BROOKINGS | QUALITY. INDEPENDENCE. IMPACT.

The role of the CFA franc in the Economic Integration of the West Africa region

Second International Conference on Sustainable Development in Africa

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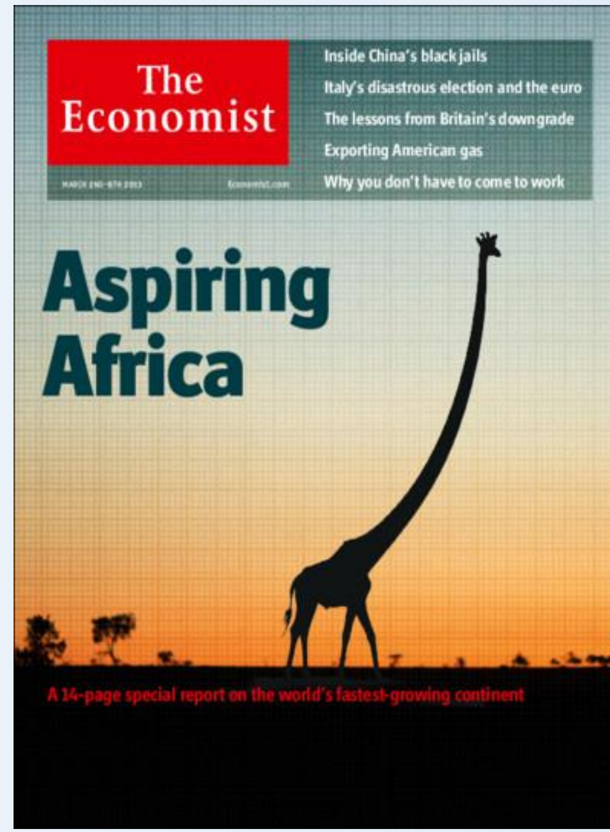
Africa Growth Initiative

