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MACROECONOMIC ASSESSMENT OF THE STRUCTURAL ADJUSTMENT PROGRAM IN BURUNDI

TABLE OF CONTENTS.

EXECUTIVE SUMMARY

The SAL I and SAF policy measures did not become effective before mid-1986, yet, by the end of the year there were indications of positive changes in the economy.

The Government of Burundi has recently reaffirmed its commitment to strengthening its financial position and to pursuing the structural adjustment initiated under SAL I. Preparatory work for the Bank SAL II and the IMF Second-Year SAF began in late 1987, and the program was recently approved by the World Bank and the IMF.

The structural adjustment proposed under SAL II will consolidate the progress so far reached under SAL I, but will also address new issues: the liberalization of the financial and labor markets and the social dimension of adjustment.

Sensitivity analysis indicates that the burden of the external debt may become quite worrisome if the economy does not grow as anticipated by the World Bank. The whole issue should be monitored closely by the newly created inter-ministerial committee on external debt management. The implication is clear: contract new loans only when necessary -- <u>even on concessional terms</u> -- and as much as possible, orient loans towards foreign exchange generating activities.

To reinforce and complement the current reform program, it is recommended that USAID consider assisting the Government of Burundi in the following areas:

- <u>Promotion of non-traditional exports</u>: through financing a study of the direction of trade flows between Burundi and its regional trading partners, including the estimation of Domestic Resource Costs for main exportables from these countries, in order to determine the long-term growth potential of Burundi's non traditional exports at the regional level. USAID can also provide assistance in studying the potential of small projects aimed at exporting to the European and American markets;

- <u>Trade liberalization</u>: USAID can reinforce trade liberalization by providing assistance in the establishment of an "ombudsman office" to serve as a vehicle for traders to air their grievance and seek relief;

- <u>External Debt Management</u>: USAID should warn the Government and foreign donors of the possibility of an exploding debt situation;

- <u>Coffee Export Tax</u>: USAID can help the Government to explore the possibility of replacing the current implicit taxation of coffee (through the Fonds de Stabilization) with a more transparent and efficient tax, which would also be easier to monitor;

- <u>Planned Urban Growth</u>: USAID can assist new entrants to the modern sector in making the transition from rural to urban life by a program of planned urban growth that would help avoid the squalor conditions that so often accompany urbanization.

I. INTRODUCTION

1. Burundi has a development potential based on several factors: good agricultural resources, favorable climate, good trade prospects with neighboring countries, and a diligent population. Currently, with a GNP per capita estimated at US$ 280, Burundi ranks among the poorest countries in the African continent, and is facing considerable demographic pressure (coming from a population growth rate of about 3 percent per year). Harnessing the development potential will be a long-term process.

2. Agriculture is the mainstay of the economy, contributing about 60 percent of GDP and 90 percent of export earnings. In this largely subsistence dominated sector, the most important crop is coffee (80 percent of export earnings).

The secondary sector is small, accounting only for 8 percent of GDP. Past industrial policies often resulted in the use of capital-intensive processes and the establishment of large-scale plants with high dependence on imported inputs.

The tertiary sector (32 percent of GDP) is dominated by the public administration that accounts for about 12 percent of GDP.

3. Since the Third Development Plan (1978-82), the public sector has played a leading role in promoting productive activities and financing infrastructural investment. The private sector plays a major role in commercial trade and in agricultural production.

4. During the late 1970's good climatic conditions, the coming on stream of several large projects, and the expansion of the public sector contributed to economic growth, as evidenced by the 5 percent average annual GDP growth rate recorded during the 1978-81 period.

However, during the same period, the deterioration of the terms of trade (45 percent between 1978 and 1981), a rapid increase in domestic demand, and expansionary fiscal policies led to external and internal imbalances resulting in low levels of domestic savings, and higher current account and budget deficits. Consequently, public domestic and foreign debt ran at very high levels and the inflation rate reached 25 percent, leading to an appreciation of the real effective exchange rate.

5. The Government responded with pervasive administrative controls, including restrictions on imports and on the capital account, and price controls on imported and domestic goods. These measures brought about a distorted domestic price structure, high rents accruing to importers, a bias against exports, and an

industrial sector operating at a portion of its capacity due to import restrictions. Weak private participation also impeded the development of non-coffee economic activities. As a consequence, the economy became overdependent on coffee and excessively reliant on the public sector: there was a lack of incentives for sustained growth.

6. Confronted by these problems, the Government, at the end of 1984, requested the World Bank and the IMF to help formulate a coherent reform program. Preparatory work for the IDA Structural Adjustment Loan (SAL) and the IMF Structural Adjustment Facility (SAF) was initiated in mid-1985 and eventually implemented starting mid-1986. On the financial front, a stabilization program -- supported by the IMF First-Year SAF -- was set up, aimed at reaching external and domestic balance. Furthermore, to address the medium and long term structural weaknesses, support by the World Bank was proposed to be extended through several Bank interventions including (i) a series of structural adjustment credits, and (ii) a series of technical assistance credits. The first phase of the SAL program (SAL I) encompassed a comprehensive package aimed at rationalizing the incentive system and improving the efficiency of resource allocation.

7. Meanwhile, during 1985-86, GDP recovered to an annual growth rate of more than 4 percent. This was essentially due to good climatic conditions and recovery in the government-dominated sectors of construction and manufacturing. The increase of Burundi's ICA coffee quota in 1985, coupled with a 50 percent increase in the world coffee price in 1986, also provided relief to the balance of payments and the budget.

8. These improvements are, however, of a transient nature, and if anything, should serve to highlight the true structural weaknesses of the economy mentioned in para. 5. Burundi's structural problems require systematic and sustained attention. The reform program initiated under the SAL and SAF should be reinforced and complemented by further initiatives, to be formulated in the IDA Second Structural Adjustment Loan (SAL II) and the IMF Second-Year SAF.

9. Concurrent to the SAL program, the World Bank has also expressed its intention to support projects focused on important issues too specific to be covered by the SAL: agricultural research, agricultural services, manpower development in agriculture, urban sites and services, expanding water supplies in rural areas, and vocational teacher training.

II RECENT POLICY REFORMS AND ECONOMIC PERFORMANCE

II.1 First-Year SAF and SAL I

10. The Government financial stabilization program (mid 1986-mid 1987), supported by the IMF First-Year SAF, included policy actions in the following areas: (See also the policy matrix in the Appendix)

- Exchange rate adjustment: aimed at correcting the real effective appreciation since 1980 and achieving a structural improvement in the balance of payments;
- External payments: the objectives were to limit the deficit of the current account, to build up foreign exchange reserves and to limit the debt service to a reasonable proportion of exports;
- Budgetary and monetary policies: the objectives were to increase the level of public savings to finance the public investment program, to set up reasonable targets for budget deficits, with a view to reduce the crowding-out of the private sector by government's domestic borrowing, to contain domestic demand, and to avoid inflationary pressures;
- Credit policies: the goals were to improve incentives for private savings and orient credit to productive sectors.

11. The Bank's SAL I program, effective from mid-1986 to end-1987, was designed to (i) improve the utilization of the public sector resources, and (ii) rationalize the incentive system and improve the efficiency of resource allocation in the private sector.

12. With an aim to improve the utilization of the public sector resources, the program covered the following areas:

- Public expenditures: the objectives were to ensure the accountability of the public investment program with available resources and stabilization requirements, to transform the budget into an efficient tool of macro-economic management, and to reinforce existing institutional capacity in view of implementing these reforms;
- Public Enterprises: the public enterprises (PE) account for more than half of formal employment and industrial value added. By their poor economic performance and management, most PEs operated at low capacity, incurred operating losses, were unable to contribute to their own investment program or service their debt, and

constituted a considerable drain to the Government budget. The SAL action plan aimed (i) at ensuring that government participation would be limited to those PEs that provide vital public services, or where strategic sectors are involved, and (ii) at maximizing the contribution of viable PEs to GDP by ensuring their efficient operation.

13. The rationalization of the incentive system and the improvement of the efficiency of resource allocation were expected to be carried out through the following policies:

- Agricultural sector policies: the action plan consisted of (i) the design and establishment of price mechanisms that would allow for regular adjustment of export crop prices, (ii) modification of processing techniques for coffee and increased efficiency in its marketing, and (iii) rationalization of the institutional framework, with specific reference to the Regional Development Companies (RDC's);
- Trade and industrial policies: the objectives encompassed (i) liberalization of imports and the rationalization of tariffs, (ii) deregulation of price controls, (iii) revision of the Investment Code, and (iv) reduction of Government investment in the industrial sector;
- Credit allocation: the objective was to orient credit allocation towards productive investments without discrimination against the small borrowers.

II.2 Implementation of First-Year SAF and SAL I

14. Implementation of the reform program started in mid- 1987, with the establishment of a comprehensive set of measures. In the external sector, between July 1986 and March 1987, the Fbu was devalued progressively by 24 percent against the SDR to which it was pegged. The automatic exchange rate adjustment was interrupted in March 1987, but was resumed again in February 1988, when the Government began another, 10 percent devaluation of the FBu. The ceiling imposed on transfers of foreigner's income was raised. The Government undertook a comprehensive import liberalization program: with the exception of three groups of locally-manufactured products, all quantitative quotas were replaced by tariffs, and import licensing became automatic, save for a group of luxury goods. With the aim of reducing high rates of effective protection for many import-intensive industries and providing a more uniform rate of protection for production of intermediate goods based on domestic resources, the Government introduced a simplified customs tariff, comprising a reduced number of duties (two instead of three) and a reduced number of duty rates (from 57 to 5); the range of the new tariff structure

was narrowed to 15-50 percent (from the 0-280% range). Luxury goods are still taxed at 100 percent. Taxes on manufactured exports were also eliminated to reduce the anti-export bias of the trade regime.

15. In the area of external debt management, the Government created an interministerial committee to monitor Burundi's external debt and provide advice on new debt contracting.

16. To improve public resource management, the Government initiated preparation work for the first three-year Public Investment Program (PIP) for 1986-89, defined to be a rolling program subject to annual revision in light of project implementation and resource constraints. In the public enterprise sector, the government committed itself to close down four unprofitable PE's, and a Service in Charge of PEs (SCEP) was created to oversee the rehabilitation programs under preparation. Along with the tariff reform (para. 14), a reform in the transaction tax was introduced, resulting in the replacement of a "cascade tax" to a single source tax, levied on production and imports. Import duty exemptions were also considerably reduced.

17. To rationalize the incentive structure, the Investment Code was revised. Most price controls were eliminated, except for eight strategic products for which price ceilings can only be imposed in case of shortages, and for a definite period of time, and for petrol and cement. To encourage an efficient utilization of credit, interest rates were raised to real positive levels. To improve the access of small and medium enterprises to banking credit, the National Guarantee Fund was strengthened (with mission to provide collaterals to small and medium enterprises).

18. In the agricultural sector, producer prices for coffee and tea were increased by more than the local inflation. Several studies were launched to assess the potential of coffee production and the agricultural pricing system. (See Chapter 3)

II.3 Assessment of reform impact of First Year SAF and SAL I

19. The SAL I and SAF policy measures did not become effective before mid-1986, yet, by the end of the year there were indications of positive changes in the economy.

Table 1. Burundi: Main Economic Indicators, 1982-87

	1982	1983	1984	1985	1986	1987
GDP mp growth rate (%)	-0.4	3.1	-0.1	7.4	4.4	1.7
GDP fc growth rate (%)	-2.0	4.0	-0.3	7.5	3.8	4.7
Per Capita Consumption growth rate (%)	0.9	-8.1	4.9	2.7	0.3	-6.8
Debt Service (US$ mn)	11.2	12.2	17.9	28.0	32.6	47.2
Debt Service Ratio (%)	10.7	12.5	16.7	23.2	26.1	43.8
Gross Investment/GD 1/	13.9	17.8	18.4	13.6	13.6	19.9
Domestic Savings/GDP	-1.4	0	4.1	4.7	5.8	7.7
National Savings/GDP	5.3	6.4	9.9	9.3	10.1	10.0
Public Investment/GDP	13.5	17.8	14.5	11.7	13.4	15.7
Public Savings/GDP	0.8	-0.4	3.0	3.4	4.4	-1.4
Private Investment/GDP	1.2	1.1	2.7	2.4	2.4	2.4
Private Savings/GDP	4.5	6.8	6.9	5.9	5.7	11.4
Gov. Revenues/GDP	14.9	12.5	14.1	13.9	15.8	12.2
Gov. Expend./GDP	27.6	30.6	25.7	21.5	22.3	25.0
Deficit/GDP	-12.7	-18.1	-11.5	-7.5	-6.5	-12.8
Current Account ($ mn)	-174	-179	-163	-128	-151	-214
Cur. Acct/GDP						
excl official transf.	-17.1	-19.7	-16.2	-11.0	-11.5	-17.1
adj for exch rate depreciation	-17.0	-19.9	-16.2	-11.2	-10.2	-13.0

1/ including stock variation.
Source: IBRD SAL II President's Report, April 8, 1988.

20. In 1986, GDP at market prices grew by 4.4 percent. Domestic inflation was kept low at 1.8 percent -- in spite of the devaluation -- since it took the imported goods at the new depreciated exchange rate 3-4 months to enter the domestic market. Furthermore, domestic prices were kept low as traders' and importers' margins were reduced due to the effect of increased competition. Before August 1986, all imported and locally produced goods were subject to price controls, with prices set on a "cost plus" basis, thereby securing a fixed margin to the manufacturers and traders. The cost-plus formula discouraged importers from looking for the cheapest sources of supply, and manufacturers from becoming more cost-effective. This situation has been reversed since the elimination of most price controls has induced domestic agents to set retail prices in light of market-related factors.

21. In part due to the tariff reform -- which increased the minimum taxes and eliminated some import-duty exonerations-- budgetary revenues increased by 20 percent. The overall financial position of the central government improved with the budget deficit declining from 7.5 percent of GDP in 1985 to 6.5 percent in 1986. As a result, government's borrowing from the banking system declined, thereby allowing an expansion of credit to the private sector.

22. The exchange rate adjustment, together with price liberalization, served to contain the growth of imports (18 percent of GDP in 1986, as compared to 19 percent in 1985 and 24 percent in 1984). But developments in the coffee sector were less positive, as the coffee export volume fell short of the level anticipated, due to marketing problems. The weak export performance resulted in the debt service ratio (debt service as a proportion of exports of goods and non-factor services) rising to more than 26 percent. The current account deficit (excluding public transfers and on the basis of a constant real effective exchange rate) was however reduced from 11.2 percent of GDP in 1985 to 10.2 percent.

