What Makes the CFA Franc Zone a Special Form of Monetary Integration ?

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Summary:

The CFA franc zone is the most notable example today of a regime change in which sovereign countries are united not only to use the same currency unit, but also to add value to that of another monetary unit in a fixed relationship. In some important respects, this zone differs from other monetary unions, including emerging unification of the European currencies, so the traditional criteria applied to identify the optimal monetary zones are not sufficient to assess its performance.

It is indeed difficult by using only traditional criteria to argue that the African franc zone is a natural monetary area: the intraregional trade is quite limited, the structure of production varies across the different countries due to the massive shocks produced by the terms of trade in the past two decades, which had a different impact on the countries of the region and factors mobility does not seem to be sufficient to make up for these differences.

The arguments in favour of specific provisions to transform the CFA franc zone is based on two grounds, the area combines the features of a monetary union and those of a zone with fixed exchange rates. Due to the fact that all African countries participating in the area have a very well developed trade with France and with other European countries, pegging their currencies to the French franc, now in euro, has contributed to the overall stability of their competitive positions. Given that the currency was issued by supranational central banks and that France experienced a relatively high stability of the price level throughout the 1980s, the countries of the CFA franc zone managed to achieve discipline and credibility in the implementation of their macroeconomic policies.

In addition, the external guarantee mechanism credits, in the form of overdrafts to *operations accounts* with France, helped mitigate some of the effects of the deterioration of the positions of net foreign assets. Therefore, if the collective well-being depends primarily on price stability and growth, belonging to the area has obviously been beneficial to those countries. However, the collective well-being also depends on the balance of the external accounts, and if the nominal exchange rate can be modified to cushion the adverse shocks caused by the terms of trade without undermining the authorities credibility and financial stability, the net benefits of membership in the area are less obvious.

Key words: CFA franc zone, African monetary cooperation, France.

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1. Introduction

The CFA franc zone consists of a group of countries of Central Africa and West Africa whose currency was be pegged to the French franc at a fixed parity in 1948, and to

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the euro since 2002. Today this is the most notable example of an exchange system in which sovereign countries are united not only to use the same monetary unit, but also to attach value to that of another monetary unit in a fixed relationship.

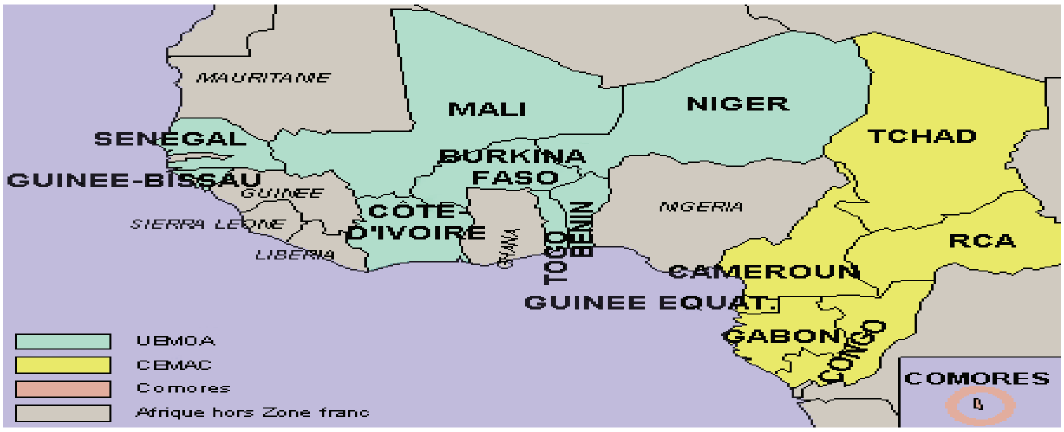
The area differs in important respects from other monetary unions, including the unification of European currencies and the traditional criteria that identify the optimal monetary areas. Most studies carried out to determine the efficiency in the area have generally focused on the viability of the fixed exchange rates. Those that emphasize the importance of low inflation are in a favorable position. Those that attach more importance to international competitiveness are critical.