1. Why focus on economic integration now?

The "Africa Rising" Narrative

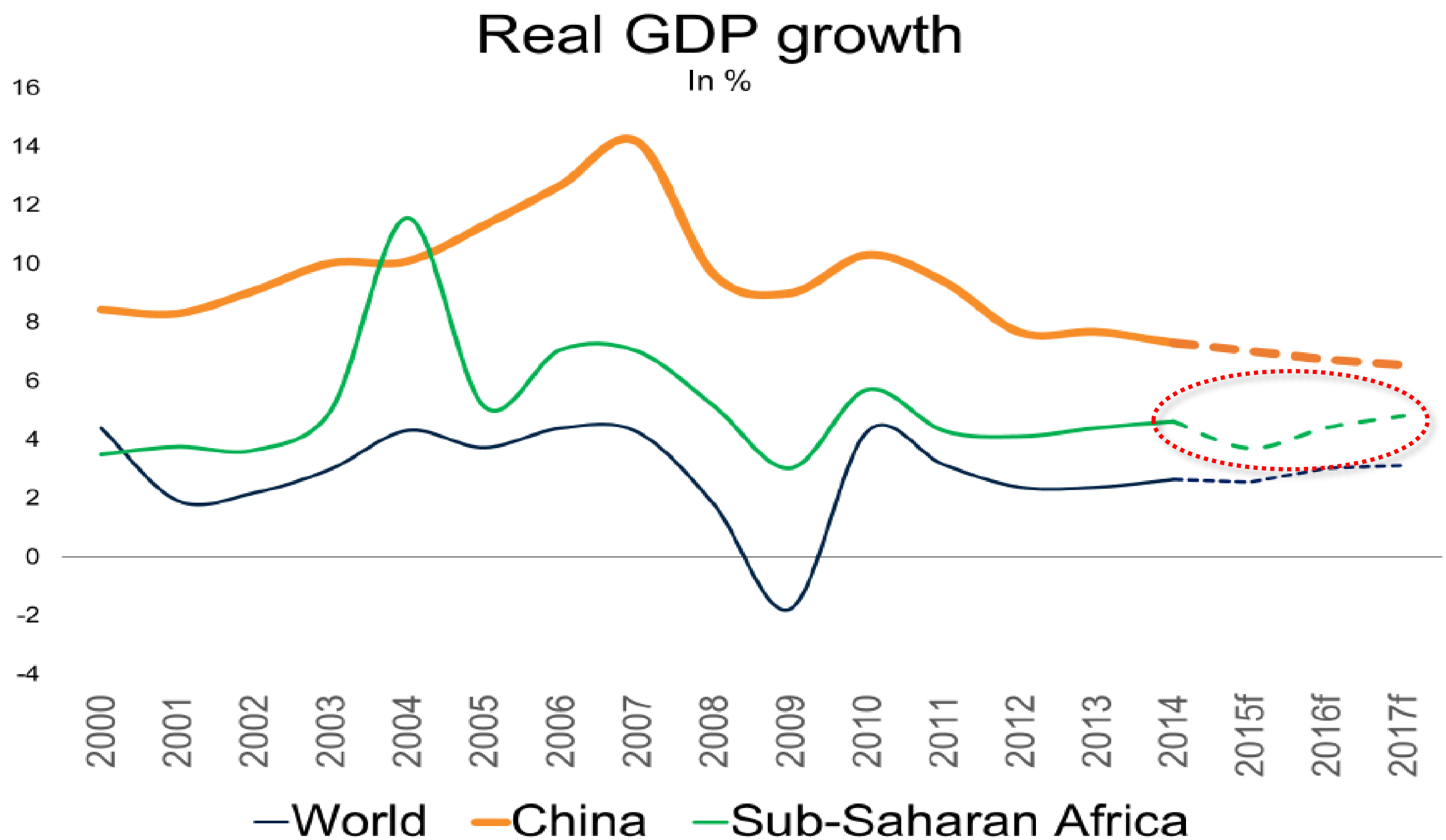
May 2000

December 2011



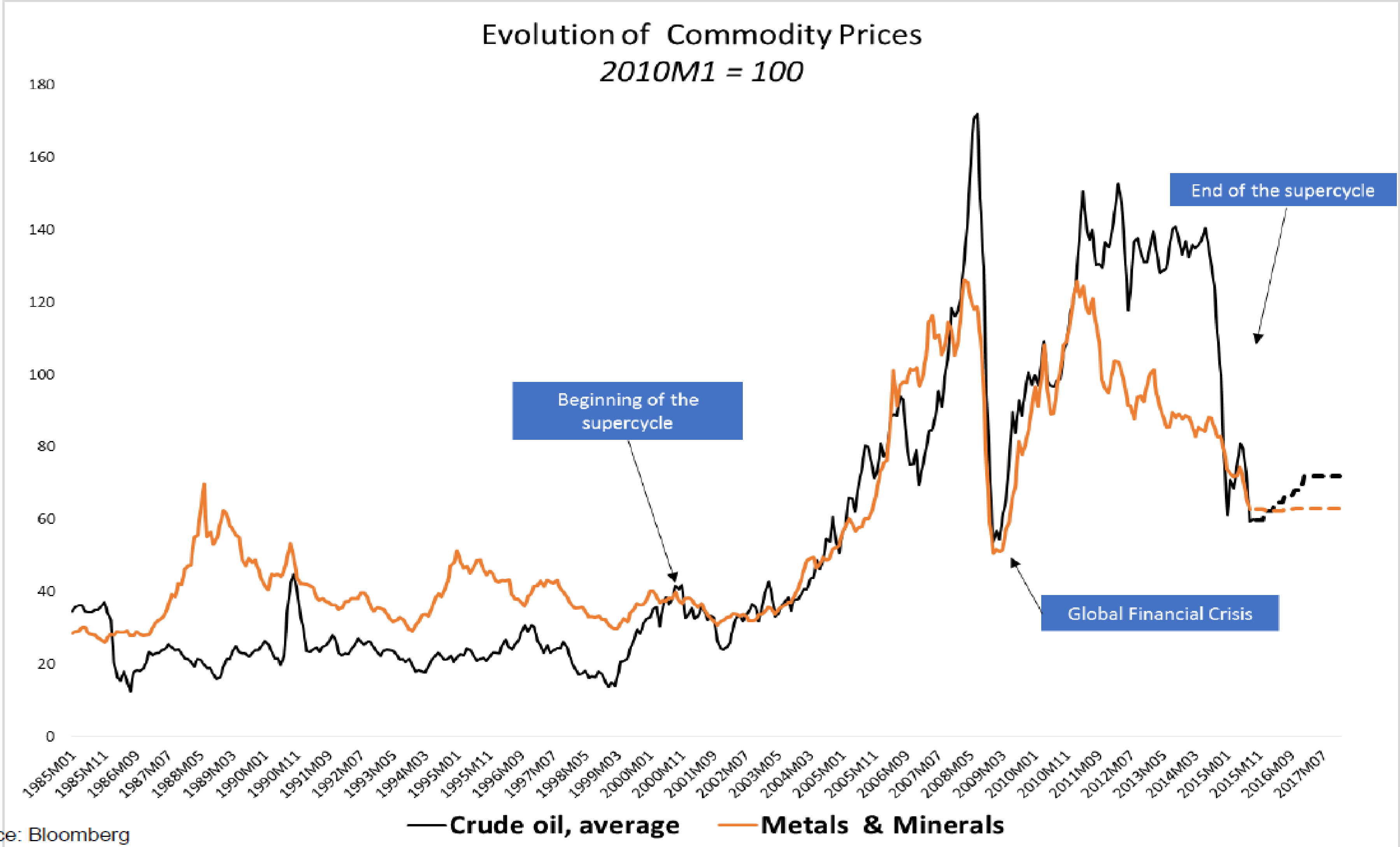
March 2013

The "Africa Rising" Narrative



Source: World Bank DEC Global Prospect Group

The "Africa Rising" Narrative



Source: Bloomberg

The "Africa Rising" Narrative

- Over the past 10 years, SSA grew 5% per year and, at this rate, it can DOUBLE its size before 2030.
- GDP growth is however slowing down, in part because of a deterioration in the external environment. Growth is expected to slow down to 3.75% in 2015 from 5% in 2014, its slowest pace sine 2009.
- Given demographic trends, GDP per capita will drop to 1.4% in 2015 from 2.6% in 2014.
- **Economic integration** can make SSA more resilient and help achieve sustainable and inclusive growth.

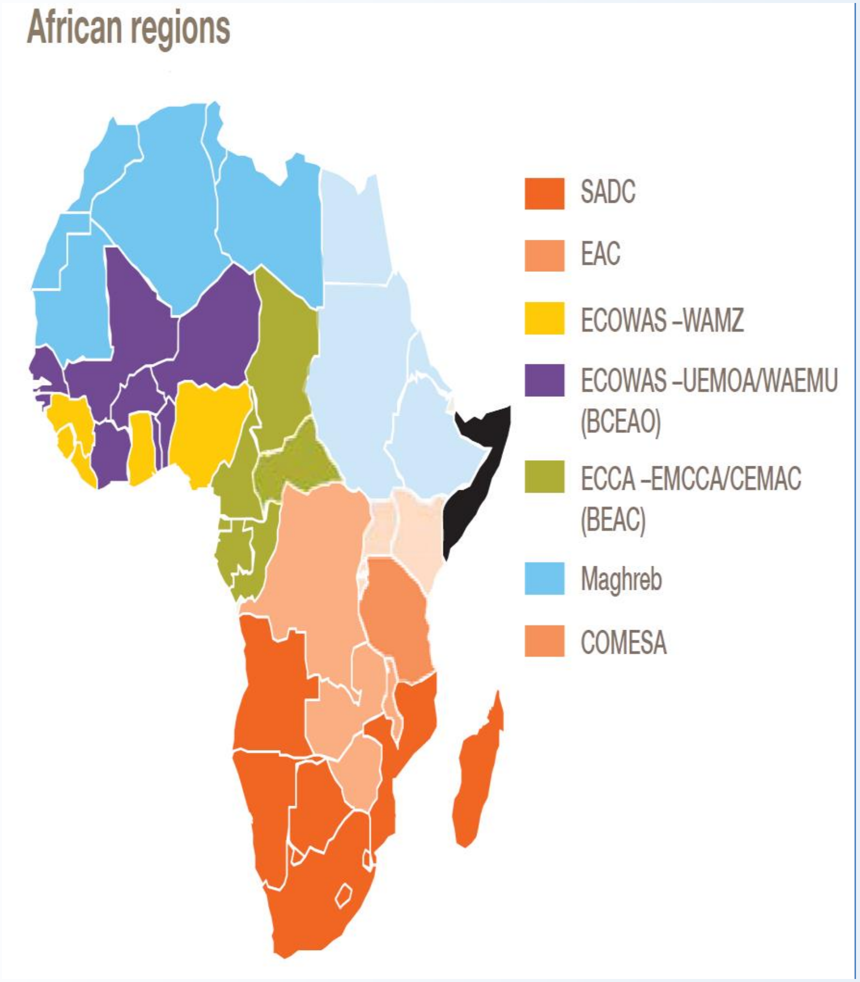
2. Political Push for Economic integration

The Road to an Africa Economic Community

- The 1991 Abuja Treaty established a roadmap towards an African Economic Community to be completed by 2028.
- The roadmap included 6 stages starting with the creation of regional blocs (the Regional Economic Communities, RECs).
- Four stages remain and progress across RECs has been uneven.

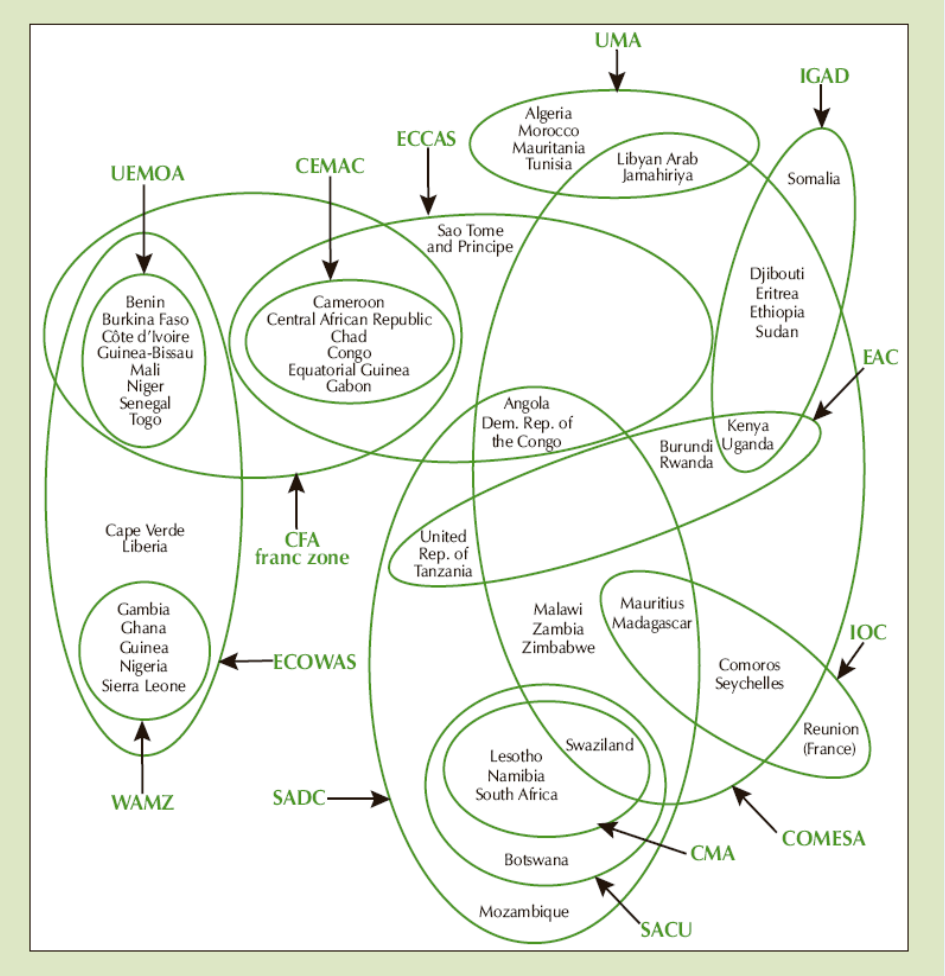
Africa's Integration

- Regional Economic Communities (RECs) are the AEC's building blocks.



Africa's Integration

- There are however multiple memberships and varied priorities.



