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EFFECTS OF FLUCTUATIONS IN THE EXCHANGE RATES OF THE MAIN INTERVENTION CURRENCIES ON AFRICAN ECONOMIES

CONTENTS

INTRODUCTION

1. The movements in exchange rates which have taken place since the 1970s have caused considerable concern because of their possible impact on the African economies. This concern was justified by the fact that, in the matter of exchange rates, it is the action taken by the main industrial countries that has the strongest impact on the operation of the international monetary system as a whole. Not only are these countries at the very heart of the world's basic commercial transactions but also their currencies dominate the international financial markets and the movements of currencies.

2. In the face of exchange rate fluctuations, especially of the five currencies which today determine the value of SDR, the Seventh Conference of African Ministers of Trade requested the secretariats of OAU and ECA to undertake an in-depth study aimed at evaluating the impact of fluctuations in the exchange rates of the main intervention currencies and at formulating proposals to minimize their adverse effects. This study is in response to this decision and is divided into three main parts:

I. PAST TRENDS IN THE FLUCTUATIONS OF THE EXCHANGE RATES OF THE MAIN INTERVENTION CURRENCIES;

II. EVALUATION OF THE EFFECTS OF FLUCTUATIONS IN THE MAIN INTERVENTION CURRENCIES ON THE AFRICAN ECONOMIES;

III. PROPOSALS TO MINIMIZE THE UNFAVOURABLE EFFECTS OF EXCHANGE RATE FLUCTUATIONS ON AFRICAN ECONOMIES

1. PAST TRENDS IN THE FLUCTUATIONS OF THE EXCHANGE RATES OF THE MAIN INTERVENTION CURRENCIES

A. Trends in exchange rate fluctuations

a) Remote causes: the deficit in the United States balance of payments and the devaluation of the pound sterling in 1967

3. The international economic framework established at the end of the Second World War was conceived essentially as a means of encouraging a progressive movement towards a multilateral system of trade and payments. The main concern was to avoid a return to the discreminatory commercial and currency practices of the 1930s and the recourse to competitive devaluations.

4. The United States, which had not suffered from the war like the European countri's and Japan, exported capital and its expenditures abroad exceeded the surpluses appearing in the current account of its balance of payments. The United States deficits thus played a critical role in stimulating the world economy by becoming the main source of monetary reserves. This resulted from the commitment made by the United States to buy and sell monetary gold for $35 an ounce and also from the convention adopted (after Bretton Woods) whereby most of the other countries fulfilled their obligations by maintaining the parity of their currencies in terms of the United States dollar. The Central Banks thus agreed to hold an increasing proportion of their reserves in the form of dollars, confident that these could always be converted at will into gold. Thus, the growth of world reserves came to depend increasingly on the accumulation of official dollar holdings, a state of affairs which could occur only when the United States balance of payments was in deficit.

5. Between 1958 and 1961[1/] the situation changed in several significant respects. The United States balance-of-payments deficit widened considerably and there was a continuous reduction in its gold stocks, accompanied by a slow loss of confidence in the American currency. The shock of this break-up of the monetary system is to have repercussions on the African currencies in 1967 with the devaluation of the pound sterling. This devaluation was followed in Africa by Sierra Leone, the Gambia, Malawi and Mauritius (14.3 per cent), whereas the other African countries of the sterling area maintained the value of their currencies in relation to the United States dollar[2/].

6. On 9 May 1971, five members of the International Monetary Fund (IMF), the Federal Republic of Germany, the Netherlands, Austria, Belgium and Luxembourg, took a certain number of exchange measures. The German authorities informed the Fund that they would no longer maintain the exchange rates for the deutschmark within the established margins. The Netherlands authorities informed the Fund that they had found it necessary to take similar action. The same day, Austria proposed to revalue the chilling by 5.05 per cent and the dual foreign exchange market system in the Belgian-Lusembourg Economic Union was modified to discourage excessive capital inflows.[3/] On 15 August 1971, the United States Government informed the Fund that the United States no longer freely bought and sold

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1/ UNCTAD " Impact of the present international monetary situation on world trade and development (TD/140/Rev.1)

2/ See Joseph TEDAJO : "Commerce, change et regulation des economies africaines au sud du Sahara au cours des annes 80:Afrique et developpement, volume VII, no. 112, 1982, pp. 60-77

3/ IMF : Annual Report, 1971, pp. 37, 38
Annual Report, 1972, pp. 37, 38

gold for the settlement of international transactions. This was the end of the convertibility of the dollar and the beginning of the fluctuations in the rates of currency exchange depending on the Bretton Woods system.

b) <u>Capital movements since August 1971</u>

7. In the weeks following the suspension of the convertibility of the United States dollar, exchange rates fluctuated on the markets and a number of commercial and exchange measures were taken to deal with the new stiuation. Intensive work was carried out both within the Fund and among member States to determine what exchange rate relationships among major currencies would give promise of stability without recourse to restrictions and large-scale intervention in the markets.

8. On 17 and 18 December, the Ministers and Central Bank Governors of the Group of Ten met at the Smithsonian Institution in Washington[4/] and reached agreement on the realignment of their currencies.

9. The Agreement provided for a temporary regime under which members could permit their exchange rates against their intervention currencies to move within margins of 2.25 per cent either side of the parity relationship, calculated on the basis of par values or central rates (rates that might be communicated to the Fund by members temporarily not maintaining their currencies on the basis of par values). A member that maintained the rates for its currency within these margins in terms of its intervention currency could permit resulting exchange rates for its currency to fluctuate within margins of 4.5 per cent from parity, with further margins of 1 per cent in certain circumstances.

4/ IMF : <u>Annual Report</u>, 1972, p. 38.

