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## **Improving Exchange Rate Management In Senegal**

Clive Gray  
James Duesenberry



CAER Discussion Paper No. 24, July 1994

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# **Improving Exchange Rate Management in Senegal**

by

Clive Gray

and

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A study within the framework of the Exchange Rate Management in Africa research project conducted by the Harvard Institute for International Development with support from the United States Agency for International Development under the Consulting Assistance for Economic Reform project, Contract PDC-0095-Z-00-9053-00

Harvard Institute for International Development  
Cambridge, Massachusetts, U.S.A.

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## Foreword

The present report has been prepared on the basis of interviews held in Dakar during September 1992; interviews in France during 1992-93; review of literature on both Senegal and the West African Monetary Union as a whole (see Bibliography); and discussions in two seminars, one on overall issues of the CFA franc held at U.S. Agency for International Development headquarters in Washington in January 1993, and another on an earlier draft of this paper held at the Centre d'Etudes et de Recherches en Développement International (CERDI) of the University of Auvergne, held in Clermont-Ferrand in April 1993. In Dakar the authors interviewed senior staff of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) and of the African Center for Monetary Studies; officials of Senegal's Ministry of Economics, Finance and Planning; managers of several Senegalese business enterprises; and officials of the U.S. A.I.D. mission to Senegal. The usual disclaimers apply.

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# IMPROVING EXCHANGE RATE MANAGEMENT IN SENEGAL

## Executive summary

Senegal is one of seven members of the West African Monetary Union (WAMU), which, like the Central African Monetary Area with its six member countries, has maintained a fixed exchange rate with the French franc for almost 45 years. The two monetary areas comprise the franc zone (FZ) in Africa. The parity of 50 CFA francs to the French currency is upheld by the French Treasury's guarantee of convertibility, exercised through a so-called operations account for each of the two currency areas. Overall balance in the two accounts has been maintained via a policy of relative monetary discipline, compared with the situation in most other African countries. The discipline is imposed principally via limits on public sector borrowing from the two central banks, which in turn are determined by the banks' boards, comprising representatives of each member government along with France. One outcome has been that the FZ countries have experienced lower inflation than most other African countries.

During the 1970s the FZ's real GDP growth rate was slightly higher than the unweighted average of other African countries; this differential increased in the early 1980s, but was then reversed in the last years of the decade. Some observers see in this reversal a significant change prompted by decreasing FZ competitiveness, reflecting an appreciation of the CFA franc's real effective exchange rate (REER). Others challenge the conclusiveness of the recent shift. Without choosing sides in this debate, the paper argues that the undisputed benefits of monetary union backed by a convertible currency would have improved the FZ's relative performance consistently had it not been undercut by lack of competitiveness due to the fixed exchange rate.

The debate about CFA franc parity has recently intensified. Lack of competitiveness has created a liquidity crisis in some FZ countries, notably Ivory Coast, leading them to favor a more flexible exchange rate policy. Speculation against the currency is increasing. Senegalese bankers and businessmen interviewed by the authors expect a devaluation in 1993.

The paper analyzes and, in several cases, disputes arguments advanced by the French authorities and the West African Central Bank in support of continuing the fixed exchange rate in the foreseeable future. Against the view that maintaining a fixed exchange rate gives the monetary authority credibility in whose absence a country suffers permanent capital flight, the paper argues that demonstrated commitment to maintaining international competitiveness, devaluing as needed to offset inflation and external shocks, is more conducive to investment and growth. An assertion that the depreciation of the Ghanaian cedi has been exclusively 'réparatrice', serving merely to reestablish a wholly discredited currency, rather than also 'strategic' in the sense of making the Ghanaian economy more competitive, is disputed based on findings of the Ghana case study in the present series.

The example of the 11 low- and middle-income countries that grew by at least 5% during the 1980s is cited; all raised the value of the dollar by at least one quarter in national currency units, the median being 129%, equivalent to a devaluation of 56% of the national currency. Major shifts in the French franc's value in dollars and DM, which did not undercut France's very respectable growth rate, are cited to show that France is advocating for the FZ a policy different

from that followed by itself.

The paper examines the view of West African Central Bank (BCEAO) management to the effect that further reinforcement of monetary and fiscal discipline is a prerequisite for eventual pursuit of an active exchange rate policy at some future time. It is argued that continued pursuit of these measures, desirable as they are, without accompaniment of an exchange rate policy in support of competitiveness, starting with early devaluation, is likely to perpetuate the FZ's current economic stagnation

Noting that management of a flexible exchange rate would be impractical under the two central banks' current rule of board unanimity with respect to changes of parity, the paper reviews alternative modes of decisionmaking that would leave day-to-day intervention to even out peaks and troughs of a floating exchange rate in the hands of the banks' management. In conclusion, recent initiatives by policymakers in some FZ countries to learn about other modes of exchange rate management are cited. It is suggested that U.S. AID contribute to this educational process.

## IMPROVING EXCHANGE RATE MANAGEMENT IN SENEGAL

### I. Introduction

Senegal's membership in the West African Monetary Union (WAMU) and, through WAMU, the franc zone (FZ), puts exchange rate management for that country in a different category from that of the other African countries--Ghana, Uganda, and Zambia--which are the subject of case studies under the present research project. Briefly, the governments of Senegal and of the other six members of WAMU, as long as they wish to remain within WAMU, cannot alter the nominal exchange rate of their common currency, the CFA<sup>1</sup> franc, *vis-à-vis* the French franc, without the agreement of every other WAMU member as well as that of the French government.

The current parity of 50 CFA francs to the French franc was fixed in October 1948, i.e. nearly 45 years before the preparation of this report.<sup>2</sup> Thus, for almost half a century, 'management' of Senegal's nominal exchange rate has consisted of leaving it unchanged *vis-à-vis* the French franc, thus allowing it to vary *vis-à-vis* all other currencies in the same proportion as the French franc's parity has varied *pari passu* with France's foreign exchange policy and movements on world currency markets.

The same holds for exchange rate 'management' by every other member of WAMU--Benin, Burkina Faso, Ivory Coast, Mali, Niger and Togo--as well as for the six members of the Central African Monetary Area (CAMA) and its Banque des Etats de l'Afrique Centrale (BEAC), namely Cameroon, the Central African Republic, Chad, Congo, Equatorial Guinea and Gabon. Many points in the body of this report apply no less to the other 12 countries than to Senegal. Since the two African monetary unions together account for less than 2% of total franc zone money supply (M2), economic and monetary conditions in the unions will have had a negligible impact on the French franc's parity.

To be sure, no two members of either union have experienced the same movements in their terms of trade or domestic prices, and all members have retained autonomy in regard to fiscal (tax and subsidy) and numerous other measures affecting relative prices of tradeable and nontradeable goods and services. Thus, taking any given year as the base period for computation of price and exchange rate indices, the real effective exchange rate (REER) has moved differently for different member countries. (See Graphs 5 and 6 below.)

At the same time the common constraints on monetary and exchange rate policy imposed by WAMU/CAMA membership have narrowed the variability of the experience of the member countries with regard to several major economic parameters, notably inflation and real exchange rates. Hence it makes sense to compare their experience with that of the remaining sub-Saharan African countries, as a number of writers have done most competently. The present authors' September 1992 discussions in Dakar included consultations with multilateral institutions about

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<sup>1</sup> CFA = Communauté Financière Africaine.

<sup>2</sup> Abstracting from the adjustment required by France's introduction of the new franc (1 NF = 100 old francs) in 1960--the previous parity was 1 CFA franc = 2 FF.

exchange rate management in the WAMU as a whole. We believe our conclusions and recommendations to be relevant to the members of both monetary unions.

## II. Advantages of the franc zone arrangement

There is a near-consensus in the literature, and in public as well as private pronouncements by both French and African participants in the FZ arrangement, regarding five positive contributions which it makes to member countries' development:

1. The assurance of convertibility between the zone's currency<sup>3</sup> and the French franc facilitates trade (i) between the member countries and France, (ii) between the member countries and other countries whose currencies are convertible with the French franc, and (iii) among the member countries, as well as capital movements from France and other industrial countries to FZ members.
2. By enabling local currency to be used directly for imports from any source and for other international payments without passing through exchange control, the arrangement relieves FZ residents of the costs and risks imposed on consumers, foreign investors, and users of tradable inputs by the exchange control/import licensing procedures in effect in nearly all other African countries.
3. Pooling of the major share of the member countries' foreign reserves--the two central banks are required to deposit at least 65% of their reserves with the respective operations accounts in the French Treasury--stabilizes access to foreign exchange in the face of differential fluctuations in export earnings and capital inflows of individual members.
4. France's agreement to grant the central banks overdraft facilities in the operations accounts--a prerequisite to the assurance of convertibility--gives each monetary union as a whole access to credit above and beyond what the central banks and/or individual countries can borrow on capital markets and from public lending agencies.
5. Internationalization of the determination of credit policy, with France enjoying *de facto* veto power, enhances member governments' fiscal and monetary discipline, thus limiting inflation and its attendant distortions.

The FZ arrangement has had another result whose net contribution to the member countries' fortunes is now strongly disputed: namely, further limiting inflation by maintaining a parity between the CFA and French francs that can only be changed by unanimous consent of the members of the respective monetary unions, including France, and that has in fact remained fixed for nearly 45 years.

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<sup>3</sup> The CFA franc of the WAMU is not legal tender in the BEAC zone and *vice versa*, but the banks of each zone exchange the two currencies at par, so this report will refer to a uniform CFA franc.

Finally, the FZ arrangement has served France's desire to maintain its long-standing political, economic and cultural ascendancy in the region. French policymakers are less inclined to acknowledge this publicly, and many opposition forces in the member countries consider this outcome not merely irrelevant, but even antagonistic to their countries' best interests. Without begrudging France a piece of foreign turf where it can loom as the most influential outside power, the present authors see themselves obliged to raise the possibility, and pursue it further below, that the French government's political goals have made its stance on the parity issue so rigid as to impede the member countries' economic growth in comparison to what could have been achieved by following a different exchange management regime.

### III. Recent evolution of the Senegalese economy

Until the 1980s the policies embodied in the agreements establishing the monetary union seemed to yield positive results for Senegal. Like many other countries, in the last half of the 1970s it benefitted from a boom in commodity prices. But at the end of the decade the terms of trade moved against Senegal while resource-based exports were also hampered by bad weather and by difficulties with the quality of phosphate production. In 1981, following two years of dry weather, depressed prices for groundnuts, and the sharp rise in petroleum prices, domestic absorption in Senegal exceeded GDP by 13% (data in 1987 CFA francs) while the fiscal deficit reached nearly 10% of GDP.

A sharp rise in groundnut earnings in 1982 led recovery of GDP and a reduction in the resource gap. The government attacked the fiscal deficit by raising taxes and limiting expenditure growth. The 1982 recovery did not, however, start a continuing expansion. For the remainder of the decade real output grew at only about 2% per year as strong investment demand was offset by fiscal restraint.

According to BCEAO and GOS data assembled by the World Bank (1991b), exports rose at only 1.6% annually from 1981 to 1990.<sup>4</sup> More recent data from the IMF's Direction of Trade Statistics show zero export growth over the period 1981-1992.<sup>5</sup> As a result of the modest growth of GDP together with reduced prices for petroleum and rice, imports also stagnated, showing annual growth of only 0.3% during 1981-92. But due to the concurrent stagnation of exports there was little improvement in the balance of payments position.

The nonperformance of Senegal's exports is due in part to difficulties facing its resource-based export industries, but it also reflects the weak competitive position of the country's manufacturing sector. Even without the rapid inflation that has often undermined the competitive position of developing countries seeking to maintain a fixed exchange rate, Senegal has comparatively high wage rates (see section V(C) below). Real wages in the formal sector have risen but productivity has not shown comparable growth. Consumer prices more or less kept

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<sup>4</sup> Semilog regression coefficient from series in CFA francs,  $R^2 = 40\%$ .

<sup>5</sup> Data from *IFS*, April 1993; semilog regression coefficient is  $-0.1\%$ , with  $R^2 = 0$ .

pace with those in France during the period 1975-86--French inflation was 166% during the period, Senegalese 158%--but from 1986 to 1991 Senegal's prices actually declined by 7% while France's rose another 17%.<sup>6</sup>

In addition to the wage problem, Senegal's manufacturing sector suffers from a restrictive labor relations code which holds down productivity. Energy costs are also high.

The weak competitive position of the manufacturing sector poses a major problem for Senegal. In the past it followed the import substitution path of development, with resource-based export industries plus a growing tourist industry providing export earnings to finance inputs for manufactures. The country was largely self-sufficient in food. Now, however, the difficulties of the resource-based exports are limiting further growth.

Some of those difficulties are temporary, the weather may get better and the terms of trade may improve. Nonetheless, resource-based exports cannot lead the development parade much longer. The growth of the groundnut sector is limited by scarcity of land and resultant competition between food and groundnut production. Agricultural productivity can be increased but that will take time and absorb foreign exchange as crops require more fertilizer, pesticides, and equipment.

The potential for increased earnings from phosphates is limited. The question of overfishing is already being raised and even if there is room for further increase in production one cannot regard the fisheries as the engine for growth. The tourist industry already suffers from high costs.

With encouragement from the donor community the GOS has made several heroic efforts to strengthen the competitive position of Senegalese manufacturing industry by modifying the real effective exchange rate. In 1980 it introduced subsidies for nontraditional exports, financed by customs duties on imports. During 1986-1988 it implemented a New Industrial Policy (NIP) embodying both trade liberalization and measures to promote restructuring of industrial firms and reduce costs of inputs including labor.

The export subsidies ran afoul of GOS fiscal constraints, and were not paid with sufficient regularity to convince manufacturers that they could be relied on. Under the NIP, manufacturers complained more about being undercut by increased imports than they took advantage of the program to reduce costs. Partly in response to this pressure, and partly to increase import tax revenue, the government raised import tariffs in 1989 and 1990.<sup>7</sup>

Notwithstanding the failure of these measures to energize nontraditional exports, the government's demand management policies have reduced Senegal's current account deficit

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<sup>6</sup> Computed from consumer price indices given in the respective *IFS* country pages.

<sup>7</sup> World Bank 1991b, pp. 8-9.

(excluding official unrequited transfers) from 24.3% of GDP in 1981 to 7.8% in 1990<sup>8</sup>, and an estimated 5% in 1991. In recent years the deficit has been approximately equal to official transfers. There is no guarantee that the foreign funds needed to cover a deficit of the current magnitude will be available indefinitely. Indeed, the sources of funding have varied in the past with changing conditions and changing donor programs. Aid from official sources almost doubled after adoption of the NIP program in 1985.

To rely so extensively on outside support is certainly tempting fate. Moreover, that approach leaves very little margin for error. Crop failures, depressed conditions in the developed countries or other unforeseen contingencies could easily create a balance of payments crisis which would force a quick resort to drastic demand restraint accompanied by exchange controls as has happened in many other cases. It makes sense therefore for Senegal to take action to improve its current account position just to ensure its ability to maintain its present level of income and imports.

The nature of Senegal's basic problem is clear. The balance of payments constraint has forced the government to impose tight limits on domestic demand. Stagnation of the present range of export products restrains the economy's overall growth. In the short run Senegal must continue with demand management measures that keep its current account deficit under control. In the long run it must also create conditions for continued growth of exports to pay for the increasing volume of imports required by a growing economy.

*Exports and Growth.* No government can be satisfied with a stagnant economy and a growing population. It is necessary to take measures which will make a resumption of growth possible. Continued growth will require a growing volume of exports in order to pay for increasing amounts of imported intermediate products and capital goods.