The Road to Monetary Unions

- A group of states sharing a common currency
- ***Monetary unions*** (also known as ***currency unions***) imply the full centralization of monetary authority in a single institution
- Currently, there are four currency unions: Euro Zone, The Eastern Caribbean Currency Union (ECCU), The Central Africa Economic and Monetary Community (CEMAC) and the West African Economic and Monetary Union (WAEMU).
- Two more currency unions are planned: the East African Community (EAC) and the West African Monetary Zone (WAMZ).
- Monetary Unions are different from currency substitution, when a country uses a foreign currency in addition or in substitution to their national currency (i.e. dollarization in the DR of Congo)

The West African Economic and Monetary Union

- Monetary and Customs Union
- Eight members: Benin, Burkina Faso, Cote d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo
- Emerged from colonial arrangements
- Created in January 1994 in Dakar, Senegal
- Regional Monetary policy is conducted by the BCEAO (Banque Centrale des Etats de l'Afrique de l'Ouest)
- Institutional arrangement with France:
  - The CFA franc is pegged to the Euro (1€ = 655.857 XOF)
  - Convertibility guarantee by the French treasury
    - 20% of sight liabilities to be covered by foreign exchange reserves,
    - 50% of foreign exchange reserves to be held in operations account in the French Treasury

3. The CFA franc and Economic integration


Mali
Niger
Senegal
Burkina Faso
Guinea-Bissau
Benin
Ivory Coast
Togo
UEMOA

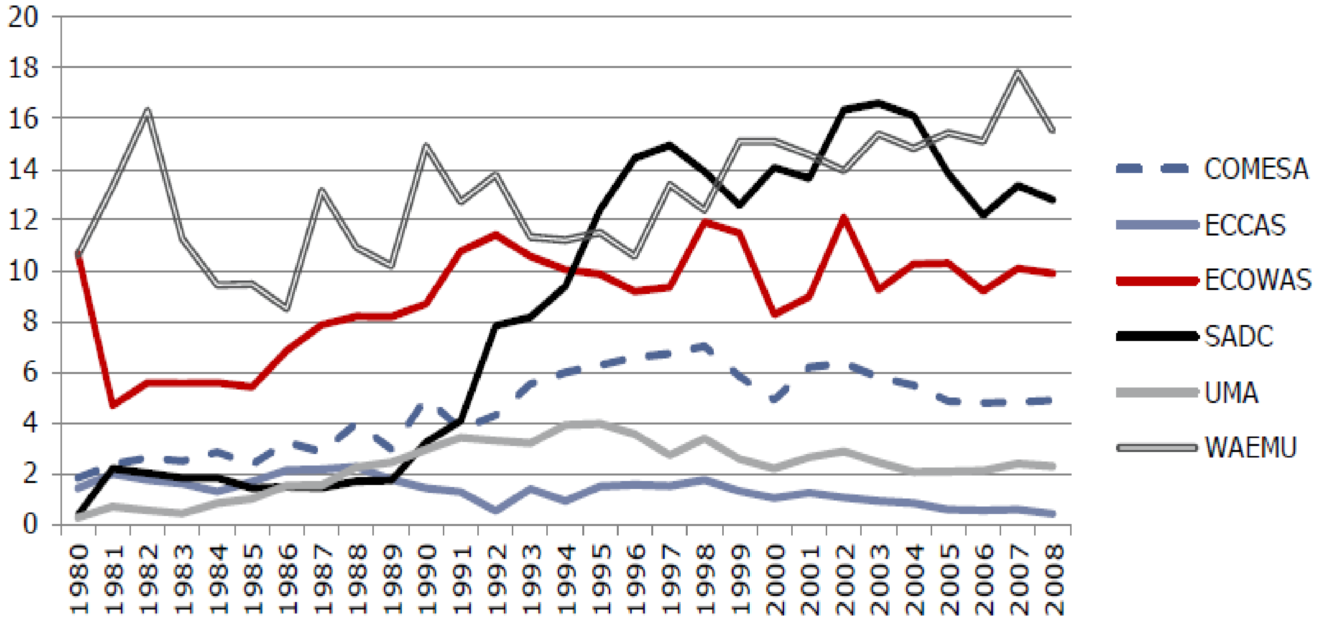
The CFA Franc and Economic Integration

Coupled with a **common institutional framework**, including a **common monetary policy** implemented by the regional central bank and **a common external tariff**, the common currency of the WAEMU, the CFA franc (XOF), is one of the key elements of regional integration.

Trade and Financial Integration

- Sharing a common currency reduces transaction costs and promotes intraregional trade
- In 1996, WAEMU member countries removed tariffs and quantitative restrictions on intraregional trade
- In 2000, the union adopted a common external tariff (CET) on imports from other countries
- In the sub-Saharan Africa region, the WAEMU has the highest level of intraregional trade
- SWIFT data shows that, WAEMU has sizable intra-Africa transaction flows especially notably three large Member States (Senegal, Côte d’Ivoire and Mali).

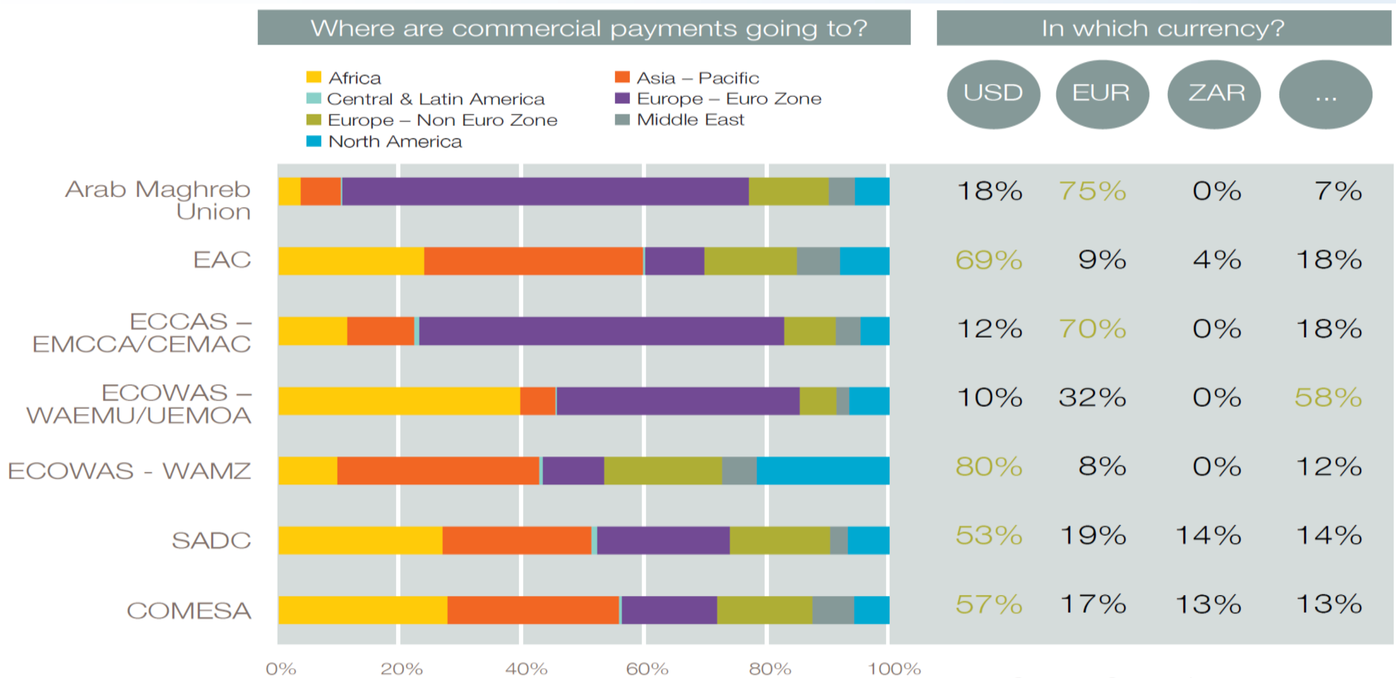
Trade and Financial Integration



Intra-regional exports as a proportion of total exports
Source: ODI, 2010

Trade and Financial Integration

- SWIFT figures show that intra-regional trade is higher in the WAEMU, reflecting the use of a common currency, a single central bank, a regional real time gross settlement (RTGS) system, and a regional automated clearing house (ACH).