23. In August 1986 the Central Bank introduced a new interest rate structure, aiming at raising interest rates (lending and deposit rates) to real positive levels (see Statistical Attachments). There was however a problem with the structure of interest rates. As the minimum remuneration on term deposits was less than the maximum charge on most loans, banks were reluctant to accept new deposits. This situation was aggravated by the lack of a mechanism (such as T-bills..) to mop up excess liquidity. In April 1987, the rates on demand deposit were lowered.

24. In 1987, the economic situation was adversely affected by the drastic 47 percent fall in the world price of coffee. While GDP growth at factor cost reached 4.7 percent, the growth of GDP at market prices was limited to 1.7 percent, due to the decline of coffee tax revenues.

25. The financial program objectives could not be attained due to the ripple effects of the coffee shortfall. For that reason, the overall deficit of the central government increased to 12.8 percent of GDP, leading to central bank financing instead of the programmed reduction in the Government's indebtedness to the banking system. The Government also accumulated domestic arrears amounting to Fbu 2.7 billion. Domestic inflation reached 7 percent. In the same time, the deficit of the current account increased to 13 percent of GDP as compared 10.2 percent in 1986.

26. Slippages in policy implementation have occurred in the areas of planning and budgetary reform, due to delays in getting the necessary technical assistance and the September 1987 coup d'etat. The new Government, however, has announced its intention

of honoring all commitments undertaken by the former regime.

27. There have been indications of more positive developments on several fronts. Price of basic commodities -- food, clothing, and basic home construction materials -- have not deteriorated since 1985. The incomes of farmers have improved, following the increase in producer prices for coffee and tea in 1986, and the elimination in 1987 of the sales tax on food crops. It is believed now that domestic competition has increased, thereby forcing firms to look for cheaper sources of inputs (whether domestic or imported goods from the regional market -- see para. 20). The currency adjustment seems to favor the development of non-coffee exports, which benefitted from increased regional economic cooperation, leading to a substantial augmentation of manufactured exports since 1986 (about 30 percent annual growth rate in volume).

28. Import liberalization appears to be effective. The World Bank documents call for a reduction and gradual elimination of all artificial impediments to imports: quotas, licenses, etc. In the short term, quotas were to be eliminated immediately, and replaced by a more rational duty structure. While merchants are still required to obtain import license and pay customs duties, they appear to be quite pleased with the reform efforts made so far by the new Government, and the conspicuously plentiful stocks of all sorts of items in Bujumbura's shops testifies to these efforts.

29. The new import tariff structure is working well. In the new tariff schedule in effect today, all the basic items were listed at between 15 and 45% customs duty, except for luxury items, which are taxed at 100%. There are still, however, some minor problems. For one thing, while licenses are issued routinely for many items, licenses for luxury items tend to take longer. For example, licenses for a number of specialty food products are slow in being processed: such items as dried seafood, dried and fresh fruits and vegetables, and cold cuts. This may be explained by the desire to "spread out" foreign exchange over a longer period of time. Also, there is some difficulty in defining what is and what is not a "luxury" item. Once the banks and customs have decided on a list, this may speed up the process somewhat. Even then, many requests are being denied foreign exchange at the Central Bank; the merchant may import the item so long as he obtains the foreign exchange, ie. on the black market. The commercial bank merely marks the license "SP", for <u>sans paiement</u>.

30. There also seems to be some problem with importing items related to transport - petroleum, spare parts, etc. - although usually someone is able to get a license to import these items. One often sees service stations that obviously have not received gasoline shipments for some time. There seems to be a system of

"circulating" the pain; if one complains loudly that one has been too long without license, the Government tends eventually to accede to that request. Again, it may be an attempt to economize on foreign exchange.

31. The Government of Burundi has recently reaffirmed its commitment to strengthening its financial position and to pursuing the structural adjustment initiated under SAL I. Preparatory work for the Bank SAL II and the IMF Second-Year SAF began in late 1987, and the program was recently approved by the World Bank and the IMF.

III PROPOSED POLICY REFORMS UNDER SAL II AND SECOND-YEAR SAF

III.1 The Main components

32. The foundations for balanced economic growth already laid by the recent reforms will be reinforced by measures proposed under the Bank SAL II and the IMF Second-Year SAF.

33. The short-term financial program under the IMF SAF is designed to contain the overall fiscal deficit, the current account deficit, and to avoid inflationary pressures.

34. The fiscal objectives are to : (i) reduce the overall central government deficit from 12.8 percent in 1987 to 9.7 percent in 1988, with an objective of reaching 5 percent by 1991, (ii) eliminate domestic arrears by end-1989; and (iii) maintain the external debt service at 12 percent of central government total expenditures during 1988-90. To achieve these objectives, the 1988 program includes: (i) measures to increase fiscal revenues by broadening the transaction tax base (from 12 percent to 15 percent), by extending the statistical tax to all imports, and by reinforcing custom duty administration to improve collection , (ii) restriction of recurrent public expenditures on personnel outlays, goods and services and recurrent subsidies, and (iii) measures to reduce budgetary financing through the banking system by 32 percent in 1988 and thus increasing credit to the private sector. Broad money growth is projected to be held at 7 percent a year, well below the projected nominal GDP growth rate.

35. The structural adjustment proposed under SAL II will consolidate the progress so far reached under SAL I, but will also address new issues: the liberalization of the financial and labor markets and the social dimension of adjustment. A quick review of the policy reform areas will follow and a full policy matrix summarizing the principal measures and corresponding timetable is provided in the Appendices.

36. Trade and Industrial Policy: the program aims at improving the competitiveness of non-traditional exports and import-substitution activities and at providing more neutral protection across economic sectors. To improve competitiveness, the currency was adjusted by 10 percent in February 1988, and the Government is committed to periodic review of its exchange rate policy in light of its external debt position, and in line with the evolution of the real effective exchange rate. The Government is also committed to complete the on-going tariff reform and to pursue the liberalization of imports. New measures specific to SAL II include: (i) promulgation of the Export Promotion Decree to revise the existing duty drawback system (rebates to imported intermediate products used in the production of exported goods), to set a concessionary tax rate based on export performance, to allow marketing expenses incurred abroad to be fully tax deductible, and to simplify administrative procedures to travel abroad; (ii) provision of assistance to exporters in marketing and technical know-how; and (iii) identification of the long-term resource and market potential of the country.

37. Public Expenditures Programming: during SAL I, the Government initiated work on the Public Investment Program (PIP) to improve the overall allocation of resources. Under SAL II, the Government will adopt a rolling three-year Public Expenditures Program (PEP), covering recurrent and capital expenditures as well as technical assistance) as a basis for rationalizing public expenditure management. A program of institutional strengthening will be developed, geared at institutionalizing the process of preparing three-year rolling PEPs.

38. Public Enterprise Reform: in the context of SAL II, the Government has clarified its objectives and strategy for intervention in the parastatal sector. The objectives include: (i) limiting State involvement to new activities with projected economic viability and to natural monopolies (public goods); (ii) requiring all parastatals to cover their operating costs and part of their investment costs and to make net contributions to public finances; (iii) eliminating all subsidies to PEs of a commercial and industrial nature. The main elements of the strategy include: (i) rehabilitation of PEs when justified by studies; (ii) introduction of performance contracts for PEs remaining under government control; (iii) reduction in the size of the sector by mergers; (iv) liquidation and divestitures; (v) financing by the State budget of the social objectives of PEs; (vi) transformation of the legal framework to increase autonomy and accountability and to require external auditing of PEs; (vii) completion of sectoral studies leading to the preparation of action plans concerning key issues, such as prices, tariff policies, incentives for employees and investors, and privatization. In the operational context of SAL II, the Government will complete the legal liquidation of four PEs

(AGRIBAL, SUPOBU, SOMEBU, SOGESA) already identified under SAL I, and will take appropriate actions with respect to a first group of PEs (CADEBU, OTRACO, ONAPHA, OTRABU, EPIMABU, ONC, ONIMAC), on the basis of recently completed studies.

39. Agricultural Policies: in parallel to devoting 40 percent of the 1988-90 PIP to the agricultural sector (see Statistical Attachments for details), the Government intends to : (i) improve productivity levels through increased fertilizer utilization, (ii) prepare pricing policies in line with production and export objectives, (iii) strengthen the efficiency of coffee exports, while assessing the potential of this crop in international markets, and the opportunity cost of coffee, and (iv) address the economic and financial difficulties of some agro-industrial projects (sugar, palm oil, rice).

40. Employment Policies: under SAL II, the objectives are to liberalize the labor market, revise the legislation on domestic and foreign labor, strengthen the role of the Ministry of Labor as promoter of employment, put in place a series of measures aimed at reducing costs to employers associated with employment, and stimulate the development of artisanal and informal activities.

41. Financial Markets: in SAL II the Government will liberalize the interest rate structure and replace the regulatory system by more efficient instruments to manage credit and liquidity. By mid-1989, the present system of multiple interest rates will be replaced by a simplified system of two rediscount rates, whereby the Government would regularly adjust the discount rate of the Central Bank, while letting all other interest rates be market determined. To encourage the banks to accept term deposits in a situation of excessive liquidity, the Government has approved the issue of Treasury bills through the Central Bank. Their interest rates will be determined by an open auction system. In order to increase competition among banks, public enterprises will be allowed to reduce their deposits with the Central Bank and to invest their excess liquidity in financial assets. In parallel, credit regulations will be simplified.

42. The Government will try to stimulate the mobilization of domestic savings, especially in the rural sector, by improving access to savings institutions (through the strengthening and expansion of savings and credit cooperatives that operate in rural areas).

43. Social Programs and Poverty Alleviation: the government will prepare a social action program giving priority to the following activities: (i) nutritional food for malnourished children, and (ii) special programs targeted to women's participation in productive activities. The Government will also undertake preparatory work to identify specific programs in the following

areas: labor-intensive components of public investments, development or extension of small productive projects to be supported by public and private donors, development of a rural housing credit program, and improvement in small scale construction technology. The Government has also started an active program to address the AIDS problem.

III.2 Economic Impact of the Reform Package: the World Bank's Scenarios

44. To analyze the economic impact of the SAL and SAF adjustment package, World Bank staff has prepared two scenarios: a low-growth ("base case") scenario and a high-growth ("alternative") scenario. These scenarios are presented in the SAL II President's Report of April 8, 1988 (para. 88-97, pp 23-27) and supersede the scenarios that were reproduced earlier in the "Burundi Structural Adjustment and Development Issues: Executive Summary" document of January 20, 1988.

45. The base scenario was built upon the assumption of an annual average growth rate of 4 percent of GDP at market prices, and did not incorporate potential additional assistance that could be mobilized under the Special Program of Assistance for the low-income debt-distressed countries in Sub-Saharan Africa (see SAL II President's Report of April 8, 1988, para. 89)

46. The alternative scenario is the scenario chosen by the Government and the World Bank as the objective of the structural adjustment reform. (see SAL 2 President's Report, para. 95).

Table 2. Burundi: Recent Performance and Growth Prospects
(Percent Annual Average Real Growth Rates)

	Actual		Pr[illegible] [illegible]88-93	
	1981-84	1984-87	Base C[illegible]	Alt. Case
GDP mp	0.5	4.5	4.0	5.1
GDP fc	0.3	5.3	3.8	4.8
GNY per capita 1/	-0.3	0	1.1	2.4
Consumption per capita	0	-1.0	0.9	2.1
Investment	1.9	4.3	2.0	4.7
Exports G&NFS	3.6	9.3	6.5	7.6
Coffee	2.3	4.8	3.1	3.1
Non Coffee	8.4	25.4	10.0	16.3
Imports G&NFS	7.6	-1.4	4.1	5.7

1/ GNY : Gross National Income
Source: IBRD SAL II President's Report, April 8, 1988.

47. The alternative scenario assumes that the increased funding from the "Special Program of Assistance ..." (see para. 45) will be available and that these extra funds lead to greater investment, more efficient use of capital, and a more efficient export promotion policy. These changes, in turn, lead to a 16 percent annual increase in non-traditional exports and ultimately to about a 5 percent rate of growth in GDP.

48. The analysis that follows is based on the alternative scenario endorsed by the Government and the World Bank.

49. From data reproduced in the SAL II President's Report (April 8, 1988) and in the Medium-Term Economic and Financial Policy Framework document (March 18, 1988), and taking into consideration the recent increase in the SAL II credit amount (from US$ 70 mn to US$ 90 mn), the capital requirements and sources for calendar years 1988 and 1989 are shown below. The financing gap for 1988 is estimated at about US$ 25 mn (using the same format as reproduced in the SAL II President's Report).

Table 3. **Burundi: External Capital Requirements and Sources 1/**
(in millions US $)

	1987	1988	1989	: 1988-92
Capital Requirements:	239	324	293	1546
Current Acct Def.	214	225	233	1241
of which interest	(18)	(19)	(20)	(100)
Amortization	29	30	31	160
Increase in Reserves	-9	64	25	119
Other Capital	5	5	5	25
Sources:				
Disbursements from existing commitments	211	90	60	225
of which grants	(90)			
Disbursements (estimated) from expected new com'ts		131	173	1021
of which grants		(105)	(110)	(580)
Total Financing	211	221	233	1246
Financing Gap	28	103	61	300
- IDA SAL 2/	28	60	30	169
- IMF SAF		18	8	25
- Identified Gap		25	23	106

1/ see Table A.7 in Appendix for more details
2/ SAL II US$ 90 mn disbursed in two tranches: US$ 60 mn in 1988 and US$ 30 mn in 1989
Source: SAL II President's Report and USAID mission estimates.

50. According to World Bank staff, the estimated disbursement from expected new commitments were derived from linear extrapolation of past trends. To that extent, the only secured sources of financing are (i) the disbursement from existing commitments, and (ii) the SAL and SAF disbursements. Thus the financing gap (excluding estimated disbursements from new commitments) is as shown in Table 4 below.