Senegal like many other countries faced with similar problems has been advised that it ought to devalue in order to make its exports more competitive. Devaluation is recommended as necessary even if not sufficient for renewed growth. However, the BCEAO and GOS argue that devaluation is not only insufficient but unnecessary for growth. Moreover, they assert that in the conditions ruling in Senegal a real devaluation is not possible. They argue that, in Senegal, it would be difficult to achieve a real devaluation because trade unions and public employees would succeed in obtaining full compensation for the increases in import prices which would follow devaluation. The devaluation would, they assert, simply set off a wage-price spiral with little net effect except to undermine fiscal and monetary discipline. In making that point they note that, in Africa, nominal devaluations very often fail to produce real devaluation. When they do so, it is only after a long period of disruptive inflation and a period of costly demand restraint.

Secondly, they maintain that, even if a real devaluation could be achieved, it would do little

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<sup>8</sup> World Bank 1991b, p. 15.

to improve the balance of payments in the immediate future. They argue that the supply elasticity of export crops, mainly groundnuts, is very low. For the reasons already noted the possibilities for increased exports of phosphates and fish are also limited. They agree that the elasticity of supply of manufacturing exports is much higher than in the case of the resource based exports. However, they say that the amount involved is too small to make much difference.

The French and WAMU authorities have recently agreed on a set of measures to improve the competitiveness of manufacturing in the region as an alternative to devaluation. The program includes proposals for increasing the economic integration of the member countries in order to gain economies of scale for local manufacturing firms. Focussing specifically on labor costs, the GOS has drafted legislation to soften some rigidities in the labor code. It is not clear that the government will have the political support needed to push this legislation through parliament.

These measures could certainly prove helpful in making the WAMU economies more efficient and should improve their competitive position. However, it is questionable whether they can provide cost reductions on a scale which could, by itself, make manufacturing exports from Senegal profitable at the present exchange rate of the CFA franc.

The next section of this paper (IV) reviews recent evaluations of the WAMU's overall economic impact. It is followed by a description of alternative measures of overvaluation of the CFA franc as a basis for determining what degree of real depreciation would be necessary to achieve competitiveness. After an account of the flare-up of the CFA franc parity controversy in 1992, Section VII reviews the arguments of the French and WAMU authorities against devaluation. Section VIII then presents an alternative view, paying particular attention to the experience of other African countries, cited by opponents of devaluation as evidence that it would not work in the franc zone.

#### IV. Economic impact of the monetary union: recent evaluations

All sources agree that the CFA zone has undergone severe economic stress since the end of the 1970s, necessitating rigorous adjustment measures. As an objective indicator of stress, all 13 countries had IMF programs at one time or another during the period 1980-92, and all had outstanding obligations to the Fund as of December 31, 1992.<sup>9</sup>

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<sup>9</sup> These obligations, which the Fund treats as a charge against gross foreign reserves in computing net foreign assets (NFA), account largely for the negative NFA of the CFA zone as reported in *International Financial Statistics*. Liabilities to the Fund and NFA as of March 31, 1992, were: BEAC: \$290 and -462 million equivalent; WAMU: \$870 and -740 m.; total: \$1.16 and -1.20 billion equivalent (converted from SDR and CFA francs at exchange rate indicated by *IFS* for March 31). Thus, the sum of the BEAC and BCEAO operations accounts with the French Treasury, the only other significant component of NFA, was nearly in balance, with the BCEAO's positive balance of \$130 million offsetting 75% of the BEAC's deficit of -\$172 million and leaving a net deficit equivalent to about \$40 million.

Guiding a multi-year research effort at the Centre D'Etudes et de Recherches sur le Développement International (CERDI) of the University of Clermont<sup>10</sup> regarding the comparative development strategies and economic performance of FZ and other developing countries, particularly non-FZ African countries, during the period 1962-1981, Patrick and Sylviane Guillaumont (1988b) drew the following conclusions in a conference volume published in 1988:

1. Corrected for exogenous factors, the average growth rate of FZ countries during the two decades (termed their 'performance') was approximately the same as the average for all other developing countries (i.e. not just African comparator countries).
2. The FZ's performance was not significantly different from that of other African countries during the 1960s, however it was significantly superior during the period 1970-1981.
3. FZ membership helps in two major ways to explain result (2):
  - a. the zone's foreign exchange regime "promoted economic efficiency by permitting relative stability of exchange rates (both nominal and real), limiting the degree of overvaluation and ensuring a permanent supply of foreign exchange, whatever the balance of payments deficit"; and
  - b. zone membership brought with it certain "structural choices" favorable to growth, notably: (i) a higher investment rate, financed by greater public saving and foreign capital inflow, the former influenced by restriction of central bank credit to governments and the latter by currency convertibility; (ii) greater openness to foreign trade; and (iii) greater preference for agriculture (all in comparison to other African countries).<sup>11</sup>

At the same (November 1986) conference, the then head of the IMF's Africa department (and soon to become governor of the BCEAO), Alassane Ouattara (1988), noted: "Even though the results are sometimes difficult to evaluate, experience seems to show that the foreign exchange regime practiced in the countries of the [franc] zone has not delayed or limited adjustment in countries which have succeeded in implementing measures aimed at both the demand and supply sides".

Less than four years later, Ouattara's successor at the Fund and the head of the Fund's Research Department approved a memorandum for an Executive Board seminar (IMF 1990) noting that continuation of the CFA franc's fixed parity meant that "downward flexibility in nominal prices and costs is needed in order to improve competitiveness and to provide

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<sup>10</sup> Recently renamed the Université d'Auvergne.

<sup>11</sup> Page 129. Translation by the present authors.

appropriate incentives in the key traded goods sectors". The paper goes on to note:<sup>12</sup>

Labor resistance to downward pressure on wages had emerged in several countries of the [franc] zone, indicating that the current strategy carries with it the risk that the real exchange rate realignment may not occur quickly enough to avoid delay in the return to external viability consistent with enhanced growth prospects. In general, the Fund has been sympathetic with the aim of the CFA franc countries to maintain exchange rate stability in the context of their regional monetary arrangements based on strong ties of solidarity. However, if the present approach of improving external competitiveness through downward adjustment of nominal costs and prices were to prove unworkable, alternative adjustment measures would have to be considered.

In other words there might be no alternative to devaluing the CFA franc.

Starting in the same year several unofficial writers, reviewing data for most or all of the 1980s, have been more explicit about the burden imposed on FZ countries by the fixed exchange rate. Devarajan and de Melo<sup>13</sup> found that, while the (unweighted) average annual real GDP growth rate of the CFA countries during 1973-81 was one percentage point higher than that of 20 African comparator countries--this of course parallels the conclusion of the CERDI conference volume--and during 1982-85 the difference was still wider, at 3.5% *versus* 1.0%, during the latter part of the decade (1986-89) the CFA zone's growth rate had fallen to 1.8% *versus* 3.0% for the 20 African comparators.

Using econometric techniques to determine whether the difference in FZ and comparator growth rates during the 1970s and 1980s was statistically significant, Devarajan and de Melo found the CFA countries performing significantly better than the African comparators in the 1970s, and worse, though not significantly so, during 1982-89.<sup>14</sup> They also found that the CFA countries failed to adjust adequately to deterioration of their terms of trade, and that what adjustment occurred consisted primarily of expenditure reduction, falling disproportionately on investment. They concluded that inability to adjust the *nominal* exchange rate had prevented the degree of depreciation of the *real* exchange rate necessary to transform resources from nontradeables to tradeables and achieve an acceptable current account balance.

A year later Devarajan and Rodrik (DR 1991) wrote even more explicitly about the burden of the fixed CFA franc exchange rate, answering with a resounding 'no' the title of their paper: "Do the Benefits of Fixed Exchange Rates Outweigh Their Costs? The Franc Zone in Africa".

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<sup>12</sup> Page 40.

<sup>13</sup> Their report was issued in August 1990, and published in a Bank volume the following year.

<sup>14</sup> Devarajan and de Melo also evaluated CFA performance against two alternative comparator groups, (i) 41 other low- and middle-income countries, and (ii) 52 other primary and fuel exporters. The CFA countries performed significantly worse than group (i) during 1982-89, and insignificantly worse than group (ii).

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Their approach was to estimate the relative preference of CFA policymakers as between reduced inflation and increased GDP growth, the latter assumed to be responsive to real exchange rate depreciation and changes in the terms of trade.

Given medium response coefficients, DR found that policymakers for the CFA zone as a whole, by accepting the fixed exchange rate, had revealed a willingness to accept less than two additional percentage points of inflation for one additional percentage point of growth. Senegal's specific parameters showed its choice as reflecting less inflation-aversion, but still accepting less than 6 points of inflation for one point of growth. Stating their "impression...that most African policymakers would be willing to trade up to about 10 percentage points of inflation for a one percentage point increase in their GDP growth rate", DR conclude that the CFA leaders' choice reflects "an excessive anti-inflation bias".

In the same year Guillaumont, Guillaumont and Plane (1991) took a fresh look at the FZ/non-FZ dichotomy, this time focusing on the comparative performance of subsets of those countries--6 FZ and 13 African comparators--in executing IMF-supported structural adjustment and stabilization programs from 1979 to 1988. The study confirms the relative appreciation of FZ REERs. It shows that prices paid to export and food crop producers increased in FZ countries and declined, on average, in the comparator countries.

Ratios of budget deficits to GDP rose faster up to the mid-80s in the FZ subset, but levels of these ratios in the non-FZ subset averaged over twice those in the FZ countries. Average investment/GDP ratios in FZ adjusters declined to 4-5 points below those of six comparators which devalued on average less than 20% per year. Finally, GDP growth rates were on average higher in the non-FZ subset.

Noting that heightened "concern about overvaluation and lack of competitiveness" in the immediate past may make 1987-1988 data less relevant, Berg and Berlin (1993) summarize the data on economic performance as follows:

...The broad conclusions from these studies coincide, with only a few dissenters. The CFA zone has enjoyed relative price stability, and at little apparent cost in terms of sacrificed growth until the late 1980s. In the past decade, its real exchange rate has become misaligned, reducing the competitiveness of its members. Economic performance has worsened since 1985, though how much worse it has been depends on choice of comparator countries and on the periods covered. It is certain, though, that investment rates have fallen more than in comparator countries, that GDP growth in the CFA countries has slowed relatively more or increased less. Most critical, many countries in the zone face acute problems of competitiveness and seem able to maintain external balance only with relatively large inflows of foreign assistance.

Comparing the growth performance of the FZ with other African countries raises the question as to what margin of difference would constitute evidence that the fixed CFA-franc exchange rate had not been an obstacle to growth. Given the benefits of the FZ as outlined in the

preceding section, one would expect, *ceteris paribus*, that FZ countries as a whole would perform substantially better than African comparators displaying far less fiscal and monetary discipline and experiencing more severe (particularly on the import side) disruptions in their external trade.

The fact that the FZ did not show significantly better performance during 1982-89 suggests that something was happening to offset the unquestioned benefits of monetary union. Since exogenous factors, notably terms of trade deterioration, did not hurt the FZ significantly more than other African countries during this period (and subsequently), one can argue that the ball is in the court of the defenders of the CFA franc parity to suggest reasons other than lack of competitiveness arising from the exchange rate system.

## V. Assessing the overvaluation of the CFA franc

In 1990-91 World Bank staff conducted a series of FZ country studies assessing the degree of overvaluation of the CFA franc by three different methods: (i) measuring the evolution of the REER up to 1990; (ii) applying estimated elasticities of supply and demand for foreign exchange and 'normal' capital inflow to calculate an exchange rate at which the balance of payments would be in equilibrium; and (iii) comparing wage costs between FZ and competitor countries. This section draws on the paper prepared for Senegal (World Bank 1991a) with respect to estimation by the first two methods, and presents later information on comparative wage costs.

*A. The real effective exchange rate approach.* Noting that choice of the base year has a substantial effect on estimated REER evolution, the Bank paper takes 1977 as the base year for Senegal since 1975-77 was the latest period in which the current account deficit was below 10% and could be financed by normal capital inflow. From 1977 through 1990 the nominal effective exchange rate appreciated by 21.3% (units of foreign exchange per CFA franc), mainly because of the French franc's appreciation with respect to the (Senegalese) trade-weighted index of currencies of Senegal's trading partners.<sup>15</sup>

This nominal appreciation was partially offset by 6.4% lower (trade-weighted) inflation of the wholesale price index (WPI) of Senegal's trading partners as compared with Senegal's consumer price index. The REER unadjusted for terms of trade changes (see following paragraph) thus rose by only  $1.213 \cdot (1 - 0.064) - 1 = 13.5\%$ . In other words, in 1990 the index of currencies of Senegal's trading partners, worth 100 CFA francs in 1977, had declined in real terms to  $100 \cdot 100 / 113.5 = 88.1$  francs.

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<sup>15</sup> For trade-weighting the Bank paper uses an IMF methodology that takes into account parameters of countries which are competitors with the country under study despite not being significant trading partners of the country. One country taken into account in the weighting by the Bank paper but not the IMF study it cites is Nigeria, given a 10% weight to account for a recent increase in Senegal-Nigeria trade. World Bank 1991a, Table 1a.

Meanwhile Senegal's terms of trade deteriorated by 14% over 1977-90. Taking into account the elasticity estimates used in subsection (B) following, the Bank paper calculates that a 13% devaluation (in foreign exchange terms) would have been required to maintain balance of payments equilibrium. Thus, the currency basket's index should have been 113 1977 CFA francs. Combining the two indices and subtracting unity, we have  $113/88.1 - 1 = 28.3\%$  as the estimated increase of Senegal's REER during 1977-1990.

The authors have not had access to the Bank's other FZ country papers but an authoritative summary of four of them gives the REER changes shown in Table 1.

**Table 1 - ESTIMATING DEGREE OF CFA FRANC OVERVALUATION- COMPARISON OF TWO APPROACHES**

	<u>Cameroon</u>	<u>Gabon</u>	<u>Ivory Coast</u>	<u>Mali</u>	<u>Senegal</u>	<u>Togo</u>
Real Effective Exchange Rate: Year of reference	1984/85	1979	1985	1976/ 1977	1977	1970
Change in REER	47%	18%	n.a.	27%	30%	-15% to <del>+25%</del>
Balance of Payments	50%	14%	35% to 108%	10%	19%	13%

Source: see text.

*B. The balance of payments elasticities approach.* In this approach the Bank writers assume supply price elasticities of 0.75 for groundnuts and fish and 1.0 for other export products, while demand price elasticities are assumed to be zero for public investment imports, -0.75 for food and commercial imports, -0.25 for petroleum, and -1.25 for other goods. They estimate that an exchange rate index of 115 CFA francs would close the balance of payments gap under the current trade protection regime, while 125 francs would be required under a tariff rationalization program eliminating export subsidies and reducing import tariffs for the latter three goods categories to 15%, 30% and 35%, respectively.

In other words overvaluation according to this approach falls between 15% and 25%. At the same time the Bank writers caution that this estimate reflects the relatively depressed level of economic activity during the 1980s and argue that a larger devaluation would be needed to support higher investment and growth with the attendant surge in import demand.

The unofficial summary of the other Bank studies estimates overvaluation by this method, assuming current tariff regimes, as shown in Table 1.