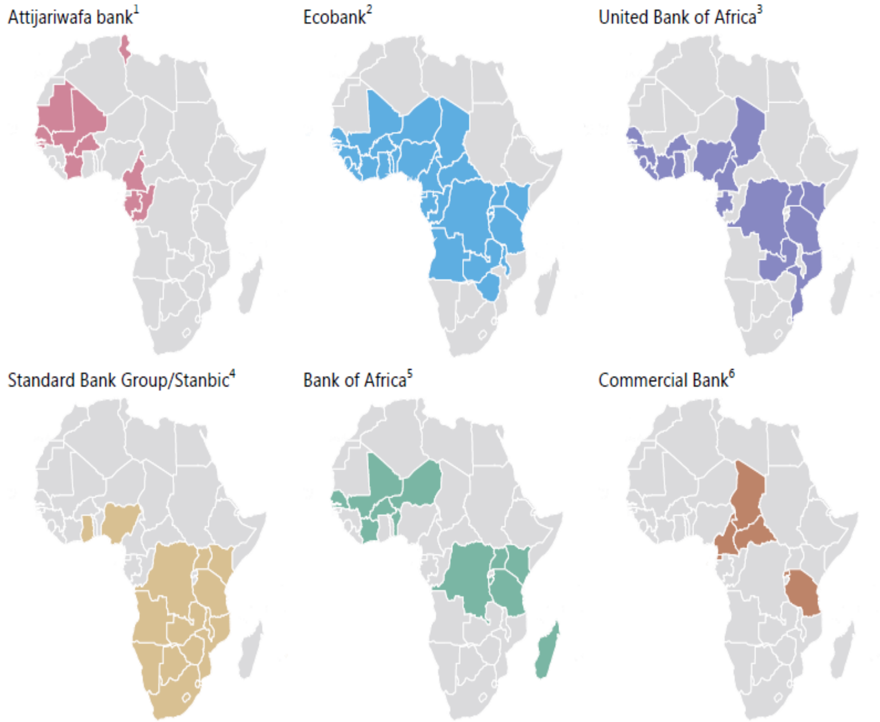
Source: SWIFT (number of cross-border MT103 sent from Africa to end-beneficiary country/region in April 2013)

Source: SWIFT (number of cross-border MT103 sent from Africa in 2012)

Trade and Financial Integration

- The growth of pan-African banking indicates progress in reducing barriers to financial integration.
- Financial integration can increase if pan-African banks are able to unlock economies of scale and scope from their expansion (e.g. in liquidity management).

Geographical distribution of pan-African banking — Graph 5



[1] Burkina-Faso, Cameroon, Congo, Côte d'Ivoire, Gabon, Guinea-Bissau, Mali, Mauritania, Senegal and Tunisia. [2] Angola, Benin, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of Congo, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Malawi, Mali, Niger, Nigeria, Republic of Congo, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, Togo, Uganda, Zambia, Zimbabwe. [3] Burkina Faso, Cameroon, Chad, Côte d'Ivoire, Democratic Republic of Congo, Gabon, Ghana, Guinea, Kenya, Liberia, Mozambique, Nigeria, Senegal, Sierra Leone, Tanzania, Uganda and Zambia. [4] Angola, Botswana, Democratic Republic of Congo, Ghana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. [5] Benin, Burkina Faso, Burundi, Côte d'Ivoire, Democratic Republic of Congo, Mali, Niger, Kenya, Madagascar, Senegal, Tanzania and Uganda. [6] Cameroon, Central African Republic, Chad, Equatorial Guinea, Rwanda, São Tomé and Príncipe and Tanzania.

Sources: IMF, *Regional Economic Outlook*, April 2011; Attijariwafa bank website.

Trade and Financial Integration

- Still, intraregional trade is low when compared to other customs union; while ASEAN and the EU's intraregional trade amounts to around 25% and 60% of all trade, respectively, that figure is estimated to lie below 15% for WAEMU

- Non-Tariff Barriers also impede intraregional trade in the region. They include:
  - Costly border procedures
  - Weak governance
  - Inadequate transport infrastructure
  - Poor business environment
  - Poor implementation of WAEMU rules of origins, used to certify products as being of WAEMU origin and tariff-free

Regional Integration through ECOWAS

- There is a political objective to create a single currency, the ECO, for WAMZ member countries (Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone), which would merge with the WAEMU CFA franc by 2020.

- Potential benefits to and ECOWAS Monetary Union include:
  - Increased regional integration, notably through increased intra-regional trade (CET in force in January 1. 2015)
  - Improved macroeconomic climate, due to set regional criteria

Regional Integration through ECOWAS

Nevertheless, based on the literature on Optimal Currency Area, there are challenges to an ECOWAS Monetary Union that will need to be addressed (asymmetric business cycles, fiscal disparities…):

- While WAEMU countries are rather homogeneous in terms of economy size and composition, ECOWAS countries are rather heterogeneous.

- Nigeria, as its economy represents 65% of the region's GDP, would be a major influence on the region's macroeconomic environment. Adjustments to shocks to the Nigerian economy would need to be managed for the rest of the union.

	Country shares of GDP of the union	*Net welfare gain or loss*[a]	*Correlation of shocks*	*Ratio of average to own financing needs*
Benin	0.0340	–0.0824	0.2677	1.1865
Burkina Faso	0.0406	–0.0662	0.1979	1.0022
Côte d'Ivoire	0.1706	–0.0957	0.0508	1.4021
Mali	0.0407	–0.0705	0.1523	1.0479
Niger	0.0301	–0.0752	–0.2465	1.1023
Senegal	0.0749	–0.0980	0.3455	1.4628
Togo	0.0215	–0.0831	0.4255	1.2133
Gambia, the	0.0061	0.0143	0.2277	1.1512
Ghana	0.1078	0.1220	–0.2748	0.9254
Guinea	0.0597	–0.0542	0.5914	1.3425
Nigeria	0.4037	0.1799	0.9429	0.8123
Sierra Leone	0.0104	0.1104	–0.1986	0.9545

Source: Authors' calculations.

a. Relative to retaining the existing WAEMU for WAEMU countries, relative to independent floating for others.

Cost and Benefits of ECOWAS
Source: Masson and Pattillo, 2005

4. The CFA franc and Convergence Criteria

Convergence criteria in WAEMU

In a monetary union, such as the WAEMU, **convergence criteria** are designed to make member countries similar enough to be well served by a common currency and a common monetary policy…

Convergence criteria in WAEMU

- First Order Criteria
  - ✓ Overall fiscal balance-to-GDP ratio : it should be less or equal to 3 percent.
  - ✓ Average annual consumer price inflation rate should not exceed 3 percent.
  - ✓ Overall debt-to-GDP ratio should not exceed 70 percent.

- Second Order Criteria
  - ✓ Wage bill-to-tax receipts ratio should not exceed 35 percent.
  - ✓ Tax revenues to GDP ratio should be equal to or over 20 percent.

WAEMU: Compliance with new convergence criteria

(Number of Countries Non-Compliant with Criteria)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Est.	Proj.				
First-order criteria									
Overall Balance/GDP (≥ - 3 percent)	5	2	3	4	6	6	5	4	2
Average consumer price inflation (≤ 3 percent)	5	3	0	0	1	0	0	0	0
Total debt/GDP (≤ 70 percent)	0	0	0	0	0	0	0	0	0
Second-order criteria									
Wages and salaries/tax revenue (≤ 35 percent)	5	6	5	5	5	5	5	5	4
Tax revenue/GDP (≥ 20 percent)	8	8	8	8	8	8	7	7	6

