medium term growth strategy is the creation of an enabling environment for private sector initiative to develop. This is the focus of the remaining sections of the paper, which examine some key structural and physical barriers to diversification, before presenting some concluding remarks.

2. The PRSP identifies accelerating broad-based growth and increasing employment and income generating activities for the poor as two of its four pillars, with a particular focus on the rural sector, as the primary sector in Burkina Faso accounts for about one third of GDP and employs more than 80 percent of the population<sup>2</sup>. In addition, about 90 percent of the poor are estimated to live in rural areas. Therefore, in the authorities' view, traditional income sources such as subsistence farming and livestock raising need to be complemented by additional income-generating activities in rural areas. The diversification strategy places strong emphasis on the intensification and modernization of agricultural activity, the provision of producer support through modern inputs and marketing services, and enhancements in physical infrastructure to reduce the isolation of remote areas. Other policies to boost growth through economic diversification include the development of the formal secondary sector by creating an environment conducive to foreign direct investment.

3. The 2004-06 PRSP indicates that while some activities to promote rural development took place between 2000 and 2003, notably in the area of irrigation and the rehabilitation and maintenance of roads, there was little evidence of a marked improvement in agricultural diversification. In particular, the 2004-06 PRSP notes that agriculture in Burkina Faso continues to suffer from recurrent droughts, insufficient mechanization, and little progress in adopting new agricultural techniques because of the low literacy level. Furthermore, development of the private sector continues to be hampered by limited access to financial

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<sup>1</sup> Prepared by Ragnar Gudmundsson.

<sup>2</sup> Between 1985 and 2004, the share of the primary sector in GDP remained almost identical, moving from 37.9 percent to 37.4 percent.

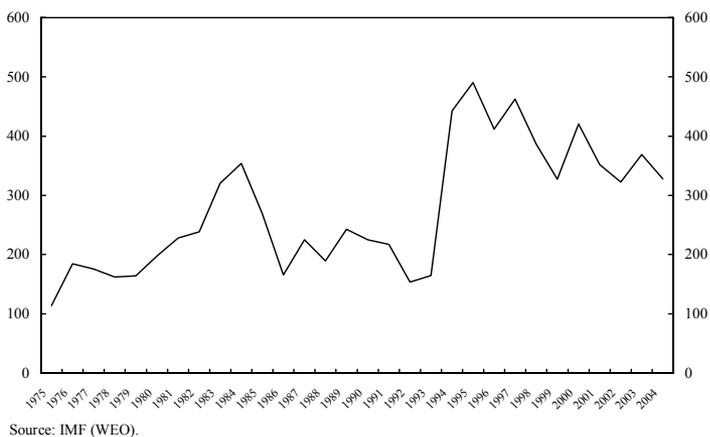
services, and foreign direct investment has remained low, with few investment opportunities, especially in a context of low productivity, institutional weaknesses, and high input and transaction costs.<sup>3</sup> As a result, four years after the publication of the first PRSP in 2000, the economy continues to be highly dependent on developments in the cotton sector.

## B. Why Diversify?

4. The exploitation of cotton has served Burkina Faso well. Growth in per capita income in rural areas has been largely driven by cotton production and exports, which have increased more than fourfold since 1994. As a result, poverty among cotton farmers is, on the basis of household surveys, estimated to have decreased from 62.1 percent in 1994 to 46.8 percent in 2003.<sup>4</sup> This spectacular achievement has been realized through an expansion of land under cultivation, an improvement in production techniques, and a restructuring of the previously State-dominated sector, notably by making farmers partial owners of the main cotton ginning company in the context of its privatization. Structural measures envisaged to strengthen further the performance of the cotton sector include the provision of technical advice to cotton farmers, ongoing research to develop new higher yielding varieties of cotton, the construction of new ginning plants, investments in rural feeder roads to facilitate the transport of cotton to ginning plants, and measures to facilitate the purchase of new equipment by cotton farmers.

