55385

UNITED NATIONS

# ECONOMIC AND SOCIAL COUNCIL

Distr.: LIMITED
E/ECA/TRADE/91/33
16 October 1991

ENGLISH
Original: FRENCH

ECONOMIC COMMISSION FOR AFRICA

Meeting of Intergovernmental Group of Experts of the Conference of African Ministers of Finance

Addis Ababa, 13-15 December 1991

Conference of African Ministers of Finance

Addis Ababa, 17 and 18 December

# IMPACT OF CHANGES IN THE EUROPEAN MONETARY SYSTEM ON THE MONETARY AND FINANCIAL SYSTEM OF AFRICAN MEMBER COUNTRIES OF THE CFA ZONE

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# I. INTRODUCTION

1. Since its establishment during the colonial era, the CFA franc zone has symbolized the acceptance of the French franc (FF) system by its African member countries. The system has operated under exceptional conditions of a generalized floating of currencies, and has even resisted the erratic fluctuations following independence.

2. With the changing of the economic and institutional framework within which the FF operates, especially the establishment of the European Monetary System (EMS), the issue arises as to the relevance of the monetary and financial systems to which African countries belong.

3. The integration of the FF into the EMS and the planned adoption of a single European currency by the year 2000 will affect the expectations and strategies of African monetary authorities and economic operators. The effects that this change will have on the franc zone are so disturbing that any attempt to quantify them let alone recognize the fact poses problems for the existing instruments analysis.

4. For lack of such a possibility, it becomes tempting to conduct a comparative cost benefits analysis of several alternative systems. It should therefore be assumed that the current system of the franc zone either could do better or a favourable impact on the development of its member countries.

5. To verify the soundness of their approach, scenarios should be constructed that will highlight the vulnerability of the system to various external shocks whose cumulative effects would be set in turn even before the are cushioned or attended by the mechanisms of the European Economic and Monetary Union (EMU).

6. If the development problems of the African member countries of the Franc zone are tied to issue of the structure and operations of the zone, its rigidity and the tendency to overvalue its exchange rate, then a structural change of the system will achieve have considerable positive results.

7. This report is divided into four chapters:

(a) The monetary and financial system of the CFA franc zone;

(b) Problems of adjusting the monetary and financial system of the CFA franc zone in view of the trend of the EMS towards a European Economic and Monetary Union;

(c) Study of scenarios; and

(d) Overall evaluation of the scenarios and their impact on the economic policies of African countries of the CFA zone.

## II. THE MONETARY AND FINANCIAL SYSTEM OF THE FRANC ZONE

8. The Franc Zone is a consequence of a series of agreements ratified by member States establishing a number of rules and guarantees. Established between Franc and its colonies and protectorates, the Franc Zone today comprises 14 African countries, seven of which are members of the Banque centrale des Etats de l'Afrique de l'Ouest (BCEAO), the six member countries of the Banque des Etats de l'Afrique Centrale (BEAC) and the Comoros which have their own Central Bank. [1]

9. The Franc Zone is based on the following three main principles:

(a) A common currency which has a fixed exchange parity relative the French franc;

(b) Community management of exchange reserves Community; and

(c) Freedom of transfer within the Zone.

10. The countries in each group have the same currency: the Franc de la Communauté financière africaine (CFAF) which, since 1948 has been 0.02 French franc.

11. The CFA franc is fully convertible and guaranteed by the French Treasury. On the other hand, the Central Banks of the African member countries of the Zone are obliged to release 65 per cent of their foreign exchange holdings to the French Treasury which deposits their value in franc in an operating account. France pays interest on these assets and guarantees their value. Whenever the African banks require foreign exchange, they can obtain it by releasing their own currency to the Treasury which is compelled to convert it, even if that places the operating account in the red. The amount convertible is unlimited. Should this account deteriorate, the Central Banks are compelled to take certain measures to rectify the situation.

12. The French franc serves as the reference unit of account for a CFA franc. However, it is not the currency for settling payments neither within the Zone since they have a common

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1/ Member countries of BCEAO are: Benin, Burkina Faso, Côte d'Ivoire Mali, Niger, Senegal and Togo while the countries of BEAC are: Cameroon, Central African Republic, Chad, Congo, Gabon and Equatorial Guinea.

currency, nor with the rest of the world since the countries can obtain the foreign exchange which they need. It is a reserve currency through which the central banks conserve a large part of their foreign exchange assets. When the operating account is in the black, the combination of the financial resources of the Zone within the French Treasury creates solidarity among the member States. The balance of the operating account is automatically influenced by the credit position of certain countries and the debit position of others. Besides the account opens a permanent and unlimited line of credit to all the members.