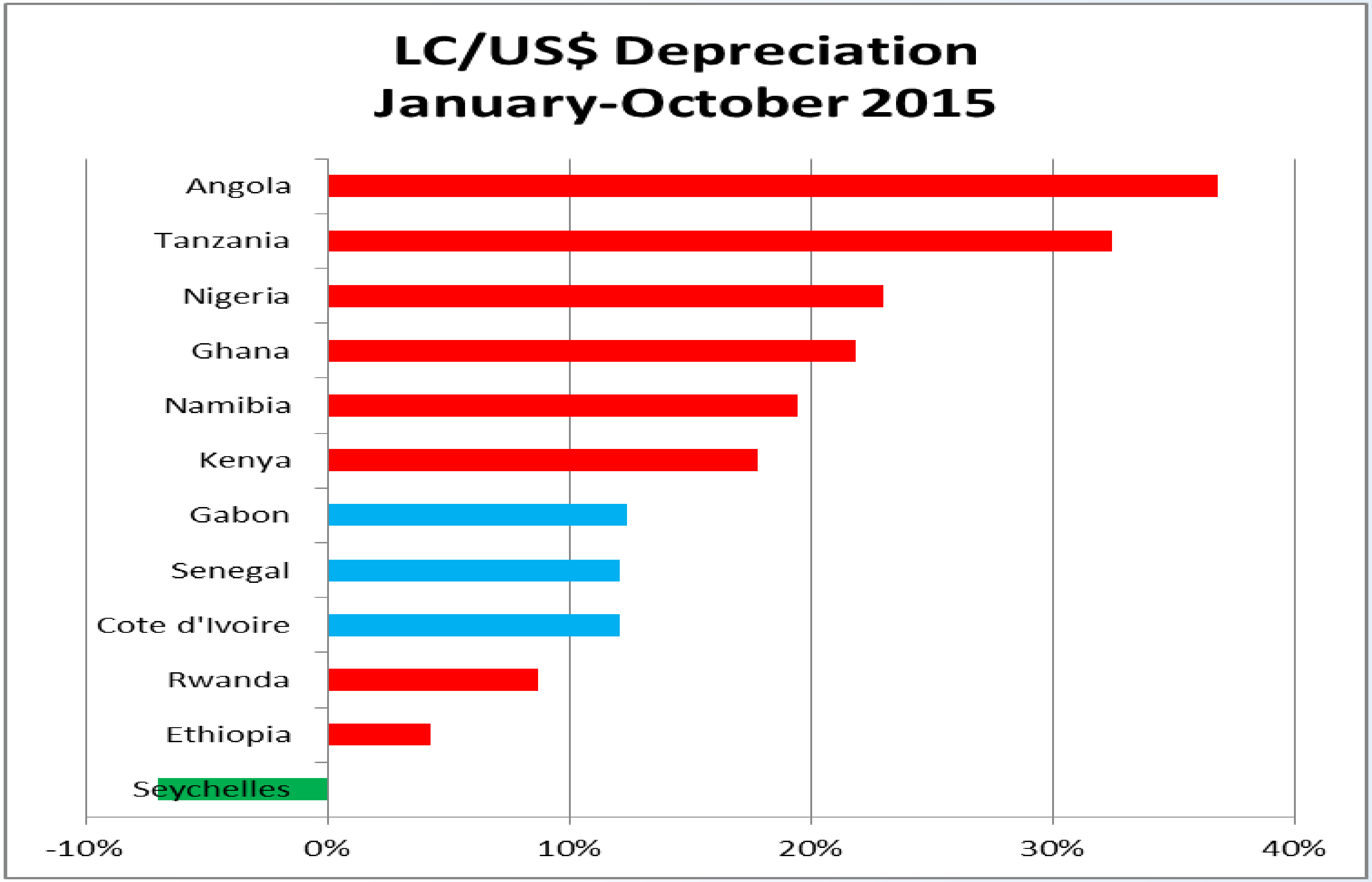
Sources: WAEMU; Central Bank of West African States (BCEAO); and staff estimates and projections.

5. The CFA franc and Monetary Stability

CFA franc and monetary stability

As a fixed exchange rate pegged to the Euro, the CFA franc contributes to monetary stability in the WAEMU. This was notably seen during the 2009 financial crisis where the currency served as a stabilizing factor… and can also be seen this year…

WAEMU – Currency Stability

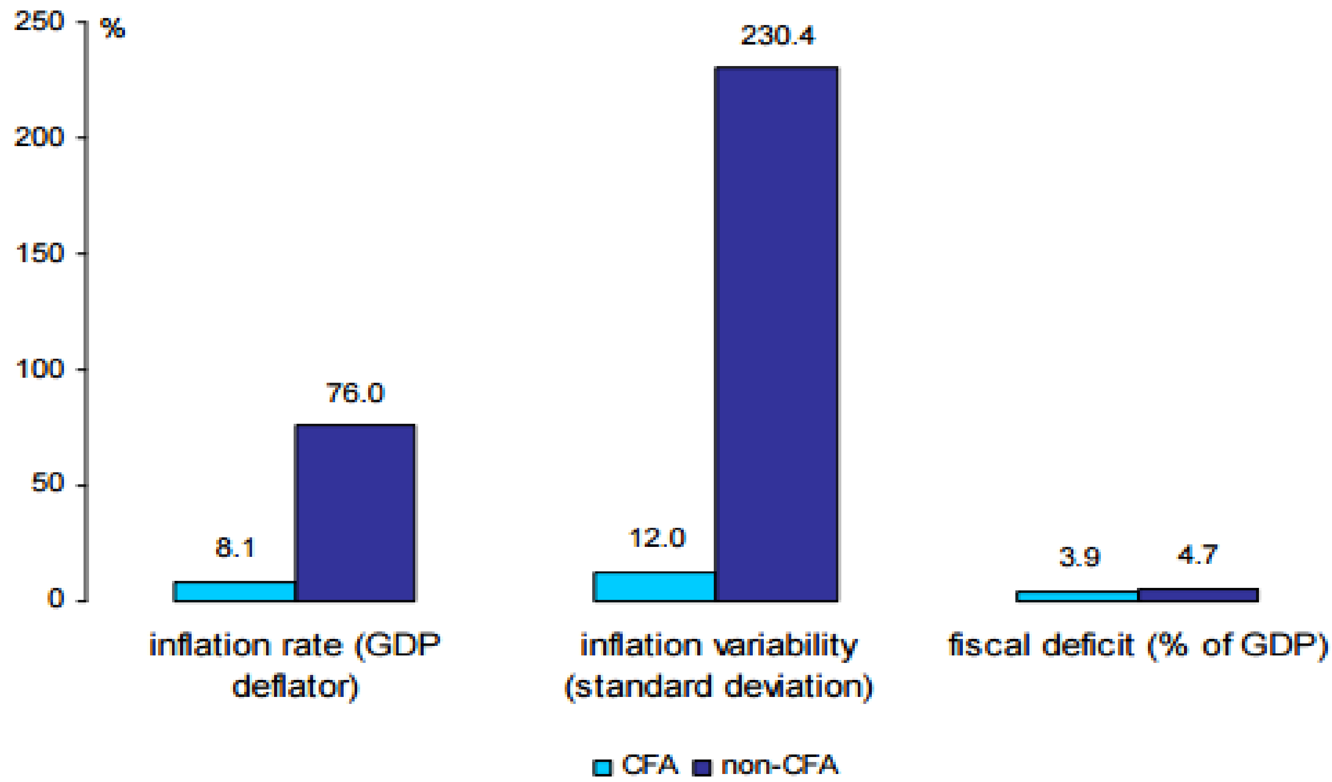


Source: www.trading.economics.com

Macroeconomic Stability in WAEMU

- The peg of the CFA franc to the euro helps in creating macroeconomic stability in the region
- The CFA franc zone outperforms fellow sub-Saharan African countries, in terms of macroeconomic stability
- Whereas several WAEMU countries suffer from political instability and weak governance, the CFA franc provides a stable monetary institutional framework