5. Why diversify if cotton has been so good for the economy? First, diversification can help reduce the volatility of income, an important consideration in Burkina Faso, where the average income is close to subsistence levels. Incomes related to cotton are subject to great volatility, putting farmers at risk in the event of a drop in world prices. Cotton farmers are not able to shield themselves from the negative impact of a bad cotton campaign by saving in good times or borrowing in bad times, as the vast majority of rural households faces severe credit constraints and has little possibility either of investing savings or obtaining loans.<sup>5</sup> World cotton prices

Figure II.1. Burkina Faso: Cotton Prices, 1975–2004  
(Cotton Outlook 'A Index', CFA francs per pound)



<sup>3</sup> World Bank, “Country Assistance Strategy for Burkina Faso,” May 2005 (Washington, DC).

<sup>4</sup> Michel Grimm and Isabel Gunther, “Operationalizing Pro-Poor Growth, A Country Case Study on Burkina Faso,” joint initiative of AFD, BMZ, DFID, and World Bank, October 2004.

<sup>5</sup> The April 2005 issue of the World Economic Outlook points to recent research demonstrating the harmful effects of volatility on growth, welfare, and poverty. In particular, the research shows that:  
(continued...)

reached a record low at end-2004 (measured in euros, to which the CFA franc is pegged), eroding part of the competitiveness gains following the 1994 devaluation of the CFA franc, and although they have improved somewhat since then, they remain at a low level by historical standards. Available data from the futures markets and the International Cotton Advisory Committee point to world prices remaining below historical averages for the next five years<sup>6</sup>. Even though Burkina Faso cotton farmers have not suffered in 2005 because the guaranteed producer price had been agreed with ginning companies before prices began to fall in the second half of 2004, income prospects linked to cotton production have waned and are projected to remain subdued for the next three years.

6. A second essential reason to diversify is that not all land is suited for cotton production. Cotton production is estimated to benefit only a fifth of rural households. As pointed out in a recent study on pro-poor growth in Burkina Faso, higher productivity in the cotton sector has not translated into significant positive spill-over effects on subsistence farmers, who represent the majority of the rural sector. Food crop farmers have enjoyed much lower growth rates than cotton farmers since 1994, and continue to suffer from a lack of investments, low productivity, and limited access to domestic and international markets. This points to the need for policies specifically geared at improving the economic prospects of food crop farmers, including by creating an environment that will strengthen incentives to diversify.

7. Third, a growth strategy solely based on a continued expansion of production in the cotton sector is subject to a number of environmental risks. While there are still margins for production to increase through investments in R&D, greater use of fertilizers, and mechanization, there is a limit to the additional land that can be put under cultivation for cotton production. Also, there are already concerns linked to environmental sustainability including, in particular, soil degradation that are exacerbated by monoculture. A diversification strategy aimed at developing market outlets for new agricultural products would encourage the rotation of crops and help promote more sustainable land cultivation.

8. In their revised 2004-06 PRSP, the authorities, while recognizing the limited results achieved to date, reemphasize the importance of their economic diversification strategy, and

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(i) in developing countries, a 1 percent increase in the standard deviation of output is associated with a 0.16 percentage point decline in the average growth rate; (ii) economies with a more diversified export base have the ability to withstand higher levels of volatility with less adverse effects on growth; and (iii) the lack of developed financial markets coupled with developing countries' limited access to international financial markets magnify the welfare costs of consumption volatility, which is on average two to three times higher than in developed countries. "World Economic Outlook, Globalization and External Imbalances," April 2005 (Washington, DC).

<sup>6</sup> International Monetary Fund, "Regional Economic Outlook, Sub-Saharan Africa," May 2005 (Washington, DC).

outline the following main areas where they intend to make progress with support from development partners:

- developing agro processing and the marketing of agricultural products;
- developing infrastructure for bringing products to market, including through investments for road construction and maintenance;
- reducing vulnerability to drought, including through continued investments for small-scale irrigation;
- improving access to physical assets, including through a reform of the land tenure system;
- enhancing access to credit, including through the development of microfinance; and
- building the capacities of stakeholders and creating a favorable institutional framework for private sector investment.