10. The provisions of the Washington Agreement ceased to be effective in March 1973. Since then, member countries have adopted a whole range of exchange regimes in the light of their particular situations and needs. Even where the major intervention currencies continued to follow the exchange regime in force up to early 1973, a number of changes took place. The most important change was the generalized adoption in 1974 of floating exchange rates, institutionalized by the Jamaica Agreement of January 1976 and the second amendment to the IMF Articles of Agreement 5/.

B. The adoption of the floating exchange rate

(a) Floating exchange

11. With the adoption of the floating exchange system, the practices may be roughly classified as follows:

(i) Independent floating;
(ii) Pegging to a single currency;
(iii) Pegging to a composite (or basket) of currencies (including the SDR);
(iv) Pegging to a single currency, with frequent changes in the peg, according to a predetermined formula;
(v) Joint floating under mutual intervention arrangements.

5/ "La nouvelle donne monetaire internationale", Les Cahiers Francais, No. 177, July-September, 1976.

12. Certain countries with a rapid rate of inflation continued the practice, adopted prior to 1973, of changing the peg for their currency at frequent intervals in the light of movements in their domestic prices relative to those abroad. One country, France, departed from the mutual intervention arrangements, known as the "snake", and floated independently for a time, although it resumed participation in those arrangements on 10 July 1975[6/]. From this time, the African countries chose to peg their exchange rates to one or several currencies. Hence they fall into categories (ii), (iii) and (iv) above, as can be seen from table II. Thus as at 30 June 1980:

- 11 currencies were pegged to the SDR;
- 14 currencies were pegged to the French franc;
- 9 currencies were pegged to the United States dollar;
- 6 currencies were pegged to a composite of other currencies;
- 1 currency was pegged to the pound sterling;
- 1 currency was pegged to the Spanish peseta;
- 2 currencies were pegged to the South African rand;
- 2 currencies were not pegged.

13. The majority of the African countries maintained a fixed link with the currency in which they traditionally intervene in the exchange market. This is the case of the franc-zone countries. This arrangement has the advantage of administrative simplicity, since it involves no more than a continuation of existing practice in the exchange market. It avoids the process of continuous decision-making that would be necessary under a system of managed floating. In addition, it ensures that trade denominated in the intervention currency is conducted at a stable exchange rate. Whenever a number of countries use the same intervention currency as a peg, there is the further consequence of a stable cross rate between these countries.

6/ IMF : Annual Report, p. 23

14. There can, however, be other consequences for smaller countries in pegging to a single currency. The most important is that movements in their exchange rate will be dominated by factors affecting the exchange rate of their partner currency, which may not necessarily coincide with their own adjustment needs or with considerations of domestic demand management. The African economies have unfortunate experience of this phenomenon.

15. In recent years price fluctuations have had a more serious effect on the depreciation of the terms of trade, particularly on the level of African trade. Furthermore, the high and variable rates of inflation registered in the major industrialized countries in recent years have resulted in substantial increases in import prices, thus worsening the trade balances of the dependent African economies.

16. In the African countries, these upsets not only contribute to inflation but, because of their fluctuating nature, impede development strategy. The increase in exchange rate fluctuations has also caused problems of portfolio and debt management in the African countries nearly all of which hold their external reserves in the major floating currencies. These questions alone bring out the need for a study on the effects of fluctuations in the main intervention cureencies on the African economies.

II. EVALUATION OF THE EFFECTS OF FLUCTUATIONS IN THE MAIN INTERVENTION CURRENCIES ON THE AFRICAN ECONOMIES

17. The effects of fluctuations in the exchange rates of the main intervention currencies on the African economies are many and varied. But the most important effects are those which concern trade and international capitalmovements, whether the national currency is pegged or not. If the currency is pegged, the economic conditions in the metropolitan countries concerned

determine the effective value of the pegged currency in relation to other currencies.[7/] Trade outside the pegged zone induces the trading countries to adopt exchange positions incompatible with a policy of monetary stability and even to take more or less strict exchange control measures which often have adverse effects on their balance of payments.

A. Effects of exchange rate fluctuations on the level of trade and production of the African countries

(a) Effects on the trade balance and on price levels

18. Whereas the effects of exchange rates on domestic prices are relatively straightforward, their effects on external trade vary, depending on the period considered. Over the short term, any variation in the exchange rate has an adverse effect because it worsens the trade deficit of countries whose currency depreciates and increases the surplus of those countries whose currency appreciates. This phenomenon is derived from the trend in relative prices (maintenance of export prices and variation in import prices), while the volume traded does not react immediately and exhibits a certain inertia (see J curve in annex I).

19. After a certain time (one year to 18 months) (see illustrated example of the J curve in annex I), the movement is reversed. The volumes traded end up by reacting to the domestic price fluctuations in the different countries to differing extents, depending on the products. The demand for raw materials is usually more rigid, while the export and import prices of manufactured goods tend to converge for each product. Since

7/ See the paper submitted by the African Centre for Monetary Studies to the symposium on the role of commercial banks and consular offices in the effective operation of a clearing house. Kinshasha, 23-24 July 1981.

African external contracts are based on foreign currencies and fluctuations in the exchange rates of the intervention currency or currencies are subject to short-term uncertainties, the risks of importers and exporters, who, in nearly all the African countries do not enjoy forward market facilities, are greatly increased.

(i) Effects on the level of imports

20. Exchange rate fluctuations have had the most rapid effects on the level and composition of imports. We may take as an example, Burundi[8/] a country whose currency is pegged to the United States dollar. The weightend cost of Burundi's imports increased by 7.3 per cent in 1978 and by 3.8 per cent in 1979. The increase in 1980 was only 0.46 per cent. Over the period 1978-1980, import costs went up 4.8 per cent. The African countries as a whole are in a similar position, The variations in their real rates weighted by imports rose by about 35 per cent from February 1977 to March 1981.[9/] We may cite 14 African countries whose currencies are pegged to the French franc. The monthly percentage variations weighted by imports rose from 0.71 (February 1977 - February 1979) to 1.14 per cent (March 1979 - March 1981), an increase of 61 per cent[10/]. For the 11 African countries pegged to a composite of other currencies, the exchange fluctuations weighted by imports rose from 3.6? per cent in 1977-79 to 4.19 per cent in 1979-1981, an increase of 16 per cent.