*C. Comparison of labor costs.* The loss of competitiveness which FZ countries have suffered as a result of the rigid exchange rate policy is illustrated by a comparison of monthly labor costs (MLC) per manufacturing worker in FZ countries with those elsewhere in the developing world. Berg and Berlin (BB 1993) provide data for such a comparison between Ivory Coast and Senegal on the one hand and Morocco, Tunisia, Ghana, Mauritius, Indonesia and Malaysia on the other, MLC in the latter countries being translated into CFA franc equivalents at prevailing exchange rates. Ratios of BB's MLC figures for the two FZ countries to those for the comparator countries, ranging from 1.56 to 4.69 for Senegal and 1.71 to 5.14 for Ivory Coast, are presented

in Table 2. Figure 1 illustrates the corresponding percentage excess of MLC in Ivory Coast and Senegal over the comparators' MLCs.

**Table 2 - MONTHLY LABOR COST (MLC) PER WORKER IN MANUFACTURING:  
Ratios of Ivory Coast and Senegal to six African/Asian countries**

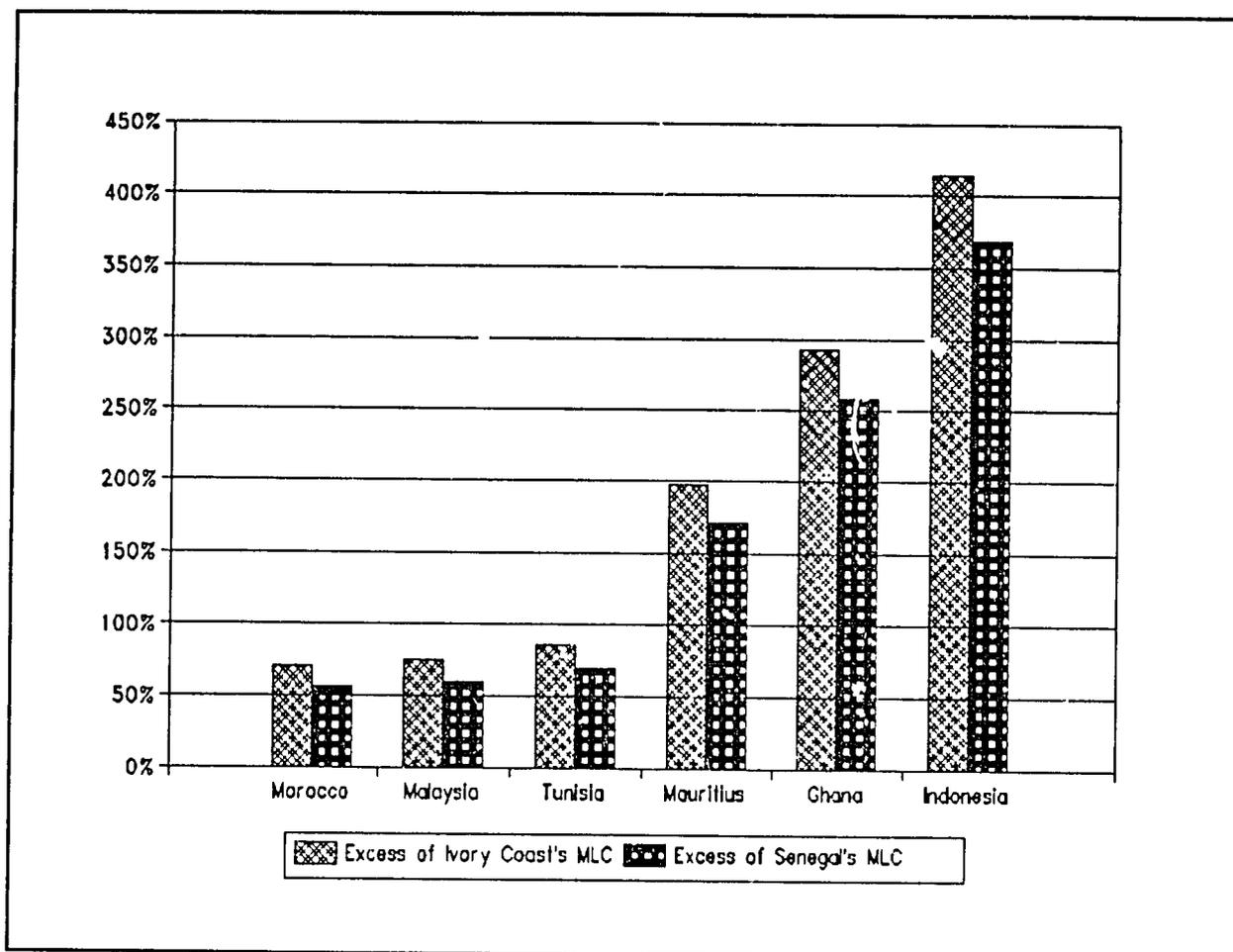
<u>Denominator</u>	MLC ('000 CFA francs equiv.)	<u>Numerator:</u>	
		<u>Iv. Coast</u>	<u>Senegal</u>
Ivory Coast	149		
Senegal	136		
Morocco	87	1.71	1.56
Malaysia	85	1.75	1.60
Tunisia	80	1.86	1.70
Mauritius	50	2.98	2.72
Ghana	38	3.92	3.58
Indonesia	29	5.14	4.69

**Source:** Berg & Berlin (1993), Annex A, Table 7. Monthly labor cost is defined as the cost of labor to enterprises including both salary payments and charges paid by employers; figures are described as derived from national data.

Business managers interviewed by the authors in September 1992 confirmed the relatively high labor costs in Senegal. A revealing insight was provided by management of a fish-packing enterprise whose previous Japanese owners had been bought out by a state company from China (PRC), where the scale of management compensation is of course substantially lower. As quoted by their Chinese successors, the Japanese described the high cost of living for expatriate personnel as the major cost element making the enterprise unprofitable.

To be sure, relatively high labor costs per worker can be offset by higher productivity, associated with greater capital endowment and/or worker skills and diligence. Senegal's capital endowment and educational system are not significantly better than those of the African countries it must compete with, and inferior to those of many Asian competitors. The managers interviewed by the authors described the skills and diligence of Senegalese workers as satisfactory, though no greater than those of workers in comparator countries.

BB provide another indicator of relatively high labor costs in FZ countries in the form of a comparison of the monthly cost of civil servants as a multiple of per capita GDP. For Senegal alone the multiple is 9; for nine FZ countries including Senegal the multiple is 10. Conversely for six non-CFA countries, namely Zaire, The Gambia, Ghana, Guinea, Mauritania and



**Figure 1 - % EXCESS OF IVORY COAST & SENEGAL MANUFACTURING LABOR COST OVER 6 OTHER COUNTRIES**

Morocco, the multiple is 3; the same figure applies to Malaysia.<sup>16</sup>

*D. Conclusion: the desirable level of devaluation.* According to the Bank's Senegal study, a devaluation of the CFA franc designed to correct the overvaluation estimated in the study should be increased by ten percentage points to permit lowering of import taxes in order to equalize returns to exporting and import substitution. Taking into account the underestimation cited in subsection (B) above, the study settles on an estimate of 43% for overvaluation in CFA

<sup>16</sup> BB 1993, Annex A, Table 8. The average cost of a civil servant is obtained by dividing total government expenditure on the civil service by the total number of civil servants.

franc terms, equivalent to 30% in foreign currency terms.<sup>17</sup>

Saying that a currency is overvalued by  $x\%$  does not mean that a devaluation of  $x\%$  would equilibrate the foreign exchange market. Apart from its impact on inflationary expectations, and thus on speculation against the currency that may accelerate inflation, any devaluation in a situation where the official exchange rate partly determines prices of goods and services entering in the consumer price index, by raising the ratio of prices of tradeables to nontradeables, exerts an immediate upward thrust on the CPI and thus on the measured short-run rate of inflation. Thus, a devaluation of more than  $x\%$  is necessary to offset the increment in inflation.

The Bank study assesses the direct and indirect import content of some 30 product groups figuring in Senegal's CPI and estimates the one-month and 2-year impact of a 100% devaluation (increase in the French franc's value to 100 CFA francs) on the index. Ignoring any impact on expectations, the results are 20% and 37% respectively.

Taking the 2-year figure, this means that any devaluation designed to overcome an overvaluation of  $x\%$  in the CFA value of the French franc must yield a nominal percentage increase of  $1.37 \cdot (1+x) - 1$ . Given a desired value of  $x = 43\%$ , the nominal increase thus comes to 96%, or 98 CFA francs. It is calculations such as these that underlie the call for a 100% devaluation (in CFA franc terms) often associated with the Bank.

The present paper will abstain from presenting independent estimates of CFA franc overvaluation, limiting itself to agreeing that the CFA franc is significantly overvalued and a new exchange regime is urgently called for. Apart from not finding it necessary to second-guess thorough empirical work by Bank staff and other analysts, the present authors support a managed float rather than a one-time shift to a new fixed rate, *vis-à-vis* the French franc, its EEC successor currency, or any other peg established by industrial countries, which is then maintained rigidly for another generation or two. A properly managed float will propel the CFA franc towards a largely market-determined level that may be lower or higher than currently estimated equilibrium values.

## VI. Flare-up of the debate on CFA franc parity in 1992

Beginning in the early 1980s the World Bank and IMF have worked with most of the CFA countries to implement adjustment programs having two principal foci, (i) to reduce fiscal deficits through enhanced expenditure control and revenue collection, and (ii) to counteract appreciation of real exchange rates by restraining inflation of nontradeables and providing incentives (including elimination of disincentives) for exporters. After a decade or more of these

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<sup>17</sup> Overvaluation of 43% in CFA franc terms means that, instead of the nominal rate of 50 CFA francs per Ffr, an equilibrium exchange rate would be 1.43 times 50 = 71.5 CFA francs per Ffr. The same overvaluation in French franc terms is measured by taking the reciprocal of 1 plus 0.43 and subtracting unity; this gives  $0.7 - 1.0 = -0.3$ , meaning that the equilibrium value of 100 CFA francs is 30% less in French currency than the nominal value.

efforts it is instructive to see where the two largest WAMU economies, Ivory Coast and Senegal, stood at the end of 1991:<sup>18</sup>

1. Ivory Coast had recorded its fifth consecutive year of decline in real GDP (total, not merely per capita), amounting to -2.2%; its largest-ever current account deficit, equivalent to \$1.45 billion; and its net foreign assets were equivalent to *minus* \$1.68 billion (this last figure represented a 4% improvement over 1990, when NFA were at their lowest--i.e. most negative--in seven years).
2. Senegal had recorded GDP growth of 1.2%, giving it an average of 1.3% for the last three years; its current account deficit, the largest since 1988, was \$238 million; and NFA were equivalent to *minus* \$467 million (this figure had indeed improved steadily since 1988, when the negative balance was almost twice as high).

By this time it was an open secret that most staff economists in multilateral and bilateral aid agencies, not excluding the French, considered the CFA franc overvalued; did not regard the "downward adjustment of nominal costs and prices" called for in the foregoing IMF paper as politically feasible; and believed that most of the CFA economies would stagnate until a change in the foreign exchange regime enabled them to put into effect a substantially depreciated real exchange rate. The World Bank (1991b) refers to large capital flights already in 1988 "in expectation of a devaluation". According to *Jeune Afrique Economie* (1992), in recent years the local (CFA) press has raised the possibility of devaluation before every semiannual meeting of FZ finance ministers, only to quiet down after each meeting publicly reaffirms the long-standing parity.

In March 1992 the U.S. Assistant Secretary of State for Africa, Herman Cohen, was quoted in the French press as responding somewhat casually to a journalist's question about the CFA franc by saying that most experts regarded it as 50% overvalued. This provoked an immediate official protest to then U.S. President George Bush by French Prime Minister Pierre Bérégovoy, followed at the next month's semiannual FZ meeting by a denunciation of American interference in the zone's internal affairs (American Embassy, Yaoundé, 1992). The meeting reaffirmed the CFA franc's parity, described by French finance minister Sapin as "the voice of reason".

Subsequent press accounts (Guéye 1992, *Jeune Afrique Economie* 1992, *Le Soleil* 1992) describe Alassane Ouattara, by then Prime Minister of the Ivory Coast, as having convinced his president (Houphouët-Boigny) that devaluation of the CFA franc was their country's only way out of its economic impasse. An article headlined "Ivoirean Blackmail" (Guéye 1992) asserted that the Ivoireans, backed by Benin (whose current president is a former World Bank staff member) and Cameroon, intended to leave the FZ and print their own currencies if the franc was not devalued.

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<sup>18</sup> GDP growth rates from World Bank (1992), page 23; current account deficits and net foreign assets from IMF (1992), respective country pages. *IFS* gives the current account deficits in dollar equivalents; our comments on NFA trends compare NFA balances stated in CFA francs.

Just prior to a WAMU summit in late July, IMF Managing Director Camdessus toured six FZ countries and was quoted in Abidjan as saying, "The Fund's position is that when there is a problem of competitiveness, it is always better to take care of it at the root rather than attack the symptom, i.e. the value of the currency" (Guéye 1992).

The July 1992 summit was touted as offering a confrontation between Ivory Coast and Senegal, the latter continuing its firm opposition to devaluation. In the event, the meeting, joined by two CAMA country presidents, produced the usual disclaimer of intent to devalue, at which point four presidents, those of Ivory Coast, Senegal, Burkina Faso (all WAMU) and Gabon (CAMA), flew to Paris to meet French President François Mitterand and issue yet another ringing affirmation of the CFA franc's parity. That meeting's communiqué (*Le Soleil* 1992) quoted finance minister Sapin as confirming that France would "naturally" maintain its existing guarantee of CFA franc convertibility.

Behind the façade, informed observers based in Abidjan reported that Ivoiréan officials had informed the French that their government would soon lack access to sufficient CFA francs, whether out of current income or bank credit, to meet its payroll. Hence, Ivory Coast's only alternative to (i) devaluation or (ii) withdrawal from the FZ and issuance of a separate currency, was an infusion of emergency aid. According to the same reports, France had provided financing to carry the Ivoiréans for a few more months.

The present authors were informed by many interviewees in Dakar that the business and financial communities regarded devaluation as a foregone conclusion, probably soon after the Senegalese presidential election in February 1993 and the French parliamentary elections the following month. *Jeune Afrique Economie* (1992) refers to the arrival in Switzerland and Monaco of suitcases stuffed with CFA francs rushing to be converted at the 50:1 rate. A French official informed the authors that significant quantities of CFA franc banknotes had recently started arriving in Paris via London, as dealers in the three neighboring anglophone countries<sup>19</sup>, formerly content to hold CFA francs as a convertible instrument, rushed to anticipate devaluation.

Favored clients were reported to be hurriedly contracting CFA loans with their local banks. CFA francs were said to be on offer at a discount of 10%, anticipating a devaluation of at least 25%. For the first time, local contractors bidding on a construction project for a multilateral agency, the African Center for Monetary Studies, were insisting on a parity adjustment clause.<sup>20</sup>

The scene was reminiscent of the periodic chaos in foreign exchange markets and flights of industrial country finance ministers to Basel before they finally learned to live with fluctuating

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<sup>19</sup> Nigeria, Ghana and The Gambia.

<sup>20</sup> Information supplied to the authors by ACMS officials.

exchange rates and stop trying to block the market.<sup>21</sup> As the leading position of the United States evaporated, the industrial countries could no longer uphold fixed exchange rates by means of a *deus ex machina* comparable to the French treasury *vis-à-vis* the FZ. For the sake of the industrial countries' eventual economic progress, they can count themselves as fortunate not to have had such a resource.