### **C. Diversification of Cash Crops**

9. A key objective of the PRSP is the diversification from subsistence farming to cash crops for the local and export markets, in order to improve rural income, stimulate local consumption and encourage the transformation of locally produced goods. To achieve this objective, the authorities plan to continue withdrawing from agricultural production and marketing activities, and instead to strengthen their support and advisory role vis-à-vis private sector operators, through extension services, research and development, enforcement of international quality and health norms, market information, and provision of infrastructure. In particular, the authorities' policy will be to help economic operators identify niche markets for the development and export of products that enjoy strong domestic and export demand, and to consolidate the marketing system for domestic urban markets and exports to the sub region.

10. With the support of development partners, the authorities will start implementing in 2006 the PAFASP (*Programme d'Appui aux Filières Agro-Sylvo-Pastorales*), a five-year program to support private sector activities, increase competitiveness, and alleviate constraints to marketing and agro processing. The program will help promote the production of fruits (mangoes, citrus fruit, bananas), vegetables (tomatoes, onions, green beans), and oilseeds (cashew nuts, groundnuts, sesame, shea nuts, and soybeans) by providing technical support to farmers, establishing an effective quality control and standardization system, and increasing productivity through the selection of higher yielding varieties.

11. An important step was taken with the opening of a fruit and vegetable export terminal in Bobo Dioulasso in March 2005, financed by the authorities and development partners, which will facilitate stocking and help producers meet quality and packaging standards for export markets. The terminal will be run as a profit-making enterprise, with producers charged for the services provided. The authorities indicated that the terminal could, in a second stage, be extended to allow for the transformation of stored goods into higher value-added products. In that regard, it will be important to ensure that such an extension will also be designed as a commercial venture with private sector involvement. In addition, the authorities are proceeding with the construction of cold storage facilities at the Ouagadougou airport. The production of mangoes well-suited for exports has been resumed in the orchard of Kéné Dougou, and local farmers will benefit from the recent creation of a private company, the Société Burkinabè de Fruits et Légumes (SOBFEL), which is established in the region of Bobo-Dioulasso and that will specialize in the transformation and marketing of fruits and vegetables.

12. A major challenge to diversify and increase productivity remains the low level of mechanization, which will be addressed by the use of ploughs or tractors on a shared basis at the level of the village. In that regard, the PAFASP will place special emphasis on access to appropriate technology and inputs, especially for women farmers. Another important challenge for the authorities is to promote the establishment of specialized farmers' cooperatives that can play an important role in managing the exploitation and preservation of land, and purchasing seeds and fertilizers on a collective basis, as is currently the case in the cotton sector.

#### **D. Food Security and Crops for Domestic Consumption**

13. In the first half of 2005, the authorities started implementing an action plan for the development of the cereals sector that foresees large-scale wheat production and the expansion of small-scale irrigation activities to enhance the profitability of other crops, including millet, sorghum, and maize. In addition to generating new sources of income for farmers and thus contributing to poverty reduction, a key objective for the authorities is to enhance the country's food security.

14. In March 2005, the authorities announced officially the launch of the Program for the Development of Wheat Farming, which aims to improve conditions for wheat production. A wheat farmers' association has been created and discussions have been held with local millers and bakers, who have committed to purchase all the domestic wheat production. The purchase price will be determined at the start of each campaign, based on current world prices, and the price paid to farmers will not exceed the world price of wheat. In addition, farmers are committed to ensuring that the quality standards demanded by millers and bakers will be met. Support from the government for the program will be provided through irrigation and harvesting equipment, which the authorities estimate can be amortized over a period of ten years. The wheat campaign will take place between November and March, during the dry season, when agricultural activity is traditionally slower, thus providing an

added incentive to farmers to diversify their activities. Several thousand families would be expected to benefit from the program over the long term.

15. Another stated objective of the authorities is to expand the production of rice. The main difficulty faced by local rice producers is that their costs are still significantly higher than those of competitors from Asia, even once the cost of transport is included, and campaigns to encourage consumption of locally-produced rice have met only with limited success. The authorities pointed out that while the production of rice in Burkina Faso may be less competitive than in other countries, one of their objectives is to promote domestic production in the event of a rupture in imports, and thus to ensure the food security of the country. They also indicated that there are presently about 7,000 rice farmers, who each have an average of ten dependents, and that phasing out rice production would have negative social consequences.