13. Membership of the Zone therefore provides a number of advantages including:

(a) The fixed exchange system allows stability and a low relative overvaluation of the currency;

(b) The convertibility and free transfer of these currencies facilitate access to external financing; and

(c) The restrictive monetary policy which keeps inflation in check has a moderating influence on interest rates.

14. Economically, member countries of the Zone appear on the whole, to have performed better than the other African countries outside the Zone. [2] However, owing both to the restrictive financial and monetary policies which places limitations domestic credit and to the freedom of exchange and transfer which reduces creditor risks, member countries of the Zone more easily and increasingly resorted in the 1980s, to relatively excessive external financing and borrowing. Furthermore, it is believed that since 1980 the CFA franc has slightly appreciated in relation to the current exchange rate. [3] Both the degree and the scope of the issue remain controversial.

15. Despite the considerable asset which the use of a common currency provides, there has been no remarkable progress in terms of economic and trade integration. The sectoral policies are hardly coordinated and trade within the Zone has remained very low. Nevertheless, the importance of the Zone to the African countries has been increasing since it constitutes a protected area in an otherwise stable world.

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2/ P. and S. Guillaumont (1988) "Stratégies du développement comparées Zone franc et hors Zone franc", Paris, Economica.

3/ The Bretton Woods Institutions believe that disallowing flexibility in the Zone's monetary system leads to an exchange rate overvaluation.

## III. PROBLEMS OF ADJUSTING OF THE MONETARY AND FINANCIAL SYSTEM OF THE FRANC ZONE TO THE EUROPEAN MONETARY SYSTEM (EMS) AS IT EVOLVES EVOLUTION TOWARDS EUROPEAN ECONOMIC AND MONETARY UNION (EMU)

### A. The EMU Project

16. The decision to establish the EMU was taken as for back as 1988 during the Hanover meeting of the Council of Europe which commissioned (the Delors Committee) to study and propose a sequenced time-frame for the achievement of European Monetary Union. The Committee's report which was submitted in 1989 proposed a graduated scheme built around for the changes centred a centralized monetary authority as well as the use of a single currency for the Community. The monetary policy would be implemented by an autonomous community institution operating along federal lines within a European System of Central Banks. The report proposes neither a timetable nor a deadline, but only the beginning of the first stage which was July 1990, and the EMU which was to come into effect in December 1992 at the same time as the European single market. During the first stage, the single market should be completed and all the currencies included in the EMS. Coordination of economic policy would be strengthened.

17. Even though, the EMU seems to have had a good take-off, it is still an uncompleted process which is likely to be questioned or change in direction. This makes any evaluation of the impact on external economies all the more uncertain.

#### (a) The Community currency

18. The major tool of the EMU would be a Community currency, in the form of the ECU. Even though this currency is to date perceived more as a unit of account, it is gradually becoming an instrument for settling account among central banks. Although it is only used in the accounts of Community institutions to express the amount of aid within the EEC/ACP framework, it is gradually becoming an invoicing or payment instrument for these institutions. Yet, it has still to become the common currency expected of it. National currencies continue to exist and to be managed by individual sovereign States. While its private use is growing rapidly on the bond markets, as an instrument for diversifying portfolios, only one per cent of the foreign trade of the Community countries is transacted in ECUs. Once the parities are permanently fixed the composition of the ECU-basket will no longer be meaningful. From a reference asset, it will become a single currency endowed with the status of a full fledged currency issued under the authority of a European central bank and its exchange mechanisms. This will be during the third stage.

#### (b) The exchange and intervention mechanism

19. Born of the margin-narrowing mechanism characteristic of the monetary snake, the EMS exchange policy is responsible for

the major achievements of exchange stability within the Community.

20. The first stage of EMU which came into effect on 1 July 1990 focused on strengthening such stability through effective pegging of all national currencies to the EMS, accompanied by elimination of exchange controls. During the transitional stage, the exchange policy will be institutionalized and managed by the European central banking system. Exchange rates would be exceptionally realigned and fluctuation in the exchange mechanism would narrow. The third stage would be devoted to disengagement from the first version of the EMS mechanism. Parities will be permanently fixed and national currencies replaced by a single currency.

