THE CFA FRANC FACED WITH THE ADVENT OF THE EUROPEAN CURRENCY (THE EURO): PRESENT AND FUTURE CHALLENGES

Visemih William Muffee

ABSTRACT: Since 1964, the CFA Franc has been pegged to the French Franc, having a fixed exchange rate. The advent of the Euro keeps the CF A franc in a very vulnerable position. This article examines the consequences of the introduction of the Euro on the CF A Franc. What will be the future of the CF A Franc, looking at its strategic importance to the CF A Franc zone countries?. It carefully analyses the importance of a common currency to both the European Community and the CF A Franc zone in the Sub-Saharan African Region. The article in the end summarises the situation and makes necessary recommendations to policy makers especially in the CFA Franc zone.

INTRODUCTION

The French Franc is one of the currencies which is affected by the integration of the European Community countries into the European single currency system. The CFA Franc has been pegged on the French Franc since 1964 and when the French Franc is completely eliminated, it may face numerous problems. What actually will be the fate of the CFA Franc in the absence of the French Franc which has always been seen as the mother currency? The presence of the Euro (E) is a clear indication that the currencies of those European countries that have joined the single European monetary system may soon disappear. For example, countries like France, Germany, Denmark, Holland, etc., fall in the group of countries that are in the European Monetary System (EMS).

The European Community started in Europe; after the 1957 Treaty of Rome. It has been a great union which originated with 6 members, namely: France, West Germany, Italy, Netherlands, Belgium and Luxembourg. The current membership is more than double the original size and the members have good plans for the union both politically and economically. Their objectives have been broad based - a European Free Trade Area (i.e. a common market), a common banking system, the Exchange Rate Mechanism (ERM) and the European Monetary Union (EMU). Thus, article 2 of the Treaty of Rome states that the European Community's main task is: 'by establishing a common market and progressively approximating the economic policies of member states, to promote throughout the community a harmonious development of economic activities, a continuous and balance expansion, an increase in stability and accelerated raising of the standard of living and close relations between the states belonging to it,' Curzon, (1990).

This paper has the following main objectives:

i) To attempt to carefully assess the position of the CFA Franc *vis-a-vis* the European currency unit - the Euro; What effect would this single European currency have on the CF A Franc which has been used in the West and Central African region since 1964?
ii) To attempt to educate the public of the CF A Franc zone on the advantages and disadvantages of the European monetary integration of 1st January, 1999;
iii) To carefully examine the importance of the CFA Franc to the countries that it serves. This will be closely followed by a careful examination of the current situation in which the CFA Franc operates, *vis-a-vis* other currencies; and
iv) To carefully examine the reasons for the January, 1994 devaluation and the usefulness of the unique currency launched in Europe in January, 1999 and to examine the dilemma of the Sub-Saharan Africa after January, 1999. From this point recommendations will be made which will enhance Government monetary policy in the CFA Franc zone.

What will happen to the CFA Franc after January, 1999? Will it be a political dream or an economic nightmare to the developing countries that use the CFA Franc? How will the introduction of the Euro affect them given their poor political and economic situation, Davies, (1993)? It may not be wrong to think that given the poor political and economic situation in the Franc Zone, most of their presidents not knowing what to expect pray that the Economic and Monetary Union (EMU) timetable as laid down by the Maastricht Treaty (1991), should come to reality bringing favourable effects with it. Thus, the first year has elapsed and the year 2000 brings in more worries as the economies of the CFA Franc zone hope for a better economic future.

The Maastricht Treaty (1991), spelled out the three stages which must be undertaken in order to achieve the objectives of the European Community by setting up the Economic and Monetary Union that led to the introduction of the Euro in January, 1999. Stage one took place on July 1, 1990 with an inter-governmental agreement and a strengthening of the European Monetary System (EMS) paving the way for all European Community Currencies to enter the Exchange Rate Mechanism (ERM). Stage two took place in January 1, 1994, with the creation of the European Monetary Institute (EMI) governed by the Council of European Community, central bank governors, who laid the foundation for stage three. Stage three gave rise to the establishment of a European Central Bank (ECB) which set up the monetary policy for the Economic and Monetary Union and is handling the management of the Euro, Davies (1993).

