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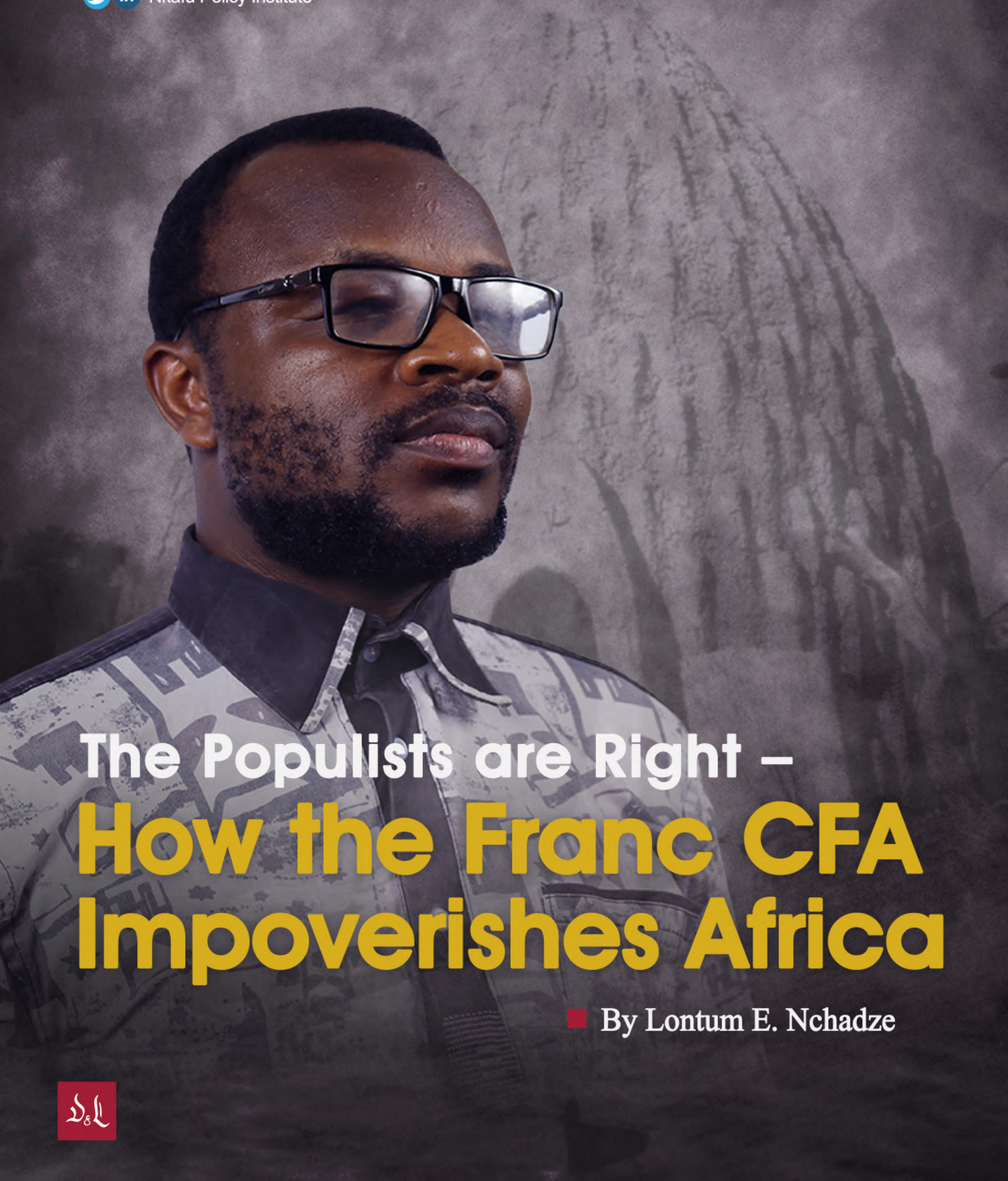

The Populists are Right – How the Franc CFA Impoverishes Africa

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D&L

In the fall of 2011, and in the wake of Europe's sovereign debt crisis, panic soared in Franc-Afrique currency markets as widespread rumors of a possible devaluation of the Franc CFA by the French treasury occupied the day. Very few could be ignorant of the catastrophic effects of such an action: an increase in the price of imports, a liquidity crisis with soaring inflation, because it had happened before. Given that CFA zone countries were nowhere close to the decade-long economic catastrophe that prompted the 1994 devaluation, the rumors fueled speculations that France was moving to a devaluation to prop up its own credit rating and request additional foreign reserves to pledge against huge loans made to failing euro-zone countries. The CFA franc has always been at the center of a contentious debate among Pan-African analysts and political upstarts seeking to dislodge deeply entrenched dictatorial regimes in francophone Africa.

Last month, Italy's Deputy Prime Minister, Luigi Di Maio, added another twist to this debate; placing French policies that impoverish African countries at the root cause of the current migrant crisis facing Europe. Laying specific emphasis on the CFA franc, he said «this currency is used to finance France's public debt and weakens the economies of those countries from which migrants depart.»

This latest remark, coming for a major European leader and appearing chiefly on social media and audio-visual platforms, has spawned a new wave of commentary concerning the French government's role in Africa's many crises, persistent poverty and underdevelopment. Some of the discussion has focused on unfair military and economic cooperation agreements including France's support for repressive post-colonial dictators who protect its economic interests on the continent and serve to broaden France's geopolitical sphere of influence. The CFA franc has been central in maintaining this sphere of influence and is usually peddled as the poster child of France's colonial turpitude. Beyond the Pan-African fervor and anti-colonial instincts that largely drive this debate, let us take a critical look at the Franc CFA.