Table 4. Burundi: Financing gap, 1988-89
in millions US $

	1988	1989
Capital Requirements	324	293
Secured disbursements:	168	98
from existing commitments	(90)	(60)
from SAL	(60)	(30)
from SAF	(18)	(8)
Interim Financing Gap	156	195
Expected disbursements:	49	8
from FED	(15)	
from Belgium	(10)	
from Italy	(10)	
from Japan/Saudi	(14)	(8)
from unidentified sources	107	187

51. The World Bank Resident Representative in Burundi has recently indicated that some donors have firmed up their commitments, and new grants can be expected from FED (US$ 15 mn), Belgium (US$ 10 mn), Italy (US$ 10 mn), and Austria (for an undisclosed amount). Japan and Saudi Arabia have committed US$ 22 mn under the SAL Special Joint Fund. It is assumed that 60 percent of this will be disbursed in 1988, with the remainder to be disbursed in 1989. Taking into consideration these amounts, the gap for 1988 is estimated at US$ 107 mn. It is expected that disbursements from grants and loans by other donors (France, African Development Fund,...) will fill this gap; however, the exact amount of grants and loans to be disbursed will only be known when all the donors indicate their commitments.

52. In relation to the financing requirements, Bank staff have estimated the debt service ratio to decline gradually, reaching 27 percent by 1992.

Table 5. Burundi: Projections of Debt Service
Alternative Scenario

	1987	1988	1989	1990	1991	1992
Debt Service ($ mn)	47	49	51	51	54	57
Amortization	29	30	31	31	33	36
Interest	18	19	20	20	21	21
Debt Serv./Exp. GNFS (%)	43.8	38.0	34.0	30.4	29.5	26.9

Source: SAL II President's Report, April 8, 1988.

IV ASSESSMENT OF SECOND-YEAR SAF AND SAL II PROGRAM

IV.1 Issues at stake

53. World Bank staff recognize that, despite the Government's commitment to the adjustment program, its successful outcome may be hindered by: (i) the volatility of the world coffee market, (ii) the protectionist policies and major payment problems associated with neighboring trading partners. In fact, a thorough examination of the components of the SAL and SAF program does point to some issues that require further attention. The following issues are at stake:

- effects of exchange rate devaluation;
- guidelines for restructuring the parastatals;
- implementation of the liberalization of trade;
- external debt management;
- budgetary discipline;
- export taxes on coffee.

53. Exchange rate devaluation: one of the main objectives for a currency adjustment is to promote exports. In the case of Burundi, 80 percent of export earnings come from coffee exports, which are constrained by quotas. There are also difficulties in transporting the product to Indian Ocean ports. Any gain from devaluation would thereby come from the promotion of manufactured and non-traditional exports towards neighboring countries. Officially, these exports currently account for about 25 percent of the value of total exports fob. The performance of these non-traditional exports is believed to be inversely related to the protectionist policies and payments problems of the countries of destination. However, the reverse may not be true. Suppose that

protectionist barriers are to be brought down in neighboring countries, -- say as a result of adjustment reform programs to be formulated by the World Bank and the IMF -- and trade to be liberalized, with every country in the region trying to promote its own non-traditional and manufactured exports. Under these circumstances, one could not say much about the growth potential of Burundi's exports of manufactured and non-traditional goods.

Table 6. Burundi: Structure of Exports (f.o.b) in millions of Fbu

	1984	1985	1986	1987
Coffee	9930	11354	17057	7175
Cotton	82	42	20	502
Tea	864	712	515	614
Hides	82	116	151	181
Manufactures	540	716	1082	1587
Others	330	521	482	390
- primary products	(311)	(505)	(459)	-
- re-exports and non-primary	(19)	(16)	(23)	-
Total recorded	11826	13462	19306	10458

Source : IBRD and Central Bank.

54. To that extent, more work needs to be done to determine the goods for which Burundi has some comparative advantage, especially with reference to a competitive regional environment. Looking at the Domestic Resource Costs (DRC) for selected goods at the <u>regional level</u> may constitute a good approach to the problem. A comprehensive study of the magnitude and direction of flows within the region would also be needed. [These studies might possibly be done by USAID.]

55. Furthermore, in terms of promoting exports that must be transported to distant markets, the emphasis should be given to high-valued, low bulk products (such as orchids, tropical fish, etc...) geared towards the European and American markets. [USAID can provide assistance in studying the potential of such projects.]

56. <u>Trade Liberalization and Promotion of Exports</u>: The Government has agreed to set up an Office of Standards and Measures and a unit to coordinate and follow-up on the export promotion program. This unit will provide exporters with market

information and technical assistance. The mission of this unit should be extended beyond coordination and follow-up tasks to play the role of an independent "ombudsman office" to which traders and other economic agents could go and express their grievances, when they feel that the policy measures agreed upon by the Government -- concerning export promotion as well as import liberalization -- have not been properly implemented. As is often the case, it is at the implementation stage that the essence and spirit of laws are violated. The composition, role and modalities of intervention of this unit need to be spelled out in an explicit manner. [USAID could play an active role at this stage.]

57. Guidelines for Restructuring the Parastatal Sector: While the divestiture of public enterprises, especially those that are not profitable, is a major objective of the structural adjustment reform program, the process may take longer in Burundi than might normally be expected. First, there simply are a lot of parastatals to be categorized and analyzed. Second, for those enterprises deemed saleable, divestiture plans will have to be developed. Third, the apparent thinness of the Burundian entrepreneurial class and its lack of capital may call for a gradual divestiture in order to avoid any socioeconomic conflicts that might arise if foreign interests with capital became too heavily involved in the private sector all at once. This will require indepth, careful analysis.

58. Fourth, former public sector activities that are purchased by or undertaken by the private sector may evolve into monopolies as a result of the rather small size of the Burundian formal sector. Hence careful thought will need to be given to the need to establish an appropriate policy and regulatory framework in which newly privatized public enterprises could contribute in a positive manner to the country's development within a competitive environment. As part of this analysis, the existing private sector regulatory environment will need to be examined in order to eliminate those aspects which may be impeding and thwarting the development of a thriving private sector in Burundi.

59. The policy prescription is quite clear: liberalization of the market place to ensure competition prior to privatization. Without this element the divestiture may reduce the government budget deficit, but fail to produce increases in productivity and economic efficiency, two important objectives of divestiture.

60. In summary, to ease the budget strain in the short run while the various studies are being conducted, subsidies to non-strategic public enterprises should be reduced or eliminated. Those public enterprises that are likely to remain in the public sector should be given more autonomy through performance contracts. In the long run, the government should create a healthy and less oppressive regulatory environment which will

allow the private sector to expand. Further diagnostic studies need to be carried out, on a case by case basis, for the 60 or more public enterprises in Burundi; in light of these results, appropriate action plans can then be prepared, fully consistent with the guidelines presented above.

61. External Debt Management: in 1987 the external public debt service jumped to US$ 47 millions as compared to US.$ 33 millions in 1986, representing nearly 44 percent of earnings from exports of goods and non factor services. This situation was due to a bunching of maturities coming to term, and a decrease in coffee export earnings due to price volatility. The government understands the serious nature of the external debt issue, and has accordingly set up an interministerial committee for the management of the debt. However, there are some weaknesses that need to be addressed. Debt statistics are not centralized, and the debt aggregates reported vary between institutions. The importance of strengthening this committee should be emphasized, as Burundi is now in the process of contracting huge amounts of loans from foreign agencies. Given the limited absorptive capacity of the country, excessive borrowing in the short-term will result in a build-up of reserves and/or more imports of consumer goods, with no positive impact on the productive structure of the country. In the long run, given the constraints faced by Burundi's exports, one is not sure whether future amortization and interest payments on debts contracted today would not constitute a formidable strain on the future flows of foreign exchange earnings. This critical situation could be furthermore exacerbated by the difficulty to reschedule Burundi's debt. Given the "preferred creditor status" of the World Bank and the IMF -- the main lenders in Burundi --, it is not likely that the Government could obtain a rescheduling of the amounts due to these institutions. [To that extent, there is a definite responsibility for USAID to alert the Government and foreign donors of the possibility of an exploding debt burden.]

62. The Budget Issue: one of the tenets of the so-called "sequencing" argument is that not much else can work if the budget remains seriously out of control. The latest projections are for a revenue shortfall of 10 billion FBu out of expenditures of 30 billion, or a 33% deficit (to expenditures) and a 16% deficit to GDP ratio. World Bank projections in the SAL II was for about a 9% deficit to GDP ratio. Unless expenditures are brought under control, this deficit problem can hamper the adjustment program.

63. Export Taxes: the World Bank calls for elimination of taxes on exports. In Burundi the only export taxes currently in effect are the indirect business taxes contained in the cost of producing exports. While these taxes generate a fair amount of revenue for the country, they tend to place domestically produced export goods at a comparative disadvantage relative to the rest

of the world. As a general rule, therefore, export taxes should be rebated.

64. One exception to this rule, however, is in the case of exports of a product whose export level is regulated as part of a cartel agreement. In light of the coffee quota imposed on Burundi, currently at about 36,000 tons, it makes economic sense for the GRB to replace the so-called Fonds de Stabilization, which, in effect, collects excess revenues from coffee sales, with an export tax. The reason an export tax is not harmful to Burundi's coffee exports is that numerical quotas allow the exporting country to capture a monopoly profit not available in a competitive environment. The export tax merely redistributes the excess income from coffee sales from the producers to the government. In contrast to the implicit taxation by the Fonds de Stabilization, the export tax has the advantage of being transparent, efficient and easier to monitor. The size of the tax should be the difference between the world price of coffee, expressed in FBu at the official rate, and the normal cost of the coffee at the point of exit from the country. [USAID could initiate preparatory work on this issue.]

IV.2 Assessment of IBRD's macro-economic projections

65. As mentioned earlier, the World Bank's alternative scenario reflected the Government's overall objectives of a 5 percent annual GDP growth allowing for a positive per capita consumption growth. Given these objectives, several strategic variables (inter alia, the volume of required imports, the required investment level, and the burden of the external debt) were endogenously derived from the projection model. These variables aim at providing a quantitative assessment of the reform impact on the economy. Here again, the conclusions reached by the World Bank need to be qualified.

66. While the projected import requirements appear to be realistic, the investment requirements, as estimated by World Bank staff, imply an immediate realization of substantial efficiency gains in investment which seem to be hard to defend. In our judgment, in the medium-term, more resources need to be invested to support GDP growth than the level estimated by Bank staff (see Appendix), and ceteris paribus, less should be available for consumption. Consequently, the claim made by the World Bank of a positive per capita consumption growth rate of 2.4 percent may not came about. Furthermore, the additional investment need to be financed, either by the private sector or through the budget. The second option is not likely, given the discipline imposed by the IMF SAF. The private sector will have to carry out this task. Private financing of any additional investment will be contingent on an adequate level of savings and on unrestricted access to credit. These considerations strengthen

the case ~~for~~ the liberalization of the financial sector.

67. External debt service: the Bank's projections showed a declining debt service ratio, based on assumptions of exports of G&NFS growing in volume at 7.6 percent per year during the 1988-92 period, on the basis of a 3.1 percent annual growth for coffee, and 16.6 percent for non-coffee items. The bulk of non-coffee export growth would originate from manufactured and non-traditional exports, slated to progress by about 25 percent per year over the projection period. Coffee prices were assumed to recover by 6.5 percent per year until the end of 1989, and stabilize at around a 2.5 percent growth thereafter. For most non-coffee exports, prices were assumed to grow in line with international inflation, at about 2.5 to 3 percent per year.

68. The rationale for a 16 percent volume growth rate per year for non-coffee exports lies in the low base from which they started, and in the Government's active export promotion, liberalization of trade and exchange rate adjustment measures, with a view to increase regional trade. However, in light of the current (or anticipated) adjustment reforms in neighboring countries -- entailing similar trade liberalization and currency depreciation policies -- there seems to be no clear basis for such sustained growth. While such performance remains credible within the time frame defined by World Bank staff (1988-92), it is unlikely that such growth will continue beyond 1992. On these grounds, the declining debt service ratio shown by Bank staff may not decrease beyond 1992, especially when the country will start to pay back loans committed today.

69. From data presented in the SAL II President's Report, IBRD projected debt service ratios for the 1988-92 period can be replicated and extended to end-1997. In sensitivity analysis case # 1, exports of non-coffee goods and NFS are projected to grow at 16 percent per year in volume in the 1988-92 period (in conformity with the Bank's alternative scenario), thereafter decreasing to an annual growth rate of 10 percent (instead of the 16 percent projected by World Bank staff). On the basis of such assumptions, the debt service ratio sets in at an increasing trend, going from 27 percent in 1992 to 30 percent by 1993 (see Appendix).

70. In sensitivity analysis case # 2, it was assumed a flat 10 percent growth of non-coffee exports over the entire projection period 1988-97, ceteris paribus, would lead to a debt service ratio of 35 percent by 1997 (see Appendix).

Table 7. Burundi: Projection of Debt Service Ratio
Sensitivity Analysis

		1987	1988	1989	1990	1991	1992	1995	1997
Projected Debt Service in US$ mn 1/									
Debt Service ($)		47	49	51	51	54	57	77	97
Amortization		29	30	31	31	33	35	51	64
Interest		18	19	20	20	20	21	26	33
Debt Service in proportion of Exports of G & NFS (%)									
Base Case	2/	44	38	34	32	29	27	n/a	n/a
Sensitivity analysis Case I	3/	44	38	34	32	29	27	29	30
Sensitivity analysis Case II	4/	44	39	36	33	32	31	33	35

1/ : including additional debt service derived from recent augmentation in SAL II credit amount (US$ 70 mn to US$ 90 mn).
2/ : IBRD projections ("alternative scenario").
3/ : Non-coffee exports growing by 16 percent per year from 1988 to 1992, thereafter declining to a 10 percent annual rate.
4/ : Non-coffee exports growing by 10 percent per year over the 1988-97 period.

71. As evidenced by the previous analysis, the burden of the external debt is quite worrisome. The whole issue should be monitored closely by the newly created interministerial committee on external debt management. The implication is clear: contract new loans only when necessary -- even on concessional terms-- and as much as possible, orient loans towards foreign exchange generating activities.

V. CONCLUSIONS AND RECOMMENDATIONS

72. The Government of Burundi has complied with most of the provisions of SAL I and the First Year SAF. It has furthermore indicated its commitment to comply with provisions formulated in SAL II and the Second Year SAF.