WAEMU – Inflation and Fiscal Deficit

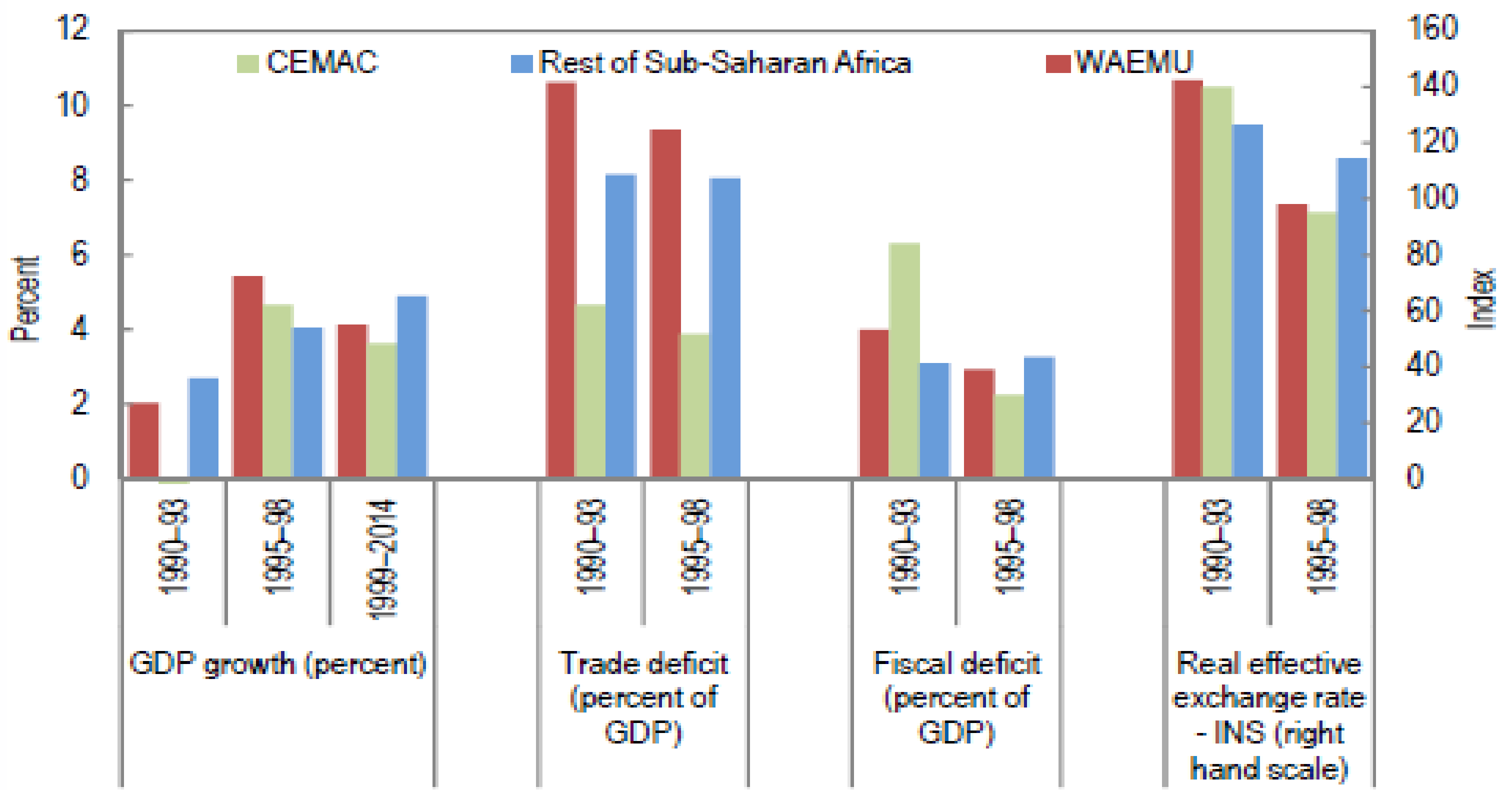


Averages of inflation rate, inflation variability and fiscal deficit in CFA franc countries and non-CFA franc countries in Sub-Saharan Africa, 1960-2004
Source: Hallet, 2008

Macroeconomic Stability in WAEMU

- Can the region leverage its macroeconomic stability to grow faster, attract investments, and be more competitive?
- What is the region’s performance on these two dimensions?
- What can be done?

Selected Indicators

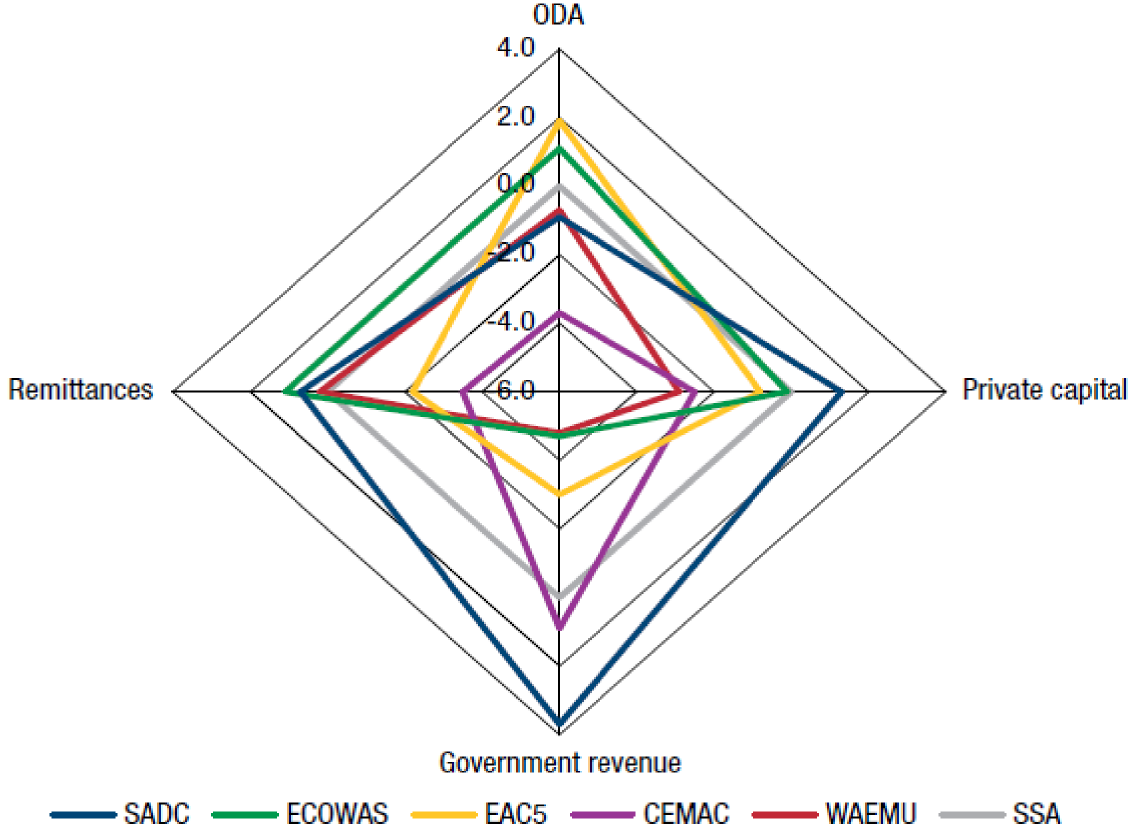


Sources: IMF, World Economic Outlook database; and IMF, Information Notice System (INS).

Source: IMF REO

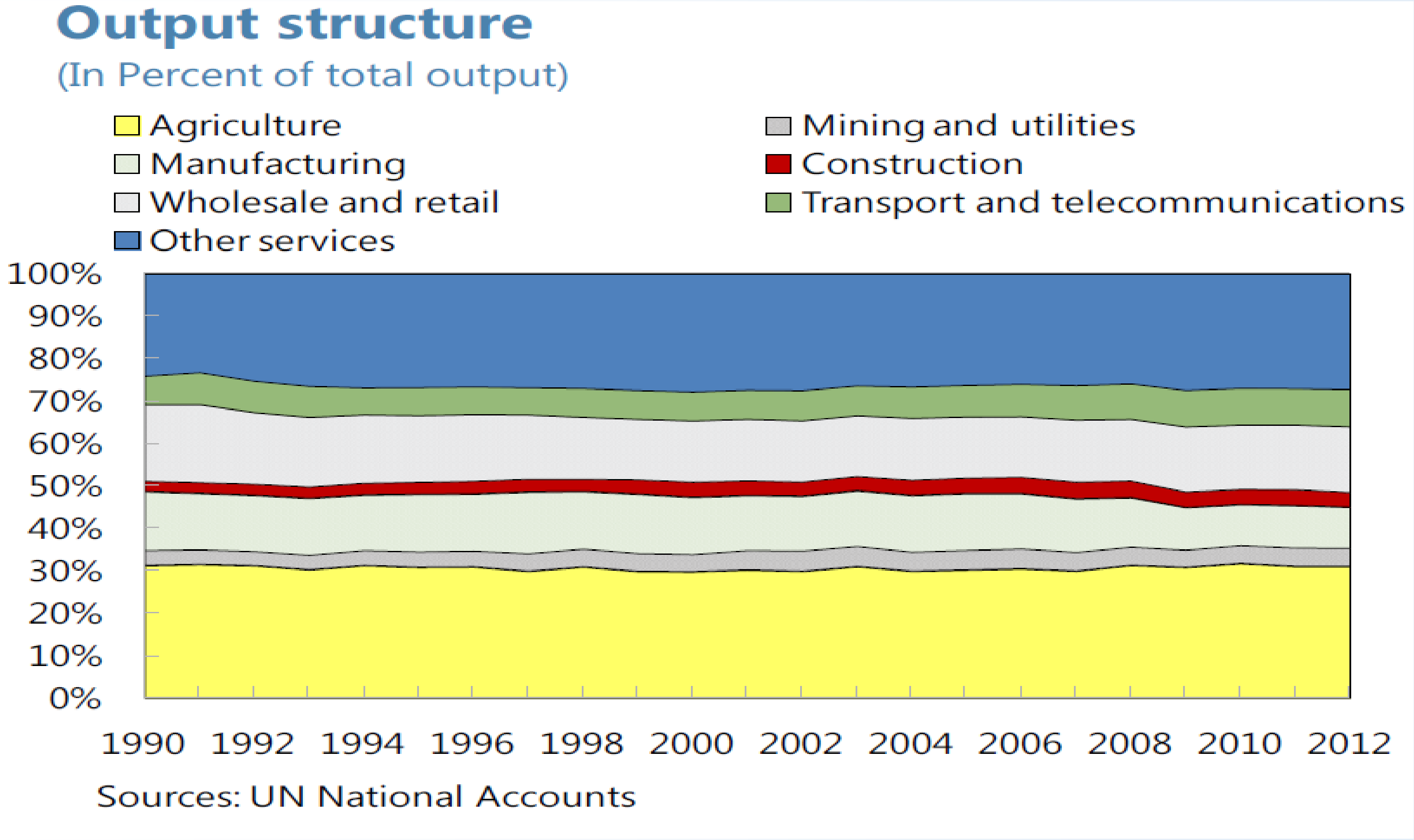
External Flows

(Deviations from SSA 1990-2012 Average, in Percent of GDP)



Sources: IMF, World Bank, and authors' calculations.

