Why abandoning the CFA Franc would be a risky operation

By Cheikh Ahmed Bamba Diagne

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The controversy over the CFA Franc gets revived on a regular basis by African politicians and intellectuals. The currency gives rise to both passionate debate and simplistic, sweeping political declarations. The CFA franc is one of two regional African currencies backed by the French treasury with pegging to the euro. It can refer to either the Central African CFA franc, or the West African CFA franc. They are separate currencies. But both are effectively interchangeable. In theory, the French government or the monetary unions using the currencies could decide to change the value of one or the other. So what's all the fuss about?

The basics of the CFA Franc

When French-speaking African states became independent, it was necessary to define the monetary relations between themselves, France and the rest of the world. With the exception of Guinea, then Mali, who chose to have an independent currency, other states' monetary relations arose directly from the status quo, and the three currencies issued respectively in West Africa, East Africa and Madagascar remained in place.

They formed the basis for the exchange rate regime of independent states in the Franc zone.

However, the Franc zone is not only an exchange system, but also one of economic cooperation. Historically speaking, there were three hallmarks to the exchange system in African countries of the Franc zone:

- First, the system of convertibility provided for complete freedom of exchange between the countries of the Franc zone, while their external exchange regulation remained identical;
- Second, the exchange rate between France and the countries of the Franc zone was fixed. In other words, the exchange rate between the members of the zone and the rest of the world was defined through the exchange rate with the French Franc;
- Last, in order to ensure convertibility and a fixed rate, the countries' monetary reserves were pooled; the African countries kept theirs in Francs, and France guaranteed the value of African currencies in relation to the French Franc. This arrangement brought into effect an "operations account" opened by the French Treasury for three African and Madagascan issuing institutions, responsible for monetary policy, which stored their reserves in the

> account. In principle, three is no limit to the amount the operations account can be overdrawn. Today, its reserves equal 50% of their net foreign assets.

The net foreign assets held by West African Economic and Monetary Union countries in their operations account amount to 2,709bn CFA Francs (€4.1bn or $4.7bn). This amount is equivalent to a third of the profits of Total, France's third largest company, or 0.18% of the French GDP.

The bitter lessons of Mali and Guinea

We must learn from others' mistakes: over a 22-year period (1962-1984), Mali had a painful experience with its currency. Upon its exit from the CFA zone in 1962, the country conducted an expansionist monetary policy, leading to the devaluation of the Malian Franc in 1967, followed by a coup d'État the following year.

Guinea-Conakry, larger and richer in natural resources than Senegal, has had its own currency since 1960. The country is worth $7bn ($16bn for Senegal). What effect does the Guinean Franc have on the country's development? The real question lies elsewhere.

Why should we, in the short to long term, resist a single currency for the Economic Community of West African States countries?

These eight countries – Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo – are worth a collective 58.966bn CFA Francs, that is, $102.2bn (the equivalent of 22% of Nigeria's GDP). Côte d'Ivoire, which represents 35.2% of the economy of the zone, has never shared governance of the Central Bank. As a result, the zone's monetary policy responds more to the needs of Cote d'Ivoire than to that of the member States.

What then would be the effect of the planned Economic Community of West African States currency, called the ECO, given that Nigeria alone represents 73.1% of the zone's wealth, against just 26.9% for the other 14 countries? Clearly, there is a strong chance that satisfying the needs of Nigeria would be the chief preoccupation of monetary policy within the region.

What we can learn from the Euro zone

Some countries do not share the same interests as Nigeria. Rising oil prices may be beneficial to Nigeria, for instance, but they have a negative effect in non-oil producing countries. Given that these states clearly do not have the same interests, how can they share the same currency?

Before discussing a single currency for the region, other issues must be dealt with: intra-regional trade must be developed, clearing houses should be established, and the optimum currency area needs to be examined.

Useful lessons can be drawn from the difficulties of the Euro zone. The Greek crisis lowered the value of the European currency, making the German economy highly competitive. Since Germany is an exporting economy, the weaker the Euro, the better its economy fares.

In contrast to other countries in the Economic Community of West African States like Nigeria and Ghana, that have seen inflation of over 10%, monetary stability is a reality in the zone: inflation has been under control ever since the CFA Franc was devaluated in 1994. Such stability has enabled the zone to set up long-term economic policies, with scant difference between optimistic and pessimistic scenarios.

The most stable monetary zone in the world

Since 2011, West African Economic and Monetary Union member States have entered an even more positive trend of stable growth. Why, then, leave when stable economic growth of close to 7% can be maintained at a time when Africa is experiencing its lowest growth rate in 25 years (1.6%), and do so to join a zone that is chronically unstable due to the influence of Nigerian GDP, three quarters of which is dependent on oil? Since the Nigerian economy relies on this volatile natural resource alone, an Economic Community of West African States currency could be expected to be highly unstable.

Although currency can be used as an instrument for development, history shows that inflation targeting – a monetary policy where inflation objectives are set for a given period – remains the dominant monetary strategy, the number one priority. Only the American Federal Reserve has a dual mission: stabilising prices and stimulating economic growth.

Today, the West African Economic and Monetary Union is the most stable monetary zone in the world. What it needs, above all, is to establish a resource processing economy, and to improve the business environment, in order to create increased added value and lower unemployment.

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