73. To reinforce and complement the current reform program, it is recommended that USAID consider assisting the Government of

Burundi in the following areas:

- <u>Promotion of non-traditional exports</u>: through financing a study of the direction of trade flows between Burundi and its regional trading partners, including the estimation of Domestic Resource Costs for main exportables from these countries, in order to determine the long-term growth potential of Burundi's non traditional exports at the regional level. USAID can also provide assistance in studying the potential of small projects aimed at exporting to the European and American markets;

- <u>Trade liberalization</u>: USAID can reinforce trade liberalization by providing assistance in the establishment of an "ombudsman office" to serve as a vehicle for traders to air their grievance and seek relief;

- <u>External Debt Management</u>: USAID should warn the Government and foreign donors of the possibility of an exploding debt situation;

- <u>Coffee Export Tax</u>: USAID can help the Government to explore the possibility of replacing the current implicit taxation of coffee (through the Fonds de Stabilization) with a more transparent and efficient tax, which would also be easier to monitor.

- <u>Planned Urban Growth</u>: USAID can assist new entrants to the modern sector in making the transition from rural to urban life by a program of planned urban growth that would help avoid the squalor conditions that so often accompany urbanization.

APPENDIX I

ICOR and Derivation of the Required Level for Investment

The ICOR (Incremental Capital Output Ratio) measures the level of investment needed for a unitary increase of the GDP. As such it indicates the efficiency of investment. A high ICOR corresponds to a situation of waste where investment resources are being devoted for non-productive uses. A decreasing ICOR over time points to an amelioration of the situation.

The ICOR derived from the evolution of GDP and investment in the Bank's projection exercises fall into the range of 5.7-5.3 for the base scenario, and 4.7 - 4.2 in the more optimistic alternative scenario (see Tables below). Compared to past levels (5 - 6), the above estimates point to a more efficient use of resources, in line with the spirit of the on-going reform.

While the ICOR range assumed for the base case does not present any problem, it should be stressed that, in the alternative scenario, trying to reach an ICOR level of 4.2 within a period of five years (1988-92) would require a sustained and substantial national effort, that may or may not be forthcoming. Under the circumstances, prudence calls for less impressive performance. It would be more realistic to retain a constant level of 4.7 over the five year projection period. On this basis, investment can be projected to increase by about 6 percent per year -- instead of the 4.7 percent assumed by World Bank staff-- thereby accounting for 21 percent of GDP by 1992, instead of the 19 percent projected by the World Bank (see Tables below).

APPENDIX II

Derivation of Debt Service Ratio Under Alternative Assumptions.

The Bank's projections showed a declining debt service ratio, based on assumptions of exports of G&NFS growing in volume at 7.6 percent per year during the 1988-92 period, on the basis of a 3.1 percent annual growth for coffee, and 16.6 percent for non-coffee items. The bulk of non-coffee export growth would originate from manufactured and non-traditional exports, slated to progress by about 25 percent per year over the projection period. Coffee prices were assumed to recover by 6.5 percent per year until the end of 1989, and stabilizing around 2.5 percent thereafter. For most non-coffee exports, prices were assumed to grow in line with international inflation, at about 2.5 to 3 percent per year.

While coffee export growth rates are in line with the historical production potential of Burundi, the projected evolution of non coffee items should be reexamined with more caution. The rationale for a 16 percent volume growth rate per year for non-coffee exports lies in the Government's active export promotion, liberalization of trade and exchange rate adjustment measures, with a view to increase regional trade. However, in reference to the current (or anticipated) adjustment reforms in neighboring countries -- entailing similar trade liberalization and currency depreciation policies -- there seems to be no clear basis for such growth to be sustained. While such performance remains credible within the time frame defined by World Bank staff (1988-92), it would be wiser not to proceed to any mechanical extrapolation beyond 1992. On these grounds, the declining debt service ratio shown by Bank staff may not decline beyond 1992, especially when the country will start to pay back loans committed today.

Working with data from the SAL II President's Report, we have replicated IBRD projected debt service ratios for the 1988-92 period and extended the projections to end-1997. For the 1993-97 period, coffee exports are assumed to grow at 3.1 percent per year in volume, with coffee prices growing by 2.5 percent annually. In our sensitivity analysis (Case # 1), exports of non-coffee goods and NFS are projected to grow at 16 percent per year in volume in the 1988-92 period (in conformity with the Bank's alternative scenario), thereafter decreasing to an annual growth rate of 10 percent (instead of the 16 percent projected by World Bank staff). The non coffee exports in real terms are then converted into current price series through the international inflation index series. The debt service figures for the 1988-97 period were provided on request by World Bank staff. On the basis of such assumptions, the debt service ratio reverts to an increasing trend, going from 27 percent in 1992 to 30 percent by 1997.

Assuming a flat 10 percent growth of non-coffee exports over the entire projection period 1988-97 (sensitivity analysis case 2), ceteris paribus, would lead to a debt service ratio of 35 percent by 1997.

Burundi: Projection of Debt Service Ratio
Sensitivity Analysis

	1987	1988	1989	1990	1991	1992	1995	1997
Debt Service in proportion of Exports of G & NFS (%)								
Case # 1 1/	44	38	34	32	29	27	29	30
Case # 2 2/	44	39	36	33	32	31	33	35

1/ : Non-coffee exports growing by 16 percent per year from 1988 to 1992, there after declining to a 10 percent annual rate.

2/ : Non-coffee exports growing by 10 percent per year over the 1988-97 period.

APPENDIX III

THEORETICAL ANALYSIS OF LIBERALIZATION

Microeconomic Theory

In this section we will use simple microeconomic models to help us study the (negative) effects of various market distortions and imperfections on economic participants.

The fundamental unit we will deal with is the market. A market is defined to be a set of participants who come together to buy and sell a product (good or service). Now, this market may be of several varieties depending upon how many participants there are on each side of the market and whether or not outside authorities impose certain restrictions on the market.

The two paradigms most often studied are the ones in which there are no restrictions on participants' behaviors and either (a) both sides of the market consist of many (infinite) participants, or (b) one side, usually the demand side, consists of many participants and the other side has just one participant, called a monopolist. The first model is known as pure or perfect competition; the latter is the monopoly model.

The main reason these two particular models are used so often is that, for both of these cases, the final solution is deterministic; we know precisely the optimal outcome in the market, that is, the number of units traded and the final price.

In figure 1a above, we depict the competitive market. The demand curve is downward-sloping, reflecting the fact that each additional unit consumed bring less satisfaction to the consumer. This assumption is known as diminishing marginal utility.

The supply, or offer, curve represents the quantity of the product that will be supplied at each price. Its upward slope reflects the fact that additional unit supplied become increasingly more expensive to produce. This condition is known as diminishing marginal product of participants of production. We might also think of this upward slope as reflecting increased unit costs of participants as they must be bid away from other markets.

Now, in the purely competitive model, like a securities auction market, all participants have the same market information, free movement into and out of the market, and all transactions clear at a single price. Thus, for each additional unit demanded, the price rises for all units traded, and for each additional unit supplied, the price for all units traded declines. It can be shown that equilibrium in the competitive market occurs at quantity Qe and price Pe, where the supply and demand curves intersect.

If the product is supplied by a monopolist, however, (Figure 1a) we observe a totally different outcome. Since the producer can choose any quantity to supply to the market, he will choose that level of output that maximizes his profit. The difference between the two types of market is that in the monopoly market, the monopolist can do something about the fact that additional units supplied lower the price for all units supplied.

This recognition of market power is reflected in what is called the marginal revenue curve and it lies below the supply curve. Market equilibrium now occurs at the intersection of the MR curve and the demand curve. We see that the monopolist charges a higher price, Pm, and sells less, Qm, than in the competitive case. Note that the monopolist charges the price on the demand curve at which Qm will be demanded.

To see why the monopoly solution is less than optimal, we must introduce the concepts of producer surplus and consumer surplus. In Figure 1a, the area of triangle XYPe is called the consumer surplus and occurs because all units are traded at a price below which they would have been traded if supply were restricted. The area YZPe is called the producer surplus, and reflects the fact that producers receive more for their goods, on average, than at lower levels traded.

We can see that the sum of producer and consumer surplus is greater under competition than in the monopoly case; the difference being the so-called "dead-weight loss" contained in triangle YAZ. The reason for this loss is that the monopolist, free to choose the level of market transactions, imposes a redistribution of surplus from the consumers to himself so as to maximize his producer surplus. The producer surplus is now the area of trapezoid PmYZW. Note that the producer actually loses the surplus in triangle BAZ, but gains that contained in rectangle Pm YBPe, his gain exceeding his loss. Since the whole surplus pie is smaller than under competition, and the producer has increased his slice, the loss of consumer surplus is greater than the gain in producer surplus. This difference is the dead-weight loss.[1]

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1 It should be noted, however, that this analysis ignores the effect on other markets of the reduced supply in the monopoly market. Since the monopolist uses less factors than in the competitive case, more factors of production are available at lower cost in the rest of the economy; that is, the supply curves in all other markets are pushed to the right. Still, it can be shown that, if we assume homogeneous actors, the first best solution is for all markets to be competitive.

The analysis presented here provides a rather robust model to understand the effects on the Burundi economy of the various conditions of the SAF and the SALs.

<u>Market Distortions and Imperfections</u>

Using the analysis presented in the preceding section, let us investigate the efficiency losses caused by various market distortions and imperfections.

By imperfection, we mean any factor, internal to the market, that moves the market away from the ideal of pure competition. A so-called "natural monopoly", in which the market is too small to support more than one producer, is an example of such an imperfection. We saw above the effect a monopoly has on market equilibrium. Another example of an imperfection is the presence of externalities, external or "spill-over" effects that are not internalized in the market.

A distortion is any external constraint on the normal functioning of a market that causes the equilibrium position to be other than that under pure competition. An example of a distortion is an import quota.

To see how various distortions affect market equilibrium, see Figure 2. An import quota is a numerical limit to the quantity of a product that can be imported into the country. Actually, any limitation on the free importation of products -- limited licensing, for example -- has the same effect as a quota.

When choosing between a straight tax on imports and artificial impediments, such as quotas and licenses, the tax is always preferable from a purely economic point of view. For this reason, the World Bank has called for rapid elimination of these non-tax impediments to imports

To see the advantages of a duty over a quota suppose that the supply curve for the import is perfectly elastic, that is, that Burundi, being a very small market, can import all it wants of the product at the world price. Limiting the quantity of the good to be imported creates excess demand for the product and the importer profits from his monopoly power by raising his price above the equilibrium price (Figure 2a).

Now, if the importer is also the supplier (Toyota, for example), then the two entities have an incentive to transfer foreign exchange out of the country by invoicing imports at more than the world price for the product. In fact, the foreign exporter can capture all of the excess demand by billing the importer for the entire amount of the excess. Thus, numerical quotas on imports can result in a dead-weight loss to the importing country and a net gain to the exporting, country equal to the shaded area in the figure.

If the object is to reduce the demand for foreign exchange, an import tariff in the amount of the dead-weight loss will generate revenue for the government in that amount per unit, and foreign exchange demand per unit will equal the world price (Figure 2b). In this case, the loss to consumers is passed on to the government of the importing country and not to foreigners. The same shaded area as before is now tax revenues to the importing country.

While an import tax is always preferable to an import quota, it can be shown that an export quota and an export tax are equivalent. To see why this is so, realize that the quota raises the world price above the equilibrium price without quotas. Now, if each of the countries in the production cartel imposed a tax equal to the difference between the world price and its domestic cost of production, domestic producers would be willing to produce no more than the quota limit. Thus, output is the same under both regimes. Furthermore, the export price of the product is still the world price. So total revenue generated is the same.

The only difference between a quota and an export tax in this case is that the tax redistributes the gains made by the cartel from the producers of the product to the government of the producing country. There is, however, no transfer between the exporting and importing countries.

Another important example of a market imperfection is the case of public goods (or bads). The nature of the distortion in these cases is that consumers and/or producers of the product don't bear the actual social costs of their consumption or production.

For example, an individual would not likely bear the full cost of protecting his house from fire; however, since his neighbors benefit from his protecting his home -- extinguishing the fire at his house reduces the likelihood that cinders will start a fire at their homes -- they should bear part of the cost also. Because of the shared nature of this type of good, they are referred to as "public goods". Other examples are national defense and public parks.

In the case of a public good (Figure 3a), the way to visualize it graphically is that the individual demand curve does not include the benefits to others. If it did, the (market) demand curve would be greater than the sum (horizontally) of the individual demands. Thus, the market demand curve, including social benefits, Dw, would be to the right of this sum, Di. Then total consumption would be at a higher level and producers would be offered a higher price. Therefore, the presence of external benefits leads to underconsumption of the good unless some method, such as public financing, is found to provide the good.

In the case of external bads, such as pollution (Figure 3b), the problem is that the consumers may not pay the full social cost of their consumption. If producers are allowed to spill effluent into a river without incurring the clean-up costs or the costs to those who get sick or can no longer fish the river, then too much of the product will be consumed from society's point of view. The private supply curve, Si, does not reflect the true, social marginal cost, Sw. The equilibrium level of transactions will be lower and the price higher if transactions reflect the full costs.