8/ Banque de la Republique du Burundi : Rapport Annuel, 1980.

9/ The African Centre for Monetary Studies : L'impact du systeme monetaire europeen sur les pays africains, p. 22.

10/ These percentages are taken from the African Centre study mentioned above.

21. The African countries produce hardly any capital goods. Any increase in their rate of capital formation generally means an increase in their import demand for such goods. And as long as the exchange rates of the major intervention currencies continue to fluctuate, the African countries cannot prevent the ensuing changes in the prices of their imports in national currency.

22. Moreover, any system of floating exchange rates gives rise to other uncertainties which cannot be eliminated or attenuated by governmental systems of exchange control. Firstly, since importers of priority items generally fear a change which may be harmful for them, they may cover themselves by increasing their forward purchases. Secondly, since the central banks responsible for the management of international reserves may buy foreign exchange at times when fluctuations are favourable to them, they may attenuate some of the uncertainties linked with the rise in the costs of foreign currency needed for imports. At this level the African countries can organize forward exchange markets. This would be all the more beneficial for Africa because, as a whole, it has many diversified sources of supply, as shown in table II.

(ii) Effects on the level of export earnings

23. Fluctuations in the exchange rates of the major intervention currencies may have an adverse effect on export earnings and may harm the economies of African exporting countries in two ways. Firstly, they will cause fluctuations in the earnings of the State and of other economic undertakings and hence in domestic consumer expenditure or external purchasing power, which in turn will effect the imports available for consumption and investment. Producers of primary commodities for the export sector, unless assisted by the State, will suffer from the effects of exchange rate fluctuations in the buyer markets.

In addition to the difficulties faced by such producers, there will be socially unacceptable inequalities in the distribution of income. When the producers adapt their expenditure to the fluctuations in their earnings, these variations in turn have repercussions on income and expenditure in other branches of the domestic economy. Thus, when export earnings decline, national income declines also. This reduces consumer expenditure and makes private investment less attractive. Most African exports are directed towards the major floating currencies. Hence their export earnings are affected to the same extent as the currencies of payment. We may quote again the case of Burundi 93.5 per cent of whose exports are paid for in United States dollars. Exchange rate fluctuations have had little impact on the nominal value of export earnings. In 1978-1980 this impact was 0.76 per cent; in 1978 0.80 per cent; and in 1980 only 0.29 per cent.11/

24. (b) Effects on the price system

The exchange rate is a price. Any change in the exchange rate tends to change price relationships. In other words, it tends to change the relationship between the prices of the same product in two countries and the terms of trade between products and factors in these two countries.12/

25. Thus, any variation in the exchange rate will have a direct impact on the import prices of a country expressed in national currency. Except for America, this impact is immediate on commodity prices which are fixed in dollars worldwide. Suppose a franc-zone country buys a barrel of oil at 32 per cent. This price corresponds to 6460 CFA if the dollar is worth 200 FCFA, to 8000 FCFA if it is 250, and to 9600 FCFA if it is 300. The effects on the prices of manufactured goods may seem less pronounced to the extent that foreign suppliers fix their prices more freely. But the general trend is the same. The

11/ Banque de la Republique du Burundi : op cit.

12/ Mr. Bye : Relations economiques internationales, 2nd Ed., DALLOZ, 1965, p. 431.

growing costs of intermediate products used in the manufacture of end goods or of the intermediate products themselves are passed on to the final consumers. Import price fluctuations take the form of a rise in terms of national currency when it depreciates and a decline when it appreciates. These fluctuations in turn affect domestic prices. The direct impact is proportional to the import share of GDP and is heightened by indirect and consequential effects derived from psychological factors or price indexing arrangements.

(c) Effects on tax revenue

26. Exchange rate fluctuations also have repercussions on other markets. All prices follow in the wake of the highest prices because of the dislocations caused in the national economy. The whole price system becomes engulfed in an upward surge. The wage-price spiral boosts demand and retail prices are pushed higher. Governments increase taxation in order to balance the budget, thus adding to business costs. As if by contagion, the whole price system spirals upward.

27. Of course, there is resistance to this movement. Concerned about its social repercussions, Governements try to hold it back by strict price controls or flexible tax legislation. But their action has only a breaking effect on the general upsurge. It also complicates the task of capital formation and distorts the structues of production.

B. Effects on capital formation and the structure of production

28. Clearly, the most controversial effects of exchange rate fluctuations are on capital formation and production structures. Experience has shown that such fluctuations influence capital formation by their impact on comparative price structures. By affecting the comparative prices of goods imported from sources

other than the pegged zone, the fluctuations will have a direct impact on the prices of capital goods in national currency as compared with the prices of goods imported from the country of origin whose currency is used as the peg. This situation may help to determine the structure of consumption and investment in the national economy as a whole.

29. The African countries' acute vulnerability to exchange rate fluctuations must be seen as one reason for their low level of capital formation. Primary-producing countries with less developed industrial sectors must struggle to survive. They cannot adapt their system of production to abrupt changes in their export earnings and import prices. Their resources are not diversified enough for such a rapid and over-all adjustment.