THE IMPORTANCE OF A COMMON CURENCY UNIT

The European Community is fast achieving most of its objectives. Even though it has taken a long time, the task is being done, because development of any kind takes a long time. This is seen very clearly, because the Common Banking Market and the European Monetary Union have given birth to the idea of the European Common Currency - the Euro, (E). With a common currency, the Europeans have all the reasons to be moving towards a unified Europe. It is advantageous for members of the common market to use a common currency unit, in order to eliminate foreign exchange problems. They are firm barriers to international trade. Hence, article 3 of the Treaty of Rome sets out the community's main activities which include the following:

- The elimination as between member states, of customs duties and of quantitative restrictions on imports and exports and of all other measures having equivalent effects;
- The establishment of a common customs tariff;
- The abolition, as between member states, of obstacles to freedom of movement for persons, services and capital;
- The institution of a system which will ensure that competition in the common market is not distorted; and
- The application of procedures for co-ordinating the economic policies of member states, the approximation of their laws so that the common market may function properly, and the creation of a European Investment Bank and Social Fund.

Despite the advantages associated with the European Community, some of its members have developed a phobia to joining the European Monetary Union (EMU). So far, some of them have refused to join the Exchange Rate Mechanism - examples being Italy, Britain, Greece, etc., but they will eventually join when they realise that there are more advantages than disadvantages.

According to Beecham (1993), it will be illogical for some European Community countries to welcome the idea of a single market, but reject the idea of a European Monetary Union. The Monetary Union will remove most trade barriers, foreign exchange barriers and pricing problems.

Trade barriers will be removed, because of the free trade zone. The foreign exchange barriers will be eliminated, because of the adoption of a common European Currency unit - the exchange and pricing problems will be eliminated if all prices are expressed in a common currency unit. There are some barriers that may not be eliminated

whatever the positive integrational steps taken by the European community members.

However, the drawback that can deter the common integration of the European Community members may be their cultural and linguistic barriers. Despite that, progress has been made and this mark of progress was expressed on 1st January, 1999, the date the European Community members achieved their objective of a single European currency. Some members have taken the challenge for the single currency first, while others will follow in the future. There are laggers in every society, who only come in when they have confidence and seen evidence of the benefits accruing to others (i.e. the pioneer countries). They are Germany, France, Belgium, Luxembourg and Holland.

THE IMPORTANCE OF THE CFA FRANC

It is proper to define the acronym 'CFA' - 'C' stands for currency, 'F' stands for fixed and 'A' stands for against. Therefore CFA Franc means currency fixed against the Franc. The Franc is French money on which the West and Central African Franc is fixed, hence 'currency fixed against'. There would equally be currency fixed against the dollar - hence CFA dollar. However, in the CFA Franc zone the abbreviation 'CFA' means: (i) in the West African Region, Franc de la Communauté Africaine and (ii) in the Central African Region, Franc de la Coopération Financière en Afrique Centrale.

However, from the several agreements entered into by France and African Countries (i.e. the West African Economic and Monetary Union (UEMOA), the Central African Economic and Monetary Community (CEMAC), and the Comores), it is certain that the CFA Franc may in the future be known as the CFA Euro.

The CF A Franc is a powerful currency that serves the interest of 13 economies in the Sub-Saharan region. These countries are: Cameroon, Chad, Central African Republic, Congo, Equatorial Guinea, Gabon, Benin, Burkina Faso, Togo, Ivory Coast, Senegal, Mali and Niger, West African Report (1996).

Benin, Burkina Faso, Ivory Coast, Togo, Senegal, Mali and Niger are all West African CFA Franc countries. They are members of the 'Union Monétaire Ouest-Africaine', with their central Bank being - Banque Central des Etats de l'Afrique de l'Ouest (BCEAO) with headquarters in Dakar.

Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea and Gabon are all Central African CF A Franc countries. They are members of the 'Union Monètaire Centrale-Africaine' - their Central Bank is Banque Centrale des Etates de l'Afrique Centrale (BEAC) with headquarters in Yaounde.

The two Central Banks issue different currencies with different names and different watemarks and colours, but under the unique acronym 'CFA Franc' - with the same exchange value. The two currencies are freely interchangeable.

These CFA Franc countries constitute a strong economic force in the Sub-Saharan region in the supply of raw materials to manufacturing firms in Europe, France in particular. For this reason, these countries were induced to maintain a fixed exchange rate between the CFA Franc and the French Franc. The French, however allowed their colonies in the Sub-Saharan region to use the Franc provided that they maintained a fixed rate of exchange between the French franc and the CFA franc.

THE CURRENT SITUATION

Before January 1994, the fixed rate of exchange between the French Franc and the CFA Franc was 1French Franc to 50 CFA Francs. In January 1994, there was the eminent devaluation of the CFA Franc which brought the rate of exchange of1 French Franc to 100 CFA Francs. This action gave the French Franc a 100% advantage over the CFA Franc.

With the fixed exchange rate system in place, the CFA Franc countries enjoy the following advantages:

- The stable exchange rate, means that there would be no exchange losses arising from the exchange of CF A Francs to French Francs and *vice versa*.
- The fact that no losses may arise from the

stable exchange rate encourages international trade between and/or amongst the countries involved. This means that when there are no fluctuations in a currency's rate of exchange, traders will not bear any exchange risk. Thus, fixed exchange rates bring about a situation of certainty.

- Another aspect of fixed exchange rate in any economy is that it is possible to avoid any competitive depreciation of the currency's exchange rate which always results when exchange rates are allowed to fluctuate, Hanson (1994).

These advantages are in favour of France only because the CFA Franc zone has very few exports. Benefits can only be obtained by industrialised countries. That is why France can afford to maintain the fixed link between the two currencies. There are disadvantages associated with fixed exchange rates, namely:

- To maintain a fixed rate of exchange against any currency means that the country must carefully accumulate enough reserves to enable it to even out all day-to-day fluctuations in the exchange rate through the help of a reserve fund called the Exchange Equalisation Account;
- In a bid to maintain a fixed exchange rate, monetary and restrictive measures must be developed to keep out imports and to improve any balance of payments deficits. This is because when a currency's rate of exchange is fixed, it brings about overvaluation where the currency cannot easily adjust to current market conditions. As a result, home produced goods become dearer, which may lead to dumping by foreign countries - e.g. the Nigerian and Cameroon case. Dumping is practised by Nigerian exporters to the Cameroon market, because the CFA Franc is overvalued thereby causing Cameroonian produced goods to be more expensive in the Cameroonian market, making them less competitive than the cheaply produced Nigerian goods. In practice, empirical evidence indicates that the purchasing power parity between Nigeria and Cameroon is 2:1 in value terms, but in cost terms it is 1:2. A basket of goods in Nigeria will cost far less there than it will cost in Cameroon - twice as much. Goods always leave a cheap zone into a dear zone in order to acquire any surpluses floating around. Empirical figures using local trade indicates that as at December 1988, about 60% of imports into Cameroon came from France, 20% from Nigeria and 20% from other countries. This was the case until the then Governor of the South West Province Oben Ashu' s 'Operation Stop Nigerian imports popularly known as 'awarawa.'
- Past experience has shown that fixed exchange rate makes it difficult for a currency to achieve a true purchasing power parity equilibrium and when this is the case a currency always suffers from over and/or undervaluation problems. Where such a situation persists, it would eventually reach a point where exchange rates will become completely out of step against such a currency. This is actually an indication that an eminent adjustment is necessary. This was exactly the situation in the Sub-Saharan region, before the January 1994 devaluation. Such a situation may have precipitated the devaluation exercise.