16. While the authorities place strong emphasis on the food security argument, economic diversification should ultimately be based on having a clear comparative advantage, and food production is not tantamount to food security. There will be little economic rationale to continue local production unless production costs can be significantly reduced through productivity gains obtained with higher yielding varieties and mechanization. While the rice varieties currently grown have yields of between five and seven tons per hectare, the authorities indicated that they have been considering the adoption of new varieties from Vietnam that could yield up to 9 tons per hectare. This option may be worth investigating, but close attention will need to be paid to the cost-effectiveness of adopting any new variety. The authorities also indicated that they were considering a commercialization mechanism similar to the one used in Mali, where, if an importer wants to import a given quantity of rice into the country, he/she agrees to purchase a corresponding share of rice from local producers. Such a measure would however constitute a restriction on imports, and should not be encouraged.

17. The authorities expressed some dissatisfaction at being encouraged to liberalize their agricultural sector without sufficient regard for domestic social and food security considerations, while high and middle-income countries continue to heavily subsidize their own agricultural production, based on arguments they consider less compelling than their own. However, it is important to bear in mind that there is an opportunity cost to the resources that would be expended in sustaining a non-competitive activity. Those resources should instead be used to create an enabling environment for crops for which there is evidence of a potential comparative advantage that can be exploited without resorting to new subsidies or trade barriers that impose costs on other segments of the population. The challenge for the authorities is not only to promote diversification, but, more importantly, to promote diversification on the basis of comparative advantage.

### **E. Livestock Expansion**

18. Livestock activities contribute significantly to the economy of Burkina Faso, accounting for slightly more than 10 percent of export earnings and representing a major

source of income for the rural population. It is estimated that livestock provides income for 86 percent of the population, and that the most vulnerable small-scale producers represent the largest contributors to the sector, with about 95 percent of total meat and milk production. The sector is considered to be internationally competitive, and therefore to be a strong potential contributor to diversification and exports growth, food security, and poverty reduction.<sup>7</sup>

19. The PRSP envisages increasing livestock productivity by use of agro-industrial by-products for cattle feed, improving breed selection, and strengthening animal health and quality checks to conform to international sanitary and phytosanitary standards. It also emphasizes the need to improve market access by renovating, organizing and managing livestock markets and by building infrastructure, such as refrigerated slaughterhouses, to facilitate meat exports based on market conditions. The authorities also intend to assist breeders by facilitating the importation of new species of cattle which are better suited for dairy products.

20. Activities recently implemented by the authorities include the establishment of new cattle raising zones and pasture areas, the vaccination of cows against contagious bovine pleuropneumonia, the vaccination of poultry against avian pseudo plague, and the creation of a center for African swine fever. A refrigerated slaughter house has recently been rehabilitated in Ouagadougou, and construction of an additional slaughter house in Bobo-Dioulasso is planned in 2006, with financial support from the World Bank. It will be important to ensure that these slaughterhouses are operated on a profit-making basis, as is the case for the Bobo Dioulasso fruit terminal. In addition to policies aimed at intensifying production, an important challenge will be to improve the organization and capacity of the livestock sector, including through support for technical training and the establishment of breeders' associations.

21. Among the main difficulties presently faced by the livestock sector is the problem of regional political instability, in particular as regards the still fragile situation in Côte d'Ivoire, which has traditionally been the main export market for livestock products. Another source of tension has come from access to agricultural land, with increasing competition for the use of land between farmers and breeders. Farming activities have increased through the expansion of land under cultivation, rather than the intensification of crops, while at the same time, the size of the livestock has increased. The number of cattle is estimated to have grown from 5 million in 1989 to 7.5 million in 2003, and is still considered insufficient to meet local and export demand. The authorities will need to address this source of tension through the selection of dedicated grazing areas with the involvement of all stakeholders at the village level.

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<sup>7</sup> World Bank, "Burkina Faso, Fifth Poverty Reduction Support Operation," April 2005 (Washington, DC).