(c) The credit mechanism

21. Since 1978, the volume of credit instruments have been strengthened. Very short-term financial support, short-term monetary support and medium-term financial assistance were offered to member States to enable them to face their intervention obligations.

22. A proposal was made to set up a mechanism for management of the EMS and exchange reserves as well as to transfer the powers of the European Monetary Cooperation Fund (FECOM) to the European Central Banking System (FECOM). The idea of a European Reserve Fund (Euro-EDF) was also advanced, as well as plans for a European Monetary Fund. The third stage would be characterised by the commissioning of Euro-EDF to support the Community's Economic Policy.

## D. THE PROBLEMS OF ADJUSTING THE FRANC ZONE SYSTEM TO THE EMF

(a) Pegging of African currencies

23. According to the new monetary integration strategy, the Franc should gradually give way to the ECU. It will not be issued by the Banque de France whose FF reserves will be gradually quoted in ECUs, including those in operating accounts opened for African central banks of the Franc Zone.

24. The more the FF evolves towards the ECU, the stronger it becomes, making the CFAF to appreciate and, therefore, to become over-valued The question then is whether the ECU will thus become the currency for settlement of account. Nothing prevents this since with the renewal of all legal obstacles to its private use, it would become widely used in all the institutions of the community to which the national central banks belong.

25. While the EMS of the 1980s had no significant impact on the Franc Zone system, the ECU of the EMU will radically change the shape of the Franc Zone by transforming it into an ECU Zone, subject to agreement by the parties concerned, mainly, the EEC,

France and African countries, without the possibility of adverse economic consequences.

26. It is, however, not certain that substituting the Franc Zone with the ECU Zone will really occur. Neither is it likely to prevent the African countries of the Franc Zone from being tied to a single currency, the FF, and at a fixed parity, but in a currency basket based on a controlled exchange rate mechanism.

(b) EMS stability

27. The benefits expected from EMS stability should derive from two kinds of reserves for the CFA Zone, namely:

(i) First, exchange rates are increasingly being abandoned by France, as an instrument of monetary policy, in favour of interest rates which, having become positive, attract African capital. The massive flow of African capital to Europe is largely due to this change in the choice of instruments;

(ii) Although the evolution of the CFA exchange rate vis-a-vis other community currencies is identical to that with the FF, the same is not the case with the actual exchange rate. Available data as of December 1990 published by the IMF shows disparities between France's and that of several African countries such as Cote d'Ivoire, Cameroon, Gabon, Togo and CAR, as well as between the nominal and actual exchange rates of France and Germany. These disparities lead to account being taken of the extent of competitiveness at the international level in order to assess the impact of a two-way exchange mechanism.

1. Questioning of Franc Zone relations as compared to other countries outside the zone

28. The Franc Zone is based, inter alia, on freedom of internal transfers and exchange control vis-a-vis the outside world. These principles are contained in the Franco-African conventions. It may, therefore, be wondered whether there is incompatibility between these principles of the Franc Zone and the Community's guidelines abolishing the exchange control and restrictions on capital movement given within the framework of the Single Act.

29. Nevertheless, maintenance of exchange control in the CFA Franc Zone would have none of a legal than an economic significance because in the end, it is the efficacy of macro-economic policies of and of policies for shoring up the banking

system which can really prevent the outflow of capital. In the end, African countries should toe France's line in that regard.

2. Risk of overvaluation

30. The permanent fixing of parities within the community will be particularly significant for the Franc Zone. In fact, a new CFA parity with the single currency should be defined. If it is fixed, it must be recognized by the Community organ responsible for managing the exchange mechanism.

31. Economically, the fixed parity of the single currency with the CFAF will result in a further over valuation of the African currency. African countries which experience a higher rate of inflation than European countries will UNDERGO strict anti-inflationary monetary discipline within the community. This will, indeed, raise questions about keeping parity at the same level.

32. Finally, the evolution of the SME exchange mechanism opens UP new prospects for African countries to cooperate with the Community. This means drawing up a new strategy for analyzing and mastering all the implications.

## IV. STUDY OF SCENARIOS

### A. Development of scenarios

33. The evolution of the EMS may lead to modification of the Franc Zone monetary system depending on whether countries opt for ECU zone integration or for a return to monetary sovereignty. Assessment of these implications will depend on the choice of parameters determining
the mode for stabilizing currencies and the level of policy coordination. Whether the system moves towards integration or forward national monetary sovereignty, the costs and benefits for African member countries will be difficult to evaluate beforehand.