## VII. Arguments of the French and WAMU authorities for maintaining CFA franc parity

In one way or another, official arguments for maintaining the longstanding CFA franc parity are embellishments of the Camdessus statement (see preceding section) that lack of competitiveness is best attacked at its roots rather than via the exchange rate symptom. This section organizes the official stand around three primary sources:

1. A 1991 circular from a French government agency to its field offices in Africa, providing guidance to them for discussions on the parity question and referred to below as the Guidelines, serves as the point of departure for describing the official French position;<sup>22</sup>
2. Representative BCEAO views are described on the basis of discussions between the authors and senior BCEAO staff in Dakar in September 1992;
3. A background paper prepared by Berg and Berlin (1993) for a January 1993 AID/Washington seminar on the CFA franc issue lists systematically arguments advanced for using means other than devaluation to restore FZ competitiveness.

Other sources, including discussions of the authors in 1992-93 with French economists in France and Africa, both in- and outside government, are drawn on to extend and clarify the presentation.

*A. Arguments of the French authorities.* Citing unspecified calculations of the IMF and World Bank, the Guidelines claim that the FZ's 1990 REER values were approximately equal to those of 1978. The period 1980-85 had seen an effective depreciation of the CFA franc, largely due to the French franc's decline with respect to the dollar, followed by a largely compensating appreciation as the franc/dollar rate reversed course. Similarly, the FZ's price inflation was more rapid than the weighted average of its trading partners up to the mid-1980s, following which it has been substantially slower.

Therefore, say the Guidelines, any argument characterizing the CFA franc as overvalued is based, not on the franc's own evolution, but rather on a cursory comparison with exchange rates of other African countries, notably the WAMU's anglophone neighbors. Earlier, L'Héritau

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<sup>21</sup> Ironically, following several years of relative quiet, members of the European Monetary System reenacted the scenario in September 1992, just weeks after the franc zone summit in Paris.

<sup>22</sup> The circular is not labelled confidential; one of the authors had access to it in Africa.

(1990) had cited the dichotomy between overvaluation in *space*--i.e. *vis-à-vis* FZ neighbors--and over *time*, the latter characterization not applying to the CFA franc.

This argument demonstrates the ease with which contrary conclusions can sometimes be drawn out of the same body of data. Subsection IV.A above cites unpublished World Bank studies, issued shortly before the Guidelines were circulated, giving REER overvaluation rates of 18% to 47% for five FZ countries, including 30% for Senegal.

The Guidelines then proceed to examine the competing devaluations in Africa, particularly those of Ghana and Nigeria, contrasting the current (1991) situation of the FZ from the positions of the other countries when they devalued. When those devaluations occurred, fiscal and monetary indiscipline and resultant inflation had pushed the parallel market exchange rates (in local currency units per dollar) as high as ten times the official rates. Most transactions in tradeable goods occurred in an underground economy that was disconnected from official circuits, making official exchange rates fictional and meaningless. The authorities could acquire only very limited amounts of foreign exchange at those rates, and that only by using the police power of the state to intervene in the market.

In these circumstances, according to the Guidelines, a devaluation becomes “réparatrice” rather than strategic--i.e. by giving long overdue recognition to the impact of preceding inflation, it serves merely to repair a situation of disequilibrium, reestablishing the connection between the real economy and formal-sector financial institutions including the tax collector. To be *strategic* the devaluation would have to go further and, by changing the relative prices actually perceived by economic agents, serve to reorient domestic production towards tradeables.

Instead, argue the Guidelines, the African devaluations have formed part of a vicious circle of inflation, depreciation of the currency *vis-à-vis* convertible currencies, devaluation, more inflation, and so on. In this connection it is noted that, out of 16 non-FZ countries devaluing before 1986, nine had devalued again in 1990 (and some also in between).

The Guidelines go on to assert that none of these countries have achieved structural adjustment conveying clear economic benefits. As regards public finances, with two exceptions the fiscal bonus associated with higher receipts from taxation of trade has been more than offset by the burden of higher debt service (denominated in local currency terms) and domestic inflation. The exceptions are Ghana, with little debt at the outset of its structural adjustment program, and Madagascar, which is alleged to have followed a strict policy of austerity.

Regarding industrial competitiveness, the Guidelines argue that ‘real and structural’ factors play a greater role than monetary factors, given the small weight of wages in manufacturing costs. They add that differential labor costs can be offset by tax measures (export subsidies). On the agricultural side, well-executed restructuring is credited with having reduced costs and raised productivity in the cotton and coffee sectors in five FZ countries.

A more recent treatment of Ghana’s devaluation policy by a pair of authoritative French

writers, Coquet and Daniel (CD 1992), complements the Guidelines' viewpoint by drawing four "major lessons [regarding] the instruments utilized and the objectives they have *effectively* facilitated...<sup>23</sup>

- Devaluation has generally not achieved the objectives initially ascribed to it.
- The nominal objectives, when they were attained, resulted more often from the accompanying measures.
- Devaluation was indispensable in Ghana, and it was effective in that it allowed the State to reestablish its authority and essential functions.
- The reasons which made devaluation necessary in Ghana do not exist in the FZ and in the short run make such a policy inappropriate for the resolution of their immediate problems."

Like CD a year later, the Guidelines find the scene in the FZ to be very different from that in the African devaluers. There is no parallel market. Inflation is under control--since 1985 only one FZ country's CPI has risen faster than France's (see Table 2 below). Given the French Treasury's convertibility guarantee, the authorities and any other economic agent can buy any amount of foreign exchange at the official rate (the circular could have added that this is partly because France helps to decide how many CFA francs are created). Consequently, argue the Guidelines, the FZ is in no need of a 'réparatrice' devaluation.

Logically, given the earlier argument, this leads immediately to the question whether a 'strategic' devaluation would bring benefits to the FZ. On this the Guidelines have much less to say. Instead they describe FZ integration as a better instrument of adjustment than devaluation, concluding that the zone should be preserved and strengthened. This implies that preservation of the FZ is incompatible with devaluation, but the point is not stated explicitly, apart from a claim that FZ members have benefitted from less capital flight than other developing countries by virtue of belonging to a union guaranteeing security of capital transfer *at a fixed exchange rate*<sup>24</sup>.

Other benefits of preserving the FZ are given as:

1. Promoting exchange among member countries, underexploited since independence because of statist and protectionist policies;
2. Via the multinational character of the two FZ central banks, controlling the excesses of other African countries in monetizing budget deficits;
3. Constituting a regional framework for 'institutional reform and real adjustment'.

No case is made that abandonment of the fixed exchange rate would result in loss of these

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<sup>23</sup> Coquet and Daniel (1992). Translation by the present authors. Emphasis given in the original. This article in the *Revue de l'OFCE* is cited at length by *Jeune Afrique Economie* (1992) in describing the official stance on CFA franc parity.

<sup>24</sup> Emphasis supplied.

benefits, and the present authors argue in subsections VIII.B and D below that the FZ could continue to confer them under a very different exchange rate regime.

In closing, the Guidelines cite 'real adjustment' measures recently introduced at the regional level, viz.:

1. Monetary policy reforms such as suppressing preferential rates, controlling end-uses of refinancing, strengthening indirect controls, and establishing regional banking commissions for prudential supervision independent of member government influence;
2. Establishing a regional working group on insurance;
3. Resolutions at FZ finance ministers' meetings calling for initiatives such as creating a 'regional business space'.

In the intervening two years, more and more resources have been devoted to the regional integration approach to strengthening competitiveness. France is supporting a move, agreed by the WAMU heads of state in July 1992, to convert the UMOA (WAMU) into a UMEOA, the 'E' standing for 'Economique'. Going still further, it is promoting economic union of the two (BEAC and BCEAO) currency areas. French technical assistance is financing studies in areas such as harmonizing government budgets and company legislation, and coordinating national statistical and social security systems as well as insurance.

The Guidelines' assertion regarding the limited impact of devaluation on industrial competitiveness is taken further by so-called 'elasticity pessimists', both French and African, who argue that (i) the supply elasticity of the primary products comprising the bulk of CFA countries' exports is very low, hence devaluation would not increase those exports significantly, and (ii) the manufacturing sector is so small that an improbably massive response would be required for it to contribute noticeably to exports.

Many official French defenders of the FZ are more explicit than the Guidelines about the harm that would result from altering the currency parity and in ruling out what the Guidelines call 'strategic' devaluation. A change in the parity--and this is the crux of their argument--would threaten preservation of the monetary union by undercutting "monetary credibility". If, the argument runs, the authorities devalue the CFA franc after insisting for 45 years on the inviolability of the 50:1 exchange rate, businessmen will not trust the new parity, confidence will be undermined, and speculation and capital flight will displace production and investment.

This school of thought does not deny that policy slippages and terms of trade deterioration in the 1980s, along with adjustment programs in neighboring countries, have lessened FZ competitiveness. In the best of all possible worlds, the argument runs, the French franc would be worth 15-20% more CFA francs, say 60 rather than 50. But the disadvantages of a devaluation under present circumstances, notably the resulting destabilization and potential breakup of the union, are believed to offset the potential advantages of increased competitiveness.

*B. Views of BCEAO managers.* The BCEAO's statutes have long provided for it to foster monetary discipline within its zone in two major ways:

1. through an annual programming exercise for each member country, a major outcome of which is to determine the ceiling on central bank credit to the government concerned (the statutes limit this in any case to 20% of the preceding year's revenue); and
2. through a bank supervision function by which accounts of all banks in the member countries are examined and any findings calling for regulatory action are reported to the responsible government. Up to 1990 a section of the BCEAO was charged with this role; it has now been entrusted to an independent commission.

In the event, both approaches fell short of their objectives in the 1980s. In the early years of the decade governments financed expansionary fiscal policies through borrowings not subject to the UMOA limit, namely (i) foreign loans, (ii) borrowing by parastatals for "social" purposes, and (iii) involuntary credit from banks to suppliers as both the governments themselves and public enterprises accumulated payments arrears. After some respite in the middle of the decade budget deficits were back up to 10.5% of GDP in 1988-89.<sup>25</sup> The BCEAO helped indirectly to finance credit expansion by lending to shaky banks and discounting (at a preferential rate) crop marketing loans that were not fully repaid. Honohan (1990) reports a net capital deficiency of banks in three WAMU countries--Ivory Coast, Senegal and Benin--approximately equal to the union's average currency issue, or close to \$2 billion.

This in turn reflects on the efficacy of WAMU bank supervision, which failed to arrest conditions, noted in the IMF's 1990 paper, such as "deficiencies in bank management, the nonobservance of normal banking procedures (such as inadequate provisioning for loan losses, nonpayment of accrued interest payments, and excessive off-balance-sheet risks) and extension of credit without proper collateral". It was in recognition of these shortcomings that the WAMU authorities established in 1990 the supranational banking commission, based in Abidjan and charged with conducting frequent bank audits, that is cited in the aforementioned Guidelines. By 1995 at least 60% of every WAMU bank's portfolio must comprise loans approved *a posteriori* by the BCEAO (de Zamaróczy, 1992).

Against this background of policy failure in the 1980s, BCEAO managers maintained to the authors that the WAMU's first priority is to reinforce fiscal and monetary discipline among member governments and financial institutions (including, by implication, itself). A devaluation of the CFA franc under present circumstances, they argued, would counteract this effort in at least two ways: by causing a fresh inflationary push through higher prices of tradeables leading to pressure for wage increases; and, by its very success in strengthening the balance of payments, easing the pressure for reduction of fiscal deficits. The authors were told that the BCEAO does not rule out resort to modification of currency parity at some (indefinite) future

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<sup>25</sup> IMF (1990). Based on commitments, GDP-weighted, before grants.

time, once a proper foundation has been laid. At the same time the BCEAO managers pointed to the difficulty of winning unanimous agreement from seven governments--not to mention the need to coordinate with the CAMA.

The BCEAO viewpoint was perhaps thrown into sharpest relief by an exchange which one of the authors initiated by listing measures that must accompany a devaluation in order for it to succeed. As discussed in the next section of this report, these measures are oriented towards creating business confidence that the economy's position will not soon lose the added competitiveness resulting from devaluation. Most important are fiscal and monetary policies holding budget deficits and credit expansion within limits that will prevent domestic inflation from significantly exceeding that of trading partners. The BCEAO team's immediate response: such measures must be taken *before* an eventual devaluation, as *prerequisites* for it to succeed.

*C. The position as summarized by Berg and Berlin.* Berg and Berlin (1993) systematize the French and WAMU arguments against devaluation as follows:<sup>26</sup>

1. Structural obstacles in sectors such as transport and agriculture, and deficient markets for land, capital and output, are the key impediments to competitiveness, not an overvalued exchange rate;
2. Devaluation would create inflationary expectations and, if accompanied by dissolution of FZ institutions, undermine monetary discipline in member countries;
3. Rejecting the highly visible, once-for-all cut in real wages associated with a devaluation, labor would force nominal wage increases soon pushing real wages back to previous levels;
4. Devaluation would relax the pressure to attain the productivity increases and cost reductions without which FZ economies cannot make significant new inroads into export markets;
5. Deciding on a new CFA-French franc parity would be difficult given the need for unanimous consent among member governments, and poses too great a risk of breaking up the zone, undermining its long-term advantages.

### VIII. An alternative view

With all due respect for the concerns of BCEAO management and the French authorities, the present section presents a different view of the pros and cons of retaining the fixed parity system in the franc zone.

*A. Timing of complementary demand management--i.e. fiscal and monetary--measures.* We first consider the strategy proposed by the BCEAO staff (it will be referred to here as the "BCEAO strategy") of undertaking devaluation only after prior fiscal and monetary measures have achieved certain targets. Reduction of the underlying inflation rate,  $r$ , to a given level,  $r^*$ , can be taken as a proxy for these targets.

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<sup>26</sup> Pages 18-21.

Let  $e_n$  represent the current nominal exchange rate (50 CFA to the French franc) and  $e_e$  the real effective exchange rate (REER) that would equilibrate Senegal's balance of payments. Then  $v = e_n/e_e - 1$  represents the current degree of overvaluation of the CFA franc exchange rate from Senegal's viewpoint. If allowed to persist over time  $t$ , this overvaluation occasions a loss of output,  $L_t$ , compared with the output  $\hat{Y}_t$  that would have been attained had  $e_e$  been the REER during this time.  $L_t$  is determined by the elasticity of output (notably but not exclusively exports and import substitutes) with respect to the exchange rate.

Let  $t_0$  represent the present, and  $t_1$  the time required for the fiscal and monetary measures in question to achieve  $r^*$ , at which point a devaluation is undertaken. Time  $t_2$  represents a medium-term planning horizon, i.e. the period over which the BCEAO compares the effects of its exchange rate policy on Senegal's real income with those of an immediate devaluation.

The BCEAO argument in support of its strategy accepts the possibility of some net loss of output

$$L_{t_1-t_0}$$

up to the moment of devaluation, while the deflationary policies are taking hold. However, the BCEAO maintains, the additional inflation touched off by a premature devaluation undermines the intent of the devaluation and otherwise undercuts production by diverting resources from productive uses. Hence, under the BCEAO strategy, output over the entire planning horizon will be greater, compensating for the initial loss. In other words:<sup>27</sup>

$$Y_{t_2-t_0} - L_{t_1-t_0} > \hat{Y}_{t_2-t_0}$$

This is far from self-evident. By pushing up prices of tradeables, devaluation has an initial inflationary impact whenever it is carried out, whether at  $t_0$  or at  $t_1$ . The key issue of political economy is how to limit increases in prices of nontradeables, notably labor, so that these become relatively cheaper than tradeables and permit the devaluation to have its intended impact on output and the balance of payments. On the macro management side the question is how best to control the public sector deficit and its financing, on the micro policy side the question is one of limiting wage increases.