## **F. Mining**

22. In May 2003, the authorities adopted a revised mining code designed to encourage investments in the sector. The adoption of this new mining code coincided with the start of a recovery in international gold prices, which had reached a historical low in 2001. While 56 exploration permits were delivered between 1997 and 2003, 120 have been delivered in the two years since the revised code was issued, and exploitation permits for gold mining have already been granted to three foreign investors. Construction of the Taparko mine started in the first quarter of 2005, and construction of the Kalsaka and Youga mines is scheduled to begin in the third quarter of the year. Based on the investment plans submitted by the three mining companies, the authorities estimate that the opening of these mines will lead to a considerable increase in Burkina Faso's gold production, which until now has mostly been artisanal.

23. The authorities' project that total gold production could increase from 230 kilograms in 2004, to 7.4 tons in 2006, 8.8 tons in 2007, and 9.4 tons in 2008. With a gradual increase in the activities of the three mines, total gold production over the 2006-2010 periods could reach up to 60 tons. The authorities indicated that two other sites (Essakane and Mana-Fobiri-Wona) have also generated interest from foreign investors, and that feasibility studies are under way. These two mines could be operational by 2008. If these optimistic projections materialize, they could have a significant impact on the economy, notably through an increase in domestic consumption linked to mining investments, an increase in government revenue,<sup>8</sup> and a sizable improvement in the country's trade balance. Based on 2004 prices, an increase in gold production from 230 kilograms to 8 tons would lead to a rise in the value of gold exports from CFAF 1.6 billion to CFAF 57.1 billion, quite significant when compared with total merchandise exports of CFAF 230 billion at end-2004.

24. The authorities indicated that, in addition, to the above large-scale mining activities, they have also been promoting artisanal mining, including through investments financed by resources provided in the context of the HIPC Initiative, as this is an activity that can contribute to raising the incomes of poorest segments of the population. These investments focus on the establishment of ore crushing and grinding plants, awareness training to reduce health and environmental hazards, and the dissemination of artisanal mining equipment.

## **G. Land Tenure Reform**

25. The authorities' PRSP rightly emphasizes that the intensification and modernization of agriculture will depend on efforts to create conditions under which more farmers can achieve secure land tenure. At present, Burkina Faso's land tenure system is based on traditional, uncodified rights. While in theory and in legal terms, all land is under the ownership of the State, in practice, land used for agricultural production is owned by the

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<sup>8</sup> The increase would come, notably, from a 3 percent ad valorem tax on gold production.

village community. A farmer interested in obtaining the right to exploit a piece of land must obtain prior approval from a land chief, who is the custodian of the land at the village level. Once the permission is obtained from the land chief, the farmer needs to obtain exploitation rights from the local prefect. These rights are granted only if improvements to the land are foreseen, through the planting of trees or the drilling of a well for instance. This system is unfortunately not conducive to larger agricultural exploitations that can yield economies of scale. It does not either stimulate investments to mechanize production, and leaves considerable uncertainty as to an investor's ability to recoup the resources that have been committed from a long-term perspective.

26. The authorities recognize the existence of a tension between the strategy to increase productivity and the relation of communities to the land, and indicated that a multidisciplinary group was created two years ago to draft a new law on land tenure that would help farmers secure property rights and facilitate investments geared at creating larger estates. While the authorities expressed the hope that the new law could be adopted as early as 2007, they indicated that the adoption of a new law would need to be preceded by extensive consultations with stakeholders. They underscored that the issue of land ownership is an especially sensitive one, and that such a crucial reform carried out in haste could have strong negative social and political consequences (citing it as one of the factors having led to political crisis in Côte d'Ivoire). Hence, the transition from a customary to a title-based land ownership system will need to be gradual, and a period of several years will be required for land tenure reform to fully impact agricultural production. Nonetheless, it should be feasible to speed up the process by putting in place a mechanism whereby tracts of land formally under the ownership of the State would be ceded to individuals and investors, while other tracts of land would remain under the responsibility of communities at the village level.

## **H. Promoting Irrigation**

27. Burkina Faso's arable land covers an area of about 9 million hectares, of which 3.5 million are presently exploited. It is estimated that about 500,000 hectares are suitable for irrigation, of which only about 6 percent were irrigated in 2000. In order to help farmers increase and diversify their production during the low season, reduce their vulnerability to drought, and stem rural exodus, a project to expand small-scale irrigation was launched by the authorities in 2001, and has been financed with resources obtained in the context of the enhanced HIPC-Initiative. These resources have been used by to purchase treadle and motor pumps, which have been provided to farmers through interest-free three-year microcredits. Farmers are expected to contribute ten percent of the loan as collateral. The project has been successful in the sense that it has led over the past four years to the irrigation of about 20,000 hectares, the creation of an estimated 100,000 jobs, and demonstrated to farmers the feasibility and benefit of diversifying their production during the low season.