30. Their development potential is also affected by the fluctuating relationships between their commodity exports and the capital goods exported by the floating-currency countries since "worsening terms of trade mean a loss of real income and hence tend to diminish productive resources available for new capital formation" 13/ Thus, exchange rate fluctuations in the currencies closely linked with those of the African countries will affect their economic policies and impede their adjustment operations. These problems have been compounded by the sudden changes in the capital value of official foreign-currency holdings which have followed similar changes in the par values of reserve currencies and regular realighments of pegged currencies.

13/ United Nations, Department of Economic Affairs, Commodity Trade and Economic Development (E/2519, p.16)

C. Effects on international capital movements

(a) Effects on the level of foreign-currency assets

31. Over the years, the African countries have built up their currency reserves as a result of their political relations with the metropolitan powers, their adherence to determined monetary zones and their participation in trade and financial networks based on their political and monetary ties. These countries must now face the problems of fluctuations in their reserves following the official dismantling of the traditional structures based on bilateral monetary relations, the increase in exchange rate instability and the unusual weaknesses of traditional reserve instruments. Half of Africa's international reserves are held in a narrow range of currencies: the pound sterling, the French franc and the United States dollar. These are the ones which have fluctuated the most. Africa has very few reserves in deutsche marks and Japanese yen[14/], which are very stable currencies.

(b) Effects on the indebtedness of the African countries

32. Some people have maintained that exchange rate fluctuations have not greatly changed the nature and seriousness of debt management problem and the strategies currently applied to reduce to a minimum the real debt burden.[15/] Such an affirmation could be interpreted as implying that exchange rate fluctuations have caused no appreciable increase in the burden of debt servicing. This is not true. Since the indebtedness of the African countries is denominated in a number of currencies, it is difficult to assess quantitatively the impact of exchange rate fluctuations on total debt trends. Although the practice is to quote figures in

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14/ For more detail see in Project UNDP/UNCTAD/INT/75/015 the report of Professor G. K. Helleiner: The impact of the exchange rate system on the developing countries.

15/ See SR Dixon-Fyle: The management of exchange rates and payments in Africa under conditions of generalized floating of major currencies (E/CN.14/WP.1/92).

United States dollars, African debt is in fact denominated in dollars (50 per cent), deutsche mark (less than 10 per cent) and Japanese yen (4 per cent)[16/] Exchange rate fluctuations therefore have complex repercussions on outstanding debt, the cost of debt servicing and the value of reserves.

III PROPOSALS TO MINIMIZE THE UNFAVOURABLE EFFECTS OF EXCHANGE RATE FLUCTUATIONS ON AFRICAN ECONOMIES

33. As pointed out earlier, changes in the value of the main intervention currencies affect international trade and disrupt the economic and financial policies of dependent economies. To cope with the uncertainties resulting from the fluctuation of major currencies, national, regional and inter-national policies and agencies will have to be instituted to secure African countries some degree of monetary stability.

A. Measures to be taken at the national level

(a) Establishment of forward exchange markets

34. Exchange mechanisms already exist for settling (spot) cash transactions. Almost all African countries have exchange market organizations with advanced methods of settling currency transactions. Within such markets, banks provide a wide range of facilities and use brokers to effect transactions spanning a relatively wide spectrum of currencies. However, the best exchange mechanism would be a forward exchange arrangement operating somewhat like an insurance scheme for which importers and exporters would pay a token premium. This would doubtless be the best way of eliminating, in the short term, the uncertainty that fluctuating currency values have created in commercial transactions. It is up to each country to determine its forward exchange needs on the basis of its market and exchange structures.

16/ OECD: 1973 Review, p. 70.

35. Some general arguments made in favour of establishing forward exchange mechanisms are that:

(i) They help to protect trade flows from the vagaries of fluctuating exchange rates. The snag, however, is that price fluctuations can become even greater impediments to trade than exchange rate fluctuations;

(ii) They also help central banks to conduct a more accurate appraisal of foreign exchange needs. Advance information of foreign currency transactions taking place on the market enables central banks more effectively to manage national foreign exchange reserves and investment portfolios.

36. All things being equal, the pace of a country's development depends largely on its importation of essential capital goods. But then again, a number of difficulties arise which have to do with excessive import costs and frequent delivery delays. It might then be in the national interest to set up a forward exchange mechanism to cover exchange risks, if nothing more. The forward exchange facilities available on international markets are not of much practical use when it comes to covering the exchange risk between the currency of a developing country and the major currencies in which its trade is financed.

(b) Proper management of external debt

37. Owing to the uncertainty surrounding medium and short-term fluctuations of exchange rates and the growing pressure to manage their external debts more actively and flexibly. This might mean adopting a repayment policy aimed at keeping absolute and relative charges payable in foreign exchange as low as possible. In this way, the risks of

losing foreign exchange on capital transfers would be minimized. Three proposals might be worth considering in this connection.

(i) The entire or a substantial amount of the current external public debt together with all new debt and repayment undertakings should be denominated in SDRs and not in several currencies or current US dollars. Expressing debt and debt servicing payments in SDRs would reduce the uncertainty occasioned by fluctuating rates as to the actual cost of the debt. In the event, a comparatively accurate assessment of repayment costs would be obtained along with a more reliable indicator of the impact that loans and other forms of assistance would have on the payments balance of lender and borrower countries alike. Then again, SDR units of account are less susceptible to depreciation than national currencies.

(ii) The second proposal would be to incorporate provisions specifying how additional foreign exchange costs arising from parity adjustments and inordinately shifting parities are to be beated. Under negotiable terms, loans would be repaid in the lender's currency and the debtor's currency at the time the debt was contracted or the loan disbursed, so long as the going rate between the two currencies is less favourable to the borrower country. To keep lender countries from construing possible exchange losses as largesse on their part, the difference might be paid in the currency of the borrower country.