Mode of stabilizing the system

34. The CFAF may be stabilized by fixed pegging to the EMS. It may also float freely. Each of these options will modify the cost benefit ratio of the zone for Africa. The variation is all the more important as it raises the following two:

(a) The percentage of African reserves held in the ECUs will certainly be different from what was held in the FF;

(b) Whether the convertibility guaranteed by France will be maintained or whether convertibility will be granted by the European Community.

The coordination level

35. The room for manoeuvre open to African countries of the Franc Zone depends on the nature of bilateral agreements signed with France and their ability to reach the common position. Depending on whether the efforts will be further based on structural adjustment by each country or on adjustment of the common monetary system, the credibility of the determination for monetary integration will be affected.

## B. The Scenarios

36. The possible continuity of the Franc Zone monetary system and its gradual expansion within the 12 member-country Europe should in no way be used as a basis for developing strategy for African Governments or their banking systems. In spite of uncertainties about its coming into effect, the transformation of Europe's Community markets into the EMU is a complete change of pattern and systems which require African countries to develop scenarios for adjusting the CFA zone vis-a-vis the evolution of the EMS. The nature of such an adjustment calls for a review of the following two variants:

Variant 1:

37. The changing of CFAF into ECUs by way of FF does not change the current institutional framework of the Franc Zone since the bilateral agreements of European countries are not questioned during the process of monetary unification. In this variant, the adjustment of the system is automatic and limited to conversion into a new monetary base for currency notes, coins, prices, statements of account and wages aimed at removing the CFAF and other community monetary signs. One extreme variant of this scenario is EEC's guarantee of the African currency.

Variant 2:

38. The evolution of the system may result in a complete change. Pressure from overvaluation of the CFA, the exchange mechanism becomes more flexible, resulting in CFAF devaluation depending on the capacity of the monetary authorities to negotiate together or individually with France or the EEC, the new system tends towards a structural change with the support of the EMS. The increased flexibility may, on the other hand, lead to renunciation of the institutional framework of the Franc Zone and each country choosing its own currency.

(i) The assumptions

39. The major assumptions concern the evolution of the EMS and the Franc Zone system. The various scenarios take account of the need to fully implement the EMU programme and the capacity of African countries to carry out structural adjustment programmes. Then again, it is assumed that international environment will remain passive.

(ii) Overall evaluations of the scenarios

40. This consists in successfully comparing the result of the various scenarios with the economic performances of the Franc Zone in various situations of the EMS. Since experience in this area is limited, only four scenarios have been tried, namely, the trends scenario, the flexible scenario, the structural change scenario and the scenario for integrating the CFA Zone into the EC monetary mechanisms.

(a) The trend scenario or automatic adjustment of the system

41. The exchange system has remained fixed, converted into the ECU and all the other mechanisms of the Franc zone are intact.

42. In order to build this scenario it is necessary to make assumptions on the basis of current trends, bearing in mind the fact that they cannot be extrapolated in the long run, and this will lead to an extreme case of an EMU that is open to non-European countries and, what is more, to countries among to the least developed in the world, or even to a crisis among the African countries.

43. The following two assumptions can be made on the basis of the changes affecting the immediate environment of the Franc Zone:

(a) The interplay of the Franc Zone mechanisms will not be basically questioned. There would be adjustments, but these would not lead to crisis even if their impact is significant;

(b) The current changes in the Community will continue in line with the defined programme; the uncertainties will be gradually removed; the expected impact and growth, stability and equity in the community will be positive and conform to forecast. As for African countries of the Franc Zone, they will continue to carry out structural adjustment programmes with greater emphasis on the social dimension and a greater research on choice of instruments; increasing tensions on the socio-economic and political variable will continue to increase the imbalances and highlight the lack of coordination among this group of countries.

44. In this scenario, the financial opening will make the monetary authorities gradually adopt such interest rates and such new policies as would check capital flight.

45. Neither foreign investments nor export earnings will increase substantially. With the CFA/FF parity remaining fixed. The lobby of French African enterprises will continue to uphold this system in order to further benefit from the gains and overvaluation. Governments support it as a means of maintaining the consumption financing mechanism. Feelings to make it

flexible will be entertained here and there without coming to anything.

46. Investments are taken over by French, European and international aid in the form of grants. New debt negotiation instruments will be experimented only to finally result in cancellations of official debt.