28. Following the implementation of the pilot project, the authorities decided to continue the promotion of small-scale irrigation activities in the context of national program that will last until 2012, and which foresees the extension of irrigation techniques to an additional 30,000 hectares of land at least. While diversification initially focused mostly on the

production of corn and beans, it has since 2004 shifted into the production of fruits and vegetables, which should benefit from the activities implemented in the context of the above-mentioned PAFASP program. The main challenge is to identify ways to alleviate the serious financial constraints faced by small farmers, who are often unable or reluctant to provide the necessary collateral amounting to 10 percent of the loan. Of the 3,391 loan applications during the pilot phase, only 1,311 projects were eventually approved, and microcredit reimbursement rates have been unsatisfactory. In addition, the authorities indicated that the low literacy level continues to impede the adoption of more efficient farming techniques, calling for increased technical support to farmers.

### **I. Improving Access to Credit**

29. Microfinance is underdeveloped and unevenly distributed across the country. While the total number of microfinance institutions reached 309 at end-December 2004, more than 80 percent of the country's 45 provinces accounted for fewer than six institutions, and a quarter of provinces accounted for only 2 institutions, to the detriment of isolated rural areas. Deposits at the level of microfinance institutions represented only 5.2 percent of total deposits in the Burkinabè financial system in 2002, down from 5.6 percent in 1999. Nominal interest rates for loans from microfinance institutions are as high as 24 percent per year, while rates of remuneration on deposit accounts range from 2 to 5 percent per year. Loans represent only about 60 percent of deposits, pointing to excess liquidity.

30. The PRSP states that the aim of the authorities is to extend decentralized financial systems from the current penetration rates of 10 to 15 percent of the population and to enhance their operational capacities through refinancing systems and guarantee funds provided by other financial institutions. However, a clear plan to translate this aim into concrete actions is still lacking. The authorities have indicated that they are currently finalizing a strategy for the development of the microfinance sector, which has benefited from the participation of civil society representatives, and which will take into account the successful experience of other countries in this area. They also indicated that discussions under way at the WAEMU sub regional level would seek to determine common guidelines for the supervision of microfinance institutions. In light of its importance for the development of the rural economy, further delays to the adoption of the strategy should be avoided.

31. It should be emphasized that a reform of land tenure that would enable farmers to use their land title as a guarantee would facilitate the development of financial services in rural areas, as the low utilization rate of deposits in microfinance institutions is linked to difficulties in securing collateral or other forms of guarantee. Looking forward, the development of microfinance should focus on increasing mechanization to achieve productivity gains in agriculture, including by facilitating farmers' access to animal-drawn farm equipment and fertilizers, as the proportion of farms with plows and draft animals is currently estimated at less than 30 percent.

## **J. Strengthening Road Infrastructure**

32. One of the main factors identified by the authorities as a constraint to the development of the private sector and the commercialization of new commodities is the weakness of the country's transport infrastructure. This is especially relevant given Burkina Faso's status as a landlocked country and the need to ensure access to harbors from where goods can be exported.

33. In the context of a sectoral program covering the period 2000-10, one of the authorities' main objectives is to ensure the maintenance of the country's 15,272 kilometers of priority road infrastructure. While at present 10,000 kilometers are maintained on a regular basis, according to the authorities, the remaining 5,272 kilometers would need to be rehabilitated in a first stage, given their poor current condition. Another key objective for the authorities will be to develop and strengthen the network of international roads, which has come under strain as a result of increased traffic in the wake of the crisis in Côte d'Ivoire, and to proceed with the asphaltting of new roads to Ghana and Togo.<sup>9</sup>

34. The authorities have indicated that as a result of political developments in Côte d'Ivoire, Burkina Faso has increasingly been used as a transit route for trade from Mali and Niger. Therefore, they consider that with appropriate investments, the country could develop as a regional transport hub and generate revenues from the use of its road infrastructure. To develop its potential as a transport hub between coastal countries and those in the interior, the PRSP underscores the need to develop inland container depots with large storage and parking capacities. In that regard, construction of a road freight terminal in Bobo Dioulasso started in July 2004.