Yet, the problem has another dimension. Indeed, if the monetary area is not optimal, needs may vary from one member country to another. This paper aims to make an objective assessment these two aspects.

Why Franc CFA area is different to the other monetary zones

This paper attempts to make an overview of the relevant features of the member states in the area and to describe the nature of its institutions (Section II). It then moves on to analyze the various economic factors that can help determine viability (Section III). Section IV summarizes the main conclusions.

Franc CFA Countries members



2. Evolution of the franc CFA zone

The CFA franc zone has its roots in the French administration colonies before and immediately after the Second World War.

In fact in the 1930s, France took action to establish monetary units in each colony, and link them to the French franc. In 1945 at the end of the war, many of these monetary units were unified to become either 'the free French colonies of Africa' or CFA or CFP French colonies of the Pacific. The Central Fund for French Overseas Territories (CCFOM) created during the war to replace the french banknotes issued during the occupation was set up to ensure franc CFA emission.

The principles governing the wider franc area included a) the convertibility into French francs at fixed parity, b) the guarantee of convertibility by French Treasury through the „*operations accounts*» for the two African central banks, c) the free movement of capital in all the area, d) the deposit of 50% of foreign currency reserves to the French Treasury and e) the elaboration of a trade policy and a common financial policy vis-à-vis the rest of the world. These different principles comprise the specific mode of governance of the area.

Initially, the CFA franc zone covered a significantly larger geographical area than its current area, and its origins are largely political, not economic in nature.

However, from the mid-1970s the area comprised more than a limited set of countries due to the withdrawal of several Member States, mostly scattered in other parts of Africa.

Thus the Saint Pierre and Miquelon islands off the coast of Newfoundland in the North Atlantic were part of the CFA franc zone until January 1973, the date on which they adopted the French franc. Another overseas department, the Reunion Island, adopted the French franc in 1975. The Comoros created their own currency in 1981 (the Comorian franc), which is still to be pegged to the French franc.

These territories, as well as other territories of the franc zone, could have been included in the analysis hereinafter. The main goal of their omission is to focus the analysis on a relatively homogeneous group of countries.

Other countries also pulled out of the area - Djibouti in 1949, Guinea in 1958, Mali in 1962 until the renewal of its accession in 1984, Madagascar in 1963 and Mauritania in 1973 - ans adopted independent currencies.

In 1985, Equatorial Guinea became the first country in the region that had not had colonial ties with France (and the first non-French speaking country).

For a detailed account of the history of the franc zone, see the work of Yansane (1984) and the following references, Bloch-Laine et al. (1956), Neurrisse (1987), St. Mark (1964) and Vizy (1989). Giulia (1988) - analyzes the 1955-1975 period. The institutional structure that was in place prior to the major 1974 reform is described in the studies of FKI (1963, 1969). Regarding the emergence of the area›s modern economic structure, see Bhatia (1985) and McLenaghan et al. (1982). From 1962 to late 1967, the parity of the Malian franc was equal to that of the CFA franc, but the currency was not convertible. From 1967 to late 1984, the parity was maintained independently vis-a-vis the French franc (at 100 Malian francs for 1 French franc) and convertibility was guaranteed through an account of separate operations open in the books of the French Treasury. The official absence of the Mali franc zone during the second period has therefore been the main practical consequence allowing a country to manage its own Central Bank and prevent the exchange rate of its currency (as legal tender) fluctuate.

It can therefore be argued that the CFA franc zone has evolved into a group of countries, whose ties are looser than before and are more of a political nature.

After an initial period characterized by a certain instability, in October 1948 the CFA franc's exchange rate was fixed at 0.5 CFA franc for French franc. This rate has not changed since 1994. The CFA has always been freely convertible in Frenc francs (now in euros) with an established parity, and the degree of mobility of capital vis-a-vis the rest of the world has been determined primarily by the evolution of capital control in France.

