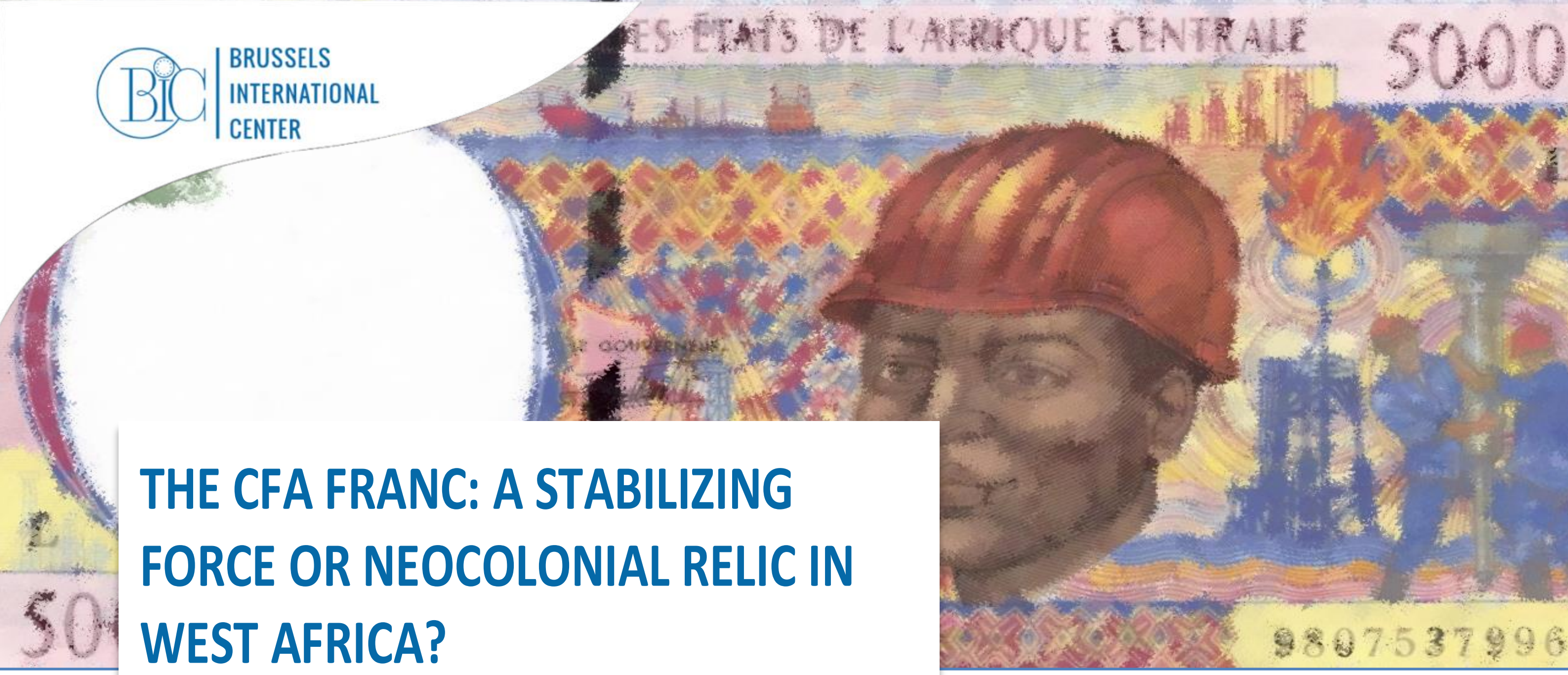

BRUSSELS INTERNATIONAL CENTER

THE CFA FRANC: A STABILIZING FORCE OR NEOCOLONIAL RELIC IN WEST AFRICA?

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INTRODUCTION:

Over the past month, Italy and France have become engulfed in a fierce diplomatic row, cumulating in the recent recall of France's Ambassador to Italy from Rome.[1] The dispute was sparked by Italian Deputy Prime Minister Luigi Di Maio, who accused France of fueling migration into Europe by destabilizing Africa with exploitative post-colonial economic policies and use of the CFA franc.[2] As a member of the populist Five Star Movement, there is no doubt that Mr. Di Maio's criticism is largely a thinly-veiled appeal to anti-immigrant sentiments across his core base. However, despite this unproductive rhetoric, it has re-sparked a longstanding debate surrounding the continued use of France's CFA franc in West and Central Africa.