(iii) The third proposal, as recommended by the Lagos Plan of Action, would be to set up an African mutual debt service guarantee Fund that might be managed by the African Development Bank or the African Monetary Fund being established to assist the most disadvantaged countries of the region, in particular the LDCs. Modalities for subscription to the Fund may be worked out from the conclusions of feasibility studies to be conducted. Contributions to finance such studies, which are generally expensive, may be collected from regional development funding agencies (in the circumstances the African Development Bank) or from oil-exporting African countries that happen to have surplus funds.

B. Measures to be taken at the regional level

(a) Establishment of commercial exchanges and of forward goods markets

38. It has been pointed out that the changing values of the main intervention currencies affect international trade in several ways. International exchanges are hampered and not all risks can be covered by forward exchange operations. So frequent have exchange fluctuations become that they eat deeply into the trade profils of African countries whose foreign trade accounts for a sizeable percentage of GNP, they dimming their hopes for a better future.

39. Commercial exchange and forward goods markets might be considered one measure for protecting African countries from the effects of fluctuating exchange rates on foreign trade and guaranteeing the stability of export earnings.

40. The role of both institutions would be to absorb the shocks of fluctuating exchange rates in the short term and of cyclical price fluctuations. By playing on the laws of the market, commercial exchanges would set initial basis prices at levels which, from demand trends and projections, appeared realistic. Obviously, the margins of uncertainty would be very wide but the forward markets would correct them.

41. Basic prices, whatever their set level, might also soon lose their relevance for several reasons. The basic price might cease to reflect general price trends either because the exchange might buy on a bear's market more than it can sell on a bull's market or sell on a bull's market more than it can buy on a bear's market. Another reason could be that international consumer cartels or groupings might collectively boycott the products traded by the African commodity exchange. Such a situation should serve as a signal for changing basic prices after due negotiations have been concluded in a commodity agreement.

42. Commodity exchanges and forward exchange markets would protect African producers from price risks and allow investors to determine the viability of their projects and how they would fare in future. In this light, the operation of African commodity exchanges and forward exchange markets would make for improvement of stock management policies.

43. The system would be financed by producer countries and the African Development Bank. No exact indication of the capital outlay appears possible because the amount involved would depend on a number of factors such as initial costs, range of price fluctuations and basic price-related adjustments. Feasibility studies should be speedily undertaken to determine the conditions under which such an institution could be made viable enough to serve as an intermediary protecting the African producer from the effects of price fluctuations and providing the foreign consumer with regular, reliable and stable supplies.

(b) Establishment of multinational marketing enterprises in Africa

44. It should be noted that the stabilization of export earnings through the marketing of African products by African commodity exchanges and forward exchange markets alone will not be enough to protect the earnings of producers and exporting countries from the effects that exchange rate fluctuations have on prices. It would be useful to set up another institution to deal with the export marketing of products not traded through the commodity exchange and the import of products on the international market. Such an institution maight be called a "multinational marketing enterprise" and would be responsible for securing supplies for its member countries at minimum cost and marketing commodities not traded on the exchange. It could conclude with foreign exporters and importers arrangements under which the major foreign exporters would undertake to supply African markets with specific items at negotiated prices. African importers would buy these items at reasonable prices.

45. Such an arrangement would have several advantages. It would serve as mutual insurance policy protecting, in principle, the interests of both exporters and improters. Industrialists would have their order books regularly full while speculation on trade flows would be minimized. Feasibility studies could be conducted on the financing, operation and viability of the institution, in the interest of producers and consumers alike.

C. Measures to be taken at the international level

Reform of the international monetary system

46. Africa's current monetary situation is one result of the collapse of the Bretton Woods fixed exchange rate system that gave way to a system characterized by unstable major currencies in which speculation disrupts industrialized by unstable major currencies in which speculation disrupts industralized economies and goes on to marignalized and shatter African economies. To bring Africa out of this situation and enable it to participate fully in the formulation of international monetary policy, the system will have to be reformed.

47. The international monetary system will have to be reformed to meet the needs of developing countries in general and of African countries in particular. Its structural deficienceis will also have to be remedied in line with the Libreville Memorandum so that it can better sustain the development of the world economy and for that matter, the development of African economies.

48. The reformed system would have to provide a sure and sound footing for the payments systems of developing countries in general and of African countries in particular. If should provide financing for international commodity reserves and keep the stabilized prices of such commodities free from the monetary erosion that affects the value of national currencies.

49. It is precisely towards this objective that the effort being made to establish the African Monetary Fund are directed.

CONCLUSION

50. The effects of the fluctuating exchange rates considered compound each other in various ways and many be felt sonner or later in time. The diverse consequences enumerated may thus have short, medium or long-term implications.

51. While the most immediate consequences are easiest to foresee, they are also without doubt, the least significant. The longer the period involved, the more significant the effects of fluctuation and the more difficult they are to identify for what they are because of the interplay of other factors. In the long-term, the fluctuation of major intervention currencies may have a decisive influence on African economies, influenced as these are by the international monetary system as a whole. The implications of exchange rate fluctuations can therefore be isolated only temporarily from general trends in the system.

52. The measures proposed mainly concern the stabilization of export earnings for commodities vulnerable to such fluctuations. The peculiar circumstances of demand for and supply of these commodities, coupled with the attendant shifts in speculation on and the uncertainties of the international market, significantly affect the foreign exchange earnings of African economies. It is precisely to solve such problems that the establishment of a commodity exchange would be welcome.

53. Since the monetary disarray created by the various fluctuations has been accompanied by high inflation in the industrialized countries, principally because of the devalued dollar and excess international liquidity, African countries also had to pay higher prices for their purchases abroad. These conditions might partly be stabilized through a radical reform of the international monetary system and the establishment, in Africa, of multinational marketing enterprises.

54. The other measures advocated, for the national level especially, involve the provision of services and not the establishment of institutions. They are certainly an important contribution to Africa's search for economic and monetary stability. However, this contribution should be orchestrated with other efforts that the international community is, or will be making.