Taking the issue of wage demands first, it is recognized that trade unions have a strong political base in several FZ countries, nowhere stronger than in Senegal, and will apply pressure to ensure that urban wages are raised to compensate fully for the impact of devaluation on prices of tradeables. The question arises as to whether this pressure is likely to be stronger under the "devaluation now" option or the BCEAO strategy. It could be argued that, the lower the current rate of inflation, the more the impact of a devaluation stands out and is likely to stimulate union pressure. The issue of wage policy is considered in greater detail in subsection C below.

As for fiscal policy, devaluation acts on both the revenue and expenditure sides. *Ad valorem*

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<sup>27</sup> The terms in this inequality represent present values at the social discount rate.

taxes on international trade rise in the same proportion as the devaluation, less the price elasticity effect on import demand; indirect taxes on domestic goods and services rise in lesser proportion. External debt service rises in the same proportion as the devaluation; purchases of materials rise less.

In 1990/91, over 50% of Senegal's tax revenue derived from taxes on international trade, mostly *ad valorem* duties and other taxes on imports. Contractual debt service charged to the budget amounted to about 43% of revenue, declining to 31% net of debt relief, while materials and maintenance were 27% of revenue (World Bank 1991b). Assuming materials etc. rise in the first year following devaluation by half its proportion, expenditure rising in proportion to the devaluation amounts to about 45% of tax revenue.

Thus the initial fiscal impact of a devaluation would probably be moderately positive in Senegal; in any case there is no reason why it should undercut ongoing pressure by the WAMU/BCEAO management on Senegal (and other member countries) to trim fiscal deficits.

The BCEAO argument also raises the question as to what criteria would be used to determine that fiscal and monetary restraint had succeeded sufficiently to warrant undertaking a devaluation. Table 3 reproduces *IFS* data on consumer price indices in the FZ countries and France, showing that only Cameroon experienced more rapid inflation than France during 1985-1990. For five of the 12 countries depicted--the *IFS* gives no price data for Benin--1990 indices are below the 1985 values, while Senegal's CPI shows no significant change. Taking the French CPI as a base, with 1985 = 100, Graphs 2 and 3 show percentage points of deviation of the FZ CPIs.

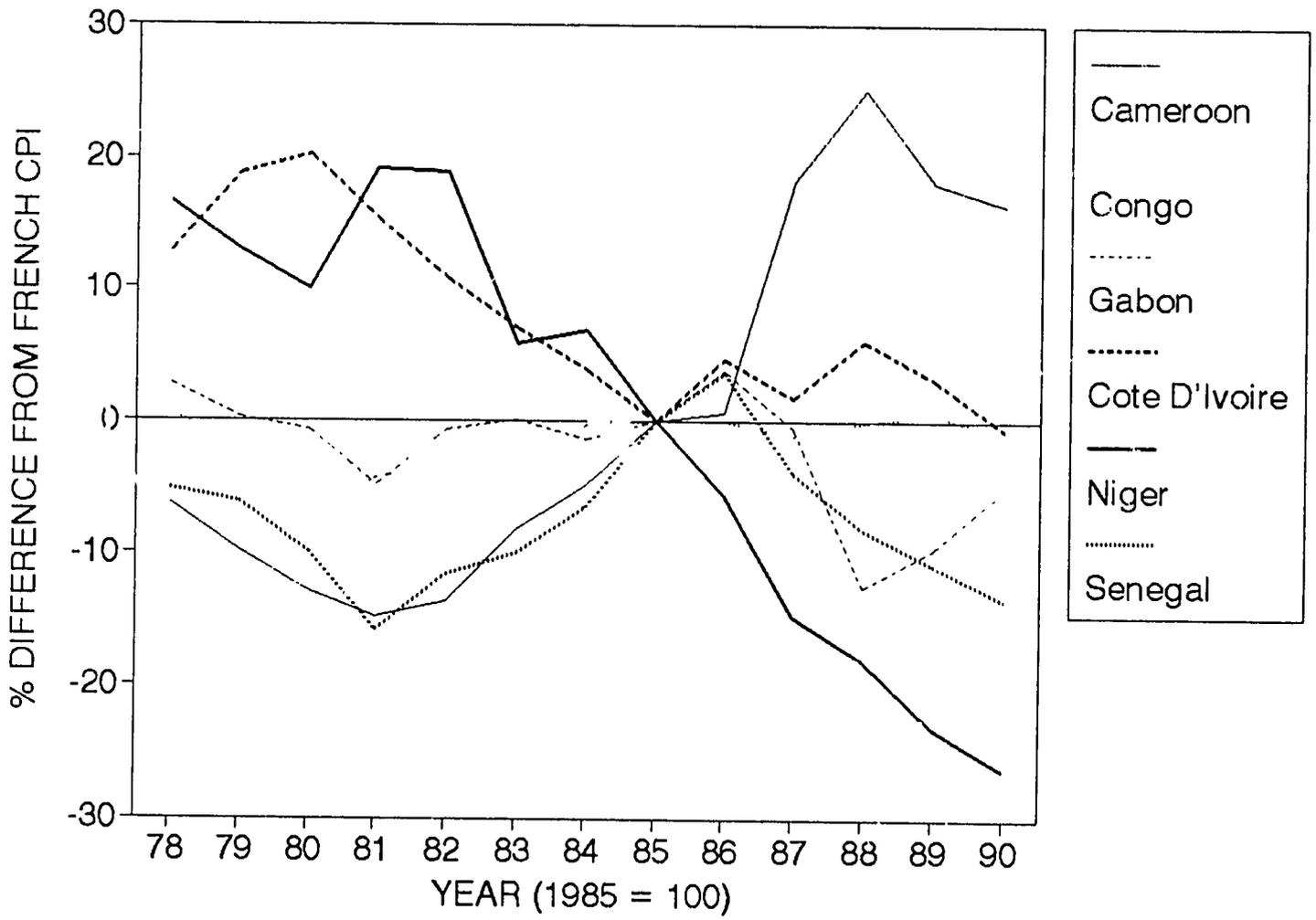
Clearly consumer price inflation in the FZ has declined dramatically since the early 1980s. Structural adjustment measures promoted by the BCEAO, the IMF, the World Bank and bilateral donors have taken hold and yielded substantial results on the fiscal and monetary fronts, though as indicated earlier, not yet in regard to output and exports. Few if any of the world's successful devaluers have started from a base of such rigid credit restraints and correspondingly low inflation rates.

In no FZ country has monetary policy reform been stricter than in Senegal. Credit to the economy grew at 1.0% per annum during 1986-90, while nominal GDP was rising at an average of 5.0% per year. The ratio of M2 to GDP has fallen steadily from 11% in 1983 to 6% in 1990 (World Bank 1991b).

In the authors' view, current restraints on inflation in Senegal and the FZ as a whole are sufficiently effective to permit a devaluation to be carried out without causing the acceleration in inflation that the BCEAO fears. On the other hand, in defense of the BCEAO position it can be argued that, if devaluation is carried out at time  $t_0$  rather than  $t_1$ , the average inflation rate  $r$  up to time  $t_2$  will be greater than both the target rate  $r^*$  and the average rate prevailing during  $t_0-t_2$  in the event the BCEAO devaluation strategy is adopted.

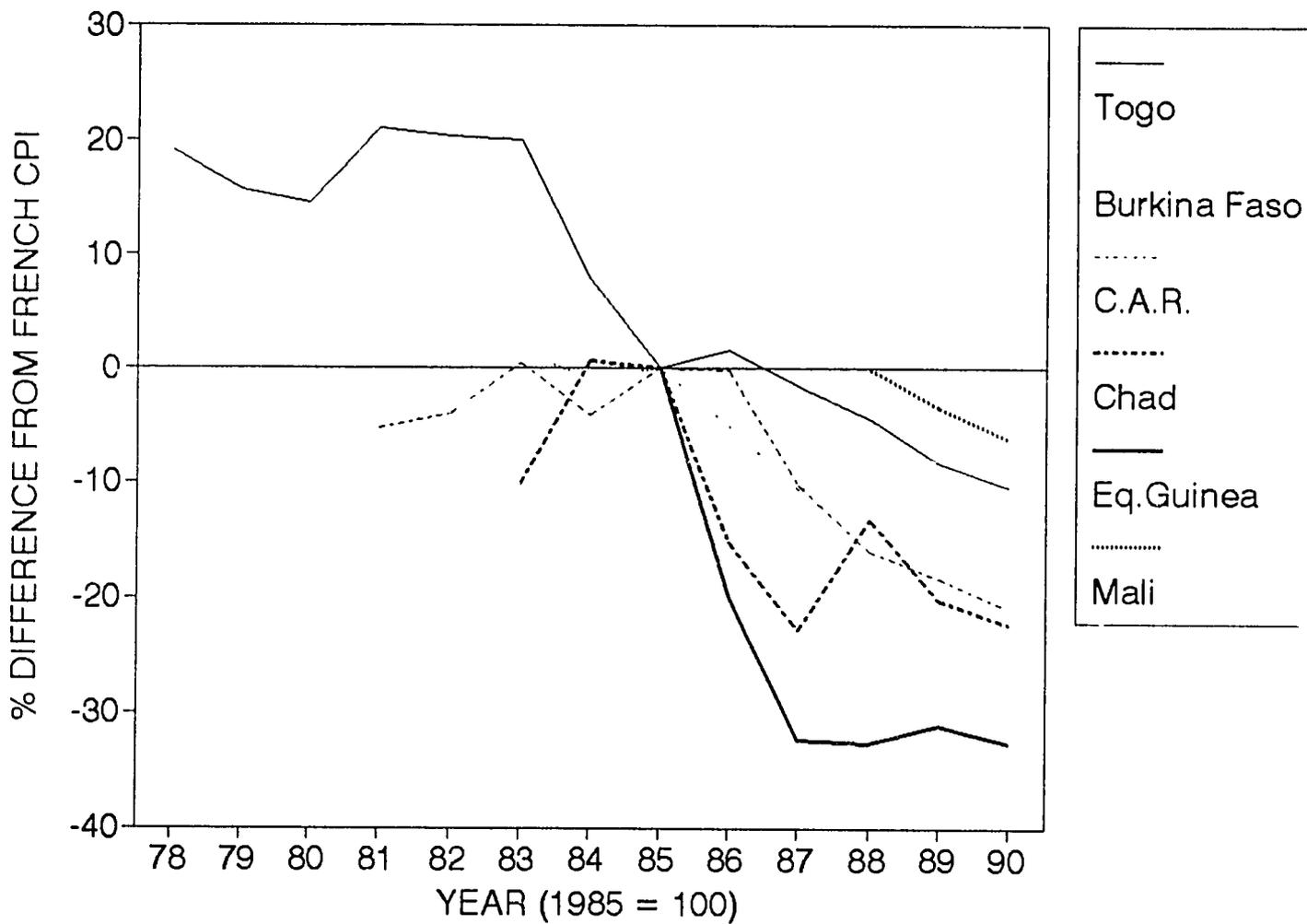
**Graph 2**

**COMPARING FRANCO ZONE AND FRENCH INFLATION, 1978-90**  
Franc zone CPIs as ratios to French CPI \* 100, less 100



**Graph 3**

**COMPARING FRANC ZONE AND FRENCH INFLATION, 1978-90**  
Franc zone CPIs as ratios to French CPI \* 100, less 100



**Table 3 - CONSUMER PRICE INDICES OF FRANCE AND FRANC ZONE COUNTRIES,  
1978-1990**  
(Average annual values, 1985 = 100)

	France	Burkina Faso	Cameroon	C.A.R.	Chad	Congo	Equat. Guinea	Gabon	Ivory Coast	Mali	Niger	Senegal	Togo
1978	50	53	47			51		52	57		59	48	60
1979	56	61	50			55		56	66		63	52	65
1980	63	68	55			59		63	76		70	57	73
1981	72	73	61	68		69		68	83		86	60	87
1982	80	82	69	77		78		80	89		96	71	97
1983	88	89	81	88	79	84		88	94		93	79	106
1984	95	94	90	91	95	94		93	98		101	88	102
1985	100	100	100	100	100	100	100	100	100		100	100	100
1986	103	97	103	102	87	102	82	106	107		97	106	104
1987	106	95	125	95	82	105	72	105	108		90	102	104
1988	109	99	136	91	94	109	73	95	115	109	89	100	104
1989	113	98	133	92	90	113	78	102	116	109	87	100	103
1990	116	98	135	92	90	115	78	110	116	109	86	101	104

Notes:

All data from *IFS* 1992 (empty spaces indicate no data provided), with the following exceptions:

Cameroon: *IFS* has just replaced an earlier series for 1985-89 with a series for which the 1985 value is 91.1. The authors have therefore multiplied figures for all years from 1985 by the ratio 100/91.1. The unadjusted value for 1990 (123.4) is the average for the year's first three quarters.

Ivory Coast: values for 1989 and 1990 are averages of values for two or three quarters only.

Congo: (ditto for 1990 value).

*If further devaluation is ruled out*, the higher inflation may make the exchange rate once more significantly overvalued by time  $t_2$ . Output over the entire period will be less than  $\hat{Y}_1$  and, depending, on the elasticity of output with respect to the exchange rate, it may be less than the output obtained by following the BCEAO strategy. Since this strategy is predicated on arriving at a nominal exchange rate that will not have to be devaluated again in the foreseeable future, the BCEAO's position can be described as internally consistent.

Conversely if repeated devaluation is not ruled out as a means of maintaining an REER of  $e_e$ , then the negative impact of the higher inflation rate on international competitiveness can be offset. Which of the alternative strategies then brings about higher output depends on the importance of the negative effects, other than appreciation of the REER, arising from the increment in inflation associated with the "devaluation now" strategy. In the authors' view, given the current economic stagnation in the FZ, the disincentive effect of postponing devaluation and achievement of  $e_e$  depresses output more severely.

*B. Exchange rate management, 'credibility', and franc zone integrity.* The view that changes

in currency parity cause foreign as well as domestic investors to lose confidence in a country's economic management, thereby aggravating inflation, capital flight and many other ills, was dominant world-wide up to the early 1970s. Even so, this view did not prevent the French government itself from devaluing (or stepping aside to let the market devalue) the effective dollar/franc exchange rate by 52% in five steps between 1948 and the Smithsonian Agreement of December 1971.<sup>28</sup> Nor did such changes undermine the confidence of France's economic actors sufficiently to prevent her GDP from growing at a compound annual rate of 5.3% from 1950 to 1971.

Graph 4 plots the movement of the franc against the dollar (left axis) and the deutschmark (right axis) during the 21 years following the Smithsonian Agreement. Notwithstanding the volatility of the exchange rates, French GDP has grown at a compound annual rate of 2.63%, bringing her per capita GDP from 87% of the United States' in 1971 to 96% in 1991.<sup>29</sup>

Needless to say, the gyrations of the franc exchange rate, both before and after 1971, reflect changing policy stances by the French authorities as well as exogenous developments in France's foreign markets. It is not within the scope of this paper to analyze and critique French monetary and exchange rate policy in the postwar period. It is, however, relevant to compare France's own experience with the assertion that allowing the exchange rate *vis-à-vis* currencies of one's main trading partners to vary depresses growth by undermining the authorities' credibility, inducing permanent speculation against the national currency and deterring investment.