The CFA franc is in fact two, nearly identical currencies employed by 14 countries in Africa across two monetary unions, which originate from the colonial currency that France created to foster integration between the various colonies it controlled throughout the early 20th century. Following the independence of the French colonies, the currencies remained in use under a unique arrangement that keeps them guaranteed by the French Central Bank and pegged to the euro.

AT A GLANCE:

- The CFA Franc provided general macroeconomic stability across West Africa for several decades, however its efficacy is challenged by the region's poor economic integration, and its members' weak integration into global value chains.

- The CFA supported a counterproductive logic focused on facilitating trade with France and developed countries, rather than tightening economic ties between African states., which distorted natural patterns of growth and regional integration.

- To reverse this trend, the WAEMU and the CEMAC should consider differentiated reforms to improve monetary flexibility and allow the CFA franc to fluctuate by tying the exchange rate to a basket of currencies.

[1] On 7 February 2019, France recalled its Ambassador to Italy for the first time since World War II.

[2] See: New York Times. "The African Currency at the Center of a European Dispute." 2019.

This arrangement has been hailed as an essential component of the region's macroeconomic stability,[3] while detractors claim that it robs African leaders of their economic sovereignty.[4] As Mr. Di Maio's pushes these broad arguments back into public debate, they merits additional scrutiny— not because Italy has launched these accusations, but because African leaders in the CFA economic zones have in fact voiced similar concerns that have fallen on deaf ears. Chad's President Idriss Deby has requested that the CFA franc continue to exist, but independently of French control, claiming that the current arrangement is discouraging African economic growth. Nigerien President Issoufou any many other African leaders have called for a new, independent common currency for the entire ECOWAS zone.[5]

This report investigates the empirical evidence behind these claims, and evaluates the CFA based on its ability to achieve the core objectives of any common currency: regional economic integration, economic convergence, and macroeconomic stability. A brief review of rigorous empirical analyses confirms that the CFA currency zones have failed to meet the first two of these objectives, and that the heterogeneous make-up of the currency zones do not constitute an optimal currency area. Despite these flaws, it concludes that the CFA franc should not be discarded completely, but rather reformed to better suit the diverse economic environments of its members.

HISTORY OF THE CFA FRANC:

Deeply rooted in bitter colonial history, the French CFA franc is no stranger to criticism. Established in 1948, the evolution of the CFA saw its usage in a much wider geographical area than is currently used today, with its origins clearly political, rather than economic in nature.[6] The CFA franc zone is divided into two monetary unions, the West African Economic and Monetary Union (WAEMU)[7] and the Central African Economic and Monetary Community (CEMAC).[8] Counterintuitively, while the two currencies maintain identical value, they are not inter-changeable.

Due to its historical role in creating and maintaining the currency, part of the controversy stems from the fact that France not only participates on the boards of both central banks in the CFA zone, but that it also has de facto veto power. This allowed France to sharply devalue the currency in 1994, for example, which will be discussed further below. The second element of the arrangement is that the French central bank guarantees the value of both CFA currencies, and in return for African countries deposit 50% of their currency reserves in Paris, but at interest rates lower than market prices. This means that African states effectively pay France to hold their money.

Nevertheless, the debate over France's continued economic involvement in West Africa is somewhat contested, and generally framed as a necessary balance between stability and sovereignty, where the CFA franc is a necessary evil that ultimately leaves African states better off. In Western circles especially, there appears to be a moderate consensus that, while the CFA franc is imperfect, it is nevertheless a necessary component to maintain economic stability and incentivize foreign investors to trade in the currency.[9]

EVALUATING THE CFA FRANC'S STABILITY:

In defense of the CFA franc, it's undeniable that the relative stability of the currency has produced some benefits. One of the most frequent defenses of the currency is its peg to the euro, which limits the impact of external shocks or dangerous levels of inflation that are often seen in many other neighboring African states. In comparison, inflation has remained extremely low, rarely surpassing 3%, and has remained remarkably stable between 2012-2017.[10] This has moderately supported standard of living, and supports medium and long-term financing via capital markets. The peg to the euro has maintained value, even throughout turbulent political situations, such as Cote D'Ivoire's electoral crises in 2010 and 2011.

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3 Issiaka, Coulibaly; Davis, Junior. "Exchange rate regimes and economic performance: Does CFA zone membership benefit their economies?" 2013.

4 Ballong, Stephane. « Franc CFA. Pourquoi ils veulent changer les règles ? » Jeune Afrique. 2015. 2855:59–61

5 The ECOWAS Common Currency is widely viewed as unlikely as the zone's largest member, Nigeria, has yet to signal strong support. See: France 24. Monnaie commune dans la Cédéao" 2018. Available here.