Table 1: AVERAGE DAILY % CHANGES IN SELECTED CURRENCY RATES AGAINST THE U.S. DOLLAR, 1975 - 1978

	1976				1977				1978		
	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter	3rd quarter
FRANCE	0.25	0.15	0.27	0.17	0.11	0.05	0.21	0.24	0.59	0.26	0.46
FEDERAL REPUBLIC OF GERMANY	0.26	0.18	0.20	0.22	0.22	0.14	0.29	0.42	0.56	0.33	0.52
JAPAN	0.10	0.11	0.16	0.15	0.21	0.26	0.18	0.30	0.32	0.48	0.62
UNITED KINGDOM	0.24	0.46	0.28	0.55	0.13	0.02	0.06	0.36	0.47	0.27	0.45

Source: UNDP/UNCTAD Project INT/75/015
Report to the Group of Twenty-four.

Table 2: EXCHANGE RATE PRACTICES OF AFRICAN COUNTRIES AS OF 30 JUNE 1980 AND PRINCIPAL TRADING PARTNERS, 1977 (CONTINUED)

	IMPORTS		EXPORTS		
	Major Sources		Major Destinations	Share %	Imports As % of ENP
Pegging to SDR					
Guinea	U.K.	16.2	Norway	24.8	N.A.
Guinea Bissou	Portugal	39.9	Portugal	59.0	N.A.
Kenya	U.K.	17.9	F.R.Germany	17.6	32.0
Malawi	South Africa	37.2	U.K.	44.8	33.0
Mauritius	U.K.	15.1	U.K.	61.7	64.0
Sao-Tome and Principe	Portugal	61.1	Netherlands	51.7	N.A.
Seychelles	U.K.	27.0	Pakistan	57.6	N.A.
Sierra Leone	U.K.	21.5	U.K.	61.3	37
Uganda	Kenya	28.9	U.S.A.	48.4	4
Zaire	Belenux	15.4	Benelux	21.9	40.0
Zambia	U.K.	24.1	Japan	16.3	38
Pegging to Basket					
Algeria	France	24.0	U.S.A.	51.8	36
Cape Verde	Portugal	58.3	Portugal	62.8	N.A.
Mauritania	France	50.0	U.K.	15.3	44
Morocco	France	27.5	France	24.7	39.0
Tanzania	U.K.	13.4	F.R.Germany	14.9	25
Tunisia	France	28.1	France	17.9	41
Other					
Ghana	U.K.	16.5	U.S.A.	16.7	17
Nigeria	U.K.	[illegible]2.0	U.S.A.	41.[illegible]	26

Source : Year Book of National Accounts Statistics, quoted by G. K. Helleiwer in Project INT/75/015, p.53

Table 3 : SERVICE PAYMENTS ON EXTERNAL PUBLIC DEBT OF AFRICAN COUNTRIES AS PERCENTAGE OF EXPORTS OF GOODS AND SERVICES, 1970 - 1980

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Algeria	3.2	5.8	11.8	12.2	12.7	8.7	13.0	15.3	29.4	25.6	23.9
Benin	3.2	4.0	3.3	1.9	4.8	3.6	2.7	1.9	3.3	5.1	2.5
Botswana	2.7	2.2	2.8	2.6	2.7	3.1	1.5	1.8	2.4	1.6	1.6
Burundi	2.3	2.6	6.6	2.5	2.7	5.6	4.4	2.9	3.5	3.1	3.1
Cameroon	3.1	4.4	4.8	4.7	4.3	5.3	5.4	5.3	7.4	9.5	N.A
Central Republic of Africa	3.2	2.0	1.4	4.6	5.1	7.9	2.1	4.7	2.6	0.1	4.5
Chad	2.9	8.5	5.0	3.5	3.3	5.9	4.1	10.0	11.8	14.4	N.A.
Comoros	–	0.1	0.0	2.1	1.1	4.6	5.7	7.0	10.8	N.A	
Congo	8.4	8.2	8.7	8.8	6.8	12.7	8.4	10.5	7.3	24.6	9.4
Egypt	28.7	28.8	31.1	40.2	21.7	22.5	18.5	24.2	22.3	15.8	18.9
Ethiopia	11.3	10.3	8.7	6.4	5.4	7.5	6.4	5.9	6.5	4.9	5.4
Gabon	5.5	7.2	7.1	14.1	4.1	5.5	6.7	9.5	20.5	17.0	15.1
Gambia	0.7	0.9	1.0	1.1	0.8	0.6	0.6	0.5	0.8	0.4	N.A.
Ghana	4.9	7.1	3.2	3.6	3.7	5.8	6.2	3.6	4.7	4.2	6.0
Guinea	28.7	29.2	31.1	29.9	16.6	14.8	15.0	19.0	20.0	22.2	24.6
Upper-Volta	3.9	4.0	.9	3.3	2.8	3.5	3.0	2.2	3.8	3.8	6.8
Ivory-Coast	6.7	7.6	8.1	7.2	7.9	8.8	8.8	10.4	13.0	15.2	21.6
Kenya	5.5	8.1	6.0	5.5	4.7	4.5	5.9	4.8	8.1	7.5	8.9
Lesotho	9.6	6.7	3.8	3.2	2.1	2.4	4.4	3.3	1.9	0.6	N.A.
Liberia	7.2	6.6	6.1	5.3	4.9	5.5	4.4	6.0	5.8	13.6	7.0
Madagascar	3.5	4.3	3.5	5.3	3.6	3.0	3.7	3.2	3.3	3.9	N.A.
Malawi	7.0	7.7	7.4	7.4	7.6	7.7	7.3	5.2	9.8	9.4	18.4
Mali	1.8	1.2	1.3	5.8	2.3	2.4	2.8	3.8	7.1	8.5	N.A.
Mauritania	3.2	3.6	10.2	9.0	6.6	20.7	37.8	22.4	16.3	32.4	11.5
Mauritius	3.7	4.2	1.6	1.3	0.8	1.6	1.0	1.6	2.4	3.7	5.5
Marocco	7.7	10.2	9.5	8.3	5.5	5.7	7.2	10.8	18.7	21.8	28.0
Niger	3.8	3.0	2.6	2.0	2.8	4.6	4.4	4.4	2.7	3.6	5.7
Nigeria	4.1	3.0	2.8	4.0	1.7	2.7	3.4	0.8	1.2	1.5	2.0
Rwanda	1.3	1.8	2.1	0.2	0.8	0.6	0.8	0.9	1.4	0.6	1.1
Senegal	2.4	5.0	3.9	7.9	5.4	5.4	5.7	6.1	13.7	13.7	N.D.
Sierra Leone	10.0	7.3	8.0	8.7	8.5	10.3	15.6	10.6	18.2	22.2	N.D.
Somalia	2.0	2.3	2.9	3.6	4.2	3.4	2.6	3.6	3.1	1.1	3.5
Sudan	10.9	12.9	13.8	11.9	14.2	21.7	14.1	7.6	9.5	33.0	17.4
Swaziland	4.7	5.2	10.1	9.5	2.3	1.6	0.8	0.9	1.6	2.0	3.2
Togo	2.9	2.9	6.4	6.9	3.4	9.8	6.7	11.4	14.5	24.4	34.0
Tunisia	17.1	14.8	15.2	10.6	6.7	6.9	7.0	9.5	10.9	11.8	11.8
Uganda	3.2	4.0	4.0	8.5	4.5	3.7	2.9	3.0	2.2	7.4	11.9
Tanzania	7.3	8.1	13.4	8.6	6.6	7.4	6.6	7.2	7.4	7.4	7.3
Zaire	4.4	4.9	8.0	6.5	12.4	15.1	7.5	8.3	8.2	9.1	N.D.
Zambia	5.4	10.0	12.9	30.9	7.3	10.2	10.2	18.7	10.8	19.7	24.4
All these countries together	6.3	6.7	7.3	8.0	5.6	7.0	6.8	7.2	8.7	10.9	11.3