Economic Structure



Source: IMF WAEMU Report 2015

5. The CFA franc and Competitiveness

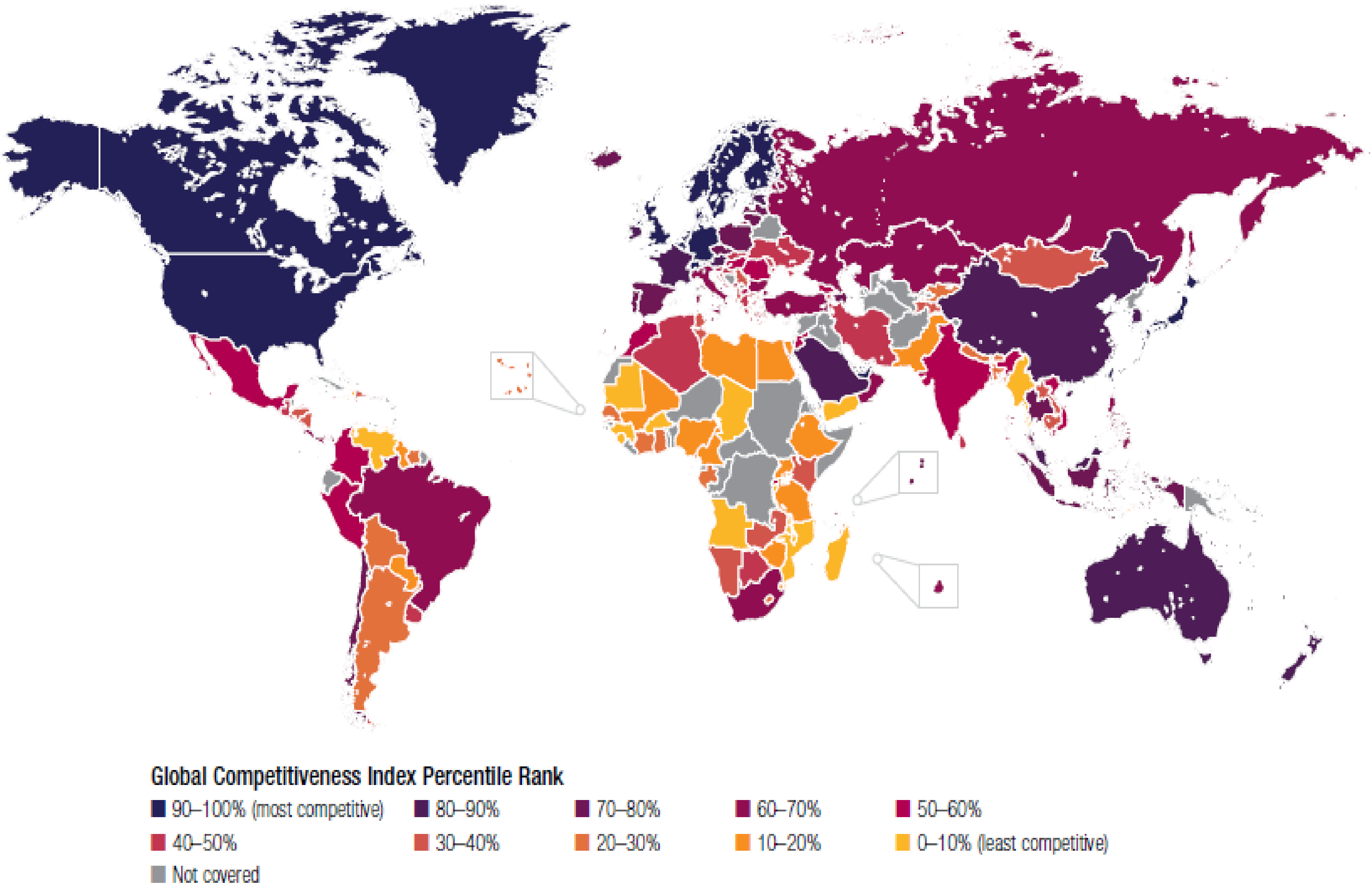
Fixed Exchange Rates and Competitiveness

- In integrating their economies, WAEMU member countries have chosen a fixed exchange rate regime
- A fixed exchange regime has well-known pros and cons
- One of the drawbacks of fixed exchange rate regimes is the risk of losing competitiveness

Frankel (2009)	Advantages	Drawbacks
Fixed Exchange Rate	❖ Credible commitment against inflation ❖ Economic stability and development ❖ Promote International Trade ❖ Reduce uncertainty and increase investment	❖ Prevent Monetary policy from changing in response to country’s macroeconomic need ❖ Extraneous Volatility, due to changes in the currency to which pegged currency is tied to ❖ Loss of Adjustment Ability to export shocks ❖ Loss of Competitiveness ❖ Importing Inflation
Floating Exchange Rate	❖ Monetary Independence ❖ Accommodation in terms of trade shocks (EX: Nigeria’s currency was devaluated as oil prices dropped) ❖ Insulation from other countries’ economic	❖ Low Protection against financial pressures ❖ Higher Volatility ❖ Potentially Risky Investment Environment

Structural Environment of the WAEMU

- Even though the 1994 devaluation brought about gains in competition, it was not a “silver bullet”
- The fixed exchange rate is not the only impediment to the challenges of competitiveness in the region
- Must look at the structural barriers to competition in WAEMU (poor institutional environment, underdeveloped infrastructures, etc…)



Global Competitiveness Index
Source: WEF, 2014

	Rank	Value
Mauritius	39	4.52
South	56	4.35
Rwanda	62	4.27
Botswana	74	4.15
Namibia	88	3.96
Kenya	90	3.93
Seychelles	92	3.91
Zambia	96	3.86
Gabon	106	3.74
Lesotho	107	3.73
Ghana	111	3.71
Senegal	112	3.7
Cape	114	3.68
Côte	115	3.67
Cameroon	116	3.66
Ethiopia	118	3.6
Tanzania	121	3.57
Uganda	122	3.56
Swaziland	123	3.55
Zimbabwe	124	3.54
Gambia,	125	3.53
Nigeria	127	3.44
Mali	128	3.43
Madagascar	130	3.41
Malawi	132	3.25
Mozambique	133	3.24
Burkina	135	3.21
Sierra	138	3.1
Burundi	139	3.09
Angola	140	3.04
Mauritania	141	3
Chad	143	2.85
Guinea	144	2.79
Sub-Saharan Africa		3.58
WAEMU Average		3.5025

Global Competitiveness Index
Source: OECD

Competitiveness

The Global Competitiveness Index places the four WAEMU countries it accounts for, towards the median.

Competitiveness

Economy	Ease of Doing Business Rank	Filtered Rank
Mauritius	32	1
Rwanda	62	2
Botswana	72	3
South Africa	73	4
Seychelles	95	5
Zambia	97	6
Namibia	101	7
Swaziland	105	8
Kenya	108	9
Ghana	114	11
Lesotho	114	10
Uganda	122	12
Cabo Verde	126	13
Mozambique	133	14
Tanzania	139	15
Malawi	141	16
Côte d'Ivoire	142	17
Burkina Faso	143	18
Mali	143	19
Ethiopia	146	20
Sierra Leone	147	21
Togo	150	22
Gambia, The	151	23
Burundi	152	24
Senegal	153	25
Comoros	154	26
Zimbabwe	155	27
Benin	158	28
Sudan	159	29
Niger	160	30
Gabon	162	31
Madagascar	164	32
Guinea	165	33
São Tomé and Príncipe	166	34
Mauritania	168	35
Nigeria *	169	36
Cameroon	172	37
Congo, Rep.	176	38
Guinea-Bissau	178	39
Liberia	179	40
Equatorial Guinea	180	41
Angola	181	42
Chad	183	43
Congo, Dem. Rep.	184	44
Central African Republic	185	45
South Sudan	187	46
Eritrea	189	47