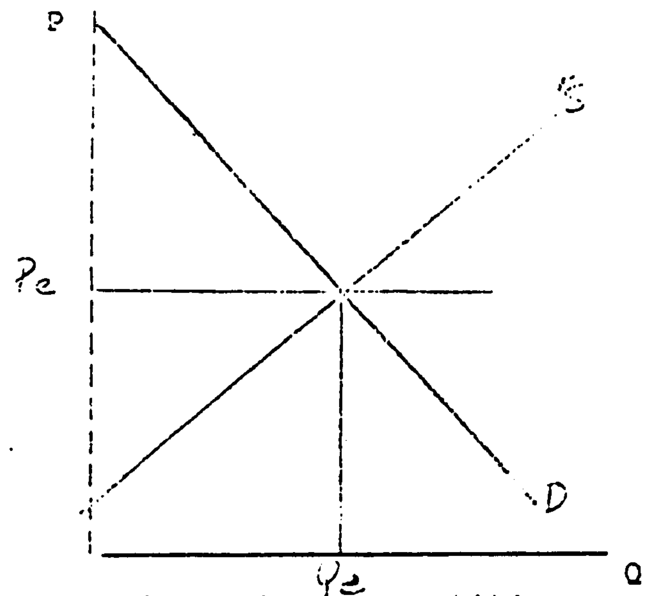

Figure 1a. Competition

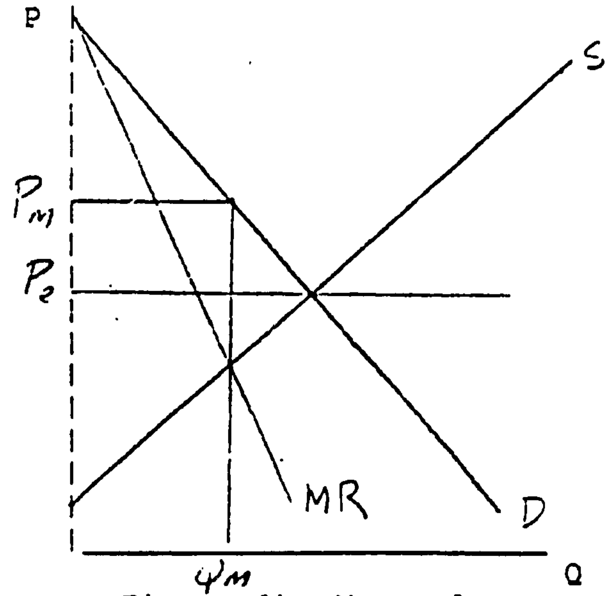

Figure 1b. Monopoly

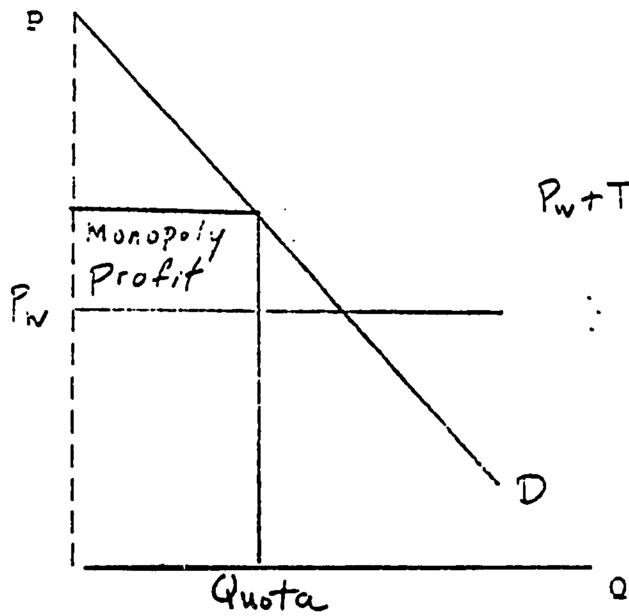

Figure 2a. Import Quota

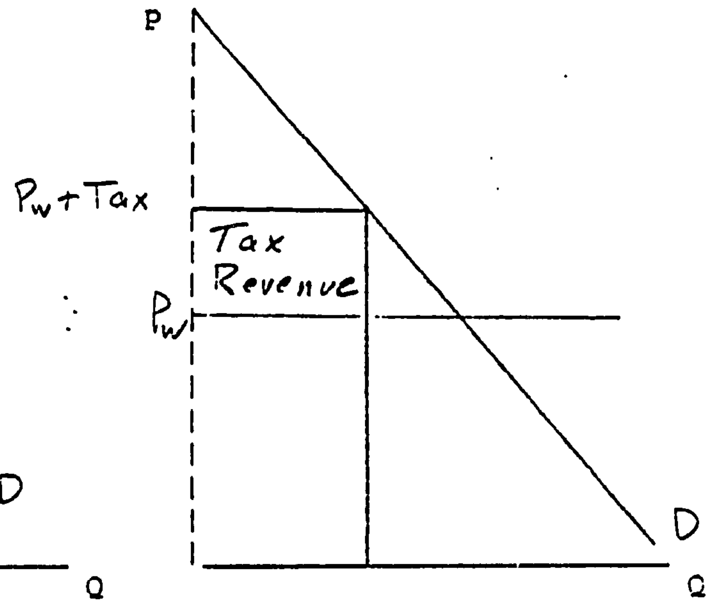

Figure 2b. Import Duty

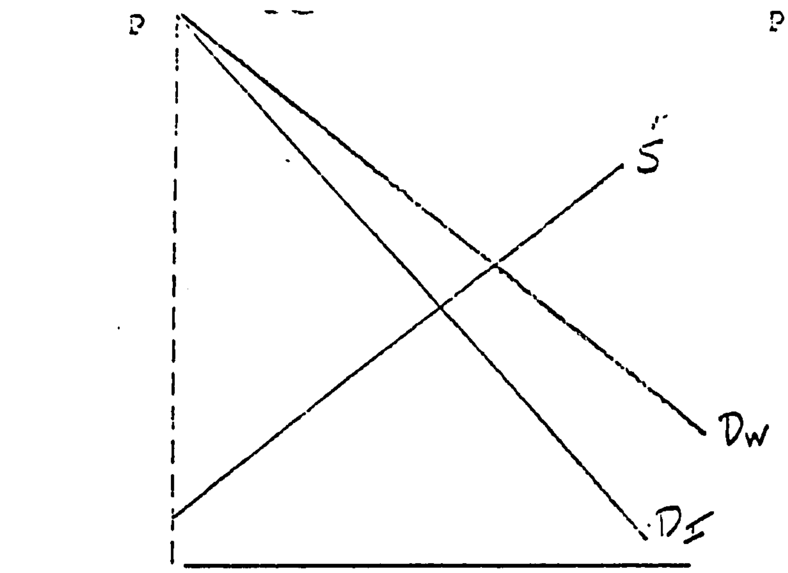

Figure 3a. Public Good

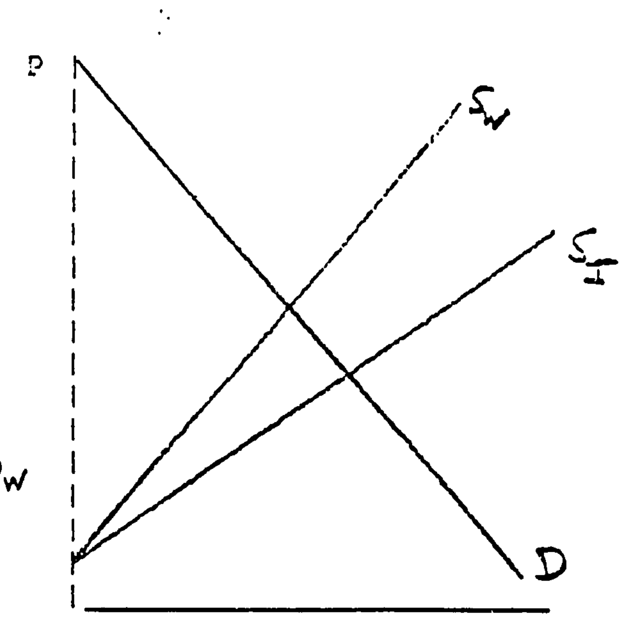

Figure 3b. Pollution

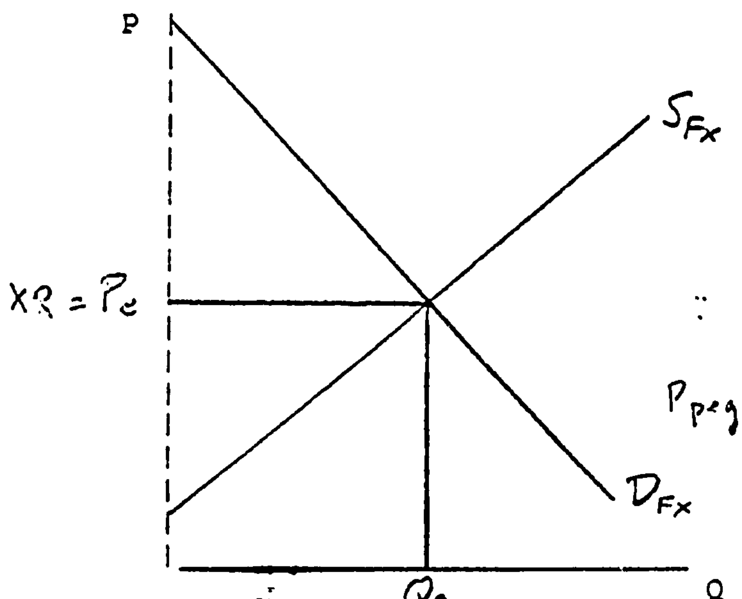

Figure 4a. Floating FX Rate

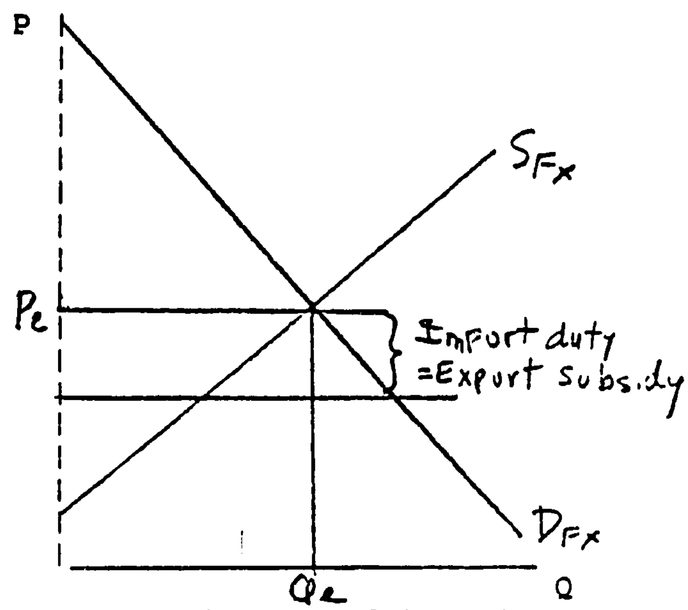

Figure 4b. Pegged FX Rate

POLICY IMPLICATIONS FOR THE FOREIGN SECTOR.

Why is Exchange Rate reform needed?

In much of the developing world, governments maintain artificially low exchange rates. This is often done in the, mistaken, belief that the country will improve its balance of payments problem. The purpose of this section is to demonstrate why such a policy is both futile and counter-productive.

To start with, let us apply our microeconomic framework to the foreign exchange sector (See Figure 4). Foreign exchange, like any other good, has a supply and demand function. The demand is a so-called "derived" demand, in that people want foreign exchange because it enables them to buy foreign goods. As with any other good, the demand for foreign exchange falls as its price increases.

The supply of foreign goods is the reflection of foreigners' demand for our products. As the price of foreign exchange rises, the price of our currency falls and foreigners will want to buy more of our products.

Now, in a floating exchange rate regime, the equilibrium price and quantity is determined at the intersection of the two curves. If, instead, the price of foreign exchange is pegged below the equilibrium rate, there will be excess demand for foreign exchange, and the value of imports (plus net capital transfers abroad) will exceed the value of exports.

One problem that sometimes occurs is that countries, such as those in the CFA zone, must peg their (common) currency to another currency. If domestic inflation, caused by a reduction in output due to war, for example, is higher than that elsewhere, then export products become relatively expensive and there will be excess demand for foreign exchange.

One solution to the problem, so long as the country is permitted independent fiscal policy, is to subsidize exports and impose an equal import tariff just equal to the difference between the equilibrium price and actual price of foreign exchange. This makes the price of one dollar's worth of imports equal to the pegged price plus the duty, which equals the equilibrium price. The price of our exports to foreigners equals the, overvalued, price of our currency <u>less</u> the subsidy, which again equals the equilibrium price. Therefore, we conclude that a pegged exchange rate regime can be made equivalent to a floating exchange rate through a regime of moving import tariff and equal export subsidy.

Let us now investigate why countries often adopt policies that actually worsen their balance of payments situation. We will start with the various arguments usually made in favor of exchange controls and then explain why each argument is illogical economically.

1. One argument against exchange reform is that it will lead to a flight of capital from the country.

In fact, underpricing foreign exchange actually contributes to this flight. This undervaluation of foreign exchange provides a disincentive to turn over foreign exchange earnings to the Central Bank and creates excess demand for foreign exchange from importers and individuals. This surplus demand necessitates the establishment of exchange controls. Thus, a regulated exchange rate system actually causes a flight of capital, rather than prevents it.

2. Those who argue against devaluation also point out that devaluation will impoverish consumers of imports due to the higher cost of these items. Furthermore, they argue, devaluation is inflationary, since it raises the domestic prices of imported goods and the domestic price of exported goods and import substitutes.

The main fallacy of the inflation argument is the fallacy of composition: the argument ignores the fact that inflation is primarily a monetary phenomenon. So long as monetary aggregates do not grow faster under the devaluation regime, devaluation's most likely impact is deflationary. This is because export expansion will actually increase GDP, which means that the same quantity of money is chasing a larger quantity of goods.

The problem with the impoverishment argument is that the people hurt most by higher import prices are consumers of imports, and these tend not to be the poorest in the country to begin with. In any event, a better solution to adverse impacts of higher import prices is through some sort of incomes policy, not exchange controls.

3. Another argument against devaluation, and one which has some merit in it, concerns a country like Burundi, whose primary export product is controlled by an international export quota. Even if (equilibrium) demand for Burundi's cheaper coffee were to expand noticeably as a result of exchange rate reform, the quota would limit Burundi's potential foreign exchange earnings.

In fact, it is not at all clear that Burundi needs to be bound by any export quota; it's coffee exports represent only a small fraction of the world's production and a compelling argument could be made for Burundi to leave the cartel, or at least cheat. In fact, however, Burundi is not currently meeting its quota, so that some expansion of coffee exports would occur in any event. For a more detailed discussion on coffee see the supplementary materials in the appendix.

Burundi might also find, as a result of exchange reform, markets for other products. In particular, a more realistic exchange rate could result in considerable expansion in Burundi's border trade. See the supplementary materials in the appendix for an outline of a possible study of the effects of exchange liberalization on border trade.

There is also the problem, for land-locked countries like Burundi, of transporting exports to world markets. Some accommodation with the neighboring countries might be arrived at, making it possible for Burundi to increase shipments. Again, the World Bank might play a role in this effort and in improving Burundi's links to the outside world through loans to those countries through which Burundi's exports must pass.

4. Another argument that is sometimes made is that even if the exchange rate were at the equilibrium rate, people would still trade in the Black Market because it's more convenient.

The easiest response to this argument is that the equilibrium rate, by definition, includes a premium sufficiently large to encourage people to turn in their foreign exchange at the Central Bank and to discourage their demand for foreign exchange until the quantity supplied equals the quantity demanded. Generally speaking, so long as there is any enforcement of exchange rules, the premium will be very slight over the Black Market rate.