Source : World Bank, Annual reports, 1978 to 1981

Table 4 : NOMINAL AND EFFECTIVE EXCHANGE RATES FOR SELECTED CONVERTIBLE CURRENCIES

		Deutsche Mark	French Franc	Japanes Yen	Pound Sterling	Swiss Franc	U.S. Dollars
				Exchange rates against the U.S. dollar a/			
1979	Third quarter	148.1	104.5	132.9	98.9	168.3	
	Fourth quarter	149.1	106.6	1[illegible]3.8	100.1	163.4	
1980	First quarter	126.7	104.5	118.9	97.5	140.9	
	Second quarter	139.9	104.9	136.4	106.3	159.2	
	Third quarter	135.8	102.1	139.9	107.5	156.6	
	Fourth quarter	125.6	94.9	146.2	107.4	146.6	
1981	First quarter	117.1	86.5	140.7	101.0	135.0	
	Second quarter	10[illegible].9	75.0	131.4	87.4	127.2	
	Third quarter	105.9	77.0	1[illegible]7.5	81.0	130.6	
	Fourth quarter	109.1	74.6	135.0	85.9	143.7	
				Effective exchange rates b/			
1979	Third quarter	127.5	93.0	130.3	91.2	145.7	93.8
	Fourth quarter	131.8	95.4	119.0	98.5	147.6	94.3
1980	First quarter	131.8	95.6	116.5	92.4	145.1	94.5
	Second quarter	129.6	94.8	123.1	94.6	143.8	94.5
	Third quarter	129.4	95.1	128.5	96.6	145.5	92.0
	Fourth quarter	124.3	91.9	137.9	100.1	142.2	94.5
1981	First quarter	119.9	88.0	146.7	101.8	135.1	98.6
	Second quarter	118.2	84.5	143.1	97.8	134.0	105.5
	Third quarter	116.5	82.8	140.3	90.5	136.0	111.2
	Fourth quarter	12[illegible].5	8[illegible].1	141.7	89.7	151.5	107.4

Source: International Monetary Fund. International Financial Statistics.

a/ End of period.

b/ Period average; as defined and calculated by International Monetary Fund, International Financial Statistics.

The J-Curve[1/]

The term "J-curve" refers to the shape of the adjustment path frequently followed by the trade balance of countries in response to an exchange rate devaluation. The initial impact of a depreciation is often negative because import prices rise more rapidly in local currency than export prices, and there has not been time for the volume of trade to adjust. After a lag, however, the trade balance improves with a reduction in the rate of growth of imports, a parallel rise in the rate of growth of exports, and a reduction in the gap between the price indices of imports and exports. As a result of these factors there is an initial decline in the trade balance, but this adverse movement will be first checked and reversed, leading the trade balance to follow the rising portion of the "J".

The chart illustrates the cumulative ourterly effects of a 10 per cent devaluation in the exchange rate of a country on the unit values and volumes of its exports and imports and on its trade balance over a period of three years. The following arbitrary assumptions are made": (1) export unit values in local currency respond to the devaluation at a rate of 1.5 per cent per quarter over a period of four quarters and thereafter at a rate of 0.25 per cent, adding to 8 per cent three years after the devaluation. (2) Import unit values in local currency respond at a rate of 7 per cent in the first quarter following the devaluation and at a rate of 3 per cent in the second, reflecting a complete pass-through after two quarters. (3) After half a year the volumes of both exports and imports begin to respond at a rate of 1 per cent per quarter with the cumulative response extending over two and a half years and adding to 10 per cent three years after the devaluation.