The CFA franc zone's original institutional structure was no longer appropriate when the Member States gained their independence at the end of the 1950s and in the early 1960s.

The area comprises both, the eight (8) members of the west African monetary Union (WAMU) that have a common central bank - the Central Bank of West Africa States (BCEAO), and a common monetary currency - the Franc of the African Financial Community. The area also includes the other six (6) African countries, whose common central bank is the Bank of Central African States (BEAC) and common currency unit - the franc of Financial Cooperation in Central Africa.

In the central area of Africa (BEAC), the common central bank issues an identifiable monetary unit for each Member State, though the respective monetary units are legal tender and have such power throughout the region. In the Western Region of Africa (BCEAO), a single currency unit is circulated. Both currencies are defined as regional monetary and are designated by the term CFA franc, but they were legal tender in their own area. That is, the monetary unit issued by the BCEAO has no legal power in the member countries of the BEAC and vice versa. The statutes of the two central banks allow them in principle to change the parity vis-a-vis the French franc independently from one another (for further details see Vizy 1989).

Nevertheless, given that the parity of the two monetary units has remained unchanged for over 40 years and that, under parallel agreements with France, the convertibility of the two monetary units into French francs is guaranteed, the CFA franc zone can be regarded in almost all its aspects as if it were a single monetary unit.

Each region is dominated by a relatively large country that represents roughly 25% of production in the region: the Ivory Coast in West Africa and Cameroon in Central Africa (see table 1). Out of the 13 countries, nine rank among the low-income states, the three fuel exporters (Cameroon, Congo and Gabon) have a relatively high per capita GDP, while the Cote d'Ivoire occupies an intermediate position.

Relations between the countries of the CFA franc zone and France are an integral part of the system. Each regional Central Bank has an account with the French Treasury called *account of operations*, in which it is obliged to hold its foreign exchange reserves (other than cash necessary for its current account).

These accounts were remunerated in French francs previously, now in Euro. France guarantees the convertibility in part by allowing Central Banks to have access to its overdraft facilities. Maintaining monetary discipline is ensured by a) the levying of interest on overdrafts, b) the application of rules under which regional central banks should limit credit when balances fall below a fixed level, and c) a ceiling to the contribution they can make to each state, which is equal to 20% of budgetary revenues for the preceding year.

The organization of the CFA franc zone - which combines the features of a monetary union among sovereign countries, linking coins and currency of a cooperating country outside the region, is virtually unique. Examples of systems that resemble the CFA franc zone include the group of countries that are not parties to the monetary arrangements of the Central Bank of the Eastern Caribbean, the Common Monetary Area, which includes Lesotho, South Africa and Swaziland and Belgo-Luxembourg economic Union. In each case, however, the structure is substantially more flexible than that of the franc zone.

The Eastern Caribbean dollar - the monetary unit of Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kittset Nevis, Saint Lucia and Saint Vincent and Grenadine - is pegged to the US dollar. Unlike France in the case of the CFA franc zone, however, the United States is not party to this agreement.

The monetary units Lesotho and Swaziland are each attached to the South African rand; although the rand is legal tender in Lesotho, the three currencies are different in all other respects. In principle, the parity of the two monetary units of the two smaller countries - Lesotho and Swaziland - could be modified without the consent of the other party (the largest country).

Table 1. GDP per capita in USD

	1970	1980	1990	2000	2010	2014
WAEMU						
Benin	114	377	391	339	690	825
Burkina Faso	81	282	351	226	574	713
Ivory coast	227	1231	887	648	1236	1545
Bissau-Guinea	110	130	230	281	518	567
Mali	60	252	285	219	621	706
Niger	144	420	313	160	351	427
Sénégal	242	629	760	474	998	1061
Togo	120	417	430	265	496	635
CEMAC						
République of central africa	103	350	490	245	446	371
Cameroun	171	754	923	583	1147	1429
Congo	205	946	1172	1035	2953	3137
Gabon	548	5869	6250	4115	9388	10208
Equatorial Guinea	228	229	297	1970	15869	17430
Chad	128	228	291	166	895	1024
Sub-Saharan Africa	217	700	589	541	1525	1773

Source: World Development Indicators (World Bank).