REASONS FOR THE JANUARY, 1994 DEVALUATION

The devaluation of the CFA Franc would have been economic, if and .only if, the Sub-Saharan Franc zone has substantial exports. Only industrialised economies can adequately take good advantage of a devalued currency, because it will render their exports cheaper and saleable to foreign markets.

The region would not by any means substantially benefit from the January 1994 devaluation of the CFA Franc, because they do not have much to export, but it is my considered opinion that France would enormously benefit.

The devaluation was, from past experience, politically motivated and was accelerated by the opposition parties in Cameroon with the 'Boycott

the French' call. This call of boycott French goods in Cameroon, actually harmed the French economy by adversely affecting its balance of payments situation. When the boycott alarm was sounded, most CF A Franc countries, especially those of the Central African zone observed the boycott. The reason was that the majority of them import from France via Cameroon, for example, Chad, Central African Republic, Congo, etc. They therefore observed the 'boycott call' for fear of seizure of their goods by the Cameroonians at the seaport. In fact, the neighbouring CFA Franc countries became sympathetic to the call and the effects reduced imports from France to the zone. The impact of the reduction was very severe on the French economy.

The devaluation, therefore, was carefully designed to enable the French economy to gain double from any small amount of exports from France to the Sub-Saharan CFA zone. This actually is making up for the reduction in their balance of payments situation, following the 'boycott the French' call.

EUROPE 1999: THE BIRTH OF THE EURO

Europe 1992 brought great economic improvement to the European Economic Community and 1999 brought the European currency (the Euro) to be used by all the European Economic Community (EEC) members.

The European currency unit is the brain-child of the European Economic and Monetary Union which has advocated a common European currency - the Euro. The Euro has from January, 1999 been deplored amongst some of the European Economic Community Countries.

The Europeans are effectively well geared for the third millennium, but the Sub-Saharan Africans have not even reached their first. The Africans may have reached it in principle, but there is still a lot to be desired in practice.

The Europeans are realistic and believe in the synergy effect of development. They work in teams and that has been their strategy, enabling fast growth and progressive development. This element of togetherness is what the Sub- Saharan Africans lack, which is the main deterrent of progress in the developing world.

THE DILEMMA OF THE SUB-SAHARAN AFRICAN AFTER 1999

According to the Maastricht Treaty (1991), from January 1, 1999, the French Franc may cease to exist. The question normally asked is what will be the fate of the CFA Franc, as the Euro becomes operational?

Economic history tells us that before 1929, most European currencies were linked to the Gold Standard, but by 1931 most of them were no longer linked to gold. After this disengagement from the gold standard, the Europeans adopted a flexible exchange rate policy which has worked perfectly (Hanson, 1994).

Hanson (1994), points out that a country when using a flexible exchange rate can adopt whatever internal monetary policy without worrying about any available linkage.

However, the CF A Franc is safe at the moment, as the following communique in its entirety, captioned - 'what future is there for the CF A Franc after the Euro? illustrates:

> On 1 January 1999, the national currencies of eleven members states of the European Community were replaced by the Euro. The community will have sole competence in matters of monetary and exchange rate policy in these eleven countries, and any agreement with third countries concerning monetary and exchange rate matters must take into account this transfer of competence. So, as from this date, what is to become of the agreements which currently guarantee the convertibility of the CF A Franc and the Comorian franc with the French Franc? Will maintaining these agreements influence the conduct of the common monetary and exchange rate policy within the Euro zone? The council has decided that these agreements did not have any impact on the Euro zone monetary policy and that they can therefore be maintained. However, the community must be regularly informed of their implementation and any planned changes. If such changes affect the nature or the scope of the agreements, it is up to the council to approve them, on the recommendation of the commission and after consultation with the European Central Bank (ECB).