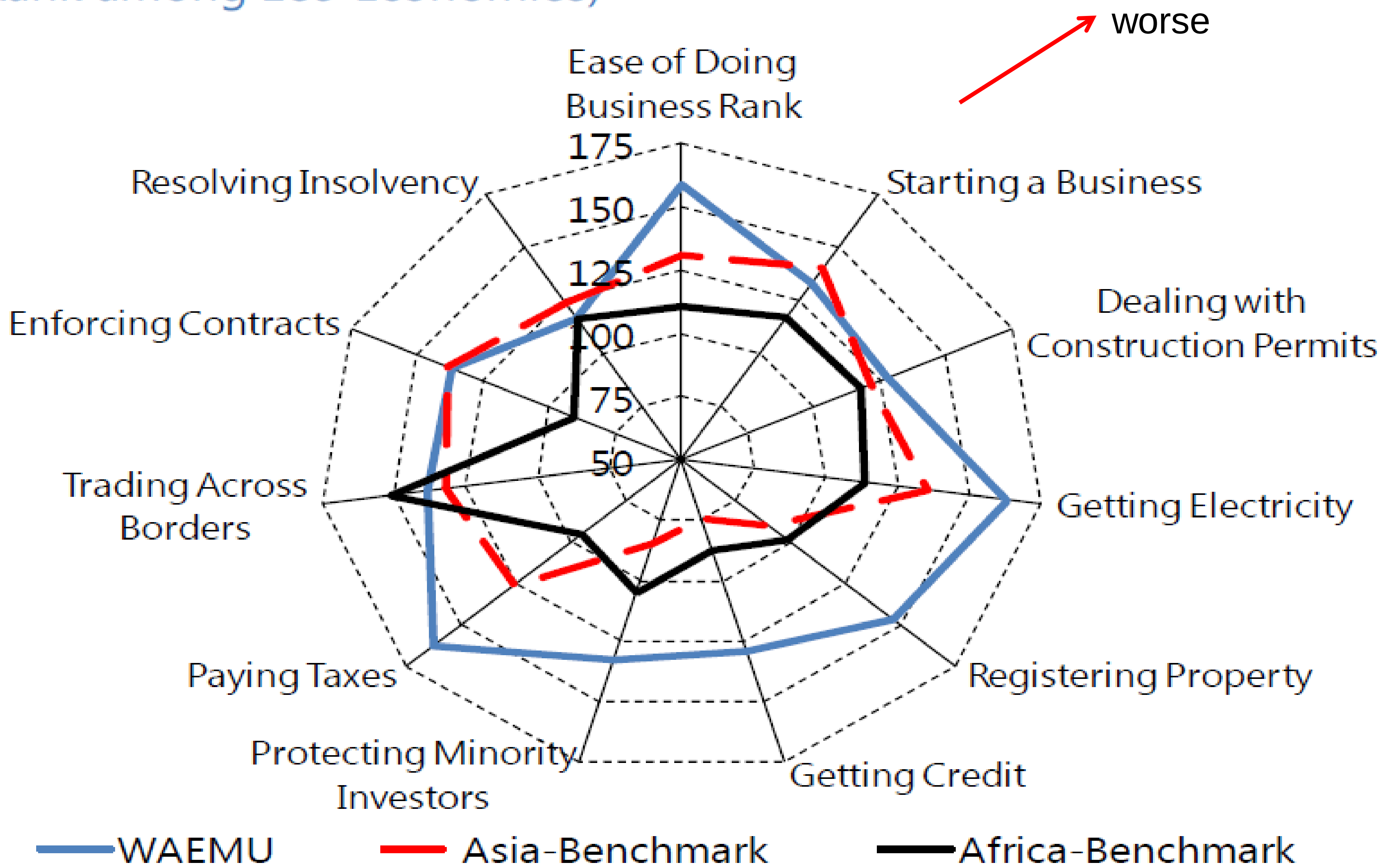
WAEMU Countries

Ease of Doing Business
Source: Doing Business 2016

When assessing the ease of Doing Business, most WAEMU countries lie towards the median.

Ease of Doing Business 2015

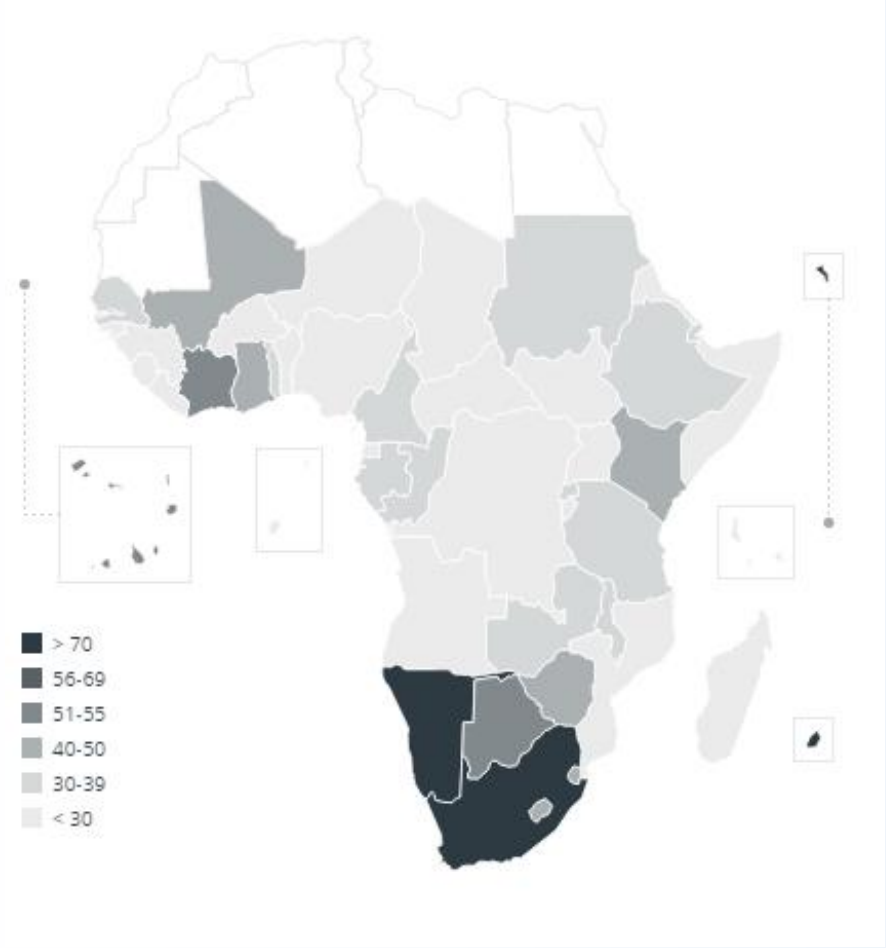
(Rank among 189 Economies)



Sources: World Bank, Doing Business 2015

IMF (2015)

Infrastructure



Ibrahim Index for African Governance, Infrastructure, Score (/100)

When assessing the existence of viable infrastructure, most WAEMU countries lie towards the lower end of the spectrum.

6. Conclusions

Conclusions

- The CFA franc is a useful tool to achieve:
  - » Trade integration
  - » Financial integration
  - » Monetary and Fiscal Stability

Conclusions

- But the CFA franc is only one tool among many and more needs to be done to:
  - » Reduce non-tariff barriers
  - » Comply with convergence criteria in particular on the fiscal front

Conclusions

- Fixed exchange rate regimes have pros and cons…
- But devaluation has not been a “silver bullet” to increase competitiveness…
- Other tools are needed..

Conclusions

- To increase competitiveness:
  - » Ensure macro stability
  - » Improve business climate
  - » Hard infrastructure gap needs to be reduced
  - » Invest in soft infrastructure (skills, technology…)

Conclusions

- Structural transformation is needed:
  - » Increase agriculture yields (above 2 tons per ha as in Côte d'Ivoire)
  - » Invest in rural infrastructure
  - » Adopt policies to increase trade
  - » Increase farmers' productivity (training and extension programs)

Conclusions

- Structural transformation is needed:
  - » Industrialization beyond investment climate reforms
  - » Promote exports with both regional and global value chains
  - » Build capabilities of domestic firm
  - » Foster industrial clusters

Conclusions

- Structural transformation is needed:
  - » Better understand the services sector: what shapes it?
  - » Leverage ICT success to increase productivity
  - » Access to finance

Conclusions

- In preparation to the planned integration with the WAMZ:
  - Trade and financial ties will need to be strengthened
  - Domestic macroeconomic frameworks will need to be strengthened

Thank You!

Brookings Africa Growth Initiative

http://www.brookings.edu/about/projects/africa-growth