The stability of monetary exchange rate of the CFA franc zone to the French franc, which has remained intact since 1948, and in 1994, is quite extraordinary for a such diverse group of developing countries. There is no doubt that it plays a decisive role in the economic performance of the region.

3. Economic Issues

We can readily assume that, according to the most traditionally used criteria, the CFA franc zone in itself would not constitute an optimal monetary or natural area. That conclusion is valid that we are relatively up to a narrow point of view such as that of the economist Robert Mundell, or is available departing from a longer list of relevant factors. What is perhaps less obvious is that only these considerations do not allow to evaluate the CFA franc zone, because the system is not limited to the African Member States. The conclusion arrived from the overview is that, it is essential to regard the CFA franc zone as part of a larger monetary area comprising France, and its role as a support system also falls within the scope of our review.

3.1. The area as an monetary union

According to the article of Robert Mundell (1961), who established a school of though on the matter, the criterion that characterizes a natural monetary union is that participating countries should feel the same effects of the disturbances (and therefore cannot expect variations in relative prices). Furthermore, there should be a high degree of factor mobility from one country to the other (countries therefore being able to adapt to the asymmetrical disturbances without having to change the structure of relative prices[1]). Yet there is a number of other criteria that have

[1] Eichengreen (1990), for example, applies these criteria to European countries and concludes that Europe remains furthest from 1‘ideal optimal monetary area that monetary unions of America

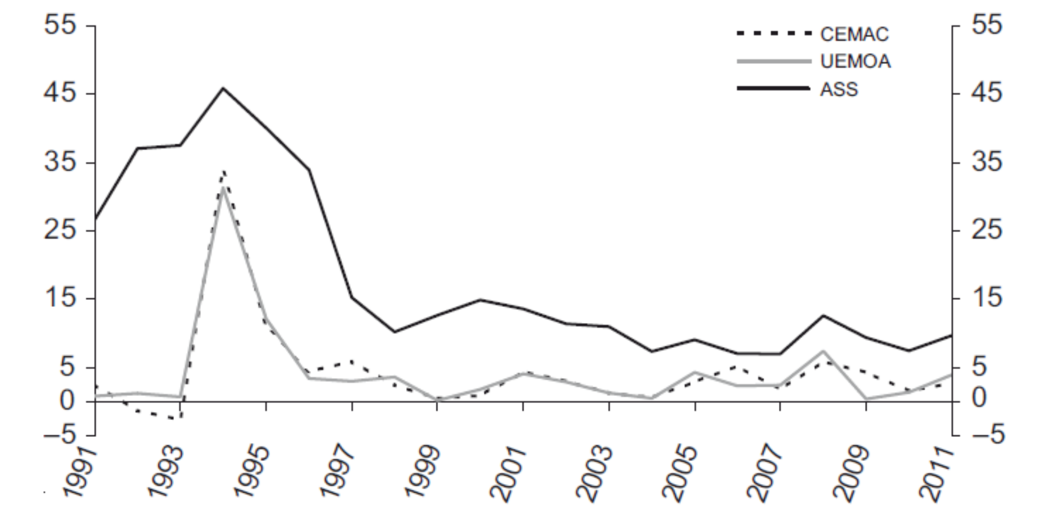


Fig. 1. Annual inflation rate (%)

been suggested at different points in time. It is generally assumed that there is no official or standard parameter to assess the sound foundation or the effectiveness of a particular monetary union.

To Mundell's criteria, one might add (at the very least) the following ones: a) flexibility at reasonable prices and wages (Marston, 1981); b) similarity of preferences in matters of inflation (Fleming, 1971; Haberler, 1970 Canzoneri and Rogers, 1990); c) high level of intra-regional trade (McKinnon, 1963 and 1979).