47. The favourable impact that the growth in Europe is expected to have on terms of trade and prices of raw materials will be limited by the increased diversification of trade, especially trade with east European countries, Asia, such African countries as Nigeria and the Mediterranean countries.

48. The balance of payments structure will not change substantially in spite of modest and controlled inflation.

49. The inflow of public capital will remain at the same level in order to offset structural deficits.

50. Intra-African trade will improve at the expense of African countries of the Franc Zone owing to the uncompetitiveness of their economic operators.

51. African countries will continue to pursue monetary economic integration which will have been vertically and virtually achieved through the EC.

52. Stabilization of the dollar under the impact of the EMU will narrow down the range of variability of exchange and interest rates. Neither debt investments in the African Franc Zone will be affected.

53. The gap between the LDCs of the Franc Zone and countries such as Cameroon, the Congo, Gabon, Cote d'Ivoire and Senegal will increase without affecting the solidarity among them.

54. African countries outside the Franc Zone will continue to be divided as to the advantages of the Franc Zone and its disadvantages for their economies. They would be in no hurry to join the monetary zone on mass.

55. Clearing mechanisms between African countries may even be rehabilitated and information exchange between central banks strengthened, with the BCEAO and the BEAC playing a greater role.

56. Through the ACP/EEC Convention, the Community will encourage views on African economic and monetary integration as well as the financing of joint projects such as data banks, information networks, support to clearing houses and financing of the social dimension of structural adjustment.

57. The institutions of the ACP/EEC Convention will try to open negotiations aimed at giving Euro-African Cooperation a monetary

dimension. They will, however, be handicapped by their low negotiating power together with their poor capacity for analysis.

(i) Impact of the scenario

58. This scenario will not change the cost benefit/cost balance of the Franc Zone, neither for the African countries nor for France. The CFAF parity is practically fixed and the FF is very stable within the EMS.

59. Should the ECU become the single currency, conversion of the CFAF into the ECU will create costs for issuing institution, enterprises and households which must adapt to the new currency.

60. In the absence of a significant direct financial impact on the Franc Zone, this scenario may stabilize the current investment climate in Africa through extension of transfer guarantee without transaction expenses to the other EC countries.

61. This scenario can only be justified if France continues to support the Franc Zone and protects it from the relevant reserves both of certain European countries and of the Bretton Woods institutions.

62. This scenario may require that support mechanisms through monetary guarantee, the whole set of operating accounts and budgetary aids be strengthened in the Community by balance-of-payments assistance, in view of increasing dependence of African countries. It also requires greater monitoring of monetary and financial aggregate of African countries.

63. Although these conditions may be necessary to make the scenarios consistent with the long-term prospects of the Franc Zone, it is necessary to find out whether they are sufficient. In other words, it may be good to know whether the EMU is prepared to allow an inefficient monetary zone on the periphery of its sphere of activities.

64. The age and strength of relations within the Franc Zone makes it difficult for France and the African member countries to allow the system to collapse abruptly.

65. The position of the Franc Zone at the periphery of the EMU changes neither the stakes nor the risks to the EC. Yet a disintegration of or a new crisis for Africa will mean different things for both countries. For France, even though such a prospect threatens its economic and trading interests, the Franc Zone does not quite constitute a big stake. It does compare in any way with what the consequences of a decision to withdraw the FF from the EMS would be.

66. The economic imbalances of African countries are so complex and serious that they are beyond France's funding capacity to handle or to tolerate the resultant instability. Hence, without wavering about its support, it is increasingly hesitant to bare the responsibility all alone. So, it may continue to support the status quo while suggesting gradual but non-decisive improvement.

67. Like in the past, France may be able to make an institutional arrangement to oversee monetary cooperation between the CFA zone and the EC by proposing various procedure that would take into account the concern for multilateralism. Countries outside the Franc Zone may thus have access to the Community's external support mechanisms by adapting the ECU as a reference currency, without, however, benefitting from the unlimited guarantees to be provided by the future EMS.

68. The trend scenario is a limited response to changes in EMU being built in an atmosphere of uncertainty and tension for African countries. The partial adjustment of the Franc Zone and the European growth prospects will, in fact, have little impact on the economic transformation of African countries.

69. Cooperation between European and African monetary institutions will encourage a gradual adaptation of the Franc Zone to the new structures. This, however, will not be without limits. It is for this reason that this scenario, even if, coherent and probable is not necessarily justifiable. This gives rise to the need to explore other ways and assumptions as well as to review the conditions for abandoning the trend scenario.