5. Finally, it is argued, devaluation will worsen Burundi's budgetary problems by forcing the GOB to pay more for foreign exchange than before exchange liberalization.

This is, in fact, the real reason governments opt to overvalue their currencies; they can get foreign exchange "on the cheap". The fact is that this is a myopic view of the world that ignores the long-run impacts of such policies on foreign trade, export production and expansion of the modern sector of the economy. It is not by accident that those countries do best that regulate least.

An additional argument in favor of a liberalized exchange rate policy is a result of the J-curve effect.

One of the problems with sudden changes in the rate of exchange is that in the very short run devaluation of the home currency may temporarily lead to a worsening of the balance of payments. The reason for this is that it takes some time for economic entities to react to the change in the exchange rate.

Exporters don't immediately expand production to reap the added benefits of the higher exchange rate and buyers of the home country exports are able to buy the same number of units for less foreign exchange than before devaluation. Thus, foreign exchange earnings may fall temporarily following the devaluation.

On the demand side, importers may have to fulfill contracts and pay for imports ordered before the devaluation. Furthermore, capital expenditure outlays that require foreign exchange may increase in order for the home country to expand future output.

One of the interesting consequences of rapid devaluation is that the unofficial exchange rate will also devalue as foreign exchange supply in that market declines.

But this J-curve effect is only temporary; the long-term effect is still to increase incomes and to improve the balance of payments situation of the country. In fact, if domestic producers are convinced that the long-term effects of the devaluation are very positive, they will want to expand their investments that much more; an even greater drain on the short-run balance of payments.

For this reason, it is prudent for a country engaging in substantial devaluation of its currency to proceed slowly in this direction. Rather than attempt to bring its currency immediately to the free-market exchange rate, it might want to devalue only one or two percent per month until the (projected) long-run foreign exchange rate is achieved.

But the most important lessen of the J-curve is not to allow the exchange rate ever to get too far out of line with the equilibrium rate. The longer a country waits and the further out of line it gets, the worse the disequilibrium becomes and the more painful it becomes to restore equilibrium.

Liberalizing foreign exchange markets and its effect on the Cross-Border Trade and Coffee Exports.

As we pointed out earlier, the gains from a free-market foreign exchange system far outweigh any benefits from a system of regulated rates and exchange controls.

On the demand side, a regulated foreign exchange rate system means that the quantity of foreign exchange demanded far exceeds that available. In order to remedy this disequilibrium situation, exchange controls limiting the sales of foreign exchange must be promulgated. Under the new reform measures of the World Bank, however, such controls are to be abandoned. These reforms, in effect, dictate that Burundi adopt a free foreign exchange market.

On the supply side, undervaluing foreign exchange overvalues domestic currency and discourages foreigners from purchasing local products. For exporters of tangibles and the producers of import substitutes, a properly-valued foreign exchange means a higher price for their products, as measured in domestic currency. Since each unit sold by exporters receives the world price, and each dollar earned fetches more when it is converted into local currency at the Central Bank, exporters are better off. So too are those employed by export manufacturers, who will expand their production and bid up the price of their labor.

Furthermore, since export producers receive the free-market value for their foreign exchange earnings, there is no incentive to sell foreign exchange in the black market. Similarly, those who produce import substitutes receive greater effective protection from imports, which become more expensive at the higher exchange rate.

One area that would be well worth further study on the supply side is on the effects of exchange liberalization on cross-border trade. It is somewhat hard to know how large that trade is, but our guess is that it is quite large, particularly with Zaire, and that Burundi has considerable comparative advantage in the production of many traditional crops because of its fertile soil and favorable climate and stable political and economic environment. We believe a study of the extent of the current border trade and the prospects for its expansion under exchange reform would be worthwhile efforts. This is a possible area for USAID support.

A second study needs to be done on the consequences of exchange rate reform on coffee exports and the possibility of capturing some of the "windfall profits" that will occur.

Currently the government has a pricing system that establishes the price for coffee at each stage of production. (See Bucknall Report for a detailed discussion of this system). The difference between the final price, earned by the BCC, and the cost to the BCC is credited to the fonds de Stabilization, which ostensibly is used to finance losses wham the world coffee price is below BCC's cost.

Following exchange rate reform, one would envision a windfall profit to BCC as its local currency earnings far exceed the cost of coffee. This "tax" on coffee exports represents a net gain to the government and could be used to assist the government in its financing. A study of the projected revenues from this windfall would be helpful.

Unification of interest rates at positive real levels.

Another provision of the World Bank documents is to bring lending and borrowing rates to the same level and to make all rates the same.

To understand how this will lead to greater efficiency, it is useful to think of the money market as one thinks of any other market with the price of money equal to the interest rate. The equilibrium rate is, therefore, the rate at which money demand and money supply are equal.

If the rate of interest is kept arbitrarily low, then excess demand for money is created and a system of rationing credit is needed. But any system of rationing will be somewhat arbitrary and some projects whose internal rates of return are below the equilibrium interest rate will be financed, while other, more worthwhile, investments will be denied credit.

Furthermore, having different interest rates for different types of projects -- agricultural loans getting one rate, import loans another, etc. -- will lead to different rates of return for different activities. The intent of the unification of all interest rates is bring about increased efficiency by making all activities pass muster.

TABLE A..

BURUNDI : Computation of ICOR

	1987	1988	1989	1990	1991	1992	1993
Base Case							
			Annual Growth Rate				
GDP mp		1.7%	4.1%	3.9%	4.0%	4.1%	4.2%
GDP fc		4.7%	3.7%	3.8%	4.0%	4.2%	4.3%
Investment		2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
			in constant 1987 prices				
GDP mp	155.4	158.0	164.5	170.9	177.8	185.1	192.8
GDP fc	142.5	149.2	154.7	160.5	167.0	174.0	181.5
Investment	30.9	31.5	32.1	32.7	33.4	34.1	34.8
ICOR 1/							
Inv/Chg in GDP mp	11.7	4.9	5.0	4.9	4.6	4.4	
Inv/Chg in GDP fc	4.6	5.7	5.5	5.1	4.8	4.6	
5 year ICOR 2/	1987-92						
Inv/Chg in GDP mp	5.2						
Inv/Chg in GDP fc	5.0						
Alternative Case							
			Annual Growth Rate				
GDP mp		5.6%	5.4%	5.7%	4.8%	5.1%	4.7%
GDP fc		4.6%	4.6%	4.7%	4.8%	4.9%	5.0%
Investment		3.0%	4.8%	4.2%	4.2%	4.1%	4.1%
			in constant 1987 prices				
GDP mp	155.4	164.1	173.0	182.8	191.6	201.4	210.9
GDP fc	142.5	149.1	155.9	163.2	171.1	179.5	188.4
Investment	30.9	31.8	33.3	34.7	36.2	37.7	39.2
	19.9%	19.4%	19.3%	19.0%	18.9%		
ICOR 1/							
Inv/Chg in GDP mp	3.5	3.6	3.4	3.9	3.7	4.0	
Inv/Chg in GDP fc	4.7	4.6	4.5	4.4	4.3	4.2	
5 year ICOR 2/	1987-92						
Inv/Chg in GDP mp	3.7						
Inv/Chg in GDP fc	4.5						

1/ ICOR = Investment in year [t] / GDP [t+1] - GDP [t]
2/ 5 year ICOR = SUM (investment from [t] to [t+n]) / GDP [t+n+1] - GDP [t]

Source of data: SAL II President's Report, April 8, 1988.

TABLE 4.1

Derivation of Investment Level Consistent with Targeted ICOR

		1987	1988	1989	1990	1991	1992
		Annual Growth Rate					
GDP mp		5.6%	5.4%	5.7%	4.8%	5.1%	4.7%
GDP fc		4.6%	4.6%	4.7%	4.8%	4.9%	5.0%
Investment		5.0%	7.0%	7.0%	7.0%	7.0%	7.0%
		in constant 1987 prices					
GDP mp	155.4	164.1	172.0	182.8	191.6	201.4	210.9
GDP fc	142.5	149.1	155.9	163.2	171.1	179.5	188.4
Targeted ICOR wrt GDP fc	4.7	4.7	4.7	4.7	4.7	4.7	
Derived Investment (billions of Fbu)	30.9	32.4	34.7	37.1	39.7	42.5	
Investment/ GDP mp							
From Derived Inv.	19.9%	19.7%	20.0%	20.3%	20.7%	21.1%	
W. Bank Estimates	19.9%	19.0%	19.2%	19.0%	18.9%	18.9%	
Difference	0.0%	0.7%	0.8%	1.3%	1.8%	2.2%	

TABLE A.3

BURUNDI: Debt Indicators, 1987-97
in millions of SDR

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
From Existing Commitments (End-1987)											
DISBURSEMENTS	85.0	65.5	43.6	31.1	16.9	6.2	3.7	1.3	0.3	0.0	0.0
AMORTIZATION	22.4	22.1	22.4	22.2	23.6	25.1	26.0	26.4	27.0	28.4	25.9
INTERESTS	13.9	13.5	13.3	13.0	12.4	11.8	11.2	10.7	10.1	9.6	9.5
DEBT SERVICE	36.3	35.6	35.7	35.1	36.1	37.0	37.1	37.0	37.1	38.0	35.4
NET FLOWS	52.6	43.4	21.2	9.0	-5.7	-18.9	-22.3	-25.1	-26.8	-28.4	-25.9
From New Commitments (1988-97)											
COMMITMENTS	78.7	188.6	87.7	149.7	89.5	159.2	111.6	154.3	126.8	135.2	144.2
DISBURSEMENTS	28.5	53.3	72.0	83.9	101.8	114.1	119.6	127.1	128.8	120.9	123.9
AMORTIZATION	0.0	0.0	0.0	0.0	0.0	0.0	0.9	7.1	9.1	11.2	19.0
INTERESTS	0.2	0.5	1.0	1.5	2.2	3.0	3.8	6.2	8.1	10.0	14.0
DEBT SERVICE	0.2	0.5	1.0	1.5	2.2	3.0	4.6	13.3	17.2	21.2	33.0
NET FLOWS	28.5	53.3	72.0	83.9	101.8	114.1	118.8	120.0	119.7	109.8	104.9
Charges from Additional SAL Commitment											
DISBURSEMENTS		14.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
AMORTIZATION		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
INTERESTS		0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total											
COMMITMENTS	78.7	203.3	87.7	149.7	89.5	159.2	111.6	154.3	126.8	135.2	144.2
DISBURSEMENTS	113.5	133.4	115.6	115.0	118.7	120.3	123.3	128.3	129.1	120.9	123.9
AMORTIZATION	22.4	22.1	22.4	22.2	23.6	25.1	26.8	33.4	36.1	39.6	44.9
INTERESTS	14.1	14.0	14.4	14.6	14.8	14.9	15.1	17.0	18.3	19.7	23.6
DEBT SERVICE	36.5	36.1	36.7	36.8	38.4	40.0	41.9	50.4	54.4	59.3	68.6
NET FLOWS	91.1	111.3	93.2	92.8	95.1	95.2	96.5	94.9	93.0	81.4	78.9

Source : IBRD, Department AF3CO.

TABLE A.4

BURUNDI: Debt Indicators, 1987-97
in millions of US$

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
From Existing Commitments (End-1987)											
DISBURSEMENTS	109.9	89.5	59.9	43.2	23.7	6.8	5.2	1.8	0.4	0.0	0.0
AMORTIZATION	29.0	30.2	30.7	30.8	33.1	35.5	36.7	37.3	38.2	40.1	36.7
INTERESTS	17.9	18.4	18.3	18.0	17.4	16.8	15.8	15.1	14.3	13.6	13.4
DEBT SERVICE	46.9	48.6	49.1	48.8	50.6	52.3	52.5	52.4	52.5	53.7	50.1
NET FLOWS	80.9	59.3	29.2	12.4	-9.4	-26.7	-31.5	-35.5	-37.8	-40.1	-36.7
From New Commitments (1988-97)											
COMMITMENTS	101.8	257.7	120.5	207.9	125.4	225.1	157.8	218.1	179.2	191.1	203.9
DISBURSEMENTS	36.9	72.8	99.0	116.5	142.7	161.3	169.2	179.7	182.1	171.0	175.2
AMORTIZATION	0.0	0.0	0.0	0.0	0.0	0.0	1.2	10.0	12.8	15.8	26.8
INTERESTS	0.3	0.7	1.4	2.1	3.1	4.2	5.3	8.8	11.5	14.2	19.9
DEBT SERVICE	0.3	0.7	1.4	2.1	3.1	4.2	6.6	18.8	24.3	30.0	46.7
NET FLOWS	36.9	72.8	99.0	116.5	142.7	161.3	168.0	169.7	169.3	155.2	148.3
Charges from Additional SAL Commitment											
DISBURSEMENTS		20.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
AMORTIZATION		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
INTERESTS		0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total											
COMMITMENTS	101.8	277.7	120.5	207.9	125.4	225.1	157.8	218.1	179.2	191.1	203.9
DISBURSEMENTS	146.8	182.3	159.0	159.7	166.4	170.1	174.4	181.4	182.5	171.0	175.2
AMORTIZATION	29.0	30.2	20.7	30.8	33.1	35.5	37.9	47.3	51.0	55.9	63.5
INTERESTS	18.2	19.1	19.8	20.3	20.7	21.1	21.3	24.0	25.9	27.9	33.4
DEBT SERVICE	47.2	49.3	50.5	51.1	53.8	56.6	59.2	71.3	77.0	83.8	96.9
NET FLOWS	117.8	152.1	128.2	128.9	133.3	134.6	136.5	134.2	131.5	115.1	111.6
Memo Item:											
EXCHR US$/SDR	1.293	1.365	1.375	1.389	1.402	1.414	1.414	1.414	1.414	1.414	1.414

Source : IBRD, Department AF3CO.