France has concluded several agreements with the West African Economic and Monetary Union (MEMOA), the Central African Economic and Monetary Community (CEMAC) and the Comores. These agreements define for the CFA Franc (issued by the Central Bank of West Africa and the Central Bank of Central Africa) and the Comorian Franc (issued by the Central Bank of the Comores), a fixed exchange rate with the French Franc. The guarantee of convertibility for the CF A Franc and the Comorian Franc is based on a budgetary commitment by the French Treasury: each of the central banks concerned keeps an operating account with the French Treasury, which in principle grants it an unlimited overdraft facility. In exchange, the central banks are required to deposit at least 65% of their external assets on their operating account. These agreements, the French authorities stress, have no significant financial implications for France. The Bank of France, for its part, which will form an integral part of the European System of Central Banks (ESCB) as from 1 January 1999, is not required to guarantee the convertibility of the CFA franc and the Comorian franc. Maintaining the existing agreements will not therefore affect the operation of the EMU.

The Council's decision therefore, provides that France can maintain these agreements after replacement of the French Franc by the Euro, and that signatory countries will retain their responsibility for implementing them. Nevertheless, France must inform the Commission and the Economic and Financial Committee of their implementation and any development likely to influence the functioning of the single monetary and exchange rate policy. It must also inform them in advance of any amendment to the current agreements where the nature or scope of the agreements is not changed. If the planned amendments modify the nature and scope of the agreements, the French authorities must submit it to these bodies and the plan must be approved by the Council on the recommendation of the commission after consultation with the ECB. The French authorities must inform the Economic and Financial Committee in advance of any change in the exchange rate between the Euro and the CFA and the Comorian Francs.

If these conditions are respected, the Council believes that it is desirable to maintain these agreements, and both France and the signatory African countries unanimously wish to retain them. But looking critically at the situation between the CFA Franc and the French Franc, the question that comes to mind is: why did France in 1931 disengage its currency from the gold standard, but in 1964 decided to keep the link between the CFA Franc and French Franc?

However, the linking of the CFA Franc to the French Franc was advantageously done by the French, in order to deprive these thirteen African CFA Franc zone countries of their economic Independence. Again, this vantage position was repeated by France by the January, '1994 devaluation exercise.

SUMMARY AND CONCLUSION

Looking at the situation in developing countries, let us strive to have a long term perspectives rather than sacrifice the future by following short term objectives. This principle is like the 'narrow gate of heaven', but we must keep to its teachings. Thus, people who become succeed in life invariably have long term perspectives. This must be our main objective which should be for the better development of our economies. We must believe and attach enormous importance to team spirit. Working in partnership is the main key to successful growth and development.

Human beings have a general policy of 'help us and we will help you'. The relationship between the European countries and the developing countries is actually an employer/employee relationship, where the employee's reward is always less than half the total output. Human policy, therefore is that based on 'no benefit no help'. For developing countries to receive help from Europe they must provide the benefit required. Time has come for Africans to face reality and to take their destiny in their own hands.

Recommendations

The CFA Franc zone countries should carefully design and implement their own new currency

system. This should be done in a group i.e. all the thirteen countries involved should do this as a team. Ghana is a good example to be cited. The country is fast gaining ground after a short period of economic perturbance ranging from 10 to 12 years. This perturbance, according to World Bank report (1984) was actually as a result of exchange rate over-valuation. The damage resulted from the cedi (the Ghanaian, currency) having a fixed rate of exchange, making it difficult for the currency to freely adjust to changing circumstances. From such evidence, the situation could be carefully averted, if a flexible exchange rate was adopted. The economy of Ghana is without doubt amongst Africa's top 20 fast growing economies.

Ghana may be a good example, but it may appear to be less cost-effective for the CFA Franc zone countries to design new currencies for their various economies. It can only be cost-effective if team spirit and/or the partnership principle is employed taking example from the Europeans and the Euro. Individual currencies will not be a reasonable idea. The funds to be used for such a purpose could be better employed somewhere else.