According to the World Bank's *World Development Report*, 11 low- or middle-income countries achieved average annual growth rates of 5.0% or more during the 1980s. Table 4 shows what happened to these countries' exchange rates (national currency units per dollar) during the same period. Once again, no evidence that devaluation undermined investors' confidence. Indeed economists' present consensus goes in virtually the opposite direction: that these economies did well in large part because investors acquired confidence that the governments concerned had finally come to understand the importance of adjusting exchange rates whenever necessary to maintain competitiveness.

Showing that the 11 highest-growth developing countries devalued to the extent of raising the value of the dollar by at least a quarter, the median being India's 129%, is scarcely sufficient to prove that the FZ's member countries would have grown by 5% or more during the 1980's had it also devalued. The only African country among the eleven is Botswana, whose relevance to the rest of the continent is often challenged because of the strong influence exerted over its economy by South Africa.

It is not argued here that examination of the eleven cases is sufficient to prove the case for

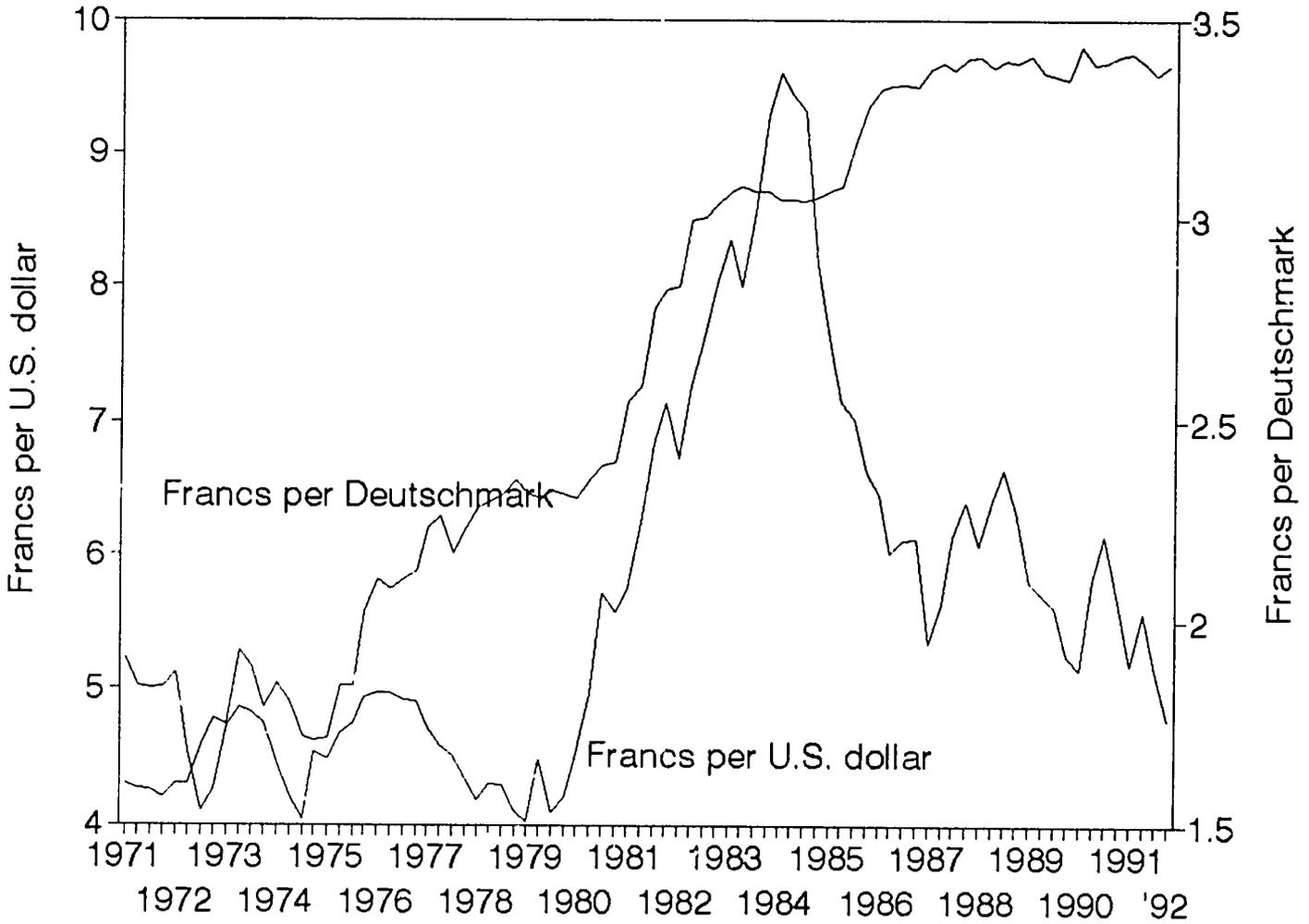
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<sup>28</sup> Number of devaluations calculated by comparing year-end exchange rates given in IMF 1992. Multiple changes within a year, if any, are not included. The rate of Ffr 2.66/\$1 in 1948 became Ffr 5.56 in 1969.

<sup>29</sup> Calculated from series in IMF 1992.

**Graph 4**

**VOLATILITY OF THE FRENCH FRANC, 1971-92**  
End-of-quarter market rates per \$ and DM



**Table 4 - CHANGES IN CURRENCY PARITY OF HIGH-GROWTH LOW- AND MIDDLE-INCOME COUNTRIES, 1979-1990**

(% changes in national currency units per U.S. dollar,  
December 1979-December 1990)

Malaysia	23.4%
Thailand	23.8%
Korea	48.0%
Mauritius	88.8%
Pakistan	121.2%
India	128.6%
Botswana	137.3%
Egypt	185.7%
Indonesia	203.2%
China	249.0%
Turkey	8188.7%

**Sources:** Countries are those identified in IBRD (1992) as low- and middle-income countries whose real GDP grew at least 5.0% per annum during 1980-90. Countries listed as meeting that criterion but excluded here are Bhutan, Chad and Mongolia. Changes in currency parity calculated from IMF 1992.

a CFA franc devaluation. Rather, the authors wish merely to note that maintenance of a fixed exchange rate has not proven essential to rapid growth of any of the top developing country performers during the past decade.

While correctly guessing the timing of a devaluation enables a speculator to make the highest return for the least investment in the short run, the East Asian Gang of Four and other newly industrializing countries (NICs) would not be where they are if many investors had not found the creation of real value added in their economies to be a more solid basis for profiting from devaluations over the medium to long term. Even though it raises the domestic currency cost of tradable inputs and foreign borrowing, by the same token devaluation increases returns to exporters and import substituters who are generating positive value added, and reduces the real cost of their domestic borrowing.

Indeed investors have much more to lose, and are likely to be much more reluctant to invest, when the authorities are defending a fixed exchange rate in which the market has lost confidence. This is because the investors must anticipate and protect themselves against a large, one-shot devaluation that will burden them with a heavy, visible loss. Conversely, investors'

gains from inflation are much more likely to protect them from losses incurred as a currency depreciates slowly from a position of market strength.

In a nutshell, the authors find that the 'credibility' argument ignores world-wide experience over the past 20 years and resurrects discredited arguments from the 1950s and '60s.

The question then arises as to whether the FZ has special features that make its members more vulnerable than non-FZ countries to the disruption accompanying a devaluation. The zone has two characteristics making it unique in the world: (i) it is multinational, and (ii) it has an operations account with the French Treasury via which France guarantees convertibility of the CFA franc. These two features underlie the benefits listed in section II above.

Admittedly the rules of consensus that have governed decision-making in the BEAC and BCEAO thus far complicate the task of agreeing to devalue and, once that decision is made, agreeing on a new CFA-French franc parity. This is especially so given that the degree of overvaluation and its trend differ among member countries. Graphs 5 and 6 show the annual movement of REER indices--value of the French and CFA francs in terms of a basket of foreign currencies--for France and five FZ countries, taking 1980 and 1985 as alternate base years. From either of these bases the current range of variation is about 30%.

However, France's economic weight and role as guarantor of convertibility would very likely enable it to carry the day once it accepts the inevitable--that a change in parity is essential to restore the FZ's competitiveness. Even lacking so dominant a member, the EEC has decided many difficult issues by consensus achieved through tough negotiations. Moreover, the two African unions are entitled to change their rules. There are many possible formulae for decision-making by multinational bodies. The U.N. General Assembly uses a simple majority voting scheme; since the WAMU has an odd number of members, it could do the same (with special procedures to cater for abstentions). The IMF and World Bank use weighted voting with GNP figuring heavily in the weights.

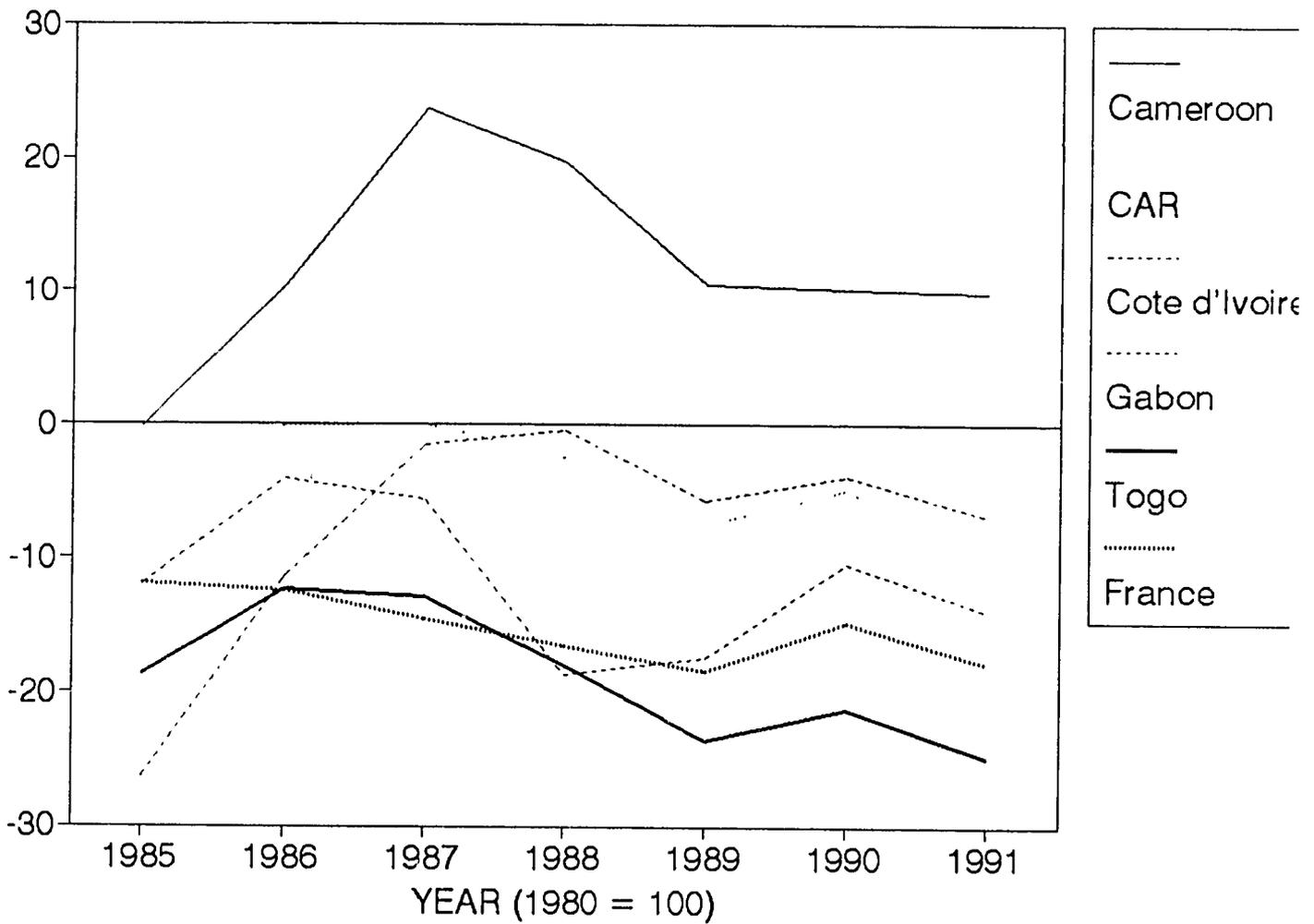
There is no reason for a change in CFA franc parity to undermine France's role as guarantor of convertibility. The operations account can function just as well at a rate of 60, 75 or 100 CFA francs to the French franc as it has at 50--indeed the account should be easier to manage as the members' balances of payments improve and the tendency towards a chronic deficit becomes less pronounced.

In the unlikely event that one or more FZ governments decide that the costs of remaining in the zone at a devalued exchange rate outweigh its advantages, the reaction of France and the other members should be to ease its/their departure. As long as the zone provides the benefits identified in section II it is hard to believe that a majority of members would desert it at any exchange rate within some reasonable range.

Moreover should France wish to retain the special influence with a departing member or members that the FZ has provided her up to now, she can propose a separate operations account

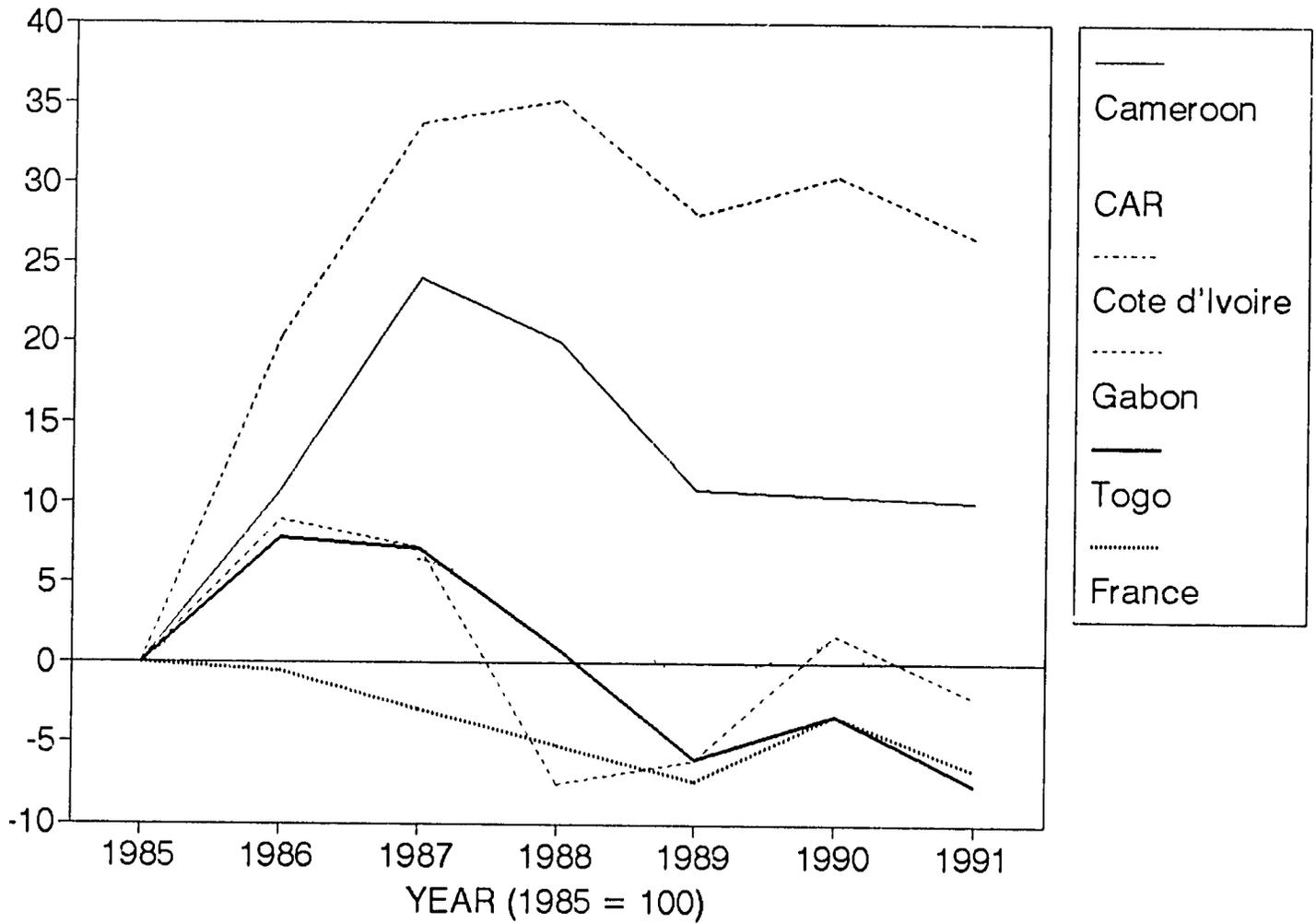
**Graph 5**

**DEVIATIONS OF REAL EFFECTIVE EXCHANGE RATE INDICE**  
France & 5 franc zone countries, REERs minus 100



**Graph 6**

**DEVIATIONS OF REAL EFFECTIVE EXCHANGE RATE INDICES**  
France & 5 franc zone countries, REERs minus 100



for that country or group of countries in exchange for a voice in decisions affecting credit creation. For 17 years--1967 to 1984--France maintained a separate operations account for Mali, and the Malian franc was convertible at a rate of 100/1, i.e. two Malian francs per CFA franc. This arrangement continued until Burkina Faso withdrew its veto of Malian membership in the WAMU, motivated by a territorial dispute.