3.1.1. Flexibility of wages and prices

Establishing a monetary union would normally depend on the limited flexibility of wages and prices. Given that the exchange rate is fixed, the flexibility of other prices (other than currency) help each country adapt independently to any disruption that could possibly affect it or its partners.

In an extreme scenario, if all prices were fully flexible (without including costs), the exchange rate could be fixed affecting the collective well-being, and optimal monetary zone would be the world economy. In practice, it goes without saying, that price flexibility is still limited, especially when it is necessary to reduce the price in absolute terms.

The tools that governments have the discretion to use in order to reduce wages in the public sector or producer prices face a contraction in export earnings, once the option of a devaluation is ruled out, the main question raises in matters of flexibility in the CFA franc zone. There have been some notable examples of reductions like this, especially after the fall in world prices of many export commodities in the mid and late 1980s. In addition, salaries in the private sector have shown reasonable flexibility. Levy and Newman (1989) provide detailed data that are based on generalized reductions in real wages in Ivory Coast between 1979 and 1984, a period during which inflation grew at a cumulative rate of 48%. Overall wages increased by 74% in nominal terms and by 18% in real terms during this period. Yet the microeconomic data show that real wages would have decreased by 8 % if there had been no change in the composition of structure of jobs.

Nevertheless, domestic prices have not shown a general tendency to respond flexibly the changing environment. In any case, there has been a strong resistance to reductions in wages and prices, whether in developing countries, and these reductions are not the fast track to a balance.

African countries in the franc zone have all recorded low inflation rates, but the financial systems of just a few countries were pressured by maintaining uniformly low rates.

On average, the economic performances in real terms were at least as good, or better than those of neighboring countries that had integrated an active exchange rate policy within their overall adjustment strategy, although some significant differences across countries have been observed.

3.1.2. Mobility of factors

Considering that wage and price flexibility is limited, it is important that there is a reasonable degree of factor mobility between countries. In particular, the unemployed should be able to travel freely to countries where jobs are relatively abundant. On this point, the results so far are also quite inconclusive.

Labour mobility labor in the region seems to be limited by the large distances that separate the agglomerations and the shortage of transportation means.

Historically, however, there has been great labor migration between the countries of West Africa. For example, over the past 20 years, 25% of employed in Ivory Coast were not Ivorian nationals. About half of these were nationals of Burkina Faso, and almost a quarter - nationals of Mali. The immigrants coming from these two countries, and Gambia and Guinea, also represented a high share in the labor force of Senegal.

If labor mobility should contribute to the functioning of a monetary union, it is essential that migration takes place. Yet migration should further respond to the changes in relative real wages and other emerging differences in economic development. However, the factors pertaining to religious or tribal order probably have a strong impact on labor flows. Many regulations were introduced after the national independence of many countries, that is at the end of 1950s, to reduce the importance number of foreigners during the colonial period.

Nevertheless, at present, the economic conditions appear to be the main reason of international migration in the region. In addition, the geographical structure of migration seems to evolve gradually and many migrants can stay briefly in a country.

3.1.3. Similarity of disruption after shocks

To the extent that the member countries of a monetary union are not even concerning their flexibly to external shocks, it is important that they shall protect some degree of shocks to particular countries.

If, for example, the composition of commercial exchanges by product is the same for each country, disturbances are likely to have similar effects on all countries. Similarly, if the foreign trade of the country consists of different products, but it is done with the same countries outside the region, it is still quite likely that any monetary area will feel the same way the repercussions of at least certain type of disturbances. In an important case and in the context of a monetary union, a high level of intra-regional trade - as in the European Community - can significantly contribute to regional stability.

Table 2. Fall in exports of agricultural products (1985 – 1990)

Pays	
Bénin	-57%
Burkina	-13%
Côte-d'Ivoire	-32%
Mali	7%
Niger	-38%
Sénégal	-20%
Togo	-14%

Sources : BCEAO report 1990.