6 Ndao, Souleymane. "What Makes the CFA Franc Zone a Special Form of Monetary Integration. Economic Alternatives. Issue 4. 2016. Available at: https://www.unwe.bg/uploads/Alternatives/S_N_2016_Issue4_en-8.pdf

7 Comprised of Benin, Burkina Faso, Cote D'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo

8 Cameroon, the Central African Republic, the Republic of Congo, Gabon, Equatorial Guinea and Chad

9 Hallerberg, Eric. "Costs and Benefits of Monetary Union. A Study of the CFA Franc Zone." Department of Economics. Emory University. 2002. See also: France 24, "African Franc Faces Unlikely Foes on Europe's Fringes." 2019. Available here.

10 Alby, Stephane. "CFA France: A New Stress Test." Economic Research. BNP Paribas. 2018. Available here.

In 2014, amongst a relative economic downturn across sub-Saharan Africa due to decrease in basic commodity prices, the WAEMU maintained a remarkably stable growth rate, with low inflation and high demographic growth rates sustaining household consumption.[11] In the CEMAC, however, where five of the six members are oil producers, the economic shock proved too costly for any macroeconomic buffers. Between 2015 and 2016, the region lost two-thirds of oil-related budget revenues and half of all exports, and overall growth is projected at just 1.6% in 2018, and 3.2% in 2019, just lower than the region's population growth rate.[12]

In light of the heterogeneous natures of both the WAEMU and CEMAC zones, as well as the varied makeup of countries within these zones, the varied experiences challenge the logic of a shared peg, rather than differentiated adjustments. It is also worth noting that despite the stated intention to boost global trade, the economies did not improve their share of the global market goods, WAEMU export market share increased from 0.13% to 0.15% since 1994, and the export market share for CEMAC has already fallen back to its level before 1995.

Furthermore, the peg to the euro may directly discourage integration into global trade because the currency persistently risks being overvalued, subject to the strict monetary policy of the European Central Bank. Quite simply, this hurts exporters by making their goods too expensive. As early as 2008, the IMF raised the dangers of these challenges, noting that the strong appreciation of the euro throughout the 2000s posed a challenge for CFA zone members.[13] Essentially, as the euro appreciated against the dollar throughout the 2000s, it the reduced value of export earnings by CFA zone countries.[14]

EVALUATING REGIONAL ECONOMIC INTEGRATION:

Despite the general macroeconomic stability provided by the CFA franc, its efficacy is challenged by the lack of growth relative to other sub-Saharan zones and lack of integration into global value chains. Conversely, the CFA franc is more conclusively evaluated by weighing the system against the basic rational for any common monetary system: the promotion of regional economic integration and economic convergence between national economies. This underlying logic of this rationale is so firm, that it served one of the earliest defenses of the currency: a system to support cooperation between members of the monetary unions.

Nevertheless, by all standards, it is clear that the CFA franc has failed to promote regional economic integration. Intra-regional trade is by far the easiest metric to evaluate this objective, and by this standard, all data points to disappointing results. Trade between the WAEMU sits at just 12%, and trade within the CEMAC zone, with almost no improvement since 1990, when the share sat at 10%. Within the CEMAC, intra-regional trade sits even lower, currently to 5%, rising from 3% in 1990.[15]

More importantly, an empirical analysis of relative growth between the CFA members offers further evidence that the CFA franc is not conducive towards economic convergence. Ndao et al. (2018) investigate the growth experience of the 14 member countries over the period 1960-2011, seeking to identity patters in growth dynamics and factors responsible for changes in relative per-capita income.[16] The results show that there is no area-wide convergence, but rather a bimodal distribution with relative growth exhibiting tendencies towards lower growth rates and lower per-capita income levels. This trend was reinforced after the 1994 devaluation, when France sharply devalued the CFA, and relative growth in subsequent decades was significantly slower than in previous decades.[17]

Collectively, these findings support analyses that examine the CFA franc from the perspective of an Optimum Currency Area (OCA) criteria, which generally find that the members are not part of a natural monetary area due to factors such as sensitivities to country-specific shocks and differing structures of production across different countries.[18] The continued durability of the CFA