However, the CFA Franc may be maintained in the CFA Franc zone and the freely floating exchange rate system adopted. Such a system may come with some drawbacks, but past experience suggests that the advantages will always outweigh any drawbacks, given a good exchange rate management.

In a nutshell, it is very advantageous to maintain a single currency in a Free Trade Zone like UDEAC - the Franc Central African trade zone, than for individual countries making efforts to design new currencies. To address this issue properly we must ask ourselves why the Europeans are very enthusiastic about using a single European currency rather than maintaining their various currency units? There are advantages in using a common currency:

i) The international currency speculators - arbitrageurs will not have the advantage of influencing the exchange rate of the currency within the countries in the zone, especially if they trade amongst themselves;
ii) According to Beecham (1993), price competition in a single market situation will work perfectly well if all prices are in a common currency;
iii) A single banking market will develop and will facilitate payments for international trade within the zone.
iv) Exchange rate turbulence will certainly be avoided, since there will be no need for the foreign exchange market within the single currency zone.

It is therefore cheaper for a trade zone to deal in a single currency than opt for individual currency units.

Dealings outside the zone where a flexible exchange rate is adopted, the powerful force of arbitrage will operate and should cancel out any emerging drawbacks. If this is not the case, then any foreign exchange risk may be avoided by employing some other forces such as the purchase and sale of forward exchange; the careful use of exchange clauses and opening a foreign currency reserve fund (Whiting, 1992).

Cameroon and the rest of the CFA Franc countries, should adopt a floating exchange rate policy, just as the Europeans did in 1931, after leaving the gold standard. This suggests that the CFA Franc will be allowed to find its own level amongst world currencies. In fact, it will be allowed to float and depreciate like any other currency before finding its proper level.

Assuming that the CFA Franc will be allowed to find its own way in the foreign exchange market, its rate of exchange, i.e. its price will be allowed to be determined by the strength of the forces of demand and supply, enabling the currency to arrive at equilibrium of the purchasing power parity of other currencies.

REFERENCES

Beecham, B. J. (1993); "Should Britain Revert the Exchange Rate Mechanism?" *Banking World* - Journal of the Chartered Institute of Bankers - London Wall Business Publications. p. 26.

Brealey, R. and Myers, S. (1994); *Principles of Corporate Finance*, International Student Edition London: McGraw-Hill Book Company.

Curzon, L. B. (1990); *Commerce: Its Theory and Practice.* London: Cassell Ltd. Publishers.

Davies, A. (1993); "EMU: Political Dream or Economic Nightmare?" *Banking World* - Journal of the Institute of Bankers. London Wall Business Publications. p. 27-99.

Douglas, Y. (1997); "The CFA and the Euro" *The Post - Buea*. November 18, 1997. p. 7.

Hanson, J. L. (1994); *Monetary Theory and Practice*, London: McDonald and Evans Publishers.

Hanson, J. L. (1986); *A Dictionary of Economics and Commerce*, London: McDonald and Evans Publishers.

Honohan, P. (1993); "Finance Sector Failures in West Africa." *Journal of Modem African Studies*, Cambridge University Press. pp 49-65.

Infleuro (1998); "What Future is There for the CF A Franc After the Euro?" *Newsletter of the European Commission*, Luxembourg: Office for Official Publications of the European Communities, .

Klein, M. W. (1998); "European Monetary Union," *New England Economic Review*, Journal of the Federal Reserve Bank of Boston, Boston, USA.

West Africa (1996); *The Pan-African Weekly* Publication - London.

Weston, J. F. and Coperland, T. E. (1995); *Managerial Finance* CBS International Editions, CBS Publishing Japan Ltd. Japan.

Widting, D. P. (1992); *Finance of Foreign Trade*, London: McDonald and Evans Publishers.

World Bank ((1984)); *World Bank Report* The Johns Hopkins University Press - Baltimore and London.

World Bank ((1995)); "Exchange Rate Misalignment in Developing Countries." *World Bank Occasional Paper* - The Johns Hopkins University Press.