35. A second essential component of the authorities' strategy with regard to transport infrastructure is the development of rural feeder roads, which currently cover 46,095 kilometers of the territory. These feeder roads are key to reduce the isolation of rural areas and thereby increase access to education and health services, and agricultural markets. The authorities' strategy envisages the rehabilitation and maintenance of 12,000 kilometers by 2007, financed in part by HIPC Initiative resources, and emphasizes labor-intensive construction methods, in order to create temporary jobs for the poorest segments of the population and stem migration to urban areas. The strategy also envisages that local populations will take on maintenance and repair tasks, with the participation the Village Land Management Committees. The costs of maintenance will be divided between central government, local governments and users.

36. The authorities' strategy to improve the country's road infrastructure is justified on both economic and social grounds, and one of the main challenges will be to find the necessary financing on concessional terms for this very costly component of their economic

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<sup>9</sup> In 2004, only 2,007 kilometers of the country's priority roads were asphalted.

strategy. It will also be crucial to ensure that adequate provisions are made in the budget for the regular maintenance of the road network, in order to maximize the longevity of the investments that will take place in the next few years. It has been estimated that ensuring the regular maintenance of roads can nearly double their life expectancy. Ensuring the regular maintenance of the road network will thus help reduce the need to contract new loans for road construction, and this could have a significant positive impact on the country's external debt sustainability.

### K. Energy Sector Reform

37. A central medium to long term objective of the authorities is to reduce the cost and improve the reliability of electricity supply, two key impediments to the development of manufacturing activities in the country. The state-owned electricity company (SONABEL) has intrinsically high supply costs, as the country has limited hydropower potential, and electricity generation is dependent on imported petroleum fuels.<sup>10</sup> As a result, electricity tariffs are among the highest in Sub Saharan Africa, as shown in the table below. Yet, even these high tariffs do not cover the costs of supply. Therefore, it appears that one must rule out a reduction in electricity tariffs in the medium term, which will inevitably make the challenge of developing competitive manufacturing industries an even harder one than at present. It is only in the longer term that a reduction in the cost of electricity can be expected, with productivity gains stemming from new investments and more efficient management.

Table II.1. Average Tariff in US Cents/kWh

<i>Country</i>	<i>Average Household</i>	<i>Industry</i>
<b>Burkina Faso</b>	<b>22.5</b>	<b>21.3</b>
Ghana	5.14	7.44
Côte d'Ivoire	8.52	5.54
Togo	10.68	10.95
Benin	12.44	11.22
Mali	17.95	18.12
European Union (avg.)	8.14	8.73

Source: World Bank

38. In addition, even though capacity has been expanding by 7 percent a year from 1995 to 2004, there is substantial unmet demand and capacity is over utilized. The basic elements of authorities' strategy for the sector are: (i) creating an institutional, legal, and regulatory framework conducive to attracting private sector resources; (ii) meeting the short term generation deficit on the Ouagadougou Regional Network; and (iii) lowering the cost and improving the reliability of supply.

<sup>10</sup> World Bank, "Burkina Faso, Power Sector Development Project," October 2004 (Washington, DC).

39. To achieve those goals, the authorities plan to establish an independent regulatory agency and to open the power generation segment to competition by transforming SONABEL into an operating/leasing company that will be managed by a competitively selected private operator. In cooperation with development partners, they will extend in early 2007 the existing Côte d'Ivoire-Bobo Dioulasso transmission line to Ouagadougou. In addition, the authorities plan to connect the current grid to the Ghanaian grid by 2012.