TABLE A.5

BURUNDI : COMPUTATION OF DEBT SERVICE RATIO

		1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	Coffee Price Index 1/	100.0	106.8	112.2	115.2	117.1	119.2	122.2	125.3	128.4	131.6	134.9
2	International Inflation Deflator 2/	100.0	102.2	105.0	107.6	110.3	113.0	115.9	118.9	121.7	124.9	127.9
	Annual Volume Growth Rates											
3	- Coffee 3/		3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%
4	- Non Coffee 3/		16.0%	16.0%	16.0%	16.0%	16.0%	10.0%	10.0%	10.0%	10.0%	10.0%
	in constant 1987 prices											
5	Exports G & NFS (SDR Mn)	83.3	89.6	96.9	105.0	114.1	124.6	132.7	141.5	151.1	161.4	172.7
6	- Coffee	53.8	55.5	57.2	59.0	60.8	62.7	64.6	66.6	68.7	70.8	73.0
7	- Non Coffee	29.5	34.2	39.7	46.0	53.4	61.9	68.1	74.9	82.4	90.6	99.7
	in current prices											
8	Exports G & NFS (SDR Mn)	83.3	94.2	105.8	117.4	130.0	144.7	157.8	172.4	188.5	206.3	226.0
9	- Coffee	53.8	59.2	64.2	67.9	71.2	74.7	79.0	83.4	88.2	93.2	98.5
10	- Non Coffee	29.5	34.9	41.6	49.5	58.8	70.0	78.9	88.9	100.3	113.1	127.5
11	Debt Service (SDR Mn) 3/	36.5	36.1	36.7	36.8	38.4	40.0	41.9	50.4	54.4	59.3	68.6
12	Debt Service Ratio	43.8%	38.3%	34.7%	31.3%	29.5%	27.7%	26.5%	29.3%	28.9%	28.7%	30.3%

1/: IBRD Commodities Projections

TABLE A.6

BURUNDI : COMPUTATION OF DEBT SERVICE RATIO

		1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	Coffee Price Index 1/	100.0	106.8	112.2	115.2	117.1	119.2	122.2	125.3	128.4	131.6	134.9
2	International Inflation Deflator 2/	100.0	102.2	105.0	107.6	110.3	113.0	115.9	118.8	121.7	124.8	127.9
	Annual Volume Growth Rates											
3	- Coffee 3/		3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%
4	- Non Coffee 3/		10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
		in constant 1987 prices										
5	Exports G & NFS (SDR Mn)	83.3	87.9	92.8	98.2	103.9	110.1	116.8	124.0	131.8	140.3	149.4
6	- Coffee	53.8	55.5	57.2	59.0	60.8	62.7	64.6	66.6	68.7	70.8	73.0
7	- Non Coffee	29.5	32.4	35.7	39.2	43.1	47.5	52.2	57.4	63.2	69.5	76.4
		in current prices										
8	Exports G & NFS (SDR Mn)	83.3	92.4	101.6	110.1	118.8	128.4	139.4	151.6	165.1	179.9	196.2
9	- Coffee	53.8	59.2	64.2	67.9	71.2	74.7	79.0	83.4	88.2	93.2	98.5
10	- Non Coffee	29.5	33.1	37.4	42.2	47.6	53.6	60.5	68.2	76.9	86.7	97.7
11	Debt Service (SDR Mn) 3/	36.5	36.1	36.7	36.8	38.4	40.0	41.9	50.4	54.4	59.3	68.6
12	Debt Service Ratio	43.8%	39.1%	36.2%	33.4%	32.3%	31.2%	30.0%	33.3%	33.0%	33.0%	34.9%

1/: IBRD Commodities Projections

[redacted]

TABLE A.7

FINANCING REQUIREMENTS AND SOURCES
in millions US$

	1987	1988	1989	1990	1991	1992	1988-92
Capital Requirements:	239	324	293	293	310	326	1546
Cur Acct	214	225	233	247	251	275	1241
o/w interest	18	19	20	20	21	21	100
Amortization	29	30	31	31	33	35	160
Chg Reserves	-9	64	24	10	10	11	119
Others	5	5	5	5	5	5	25
Sources							
Disbursements from							
Existing Commitments	211	89	60	43	24	9	225
(o/w Grants)	91	0	0	0	0	0	0
Disbursements from							
Expected Commitments		131	173	209	242	266	1021
(o/w Grants)		105	110	116	121	127	580
Financing	211	221	233	253	265	275	1246
Gap	28	103	61	40	44	51	300
SAL (revised est.)	28	61	31	26	26	26	169
SAF	0	17	8	0	0	0	25
Gap	0	25	22	15	19	25	106

Source : IBRD Country Economist and USAID mission estimates

Table I.1: GDP by Industrial Origin, at current prices
(in billions of Fbu)

	1983	1984	1985	1986	1987
Primary Sector	53.83	64.59	77.66	80.98	84.05
o/w Export Crops	5.81	4.74	5.60	6.41	6.72
o/w Food Crops					
Secondary Sector	14.58	14.87	16.41	18.53	na
o/w Manufacturing	4.51	5.36	5.61	6.50	na
Tertiary Sector	25.63	27.96	32.13	34.81	na
o/w Public Admn	11.92	14.05	16.13	17.86	na
GDP at Factor Costs	94.04	107.42	126.20	134.32	84.05
Net Indirect Taxes	6.62	10.75	12.59	14.49	-84.05
GDP at Market Prices	100.66	118.17	138.79	148.81	na

Table I.2: GDP by Industrial Origin, at constant 1970 prices
(in billions of Fbu)

	1983	1984	1985	1986	1987
Primary Sector	17.33	16.43	17.74	18.31	18.94
o/w Export Crops	2.28	1.67	2.24	2.29	2.26
o/w Food Crops	12.86	12.58	13.25	13.68	14.05
Secondary Sector	4.22	4.52	4.75	4.91	5.16
o/w Manufacturing	1.44	1.66	1.94	1.96	2.08
Tertiary Sector	5.99	6.31	6.38	6.60	5.15
o/w Public Admn	1.66	1.66	1.69	1.74	1.92
GDP at Factor Costs	27.54	27.26	28.87	29.82	31.22
Net Indirect Taxes	2.41	3.58	3.28	3.79	2.96
GDP at Market Prices	29.95	30.84	32.15	33.61	34.18

Table II.1: GDP by End-Uses, at constant 1970 prices
(in billions of Fbu)

	1983	1984	1985	1986	1987
GDP at market prices	29.95	30.84	32.15	33.61	34.18
Resource Gap	2.57	2.32	1.18	1.30	na
Imports GNFS	5.77	6.23	5.53	5.52	na
Exports GNFS	3.20	3.91	4.35	4.22	na
Total Expenditures	32.53	33.17	33.34	35.20	na
Consumption	26.24	28.32	29.19	30.08	na
Public	3.28	3.24	3.30	3.76	na
Private	22.96	25.08	25.89	26.32	na
Investment	6.29	4.85	4.15	5.12	na
Fixed Investment	5.04	4.74	4.31	4.83	na
Public	4.39	4.01	3.58	3.94	na
Private	0.65	0.73	0.73	0.89	na
Change in Stocks	1.25	0.11	-0.16	0.29	na
Domestic Savings	2.70	1.44	1.50	2.78	na

Table II.2: GDP by End-Uses, at current prices
(in billions of Fbu)

	1983	1984	1985	1986	1987
GDP at market prices	100.66	118.17	138.79	148.81	na
Resource Gap	14.79	16.24	12.33	5.81	na
Imports GNFS	23.78	29.68	26.92	27.83	na
Exports GNFS	8.99	13.44	14.59	22.02	na
Total Expenditures	115.45	134.42	151.11	154.62	na
Consumption	92.47	112.70	131.88	138.65	na
Public	13.34	15.36	17.64	21.20	na
Private	79.13	97.34	114.24	117.45	na
Investment	22.98	21.72	19.23	15.97	na
Fixed Investment	19.44	20.79	19.85	19.18	na
Public	16.94	17.60	16.48	15.63	na
Private	2.50	3.19	3.37	3.55	na
Change in Stocks	3.54	0.93	-0.62	-3.21	na
Domestic Savings	8.19	5.47	6.91	10.16	na

Table III.1. Balance of Payments.
In millions of US $, at current prices

	1983	1984	1985	1986	1987
Exports G & NFS	97	101	125	137	108
Merchandises fob	81	88	112	126	96
o/w Coffee	70	83	93	116	70
NFS	16	13	13	11	12
Imports G & NFS	256	216	204	214	233
Merchandises fob	184	184	171	179	190
NFS	72	32	33	35	43
Resource Balance	-159	-115	-79	-77	-125
Net Factor Income	-26	-27	-31	-52	-64
o/w Interest	3	8	9	12	
Net Current Transfers		38	38	62	58
Private	52	6	8	5	4
Public		32	30	57	54
Current Account Balance (including Capital Grants)	-134	-136	-103	-124	-186
Direct Investment	0	1	1	3	2
Official Capital Grants		40	40	43	37
Medium & Long Term Loans		81	56	67	118
Disbursements		90	73	88	147
Amortization					
Net Short-Term Capital		0	0	0	-1
Capital Not Elsewhere Include	0	0	0	0	0
Changes in Net Reserves	-15	2	-9	-17	9
Memorandum Items:					
Net Reserves (end-year)	27	20	30	69	61
Import equivalent		0.8	1.1	2.5	1.5
Debt Service		na	na	na	na
Debt Service / Exports	7.3	16.9	18.3	22.3	na
Exchange Rate Fbu/US $	92.95	119.71	120.69	114.17	123.56

Table IV.1. Overall Budgetary Operations
In billions of Fbu, at current prices

	1983	1984	1985	1986	1987
Revenues and Grants	16.58	21.81	24.49	29.00	na
Revenues	12.87	17.04	19.69	23.83	na
Tax Revenues	11.86	16.03	18.22	21.21	na
Income Tax	3.45	3.90	4.04	4.43	na
Transaction Tax	2.07	2.54	2.85	3.24	na
Beer Tax	3.16	3.36	3.76	3.76	na
Import Duties	2.77	3.24	3.38	4.28	na
Coffee Export Duties	0.00	2.68	3.66	4.96	na
Others	0.41	0.31	0.53	0.54	na
Non Tax Revenues	1.01	1.01	1.47	2.62	na
Grants 2/	3.71	4.77	4.80	5.17	na
Total Expenditures	31.75	31.59	31.56	33.98	na
Current Expenditures	13.48	14.12	16.06	17.56	na
Salaries	6.03	6.47	7.08	7.81	na
Goods & Services	2.30	2.77	3.79	4.25	na
Transfers & Subsidies	1.26	1.24	2.15	2.09	na
Others	0.02	0.78	0.55	1.18	na
Interests	0.85	1.55	1.98	2.23	na
Unclassified 3/	3.02	1.32	0.51	na	na
Capital Expenditures	18.27	17.47	15.50	16.42	na
Adjustment for other operations	0.22	0.66	1.23	0.30	na
Overall Balance (commitment	-14.95	-9.12	-5.84	-4.69	na
Overall Balance (Cash)	-12.55	-10.53	-7.40	-6.06	na
Financing	12.54	10.52	7.40	6.06	na
External	9.70	8.10	5.32	6.48	na
Disbursements	10.27	8.91	6.72	10.27	na
Amortization	-0.57	-0.81	-1.40	-3.79	na
Internal	2.84	2.42	2.08	-0.42	na
Banking System	2.89	1.71	1.63	-1.08	na
Non-Banking System	-0.05	0.71	0.45	0.66	na

Description of macro-policy	What has been done to date	What remains to be done
I. Macroeconomic Management	Agreement on macroeconomic framework for 1988-90 including exchange rate adjustment BOP and public finance objectives.	Prepare and agree on macroeconomic framework for 1989-91, including overall budgetary deficit.
1.1 Exchange Rate Increase/maintain competetiveness of Burundi's exports, eliminate bias against traded goods, achieve structural improvement in BOP.	Adoption of a flexible exchange rate. Cumulative adjustment of 23% in foreign currency terms between July 1986 & March 1987. 10% adjustment in Feb. 1988.	Additional exchange rate adjustment as needed taking into account evolution of exchange rates in neighboring countries and level of net reserves. (How is this going? Some foot-dragging; real devaluation still about 10-20% below unofficial rate)
1.2 Monetary policies Issues related to size of budget deficits, credit allocation, efficiency of the credit system.	Review financial system and first measures implemented in the context of APEX credit.(FY88) (APEX [illegible])	Liberalization of interest rates and policy reform.
1.3 Budgetary policies Overall public spending should be adjusted to resource availabilities and medium-term financial equilibrium. Priorities should be defined in the context of reinforced three-year [illegible]. Control and rationalization of expenditures.	Tax measures: reform of the transaction tax. (Oct. 86); reduction of import duty exemptions and reform of import tariff structure (July 86/Jan. 88)	Revenue measures: - Enlarge basis of the transactions tax and increase excise tax on beer and soft drinks. - Strengthen monitoring and control of customs duty exemptions and import valuation system; extend statistical tax of 4% on all imports - Study to symplify the income tax system. - Strengthen custom administration to reduce fraud and improve collection of tax revenue.
	Increase participation of public enterprises in their debt servicing in 1987. Elimination of arrears in Dec. 1988. Elimination of transfers to public enterprises of a commercial nature.	- Further increase participation by public enterprises in their debt servicing; eliminate arrears on domestic payments and avoid new arrears; adjust global expenditure to revenue shortfall. - Introduce selective recruitment system for civil service and rationalize the civil service. - Prepare 1989 budget based on the relevant annual tranche of the [illegible].