(b) Flexible scenario: partial adjustment

(i) Assumptions

70. The major assumptions linked to this scenario are based on the fact that implementation of the structural adjustment programmes is top-sided, thus leading to exorbitant external support and making it impossible to redress the socio-economic imbalances of African countries.

71. The success aimed at in implementing structural adjustment reforms cannot be matched by the expected benefits of currency stability. In this scenario, the uncertainties about the EMU are compounded by the high transition and adaptation costs which make European countries increasingly reluctant to invest their efforts in non-European countries, especially in Africa.

(ii) Results

72. Under such a tense situation, solidarity among the surplus and deficit countries of the Franc Zone has started falling apart.

73. The overvaluation of CFA compounded by capital flight, treatment bankruptcy of enterprises and the rise in the informal financial sector has an adverse effect on the foundation of the Franc Zone.

74. Under the pressure of the competitive efforts of African institutions, the Franc Zone cannot claim not to be an impediment to African economic integration and not to be tying up African countries in a relation that keeps them structurally dependent.

75. During the EMU phase, there is no clear-cut demarcation between France's monetary authorities and those of EC. African policy institutions whose dependence has doubled are reducing their adherence to the Franc Zone structure.

76. Finally, African countries are making their currencies flexible individually or according to their affinities. Since the mechanisms of the Franc Zone are no longer working, they now have to negotiate change agreement with their trading-partner countries. Generally, African member countries of the Franc Zone have a system similar to that of most other African countries, namely: flexible pegging to a currency or a basket of European currencies. In the extreme variant of this scenario, currencies float freely.

77. Return to flexibility will only be beneficial if it is not accompanied by repeated and widespread devaluations in support of high rates inflation. In contrast, fixing a new exchange rate would mean a break up of the current arrangement and, thereby, a loss of benefits and elimination of the resultant costs.

78. In reappropriating external reserves, each country increases its financial wealth without correspondingly strengthening its capacity to keep its currency convertible.

79. In spite of arguments in favour of national monetary sovereignty, the performances of a floating currency system are disappointing. The African experience truly illustrates this. This scenario is characterised by an increased vulnerability to external chocks and to higher adjustment cost. The result is the individualistic policy.

80. Other monetary arrangements may result from this, but the rocking of the boat after more than a half century of existence, is unprecedented in the recent economic history of these countries with all the possible consequences on their viability.

(c) <u>A regional structural change scenario</u>

81. Before delving into this scenario, the following three questions need to be asked:

(a) Can the CFA Franc Zone survive with a monetary dimension alone, that is, without economic support?

(b) Can the CFA Franc Zone do without external financial support or at least make such support relative?

(c) What shape can be CFA Franc Zone take and what will be the conditions for its change of system and structure for survival?

82. All efforts to integrate the Franc Zone into the ECU zone have led to an extreme situation. The same is the case with the assumed breakup between France and African countries, with each national currency having to float freely.

83. These two views which raise the issue of either simple integration or a dispersion of these countries have eclipsed whatever importance the structural change mechanisms of the monetary system may have as well as the efficient restructuring of the banking system.

84. There will be no need for balance between the benefits of the ECU zone extended to Africa and the cost of the disintegration of the current Franc Zone if there is no database allowing for simulation. The most that can be done, might well be to identify a series of bottlenecks eliminated in order to give the CFA zone the integrated economic dimension which it lacks.

85. This approach involving the elimination of obstacles or constraints affecting the CFA zone's economic integrations will make it possible to incorporate the zone into a more integrated economic, monetary and financial environment as well as to introduce a degree of flexibility into the nominal exchange rate by securing the participation of France and the EC in the overall adjustment effort.

86. The change of system and structure requires destroying the zone's current hegemony, achieving economic, monetary and

financial integration among the various countries and an optimum sharing of jurisdiction by regional and national entities.

87. Substituting France's monetary hegemony with European monetary multilateralism will require consolidating links between the CFAF and the EMS as well as gradually abandoning the existing links between the FF and African currencies.

88. Once the EMS has incorporated all the currencies of the Community and the European single currency been fully instituted, the question that will be posed will be mainly that of the choice of parity and exchange rate of the African currencies. This means that African Governments, technical organs and transaction the banking system of the Franc Zone will have to redefine their role.