WHAT IS THE CFA FRANC?

The colonies françaises d'Afrique (French colonies of Africa), [1] as the currency was then called, was created in 1945, ostensibly as a selfless gesture to protect France's African colonies from a devaluation of the French franc. The currency was at the time pegged to the now defunct French franc, with the French government being solely responsible for determining the exchange rate. Under this control mechanism, participating countries were required to deposit 65% of their foreign currency reserves into the French Treasury which, in turn, dictated monetary policy and mandated when and how Francophone African governments could access their money.

Today, except for a few administrative adjustments, the arrangements remain much the same. Technically, two separate CFA francs are in circulation between two monetary unions: the West African CFA franc (XOF) which is used by the eight countries that make up the West African Economic and Monetary Union (UEMOA) and issued by the Central Bank of the West African States (BCEAO) located in Dakar, Senegal; and the Central Africa CFA franc (XAF) used by the six countries that make up the Economic and Monetary Community of Central Africa (CEMAC) and issued by the Bank of the Central African States (BEAC) located in Yaounde, Cameroon.

Four basic principles are at the core of France's relationship with the CFA countries: Firstly, the French Treasury guarantees the convertibility of the two CFA francs without any limits. Secondly, the two CFA francs are convertible at a fixed exchange rate into French francs (now euros), which currently stands at 655.9 CFA francs per euro. Thirdly, there are no de jure controls (legal claims) on the movements of capital within the CFA zone. And finally, member countries must pull together a minimum of 65% (revised to 50%) of their international reserves (corresponding to 20% of each central bank's monetary base) into an operations account managed by the French Treasury.

Many analysts consider these arrangements a financial anachronism, pointing to the fact that it allows France unbridled control of the monetary policy of 14 sovereign states. By depositing such huge proportions of their foreign

[1] The two CFA francs in circulation today have different names: The West African CFA (XOF) is the Communauté financière d'Afrique ("Financial Community of Africa") or Communauté Financière Africaine ("African Financial Community"), while the Central African CFA (XAF) is the Coopération financière en Afrique centrale ("Financial Cooperation in Central Africa").

reserves in an account managed in the name of France, member countries cannot use such resources as collateral to obtain credit. In addition, with French representatives on the board of the two CFA central banks, these boards rely on French approval for basic monetary policy tools such as determining interest rates or controlling money supply; thereby relinquishing the management of their currencies, and through that, their economies largely into the hands of the French. The crucial question is whether such an arrangement is beneficial or detrimental to member countries?

ASSESSING BENEFITS AND COSTS TO MEMBER COUNTRIES

Proponents of the CFA argue that such an arrangement has helped maintain financial stability in the zone, pointing to such factors as low interest rates, stable exchange rate, low inflation and more advanced regional integration to buttress their views. However, a closer look suggests that these benefits are more illusory than genuine.

By having a fixed exchange rate and allowing for free movement of capital in the zone, interest rates in CFA countries have remained relatively low, historically hovering between 1% and 5%, compared to double what we see in neighboring countries such as Ghana and Nigeria. However, these interest rates are artificial, not reflecting real economic fundamentals in member countries. They keep member countries in a state of structural deficit that renders development policies irrelevant. In addition, as African countries increasingly look to Asian markets for economic fortunes, CFA zone countries will remain extremely vulnerable to foreign exchange shocks in Europe. This is exactly what happened in the 2000s when a strong appreciation of the euro hiked real interest rates in nearly all CFA zone countries, forcing a decline in their competitiveness until increased terms of trade as a result of a rise in commodity prices brought about recovery.

Others argue that the CFA zone offers low inflation and a stable exchange rate, which should encourage trade and foreign investment. In fact, existing empirical evidence suggests that CFA zone countries benefit from lower inflation and better fiscal discipline compared to similar developing countries, particularly other sub-Saharan African countries. But this has neither made the area more attractive to foreign investors nor conferred any significant advantage in economic growth over other countries with a comparable level of development. It is not difficult to see why. In the last twenty years, exports from the CFA zone to the euro zone fell from 50% to 25% in favor of exports to Asia and Nigeria. This weakens the benefits in terms of exchange rate stability with the euro zone since there is less trade between the two areas. In addition, since export earnings are generally reported in dollars, which CFA zone countries must convert into euros, any appreciation of the euro against the dollar reduces the value in terms of exports earnings in the CFA member countries.

Finally, proponents of the CFA franc point to regional integration, claiming that it is further advanced in the CFA zone than anywhere else in Africa. These monetary unions belie the economic realities on the ground. The geographical region that makes up the CFA area is far from an optimal currency area - a currency zone in which the benefits of sharing a single currency are higher than the costs. Despite a common currency, intra-regional trade within the two CFA monetary unions is less than 20% of total trade, compared to more than 60% within the euro zone. The level of financial development (the ratio between M2—a measure of money supply — and GDP) is 26 percent for UEMOA and 16 percent for CEMAC, which is much lower than in other regions in Africa.

Therefore, as it stands, the CFA franc is a colonial relic that has not evolved to meet the current needs of its clients. It is a punching bag for populists in Africa and now Europe, who are bent on destroying the vestiges of colonialism. Some analysts have suggested that adjustments to the way the currency works – limited transferability to control capital movements and resting full control of foreign reserves with regional central banks to help with financial development to name two – may help realign the currency to the needs of member states. However, to make such proposals, one must assume that French objectives are truly benevolent.

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