[illegible] and Industrial Policy
([illegible] Incentives)

[illegible].1 [illegible] Liberalization		
[illegible] distortions caused by quantitative [illegible] restrictions; improve competition among [illegible] producers and importers; eliminate the [illegible] bias.	Automatic import licences for all products except glass, textiles and pharmaceuticals, and a few luxury items. (August, 1986). First group of restrictions on imports of luxury items were eliminated in Jan. '88. Period of licenses validation has increased from 4 to 3 months; time required to validate was reduced to 10-15 days (Jan. 1988). (What does this mean?)	- Increase the ceiling below which commercial banks are allowed to grant automatic licences fora FBu 1 million to 10 mn. Eliminate remaining import restrictions: - on imports of luxury goods - on imports competing with production of ONAPHA (pharmaceuticals) and VERRUND! (glass) within the framework of rehabilitation of concerned enterprises. - on imports competing with protection of COTEBU (textiles).
[illegible].2 Price liberalization		
[illegible] distortions in the price structure, and allow enterprises to establish financial [illegible].	Liberalization of price of all products except eight strategic products for which price ceilings can be imposed in case of acute shortages (for a maximum of 4 months); petroleum and cement; and export crops in July 1986. Adjustment of tariffs for water and electricity (Feb.'88).	- Review any adjustment of water and electricity tariffs (to strengthen REGIDESO financial position) and of petroleum products prices (to reflect increased costs and ensure adequate fiscal revenues). - Liberalize prices of certain agro-industrial products (rice, wheat, palm-oil and sugar) in the context of the program to be prepared for concerned enterprises.
[illegible].3 Tariff reform		
[illegible] progressively the average high level of tariff protection, narrow the range of tariffs, [illegible] protection among sectors.	Consolidation of fiscal and import duties and tariff reform. Number of duties reduced from 57 to 5. Range of duties fixed at 15-50%, except for luxury goods (1[illegible]%) (July 86). 2nd phase of the tariff reform; range reduced to between 45% for manufactured products and 15% for intermediate goods. Capital and essential goods remain at 15% (Jan. 88).	Third phase of tariff reform, based on study to clarify nomenclature between final and intermediate goods, take into account ZEP tariff, and review level of tariffs on intermediate goods while maintaining fiscal revenues (study completed in Sept. 88).
[illegible].4 Export promotion		
[illegible] to potential and established enterprises to expand sales toward neighboring countries and prepare the basis for long-term plan for export-oriented industries based on the comparative advantage of Burundi.	SAL I reforms included FBu depreciation, import liberalization, price deregulation, re-activation of draw-back system, elimination of taxes on non-traditional exports. Agreements with CEPGL and ZEP countries have been pursued by new Gov't. (Draw-backs are rebates for re-exported [illegible] goods)	- Promulgate decree on export promotion, introducing simplified duty draw-back, preferential profits taxes for exporters, allowing marketing expenses to be deductible from taxed profits; and simplifying emigration procedures for industrialists to visit foreign markets. - Set up Office of Standards and Measures - Create unit responsible for coordination and follow-up on export promotion program, and support to exporters with market information, technical assistance. - Undertake study to identify Burundi's long-term [illegible] and market potential, and viable export [illegible].

2.[illegible] [illegible]ent incentives		
Improve [illegible] access of small and medium enterprises to banking credit in order to stimulate their contribution to production and exports.	. Implementation of revised Investment Code and re-activation of the Guarantee Fund(July 1986) (Like FICA?) . Increase on limits on outward foreign remittances. (May 86, Jan. 87) . Liberalization of the profession of importer (July 86)	- Announcement of program's objectives and measures to inform general public and increase private sector confidence. - Implementation of general procedures to ensure efficient use of the Fund.
3. Public Expenditures Management		
Improve efficiency of public expenditures; increase coordination between capital and recurrent expenditures; ensure implementation of high priority investment projects.	Preparation of 3-year PIP for 1986-89 and identification of core program taking intoo account available resources and fiscal policy objectives. (Sept. 85/ Sept. 86) First guidelines and parameters to be used in project evaluation in 1986.	- Full agreement on 1988-90 PIP, notably concerning the stadium and central market projects. - Agree on action plan to strengthen MINPLAN - Agree on action plan to strengthen MINFIN and core Ministries.
Public Expenditure program	First report prepared in May 1997. Report on need for restructuring and strengthening of planning system. (Jan. 1997)	- Launch public expenditures review as basis for 1989 "zero basis" budget. (How's ZBB going?) - Preparation of PEP for 89-90 and pilot unified budget for 1989 based on "zero basis" budget (launched in April 1989) and sector PEP's (education, health, agriculture, RDC's, road maintenance) - Complete TA survey - Census of public service, structure and salaries, adopt revised recruitment procedures and salary structure. - Reform of budget/programming system: adopt double entry public accounting system, system of defining priorities, move into budget by priorities.
4. Public Enterprises		
Rehabilitation of the sector and improving [illegible] of follow-up on performance.	Creation of the service in charge of public enterprises (SCEP). (June 85). (Couldn't get to see these guys)	Reinforce SCEP and implement training program.
Legal framework	Draft decree (Jan. 1988)	- Adoption of decree on PE legal framework.
Liquidation	Closure of four enterprises (Aug. 86)	- Legal liquidation of SOGESA, AGRIBAL, SOPOBU, SONEBU.
First phase of Rehabilitation	Rehabilitation program for OTRACO (Oct. 87), CADEBU, OTRABU (March 88), ONAPHA, EPI[illegible]BU, O[illegible], [illegible] (April 1988)	- Signature of performance contracts: ????? OTRACO (April 88) CADEBU, OTRABU (June 88) ONAPHA (July 88) VERRUNDI (Dec. 88, 2nd tranche)
Second Phase of Rehabilitation:		- Rehabilitation program for [illegible] - Minoterie de [illegible], Milk plant, and [illegible].
Third Phase of Rehabilitation:	The government decided to rehabilitate the housing offices (ONL and SIP), ONATEL (Telecommunications) and three publicly owned hotels.	ONL/SIP, ONATEL, Hotels: - Rehabilitation program Signature of performance contracts:

... Studies		- Launching sector studies as basis for policy reforms: Price/tariffs and incentive system Privatization Crossed debts and monitoring financial relations State/PE
Management Information	Preliminary Project	- Definitive program - Implementation
5. Agriculture		
5.1 Coffee	Measures to reduce humidity levels of fully-washed coffee. (Feb. 86) Launching of a census (OCIBU) of coffee trees to assess the potential of coffee production (1988) (How's this going?) (I'd really like to see this by vintage of trees)	- Elaborate long-term strategy for coffee production based on study to define (i) the production potential in terms of opportunity costs with respect to other crops/activities; (ii) perpectives of export potential for Burundi coffee - Eliminate the "potato" taste" - Define future structure of management for washing stations - Implement new pricing system (echelle mobile) aimed at symplifying the system; introduce sliding scale for fully-washed coffee; introduce position for coffee research. - Technical assistance to BCC in order to improve its marketing capabilities. (Very important! BCC bad news) - Put in place information system to follow up on world coffee prices.
5.2 Agricultural Exports		- Study relative advantages of export crops including assessment of needed exchange rate policy to ensure an improvement in producer prices and an adequate financial situation in the sectors (coffee, tea, cotton)
5.3 Fertilizer Policy		- Elaborate long-term policy on fertilizers; evaluate economic utilization of chemical fertilizers; implement national program of improved seeds; improve participation of private sector.
5.4 Agro-industrial Projects		- Sugar: syudy of options for **sugar production.** Agreement on action plan **for 1989** - Rice: Plan to liberalize marketing of rice Liberalization - Palm oil: Revision of plan to extend processing plant.

yment Policies		

employment creation to absorb the ew entrants in the modern sector, policy measures	In addition to macroeconomic measures under SAL I, Gov't has abolished the progressive labor tax, relaxed former restrictions on urban settlement and population mobility and elimited the "permit de sejour".
	(This could be very important. Need good monitoring to guarantee adequate labor mobility for reform to work)
		- Liberalize system of recruitment; firms are allowed to recruit directly without mandatory consultation with Ministry of Labor. Report on vacancies is voluntary. Placement committee's functions are revised. (??)
		- Review law on foreign labor
		- Review functions of the MOL and define new role for Labor department.
		  - agreement on new organigram
		  - Implementation
		- Reinforce DMO including improvement in statistical basis on employment and salaries. (DnO??)
		  Launching ILO project
		  Propositions for improving capacity (??)
		- Eliminate ban on imports of second-hand technology (?) when accompanied by performance guarantee certificates
		- Adopt revised medical tax code to remove "anti-labor" bias. (??)
		- Implement health insurance system for private employees.

tary and credit policies		
the system of allocating credit and ation of domestic credit	Increase of real interest rates to positive levels. (Aug. 85) Increase of 5 percentage points in rate on 12 months savings deposits and revision of interest rate policy (July 85) Revision of interest rates in May 1987.	First Phase: - Eliminate a priori authorization from BRB on individual credits above FBu. 10 mn. - Allow PE's to deposit their liquidities in the most profitable fashion. - First issue of treasury bills by public auction (open to all financial institutions); calendar of issues for the 2nd quarter 1988. - Deregulate interest rates on non-rediscountable loans and eliminate minimum interest rates on cash deposits. - Implement Compulsory Reserves System Second phase - Issue of treasury bonds with progressive rate (sur formule) - Reduce number od rediscount rates from 7 to 3. - Reduce maximum number of interest rates on rediscountable credits from 8 to 3. - Eliminate all minimum interest rates on deposits except for passbook deposits. - Revise use of medium term liquidity ratios

		Third phase - Reduce number of rediscount rates to 2 (normal and preferential rates). - Eliminate maximum interest rates on credits and of minimum rates on deposits. **Fourth phase:** Liberalization of all interest rates.
National Guarantee Fund		- Adopt procedures of National Guarantee Fund.
Loi Foncier		- Revise disposition granting to Treasury prior claims on collateral property
3. Social and poverty allocation programs		- Join the UNDP-financed/Bank executed projects - Define program of well targeted poverty alleviation actions focused on (a) nutrition program for children; (b) support to women in development; (c) support to small scale productive projects; (AIDS) (d) study on food aid; (e) coordination of donors assistance in AIDS programs. - Prepare monitoring system focused on social and economic variables.
4. Follow-up on adjustment program		
	Creation of comite de suivi at ministerial level and of permanent secretaries	- Reinforce Comiti de Suivi with permanent secretariat and preparation of system of indicators. (What's been done so far in the way of monitoring?) - Coordinate closely with resident mission.

The following pieces are the result of our discussions with members of the Burundi community over the past three days. As promised, we have looked into various matters concerning employment policy and prospects during the life of the SAL-2.

What we have found is not promising at least in the near term; however, it does offer some possibilities in the way of directing USAID resources. I trust you will find these reports enlightening.

POPULATION MOBILITY AND THE URBAN SECTOR

In all of our discussions with officials and others, we have gotten a consistent message as concerns population mobility: this Government is committed to maintaining a large, overpopulated, rural population of subsistence farmers and a smaller, well-behaved urban population. This policy is fundamental to the Government agenda and will continue until rural population pressure forces the GRB to reverse direction.

Equally clear to those of us who have studied Burundi, is that the country can not continue to grow at a 3 percent annual growth rate for much longer unless it urbanizes. Eventually, population pressure on the land will be intolerable and farmers will no longer be able to subsist. We do not believe that improved farming practices without easing these population pressures is enough.

This tension between two inconsistent facts leads us to believe that USAID should try to do something to help the country in this dilemma. We have proposed one possible initiative, a planned urban growth program, to help ease the inevitable tension that occurs when large masses of people migrate to urban areas. There are certainly other alternatives, and we recommend that USAID consider financing a study of other directions to take.

While this particular program is directed toward relieving population pressures in the major population centers -- Bujumbura, Gitega, etc. -- it has also been suggested that a program to develop small, rural towns is also a possibility.

A PROGRAM OF PLANNED URBAN GROWTH

One of our main concerns is in the area of population mobility. The current policy -- mobility laws and "permis de sejour" -- restrict free movement of the population, while successfully avoiding many of the problems inherent in unbridled urban growth: inadequate housing, sewers, roads, etc. One of the attractions of Bujumbura, as well as the other urban centers of Burundi, is the absence of the urban squalor so often found in other African countries.

While the objectives of these laws are commendable, they are inconsistent with the objective of increasing market efficiency. In the modern sector, these laws may retard the dynamics needed for economic growth by restricting the ability of Burundian employers to choose from a large labor pool with differing skills and talents. Furthermore, these restrictions lead to an over-populated rural sector, smaller average land holdings, and lower average agricultural output, both per capita and per hectare. They also reduce the size of the domestic market for Burundi's own agricultural output.

USAID could assist Burundi as it struggles with the conflict between increased economic growth and the frictions attendant to unrestricted urban development, through a program of planned urban growth. This program could consist of a number of measures that would reduce pressures in urban areas impacted by the free movement of the population into urban areas. Such a program might include some of the following elements:

a) Initially, a study of the expected impacts of free mobility: the productivity gains and the welfare costs attending the loss in quality of life in urban areas.

b) Design of a program to set aside space for planned communities where newcomers can settle temporarily while getting established -- job seeking, capital accumulation, etc. -- and to provide zoning regulations to prevent barrio conditions.

c) Inputs to help provide essential services in these zones: clean running water, toilet facilities, sewers, roads, etc.

d) Assistance to residents in building quarters conforming to the zoning restrictions. Loans and grants to newcomers for purchasing building materials: corrugated roofs, bricks, cement, wood, etc.

PROSPECTS FOR INCREASED PRIVATIZATION OF THE BURUNDI ECONOMY

Twin objectives of the liberalization program are privatization of the economy and rationalizing the financial sector. It is hoped that unification of the interest rate structure at positive real interest rates will generate additional savings to provide sufficient capital for entrepreneurs to invest in the Burundi economy.

To assist the financial sector in its foreign exchange needs, SAL-2 provides for an $8 million APEX fund as start-up capital for small businesses. Furthermore, a Guarantee Fund to insure the commercial banks against losses is envisioned.

Despite these provisions, in our discussions with the commercial banking sector and the Secretary General of the Chamber of Commerce, we have identified several perceived problems that may arise in these efforts. Among these are:

1. Removing the Government from interfering in the financial sector. The Government is still a major share holder in the commercial banks and may continue to insist that the banks make loans that are unwarranted on financial grounds.

2. A lack of coordination of investment projects with neighboring countries can lead to duplication of effort and fragmentation of markets. We learned of two recent cases -- the battery factory and matches -- in which Rwanda and Burundi will be competing with each other for a very small market. In the case of the battery factories, the same person is building both.

3. Burundi has a scarce supply of the expertise needed to identify and assist new entrepreneurs in their investment efforts. Neither the Chamber of Commerce nor the commercial banks has, in the past, been involved in major venture capital projects, and the type of people who usually help identify potentially profitable projects -- former businessmen who have either retired or have sold out their interests in businesses -- are absent in Burundi.

4. The Government has refused to repeal the 10 million FBu deposit required of all foreign importers. This tax, which discriminates against foreigners, directly contradicts the effort called for in the SAL documents. Hopefully, the Government will go forward with its plans to pay interest on these accounts, but, as of yet, this has not happened.

5. As of yet, the commercial banking sector has been unable to generate commercial bank deposits form the profits of small entrepreneurs. These businessmen, who tend to be concentrated in

the distribution sector, continue to horde their money rather than deposit them in the banks. Hopefully, as real interest rates on deposits achieve positive levels, such savings will be generated.