89. The new structures will be part of a framework for changing the monetary system by moving from pegging attachment to a single currency to a basket of currencies, elimination of a fixed rate and changing of the rules for common management of reserves and for banking control. This type of change can only be effected gradually and under the supervision of France.

90. In order to avoid a violent change, relations between the French monetary authorities and those of the Franc Zone should, therefore, become more indirect and gradual.

91. This proposal will, by combining decentralization and introduction of new methods of managing the monetary and financial system, favour movement from a type of economic and monetary competence to a new and better type which will transform the economic structures of these countries. Such a process is long-term and that can only be achieved through many little timely amendments to the principles and instruments of the Franc Zone.

92. There may, however, be counter forces to these changes which a prospective approach would involve. Such forces may block the change process as some actors have refused to consider a structural change for the Franc Zone for fear of losing their acquired position. The forces may provoke the monetary authorities of the Franc Zone to retaliate by proposing solutions based on the current rules.

<u>Impact of the scenario</u>

93. Transformation of the Franc Zone in a more African perspective indeed requires that the current principles be gradually, abandoned.

The monetary cooperation agreements and conventions signed with France will eventually lose their force with time.

94. Since the countries will have to determine the system and parity of their currencies, they would no longer need to refer directly to the FF nor to centralize their external assets in the operating accounts.

95. The geographical, linguistic and historical criteria for membership of the zone will be eliminated in favour of an expressed political will for a subregional economic and monetary integration.

96. The monetary and banking authority will directly manage their monetary zone and take charge of their own future.

97. All the African and foreign actors are naturally working together to making the scenario desirable.

(c) <u>An extreme scenario: EC integration of the Franc Zone into its mechanisms</u>

98. This scenario is very unlikely for the fact that there is no institutional framework in the EC which has the monetary capacity to implement this. This framework is linked to the establishment of the Political Union programme.

99. This scenario is based essentially on the take-over by the ECU as the reserve asset and its role in the organization of the International Monetary System (IMS). Its extension to the Franc Zone will raise more problems than it will provide responses to the adjustment of African countries.

100. EC member States are divided as to whether it is advantageous to have a fixed exchange rate between the ECU and foreign currencies. They disagree on the idea of guaranteeing these currencies' stability through automatic community support. The Franc Zone is far from being considered a favourable monetary zone by several States.

101. On the African side, it will be difficult to justify exclusion of the other non-Franc Zone African countries from such a mechanism. Several countries seem to prefer a flexible system. In the absence of a central decision-making authority in the Community, as well as a procedure for constant control, it will be difficult for the EC to fully and efficiently operate the mechanism.

102. France's efficient control on the Franc Zone was possible because of the huge bilateral aid that it provided the zone.

103. Adoption by the Franc Zone of the EC monetary policy regulations requires sound domestic monetary stability, reabsorption of public deficit and restructuring of the financial environment. This option may rather impede the adjustment process of these countries.

104. It should, in fact, be pointed out that this scenario only differs from the trend scenario by the source of its convertibility guarantee - EC for the former and France for the latter.

## V. OVERALL ASSESSMENT OF THE SCENARIOS AND THEIR IMPACT ON THE ECONOMIC POLICIES OF AFRICAN COUNTRIES MEMBERS OF THE CFA ZONE

105. The method used in the overall assessment of the scenarios and impact of each scenarios are:

(a) Efficiency of adjustment in terms of capacity to satisfy basic needs;

(b) Stability or reaction to external shocks, and credibility of the system;

(c) Influence on African regional integration;

(d) Foreign influence.

106. Each of these conditions should be weighted under the following criteria: weak, average, high.

107. The synthesis of the assessment will make it possible to qualify the scenario on the basis of the magnitude and extent of the adjustment involved.

Impact of the scenarios on the economic policies of African countries

| | Overall | efficiency | stability | regional influence | external influence |
|---|---|---|---|---|---|
| 1 trend scenario | automatic adjustment | weak | high | average | weak |
| 2 flexible scenario | partial adjustment | average | weak depend-ing country | weak | weak |
| 3 regional structural change scenario | structural changement | average | average | high | high |
| 4 extreme | limited case | weak | average | weak | weak |

108. From the above table it is possible to develop a statistical matrix that can be used to assess the impact of the scenarios on the major macro-economic variables and scope of the Franc Zone, namely: GDP, balance of payments, debt, exchange rate, investment, capital flows and interest rates.