*C. Interpreting the experience of African devaluers.* The summary of official French views in subsection VII.A cites global evaluations of the devaluation experience of 16 other African countries and specific analysis of Ghana's.

One cannot dispute the contention that, once the typical African country has devalued, it has come under heavy pressure to do so again within a few years--some indeed within a matter of months or even weeks--and the majority have in fact done so. This raises two questions:

1. what has been the relative contribution of each African devaluation at time  $t$  to the inflation that imposed pressure to devalue again at time  $t+n$ ?; and
2. is it inevitable that devaluation will undermine fiscal discipline?

Responding to the first question, as noted in subsection V.B, any devaluation where the official exchange rate plays a sufficient role to influence prices of some goods and services figuring in the consumer price index will exert an immediate upward thrust on measured short-run inflation. However, if the devaluation restores the value of foreign exchange to its social opportunity cost, *and* the government conducts a fiscal and monetary policy that holds the budget deficit close to the level that can be financed by capital inflow--a heroic assumption, to be sure--then inflation in the medium- and long run will be less than it would have been in the absence of devaluation.

This is because, in an economy lacking the FZ's automatic access to an operations account in a foreign treasury, an exchange rate that overvalues the local currency makes the demand for tradeable goods exceed their supply at prices conforming to the official exchange rate. The resulting shortages accelerate inflation and increase the returns to smuggling, which in turn depresses government revenue, aggravating the budget deficit and thus inflation. According to the previously cited French literature, this is indeed what had happened in Ghana and several other African countries before devaluation.

However, that literature challenges vigorously the assumption of a tight fiscal and monetary policy. Indeed it says that each devaluation has encouraged a *laxer* fiscal and monetary policy than would have been pursued in its absence, precisely because it has reduced the short-run cost of inflation. This contention must also be accepted--if one reduces the cost of inflation in the short run, then governments operating in the political environment of a typical African country will undeniably 'buy' more short-run inflation.

On the other hand, in the medium to long term, it is the fiscal and monetary policy follow-up

to devaluation, rather than devaluation *per se*, that determines the rate of inflation. Moreover, the French literature is the first to note that many non-FZ African countries have followed lax fiscal and monetary policies long before they devalued. To say that an African devaluation restoring the exchange rate to equilibrium inevitably triggers a vicious circle of inflation and further devaluation ignores counterbalancing policy options that a government can pursue and that several have recently pursued, usually with a guiding hand from the IMF and the donor community. This includes several anglophone countries that at one time or another had lapsed into or approached hyperinflation, notably Ghana, Nigeria, Tanzania and Uganda.

This leads into the second question above. Opponents of devaluation have argued that to admit the possibility of devaluation is to remove an important barrier to laxity in fiscal policy. They believe that non-FZ African countries have been encouraged in pursuing inflationary policies by the option to devalue. In fact, however, those countries have been very reluctant to use that option. They have followed inflationary policies and then used exchange control and other measures to avoid devaluation.

When they have devalued, African countries have usually adopted restrictive fiscal and monetary policies at the same time. Indeed, the need for demand restraint to accompany devaluation is part of the standard doctrine of international agencies. It is true, of course, that many have been unable to maintain demand restraint but not because of the illusion that flexible exchange rates bring fiscal freedom.

It is worth noting that Asian countries, e.g. Indonesia and Malaysia, which adjust their exchange rates by a crawling peg policy or periodic adjustments, generally pursue conservative fiscal and monetary policies.

*Inflation experience outside the franc zone.* Much of the inflation in non-FZ African countries can be attributed to the fiscal and monetary policies of the countries involved. Those policies were responsible for inflation in two quite different ways:

First, governments often undertook development programs which generated excess demand. In some cases a favorable shift in the terms of trade enabled them to increase development expenditures without concern for balance of payments problems.

Second, fiscal and monetary policies were adjusted to accommodate inflationary pressures from a variety of "supply shocks", e.g. reversal of earlier improvements in terms of trade, droughts and political instability. The resulting balance of payments problems were dealt with first by borrowing, and then by exchange control, import licensing, and other protectionist policies. Domestic inflation was partly suppressed by rationing, price control, and subsidy schemes. Demand restraint was avoided where possible and formal devaluation was postponed as long as possible. Inefficiency in the operation of exchange control led to shortages of intermediate inputs and spare parts and so reduced output in a self administered supply shock. Ultimately the inequities, corruption, and inefficiency of the control systems forced a recognition of the need for some devaluation and for demand restraint. International agencies and other

donors, of course, played a role in the transition.

Devaluations were often too small or applied only to part of the foreign exchange market. Monetary and fiscal policy did not change enough to eliminate excess demand. Many programs were abandoned and then replaced by new agreements with international agencies with many of the same elements.

Over the years successive devaluations have reduced the foreign exchange value of some currencies to a fraction of their original worth and continuing inflation has cut their purchasing power by as much or more. It cannot be said that devaluation caused the chronic inflation suffered by so many countries. It is, perhaps, nearer the truth to say that inflation caused devaluation but both were the consequences of the monetary and fiscal policies and the interaction of those policies with supply shocks.<sup>30</sup> Those shocks would, taken by themselves, have exerted some temporary inflationary pressure as they did in the FZ countries. They generated continuing inflation and further devaluations when they were fed by accommodating monetary and fiscal policies.

When we ask how a nominal devaluation is likely to affect the rate of inflation we cannot expect a meaningful answer until we say what macroeconomic conditions prevailed before the devaluation and what policies will be employed afterward. Three types of macroeconomic policy response to devaluation may be considered: first, complete accommodation; second, a predetermined growth rate for money with no accommodation; and third, a compromise between the first two.

In non-FZ Africa, excess demand usually prevailed before the devaluation. Afterward, monetary policy accommodated price increases arising from excess demand in the domestic market as well as those resulting from higher import prices. In those circumstances it is not surprising that no real devaluation was achieved.

Now consider the hypothetical case of an economy initially in external and internal balance. An adverse shift in the terms of trade reduces national income and causes a current account deficit. The government pursues a policy of keeping the rate of growth of nominal demand unchanged after the devaluation. We should then expect a temporary rise in prices but not a continuing inflation.

The devaluation will initially raise the prices of goods with significant import content as well as the prices of import-competing goods including domestically produced food. Some wages will also be increased in response to the cost-of-living increase. But if nominal demand does not increase, domestic absorption must contract as prices rise. Ultimately, domestic absorption must contract enough to balance the loss from the change in terms of trade. There should also be a

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<sup>30</sup> Adda (1992), critiquing Coquet and Daniel in the same issue of the *Revue de l'OFCE*, notes that, while devaluation may trigger demonetization, the latter can and does occur in the absence of devaluation and in some cases precisely because of a refusal to devalue.

reduction in the volume of imports and a rise in the production of exports as the relative price of tradeable goods increases.

Under a more realistic demand management policy, nominal aggregate demand would respond to accommodate part of the price increases initiated by the devaluation. The first round of price increases would lead to further price increases but, so long as competitive conditions and supply elasticities prevented complete compensation for cost-of-living increases to every group, the sequence of price increases would converge and the shifts in output, exports and imports would ultimately be similar to those in the previous case.

Putting aside the two extreme cases outlined above, one can see from the third that the outcome of a devaluation must depend jointly on two factors. First, the underlying market structure in the economy. That structure including the competitive position in various markets as well as the economic and political strength of trade unions will determine how wages and prices respond to the interaction of the cost push from devaluation and the ensuing changes in nominal demand. The second determinant of the outcome is the capacity of the government and central bank to resist pressures to expand nominal demand when prices rise.

The following simple model can be used to summarize the points made above:

$$\begin{aligned} 1) \quad P_{ct} &= aP_{nt} + (1-a) \cdot E_t \\ 2) \quad P_{nt} &= A_1 \cdot \sum w_i P_{ct-i} + A_2 \cdot [N_t - P_{ct-1}] \\ 3) \quad P_{ct} &= a[A_1 \sum w_i P_{ct-i}] + A_2 \cdot (N_t - P_{ct-1}) + (1-a) \cdot E_t \end{aligned}$$

where:

$P_{nt}$  is the rate of change of the price of nontradeable goods including wages (for simplicity, prices of tradeables are assumed constant)

$P_{ct}$  is the change in the cost of living index

$N_t$  is the change in nominal aggregate demand

$E_t$  is the rate of change of the exchange rate

The coefficient  $A_1$  reflects the aspects of market structure that determine the response of wages and nontradeables prices to past increase in the cost of living.  $A_2$  reflects the aspects of market structure that determine the effect of "real demand" on prices.

The movement of  $N_t - P_t$  indicates the stance of monetary policy. If its value is kept at zero monetary policy is fully accommodative. If  $N_t - P_t$  is negative, monetary policy is restrictive and if it is positive it is not merely accommodating but actively inflationary.

For simplicity let us reduce the lag term to  $P_{ct-1}$  so that equation 3 becomes:

$$P_{ct} = A_1 a P_{ct-1} + A_2 (N_t - P_{t-1}) + (1-a)E_t$$

If  $N_t$  is kept equal to  $P_{ct-1}$  while  $E_t$  is always set equal to  $P_{ct-1}$  in order to maintain a constant real exchange rate we will have

$$P_{ct} = A_1 a P_{ct-1} + (1-a)P_{ct-1}$$

If  $A_1=1$  the equation reduces to  $P_{ct}=P_{ct-1}$  so that any inflation once begun will continue indefinitely. If there is an initial devaluation prices will rise and then continue to rise at a steady rate. If however, the feedback coefficient is less than one each term will be less than the preceding one and the inflation rate will decline toward zero. In fact it is very unlikely that in the conditions of the WAMU there should be a one for one adjustment of all the nontradeables prices to match the impact of rise in the price of imports.

Domestic food prices will rise because of increased costs for imported inputs, because of increased use of land for export crops whose price has risen and because of increased demand as result of higher prices for imported food. Nonetheless one does not expect prices to rise in proportion to import prices. The earnings of workers in informal service and artisanal sectors are unlikely to rise enough to fully compensate for increased import prices.

Nonetheless, one might expect that without demand restraint there might be a strong response to cost of living increases in some WAMU countries which could start a strong though diminishing wage-price-exchange rate cycle. But it is certainly not necessary to permit demand to increase to fully accommodate each increase in prices. That would not be in the WAMU tradition.

It should therefore be within the powers of the WAMU countries to limit the force of the wage-price-exchange rate spiral to achieve a real devaluation. That would require some demand restraint but so would the policy now in use.

A final point is most relevant to those countries which have used protectionist measures to limit their current account deficit: a devaluation of the nominal exchange rate will permit them to reduce tariffs and so reduce the initial price increase resulting from devaluation. They will then rely more heavily on export expansion than on import limitation.

*Empirical Evidence.* First, we may observe that the model used above can explain some of the basic differences in FZ and non-FZ performance. As already noted both groups of countries were subject to changes in terms of trade, and to supply shocks from bad weather. On occasion some of the FZ countries experienced excess demand. However, the rules of the monetary unions imposed a more severe limit on demand creation in the franc zone than elsewhere in Africa.

There are few empirical studies of the relation between devaluation and inflation in Africa. The task is made difficult because so many factors are at work and because the data are weak. "Event" studies of the type done elsewhere are difficult because in many cases devaluation is an almost continuous process. Moreover, when there are exchange controls and parallel markets there are not one but many exchange rates. They change at different times and their relative importance changes.

A recent study by Joshua Greene (1989) indicates that one might expect a feedback coefficient from change in the exchange rate to change in the CPI of about .4 or less. A ten percent rise in the price of foreign currency increases the CPI by four percent or less. That estimate is supposed to include the direct increase in import prices and any induced increases in any other markets; it does not allow for the need for further devaluation to achieve the initial real exchange rate objective. The estimate is biased downward because the measured devaluations were only for the official rate.

We have attempted a number of single country regressions, again relating change in exchange rate and change in nominal GDP to change in CPI. The coefficient on the exchange rate change varied widely but only Mauritius had a coefficient near one. A study of Zambia using a more elaborate methodology produced a relatively low coefficient.<sup>31</sup>

Those results are far from definitive but two points may be made. First, they are more relevant to the problem in hand than studies which merely observe that devaluation was often accompanied by inflation and that many nominal devaluations did not result in a real devaluation.

Second, it may be said that, even after allowing for downward bias in our results, the coefficients relating inflation to devaluation are so low that they could be adjusted upward a good deal without reaching one. Moreover, the opposite bias from the neglect of possible tariff adjustments should not be ignored. Finally, the coefficients on the demand variable indicate that one should be able to check a wage-price-exchange rate spiral by demand management if one wished to do so. Obviously an incomes policy could reduce the cost of adjustment significantly.

*Effects of Real Devaluation on the Balance of Payments.* The immediate object of a devaluation is to reduce the current account deficit by providing greater incentives for export production, and for production of import-competing products, while encouraging a shift of expenditures toward nontradeable goods and away from imports. Most countries with substantial current account deficits also have excess demand. Their investment expenditures exceed the amount they can save (when their resources are fully employed) plus capital inflows. Elimination of the current account deficit requires a reduction in domestic absorption to release resources for use in production of goods to produce additional exports and to match the new

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<sup>31</sup> [Studies conducted within the framework of the current African exchange rate management project; references to be supplied once reports are complete.]

demands generated by the devaluation.<sup>32</sup>

The economic and social adjustments needed to achieve internal and external balance pose difficult social and political problems. But even when those difficulties can be overcome there remains the question of the economic feasibility of achieving the required changes in production. While in practice short and long term effects overlap, it may be useful to consider the effects of devaluation in terms of short run supply responses from existing capacity which can serve to reduce if not eliminate the current account deficit, and then turn to a longer, more growth-oriented perspective.