40. A key challenge for the future will also be to improve the supply of energy in rural areas, where most households do not have access to electricity. As expansion of the national electricity grid is not considered a cost-effective option, investments will need to focus on the development of alternative and renewable energy sources.<sup>11</sup>

### **L. Enhancing the Business Environment**

41. In their PRSP, the authorities indicate their intention to improve the climate for private investment, with a focus on upgrading existing legislation, standards, and regulations, and carrying through reforms to make a decisive improvement in the court system.<sup>12</sup> The strategy also underscores the need to simplify administrative formalities for new businesses and reducing application processing times, and to reduce unit labor costs by cutting the social welfare contributions paid by employers in the modern sector. A third aspect of the strategy relates to building the government's capacity to regulate utility markets, and privatizing existing utilities to facilitate the entry of new operators and an injection of new resources and technology.

42. A new labor law was adopted in September 2004 that aims to reduce labor costs by making the rules governing labor contracts more flexible and streamlining procedures for out-of-court settlements of labor disputes. In May 2005, the government approved the creation of a center for business registration that consolidates and simplifies administrative requirements, including the reduction of administrative fees for establishing businesses. In addition, a center of arbitration was created to expedite the resolution of labor disputes. While the privatization program launched by the authorities in 1991 has generally been successful, progress regarding the privatization of key public utilities has been slow, and the government's credibility will be enhanced by bringing ONATEL (the national telecommunications company) to the point of sale and transferring assets to the new operator, as well as the issuance of a tender for the selection of a private operator for the management of the SONABEL in early 2006.

43. While the above measures are encouraging, it appears that investment opportunities for foreign investors will remain limited in the medium term. The costs of key infrastructure

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<sup>11</sup> World Bank, "Country Assistance Strategy for Burkina Faso," May 2005 (Washington, DC).

<sup>12</sup> Issues related to good governance, which are also key to enhancing the business environment, are examined in detail in the accompanying paper on the fight against corruption in Burkina Faso.

services are high not only compared to other countries in the WAEMU, but especially compared to those of competitors in other regions. A 2001 study prepared by the government of Burkina Faso and the World Bank indicated that the costs of water and electricity were nearly twice as high as those of Asian competitors, and that wage costs in the formal sector in Burkina Faso were 94 percent higher than in Mali, 60 percent higher than in Benin, and 70 percent higher than in Togo.<sup>13</sup> For example, while the authorities envisage in their PRSP the development of a processing industry in Burkina Faso and the emergence of cotton mills and textile plants, the experience has so far been unsuccessful, and the only remaining spinning plant is facing considerable financial difficulties, owing in part to political instability in neighboring Côte d'Ivoire. At the present stage, it is too early and unrealistic to envision a move from the production of primary commodities to manufacturing industries with higher added value.

### **M. Conclusion**

44. Cotton production will likely remain the dominant sector in Burkina Faso's economy, representing the main source of growth for the next three years. In that regard, the authorities have on several occasions stated that the development of the cotton sector would benefit from the elimination of subsidies in the US, the EU, and China. They hope that significant progress will be made in this area in the context of the WTO in the course of 2005, and that a gradual elimination of subsidies will start having an impact on world prices and the demand for cotton from Burkina Faso in 2006. In that regard, a recent study by the Food and Agriculture Organization estimated that cotton subsidies in middle-and high-income countries reached US\$3.4 billion during the 2003/04 season, and that the impact of subsidies on world prices averaged 15 percent.<sup>14</sup>

45. A sustainable growth strategy that will contribute to a reduction in volatility and an improvement in social indicators must rest on the development of new crops, on the intensification of livestock activities, and the creation of the necessary infrastructure to support the production and commercialization of new products. The authorities' analysis of the constraints to their growth strategy and the policies to address them is sound, and they have starting implementing activities that will help them achieve economic diversification. Looking forward, it will be important to ensure that economic diversification is based on the development of activities where the country has a clear comparative advantage.

46. Some of the envisaged policies will require considerable financial support, notably in the area of road infrastructure, and they will take considerable time to have an impact on the

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<sup>13</sup> Ministry of Economy and Finance of Burkina Faso, World Bank, "Burkina Faso: Competitiveness and Economic Growth, Policies, Strategies, Actions," 2001 (Washington, DC).

<sup>14</sup> Food and Agriculture Organization (FAO), 2004, "Cotton: Impact of Support Policies on Developing Countries—A Guide to Contemporary Analysis," FAO Trade Policy Technical Notes, No. 1 (Geneva).