[11] Ibid.
[12] Ibid.
[13] International Monetary Fund. "The CFA Franc Zone. Common Currency, Uncommon Challenges." 2008. Available here.
[14] CFA member countries are increasingly trading with China, Nigeria, India and others, while exports to the Euro zone falling sharply from 50% to 25% over the last 20 years. This also curbs the benefits of direct exchange rate stability with the Euro. See: Coulibaly, Issiaka. "Costs and Benefits of the CFA Franc." World Policy. 2017. Available here.
[15] UNCTAD Statistics Database. 2019.
[16] Ndao, Souleymane; Nenovsky, Nikolay; Tochkov, Kiril. "Does Monetary Integration lead to income convergence in Africa? A Study of the CFA Monetary Area." Portuguese Economic Journal. 2018.
[17] Ibid.
[18] Cecile Couharde; Issiaka Coulibaly; David Guerreiro; Valerie Mignon. "Revisiting the theory of optimum currency areas: Is the CFA franc zone sustainable?" Centre D'Etudes Prospectives et d'Informations Inernationales. 2012. Available here.

franc, despite its failure to meet OCA criteria, is a clear indication that it exists for political considerations, rather than economic ones.

ARE CLAIMS OF NEOCOLONIALISM EXAGGERATED?

In 1984, Kwame Nkrumah, wrote that neo-colonialism is essentially the system by which geopolitical power has been exerted upon African countries, essentially to accomplish objectives formerly achieved by "naked" colonialism.[19] A common example is France's Military Assistance Agreements and Military Technical Agreements with African states, where neo-colonialism is disguised as an altruistic offer of military support that supports local elites. By educating military officials, police and army, a former colonial power retains valuable influence over the country's security system.[20]

While critics claim that CFA franc is evidence of French neo-colonialism, the reality is a more complex product of the structural unequal and asymmetrical economic relationship between France and these countries. The effect of this relationship is not always intentional, but can disrupt natural patterns of regional growth and integration. For example, while integration naturally builds from complex interdependence between economies, the vertical integration of African economies into the economies of advanced countries proliferates a distorted economic organization that reflects historic and colonial ties.[21]

This can be concretely analyzed through trade, where African economies have grown dependent on the production of primary goods for export to developed countries, developing a pattern of producing similar goods, which none of them need from the other. This means that despite the proliferation of overlapping regional economic organizations and zones across Africa, the driving logic remained behind trade remained with developed countries, rather than tightening economic ties between African states.[22]

Despite its ability to maintain low-inflation and general stability, the CFA franc unfortunately reinforces this paradigm. The arrangement did not promote regional economic integration, convergence between its member economies, or impressive growth relative to other sub-Saharan economic zones. Conversely, it largely solidified integration with French corporations, while making it slightly more difficult to export competitive products and individually adapt to new economic landscapes.[23] Ndao et al. conclude that the CFA franc's most limiting factor is the lack of monetary flexibility and poor structural reforms across the region, which in turn impact financial sector development.

In order to reverse this trend, and allow the CFA franc to positively contribute to regional economic integration, it will be essential that France and the two monetary unions consider reforms to allow for more monetary flexibility, such as differentiated adjustments between the two currency areas or tying the exchange rate to a basket of currencies.[24] While the CFA franc will always be connected to its historical and political origins, it may still prove economically useful with the appropriate reforms.

RECOMMENDATIONS:

- The WAEMU and the CEMAC should consider differentiated reforms to improve monetary flexibility, promote structural reforms, and allow the CFA franc to fluctuate by tying the exchange rate to a basket of currencies.

- The French Treasury should improve transparency regarding management of the CFA exchange reserves, and increase the minimum interest rate to market inflation rates.

- All ECOWAS members, particularly Nigeria, should pursue the stated goal of circulating a common currency by 2020, and continue to support the Presidential Taskforce on Common Currency for the West African Monetary Zone (WAMZ).

- Development of the ECOWAS common currency should consider existing flaws of the CFA, take measures to develop the financial sector, address budget-deficit constraints, and allow sufficient flexibility to promote growth.[25]

[19] Nkrumah, Kwame. "Neocolonialism. The Last Stage of Imperialism." New York: International Publishers Co. 1984.
[20] Profant, Tomas. "French geopolitics in Africa: From neocolonialism to identity." Perspectives, 18(1). 2010.
[21] Okeke, V. and Aniche, E. "Economic regionalism and Dependency in Africa: A Study of African Economic Community." Arabian Journal of Business and Management Review. Vol. 1, No. 11. 2012.
[22] Ibid. To date, Central African countries export more to France than they do to each other.
[23] Ndao et al. 2018.
[24] This has been advocated by Carlos Lopes, former executive secretary of the UN Economic Commission for Africa.
[25] Coulibaly, Issiaka. "Costs and Benefits of the CFA Franc." World Policy. 2017

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