In 1991 Senegal's current account deficit of \$238 million was approximately 5% of GDP. Merchandise exports were \$903 million, imports \$1,187 million (both f.o.b. measures).<sup>33</sup> We adjust the import figure to a c.i.f. base by adding a notional 10%. Eliminating the deficit via equal dollar-value contributions from exports (f.o.b.) and imports (c.i.f.) would require expanding exports by 13% and reducing imports by 9%.

Those numbers are not physically impossible but a substantial real devaluation would be required to provide the necessary market incentives. A recent estimate suggests that, with a substantial reduction in tariff barriers, a devaluation of 50% would be required (Salinger and Stryker 1991).

*Short Run Effects on Agriculture.* In the short run we hope that the improved incentives for agricultural exports will induce increased production of export crops. That will involve more imports of fertilizers and pesticides and may also induce some shift of land use from food crops to export crops. Whether the latter shift occurs or not will depend in part on the effect of price increases for imported food induced by devaluation. Since there is no shortage of farm labor, the increase in exports should not reduce productive capacity elsewhere.

However, the potential effects of a devaluation taken by itself are limited and it takes considerable time to realize them. A variety of other actions to improve transportation, storage, timely availability of fertilizer and so on can increase agricultural production. Those measures may be regarded as alternatives to devaluation but they can also be seen as complementary. In many cases the two kinds of action reinforce each other so that the yield of the two taken together is greater than the sum of the separate yields.

*Other Sectors.* Agriculture is most important simply because it accounts for such a large share of exports. In Senegal's other resource based sectors-- fishing and phosphates--the benefits from

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<sup>32</sup> Not all countries with current account deficits have excess demand. The United States and several other OECD countries have large current account deficits while suffering from excessive unemployment. If the exchange rate or some other policy could increase U.S. exports or reduce imports by enough to eliminate the current account deficit there would be no present difficulty in meeting the additional demand.

<sup>33</sup> IMF 1993, Senegal country pages.

devaluation are limited by the basic supply conditions. Tourism has a much larger potential but is a highly competitive area. Moreover, immediate gains are limited by the amount of unused capacity. When capacity is fully utilized a considerable investment will be required for further gains.

The same is true of import-competing manufacturing sectors. In the short run they can benefit from devaluation only to the extent that they have excess capacity. Thereafter further gains require investment.

All those considerations should serve to emphasize the need to use a relatively long time horizon in evaluating the potential benefits from devaluation. Together with the experience of countries which have devalued they should also emphasize the need to have realistic ideas of the time and resources required to develop the exports and the expanded domestic production needed to solve current balance of payments problems and lay the groundwork for future growth.

*Long Term Aspects.* It is important to recognize that the benefit from devaluation will not appear at once. In developed countries it usually takes two years to reap the full benefits of a devaluation. In developing countries, where the benefit depends on structural change or interaction with investments, the full gestation period for the gains from devaluation is likely to be considerably longer.

In this vein it is useful to revisit the Ghanaian experience, whose implications for the *pro*-side of the CFA franc devaluation debate Coquet and Daniel (CD 1992) go to great lengths to disprove.<sup>34</sup> The companion case study by Stephen Younger in the present series paints a rather different picture from CD. Like them, Younger emphasizes the role of fiscal and monetary “mesures d’accompagnement” in reducing both inflation and inflationary expectations in Ghana. However he also shows that these measures have formed an integrated package together with the establishment of a market- (specifically, auction-) based foreign exchange regime which prices foreign exchange at its social opportunity cost.

This in turn has greatly increased the confidence of the business community that investment in efficient production of tradeables, conforming to Ghana’s comparative advantage, will be profitable, and even more important, that whatever fiscal and monetary policies the government pursues in future are much less likely than before to undermine this profitability. This has had two results: firstly, Ghana has lured back into its formal trade channels the cocoa that previously exited through its CFA neighbors. Cocoa export volume in 1991 was 45% above that in 1985; in 1989 it was 62% higher, but more recently the declining world price has taken its toll.<sup>35</sup>

Secondly, Bank of Ghana figures show the total dollar value of timber, minerals and energy

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<sup>34</sup> Approximately one-third of their article on the future of the franc zone is devoted to a discussion of Ghana.

<sup>35</sup> Export volume indices from IMF 1993, p. 244.

exports growing by 7.1% p.a. during 1986-91. Even more significantly, according to data of the Ghana Export Promotion Council, nontraditional exports (NTE) grew at more than 8% per annum during this period, reaching \$68.4 million in 1992.<sup>36</sup> The consistent profitability of NTE has attracted significant new foreign investment--for example, a new \$10 million tuna cannery is projected to export \$25-30 million worth per annum, while a garment factory established by Hong Kong Chinese interests, joining an earlier textile factory financed from the same source, is a likely forerunner of substantial clothing exports.

The increase of cocoa exports can be ascribed to a 'réparatrice' devaluation, but the performance of nontraditional exports shows that the exchange rate reform is also having a 'strategic' impact. Ironically, it is this 'strategic' impact, contradicted in the authoritative French literature, that is now causing such concern on the part of Ghana's CFA neighbors, not only in the form of competition that is undercutting their own nontraditional exports, but also through a reverse flow of their primary product exports through Ghana and Nigeria.

What must be emphasized is the length of time which Ghana's program has required to produce results in terms of the exports needed for sustained growth. Departing from a base of only \$14 million in 1986, NTE will have needed a full decade to make a significant contribution to the balance of payments.

A devaluation should be regarded as a critical element in a program to achieve current account balance--less in the short than in the long run, to be sure--and to provide the basis for the continuing increase in exports required for a rising per capita income. For Senegal, devaluation appears to be a necessary condition for that objective even if it is unlikely to be a sufficient one.<sup>37</sup>

To get exports on to a satisfactory long term growth path, Senegal needs to reach a wage level in the formal industrial sector low enough to enable it to compete in some set of labor-intensive industries. The wage level measured in foreign currency must be competitive with wages in other developing countries after allowance for differences in productivity, transportation and energy costs, taxes, regulatory costs and a risk-return combination that will overcome inertia. (To say that is not to urge any particular nominal exchange rate policy. The stated criterion could be met by adjusting the nominal wage, by adjusting the nominal exchange rate to price movements, or by floating the exchange rate.)

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<sup>36</sup> Bank of Ghana and GEPC data were supplied by USAID/Ghana through AID/Washington's Africa Bureau. Growth rates calculated by semi-log regression.

<sup>37</sup> Cf. Adda (1992), who notes that CD pose the wrong question in asking--and answering in the negative--whether devaluation of the CFA franc can be expected to restore the FZ's trade balance in the short run. The imperative, he argues, is to initiate a change in the structure of production over the long run. The corresponding policy question, which Adda and we likewise answer in the negative, is not whether devaluation will accomplish this by itself, but whether any alternative set of measures can accomplish it if the current exchange rate is maintained.

In principle there is always some real exchange rate that will make any country's industry competitive, but the amount of exchange depreciation required will depend to a very considerable extent on other measures which can improve efficiency. Structural adjustment programs involving tax reform, improved budgeting, privatization, financial reform, elimination of subsidies and outward-oriented trade policies as well as devaluation are undoubtedly needed. So too are a variety of infrastructure investments.

Changes along those lines are proposed or underway in many African countries. Some other measures more directly related to conditions in Senegal have been proposed by the GOS. Changes in Senegal's labor law now under discussion should increase productivity as well as reduce regulatory vexation for potential entrepreneurs. Measures to increase regional integration would not only provide scale economies for further import substitution but also provide a better base for potential exports from the region. All those measures could serve to reduce the amount of real devaluation required to restore Senegal's competitive position. That is important because devaluation arouses political opposition even when the eventual demand compression measures entailed by failure to devalue impose a much higher social cost.

Thus, devaluation on the one hand and actions like those proposed by the GOS should be regarded not as alternatives but rather as complements to one another. Because devaluation involves painful changes in income distribution, it will be difficult to initiate and sustain a large enough real devaluation to put Senegal on a satisfactory growth path. But it is also unlikely that any set of measures not involving devaluation will do so. The two together may succeed.

Along with many other components, devaluation is therefore an essential part of a long-term expansion program. For such a program to succeed three things are necessary.

First, the GOS needs to commit itself to the establishment and maintenance of a real exchange rate which in conjunction with other measures can realistically be expected to make it possible for nontraditional export volume to grow.

Second, a realistic program takes time. The international agencies and other donors must be prepared to provide balance of payments support for long enough for the program to yield results. In particular, balance of payments difficulties should not choke off the investment needed for development, including maintenance and upgrading of existing capital. (On the other hand policy measures, including privatization, for upgrading the quality of investment should also be pursued.)

Third, there must be some mobilization of political support for measures to limit the inflationary impact of a large devaluation. There must be support for an incomes policy to limit the response of formal-sector wages to any initial increase in the cost of imports. There must also be support for the demand restraint which will be required to limit inflationary pressures.

The final message is that while the moment of truth can be delayed, it will ultimately be necessary to devalue. It will probably be even more painful and difficult to make the necessary

adjustments if the basic balance of payments situation is allowed to grow much worse before any action is taken.

*D. Managing a devalued CFA franc.* Assuming that the CFA franc's present parity will be changed in the near future, as many observers expect, the question arises as to how the currency should be managed in the future. No one would disagree that if there is to be a devaluation, it should be of sufficient magnitude to take the CFA franc to a level where at least most of the WAMU and CAMA economies will be competitive and exports will start growing faster than the current GDP growth target of 5%, i.e. at least 6% in the near term.

Once the new parity is determined, should the partners be prepared to go through the same deflationary contortions to uphold it as they have the current rate? If the FZ members want to follow the growth model of the newly industrializing countries in Asia, the lesson is: there are things governments can do to promote industrialization--and perhaps even more things they can do to hinder it--but one of them is *not* to defend an exchange rate against clear market signals that it is overvalued.

Indeed the healthiest thing the partners can do is agree on a new decision-making structure in the BCEAO that will enable the CFA franc's parity to be modified in response to market signals without it being a traumatic experience requiring emergency summit conferences in Paris. Obviously it is impractical to get seven (or, harder still, thirteen) member states plus France to agree to each shift in a floating exchange rate. Instead, the BCEAO should establish an office of exchange rate analysis and staff it with professionals who are qualified to follow market developments and make an ongoing assessment of the WAMU's competitiveness.

Taking into account the advice of this staff, the Bank's management would then decide whether and how to intervene to dampen speculative peaks and troughs. These decisions might be subject to review by a subcommittee of finance ministers (who are, of course, in turn subject to direction by their presidents). In one way or another this model is followed by nearly all the high-growth countries listed in Table 3.

The authors see no reason why a flexible management of the CFA franc exchange rate should be inconsistent with any of the benefits of the FZ. As long as France maintains the operations account, the CFA franc will remain as convertible as the French franc itself, with the same potential for short-term changes in value.<sup>38</sup>

If one decides to hold a quantum of assets in French francs, one has no guarantee that the

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<sup>38</sup> An issue of management of the operations account is the amount of foreign exchange equivalent that the French treasury requires the FZ central banks to maintain in the account in the form of CFA francs. The level is presently fixed, meaning that the amount of CFA francs varies with the French franc exchange rate, with corresponding expansionary and contractionary implications for the member countries. Relaxation of this requirement would ease monetary management for the countries, while increasing the foreign exchange risk for France.

assets will buy as many dollars in a month's, week's or even day's time as they will today. But one is confident of being able to convert them on any given day at a price 'not very far' below the preceding day's price, say 5% at most. Thus the system protects one from catastrophic loss, and it will work likewise for the CFA franc once this has assumed a value that the market trusts.

### **IX. Operational implications: a call for educational measures**

In the authors' view, the continuing (if steadily weakening) opposition to flexible exchange rate management on the part of the FZ authorities reflects adherence to an outmoded doctrine more than a rational evaluation of costs and benefits of alternative policies. The doctrine is inconsistent with France's management of her own exchange rate *vis-à-vis* several key trading partners, and also carries with it an implication that the ex-colonies, even with French participation in decision-making, may not be competent to operate a modern floating-rate regime such as has become well established in the Asian NICs and towards which several non-FZ African countries, including neighbors and competitors of the FZ, are making significant progress.

American officials stationed in the FZ report increasing initiatives from senior local counterparts to obtain information about modes of operating alternative exchange rate regimes. The authors believe this to be a fruitful area for technical assistance through AID as well as other donors, including multilateral agencies not constrained by French opposition. Of greatest use, in their opinion, would be working visits by FZ officials to other low- and middle-income countries where floating pegs of one kind or another are institutionalized and the role of foreign exchange parity as a political football is steadily diminishing.

### **Postscript**

On August 2, 1993, the BCEAO and BEAC announced that they would no longer redeem FCFA banknotes--i.e. repurchase them with French francs--outside the African franc zone. Commercial banks in France were given a few hours to report their existing stocks of the banknotes to the Banque de France. The measure's stated purpose was to combat illegal export of capital via export of CFA banknotes. No new restrictions were imposed on exchange of FCFA for French francs through bank outlets in the African franc zone.

The CFA/FF premium on the parallel market in Accra had been running in the 8-10% range in the preceding months. The market's immediate reaction to the partial suspension of convertibility was a sharp reduction in the premium, presumably on the basis of an understanding that the measure would strengthen the FCFA in the short run and forestall devaluation for the time being. However the next day the premium regained its former level; during the ensuing two weeks it averaged in the 6-7% range, and then shot up over 12%, remaining in the vicinity of 12-15% until year's end. Apparently the market eventually decided that the central banks' step foreshadowed a formal devaluation.

During this period commercial banks reported a sharp increase in FCFA deposits as

banknotes that would otherwise have been exported to circumvent restrictions on capital export and forestall documentation of interest to the tax authorities found their way into the banks en route to exchange for French francs. The authors lack access to data on sales of French francs through the banking system, but these were reported to have increased up to year's end as the central banks honored their commitment to redeem FCFA within the local currency area.

Meanwhile the French government, seeing its own fiscal situation deteriorate under the impact of recession, increased the pressure on its African partners to come to terms with the IMF and World Bank--in other words, accept their prescription to devalue. In its November 1993 issue *Jeune Afrique Economie* reproduced a September 16 letter from Prime Minister B. Jaurès, evidently circulated to all African franc zone presidents, stating that France would restrict its nonproject aid to support of agreements reached with the IMF. The view of the French authorities as summarized by *JAE* was that devaluation of the FCFA had become a "necessary evil". An unnamed high French official was quoted directly as saying that all the African partner governments now shared this conclusion.

The magazine went on to describe the event as "a matter of days", with only the level of the parity change remaining to be settled. "Barring a last minute surprise", it said, this would fall within the range of 30-50%. (Applied to the value of the FCFA in French centimes, this would imply a new rate in the range of FCFA 70-100 to the franc.)

The matter finally came to a head at top-level meetings involving France, the two central banks, the FZ-member countries, the IMF and IBRD, starting in Paris in the first week of January 1994 and concluding in Dakar on January 10-11. The Dakar session announced a new parity of FCFA 100 to the French franc, with France guaranteeing convertibility as before. France and the multilaterals pledged a variety of aid instruments to ease the burden of the new rate on poor consumers and promote growth of the FZ economies. The IMF indicated it would approve temporary commodity subsidies from government budgets, which were expected to benefit from the devaluation coupled with forgiveness of much of the outstanding bilateral debt to France. (*Financial Times*, January 13, 1994.)

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