Intraregional trade comprises a relatively small share of the total trade of the countries in the CFA franc zone, and it is certainly negligible compared to intra-European trade, for example. Consequently, the positive effect that the use of a common currency has on transaction costs would be lower in the CFA franc zone than in Europe.

The declared trade between countries of the CFA franc zone comprises about 14% of total trade for the member states taken together. This figure is at odds with the 55% share that intraregional trade had during the same period for the countries participating in the exchange mechanism of the European Monetary System. Moreover, probably the importance of intraregional trade is somewhat overstated, because trade in warehouse has not been fully taken into account: indeed, the relatively high estimates with regard to the enclaves countries, including Mali, Burkina Faso and Chad, are due to a large quantities of exports respectively to Senegal, while the Ivory Coast and Cameroon are re-export destinations.

The limited share of intraregional trade is explained in several ways.

Firstly, given that incomes are very low throughout the region, the domestic market for exchangeable goods produced by these countries is not developed. A fortiori, the potential for specialization of production in the region is limited.

Secondly, networks of transport and communications in the region are insufficient, especially if we take into account the great distances.

Thirdly, the domestic producers in a number of countries enjoy a protection element. In most cases, imports from countries belonging to the same region (West Africa or Central Africa) are not subject to restrictions.

Fourthly, a volume of unregistered but probably significant intraregional trade is part of the informal sector and is therefore not taken into consideration in this paper.

Besides the benefits that can derive from their participation in a monetary union, countries in the CFA franc zone can benefit from linking a reference unit, the euro, because of their integration has extensive European monetary area. These benefits may include economic stability from the Credibility of the measures taken by the government or the discipline of the implementation of these measures; guaranteeing the convertibility of their currency unit; and support, including economic, France or other countries. But the benefits should be reports to the costs imposed by the abandonment of monetary policy as an instrument of independent economic policy in the long term and the possibility of an overvaluation of the real exchange rate.

The arbitrage which operates will be more beneficial to the countries of the CFA franc zone insofar as their external trade is with Europe because a similar geographical distribution of foreign trade plays the same role as the high level of intraregional trade.

4. Conclusion

We cannot give a simple and straightforward answer to the question whether the CFA franc area is a set of effective arrangements for the effiecient pursuit of economic policy of member countries.

Based on traditional criteria, it is difficult to argue that the African countries-members of the franc zone are a natural monetary area: intraregional trade is significantly limited, the structure of production shows considerable differences across countries, the massive shocks generated by the terms of trade over the last two decades influenced the countries in the region. In all countries, the inflation rate remains low, at least compared to Sub-Saharan Africa, though the maintenance of uniformly low rate puts pressure on some countries' financial systems. In real terms, the region's economic performance has generally been as good as, or better than, those of neighboring countries that have pursued active exchange rate policies as an integral part of their strategy of global ajustment.

In its relationship with the CFA franc zone, France has had a more distinct role and anchor function covers a more formal character.

Given that the monetary unit is issued by supranational Central Banks and that France experienced a relatively high price stability in the 1980s, the countries of the CFA franc zone could develop their macroeconomic policies in a disciplined and credible way. Indeed, they have registered a low inflation without sacrificing the growth of their production.

In addition, access to the external credits in the form of overdrafts at *operations account*s with the French Treasury helped to mitigate in part the effects of the deterioration of net positions of foreign assets.

Finally, the answer to the above question also depends on the nature of both the function of collective welfare and the transmission process of economic policy issues, which fall beyond the scope of this paper. If collective well-being is primarily a function of price stability and economic growth, the participation in the zone provides gains and benefits. However, if collective well-being also depends on the external balance and if the nominal exchange rate can be modified to cushion the persistent shocks caused by an unfavorable change in the terms of trade without undermining the credibility of the authorities' commitment to financial stability, then the answer is not as clear and straightforward.

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