109. Although subjective, the scenarios given in this study highlight the challenges posed by the evolution of the EMS and gaps in the information through which all the implications for the CFA Franc Zone may be assessed.

110. Views on the planned reforms should continue to be strengthened and consolidated through an evaluation of the capacities of the zone, the monetary unions and the African States to anticipate the impact. The conclusion that may be drawn will serve as a basis for drawing up special policies and measures for assisting countries of the zone to

overcome the adverse effects of the change in system. The assessment should be complemented by a legal framework for protecting the monetary interests of countries. Since the meeting of Ministers of France takes place informally, it should be institutionalized and given the authority to negotiate in the EC on behalf of the entire zone.

111. The structural reforms undertaken by the EC, under the Single Act and for creating the EMU, aimed at improving the supply conditions in the European economies are already affecting Governments and economic agents. The risk raised by the monetary and financial integration to the CFAF zone is genuine as it leaves these countries to bear the brunt of the adjustment effort.

112. The financial efforts made at bilateral level and within the context of the Lome Convention, even though substantial, lack an overall strategy and, among other things, provide for no monetary dimension in the Convention.

113. Under the Lome IV Convention, resources should be allocated to finance new initiatives aimed at adapting the capacity of Euro-African institutions to convert the impact of the Community projects into new financing and investment facilities.

114. The magnitude of the adjustment process in Africa and the current complexity of the EMU Programme should not be used as a pretext for postponing the structural change of the system.

115. The EC's support, in the medium term, should involve channelling the current adjustment trend of the Franc Zone towards changing the systems structure.

## VI. CONCLUSION

116. The analysis shows that the evolution of the EMS will expose the CFA Franc Zone to a series of external shocks whose effects will be worsened by the rigidity of the monetary regulation instruments and by the impossibility of carrying out adjustment through the CFAF exchange rate because of the fixed parity rules. Come Europe 1990, the member

countries of the CFA zone will be faced with a situation of negotiating new institutional arrangements with the EC.

117. However, the new framework will certainly raise a series of questions, such as:

(i) Issues to be negotiated

118. Attachment of the Franc Zone to the EMU is a worthwhile working hypothesis given the current changes in the positions of the African countries and France alike. Adequate management of the institutional framework is necessary as neither the Commission nor the EEC/ACP Convention has, to date, the legal capacity to instigate, indeed conduct, preliminary negotiations. African countries of the Franc Zone will therefore not have to wait for the establishment of a central bank and the adoption of a single currency before beginning such negotiations. The other African countries excluded from this process will have to react against such an exclusion with all the risks of dispersion that this entails. Each one of them would like to know what position to adopt in order to benefit from the opportunities offered to African countries in this regard.

(ii) The Franc Zone, the EMU and the IMS

119. It will be necessary to know what the actual position of the EMU will be in the restructured IMS and what the IMS configuration will be after the EMU is established.

(iii) The Franc Zone, the EMU and the ECU

120. From the point of view of African countries, it will also be necessary to know how the hegemonic monetary system organized around the dollar will differ from a monetary system dominated by the ECU.

121. Confrontation between the special drawing rights (SDR) and the basket-ECU/single currency will pose problems of choice of reference instruments.

122. For African countries, the choice is very likely to be based an external consideration rather than on adjustment and transformation requirements, given their degree of dependence.

(iii) The Community's aid

123. It will be necessary to know what impact the EMU will have on the EEC/ACP Convention and on the aid of the 12-member-country Europe to Africa.

124. Some provisions of the Lome IV Convention constitute a beginning to monetary cooperation, and the impact of the Single Act and the EMU on the Community's GDP growth indicate that the aid may be consequently increased.

125. Faced with these questions and others linked particularly to the exchange policy and the future role of the Banque de France, African countries will need to devise a political response to the European monetary and financial integration strategy.

126. This response will imply organizing a new monetary zone with the following roles:

(a) To protect the currency's parity within the zone against external shocks and fluctuations;

(b) To centralize and manage the common reserves for the benefit of trade among members;

(c) To advise, coordinate and assist countries in defining objectives for adjusting and transforming their economic, monetary and financial systems;

(d) To provide the required technical assistance for management and mobilization of external resources including debt;

(e) To secure dissemination of information among States.

127. The fact that almost all the member countries of the Franc Zone have implemented SAPs and decided to apply all measures recommended, may encourage the EC to finance a part of the support mechanism and to bring it to guarantee that a restructuring of the Franc Zone will also imply increased financial support.