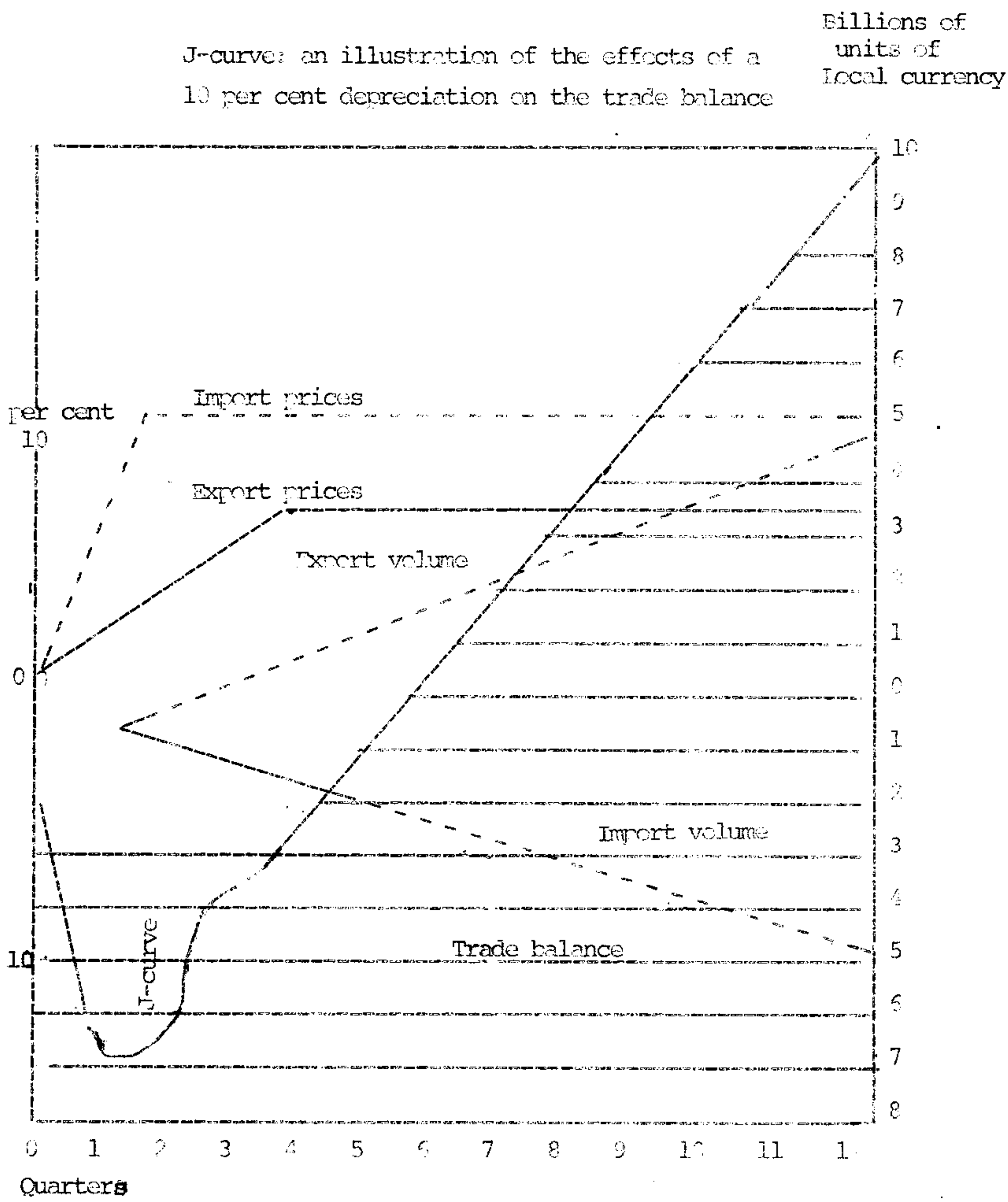
ILLUSTRATIVE CALCULATION OF "J" CURVE: PRICE AND VOLUME EFFECTS OF A 10 PER CENT DEPRECIATION

(IN BILLIONS OF LOCAL CURRENCY UNITS)

Quarters	IMPORTS			EXPORTS			
	Assumed rate of change in import prices ((cumulative per cent)	Assumed rate of change in import volume (Cumulative per cent	Value of imports (L/C units) 1/	Assumed rate of change in export prices (Cumulative per cent	Assumed rate of change in export volume (Cumulative per cent	Value of exports (L/C units) 1/	Trade balance (L/C units) 1/
Base quarter	-	-	64.8	-	-	6[illegible].1	-2.7
I	7.0	0	69.4	1.5	0	63.0	-6.4
II	10.0	0	71.3	3.0	0	63.9	-7.4
III	10.0	-1	70.6	4.5	1	65.5	-5.1
IV	10.0	-2	69.9	6.0	2	67.1	
I	10.0	-3	69.[illegible]	6.25	3	67.9	-1.3
II	10.0	-4	68.4	6.50	4	68.9	+0.5
III	10.0	-5	67.7	6.75	5	69.6	+1.9
IV	10.0	-6	67.0	7.00	6	70.4	+3.4
I	10.0	-7	66.3	7.25	7	71.[illegible]	+4.9
II	10.0	-8	65.6	7.50	8	7[illegible].1	+6.5
III	10.0	-9	64.9	7.75	9	72.9	+8.0
IV	10.0	-10	64.2	8.00	10	73.0	+9.6

1/ Local currency units.

J-curve: an illustration of the effects of a 10 per cent depreciation on the trade balance



1/ The price and volume effects of the depreciation are shown as cumulative quarterly per cent changes (left scale). The price and volume effects of the depreciation on the trade balance are expressed in units of local currency at an annual rate (right scale).