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Contemporary Issues in African Trade and Trade Finance

CIAT

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CFA FRANC SPECIAL ISSUE

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THE AFRICAN EXPORT-IMPORT BANK

CONTEMPORARY ISSUES IN AFRICAN TRADE AND TRADE FINANCE (CIAT)

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The Contemporary Issues in African Trade and Trade Finance (CIAT) is introduced by the bank to provide a platform for the staff of Afreximbank and other individuals knowledgeable in African trade and trade finance to publish articles in the areas of trade, trade finance and economic development in Africa. The CIAT publishes technical and non-technical papers. Edited by a committee, drawn from both internal and external sources, it also publishes relevant papers at conferences or seminars and those presented at the bank's internally organised Knowledge Sharing Sessions. The journal welcomes editorial comments and responses which will be considered for publication to the extent that space permits.

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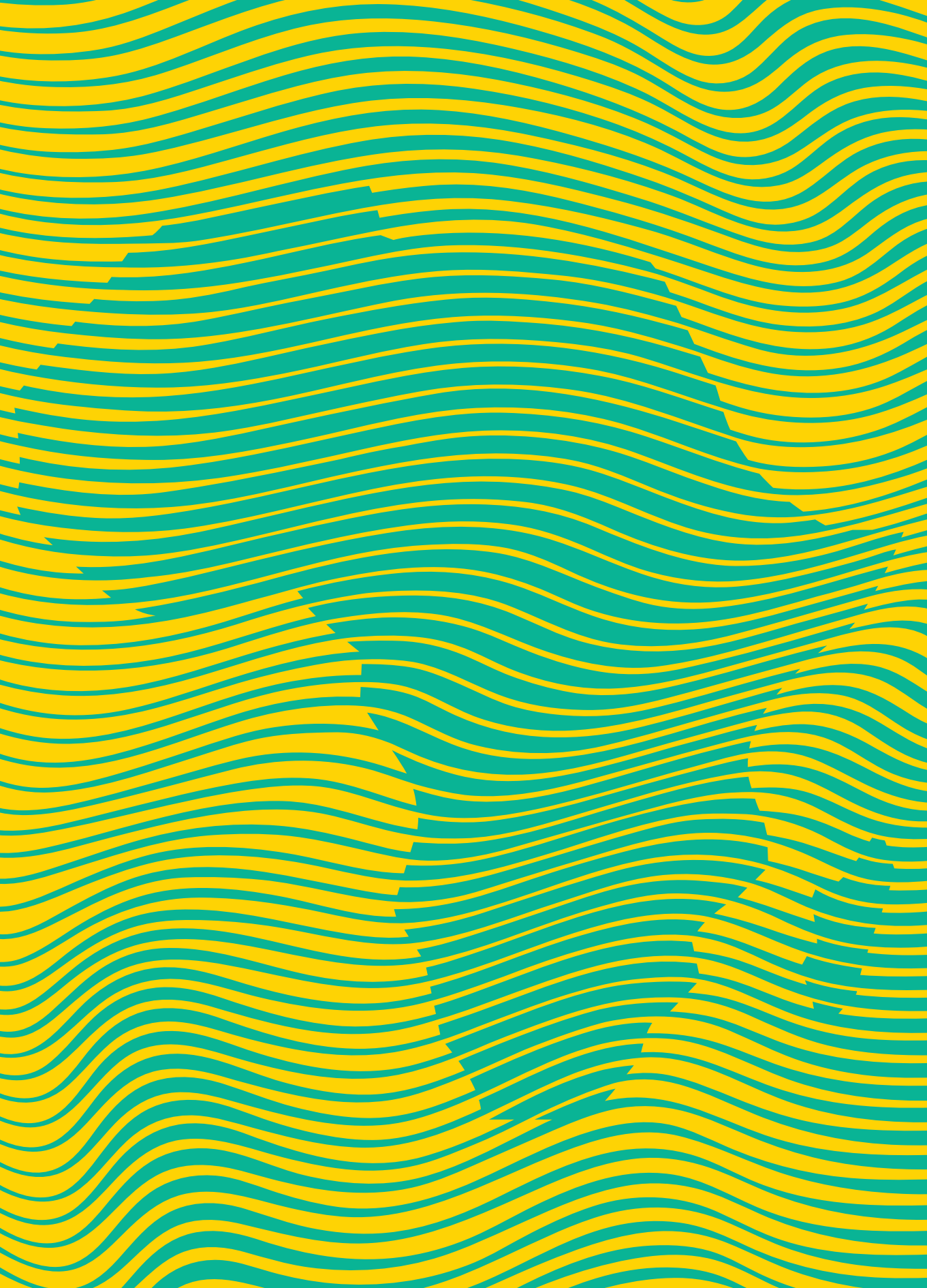

Foreword

"We won't make the weak stronger by making the stronger weaker, as a very wise man once said. That applies to the economy as well. If Germany were less competitive, the euro area as a whole would lose, because less could be produced then." That is how Mario Draghi, the president of the European Central Bank between 2011-19, described the challenge facing policymakers in a monetary union comprised of countries at different stages of economic development and exposed to different shocks.

During his tenure the stability of the euro area was brought into question by the European sovereign debt crisis, exacerbated by widening spreads and competitiveness gaps between northern and southern members of the union.

In comparison to Europe's experience, economic integration and growth convergence in Africa is made even more difficult owing not only to the myriad stages of developments at which countries find themselves, but in light of several other overlapping challenges. These include the potential size of the membership group—the African Union comprises 55 countries—and the coexistence of differing exchange rate regimes and monetary arrangements. In particular the CFA franc—which, on the one hand, has been an anchor of price stability but, on the other, has undermined the competitiveness of CFA member countries in West and Central Africa—could undercut the process of regional convergence and the implementation of the African Continental Free Trade Area (AfCFTA).

In practice, the automatic adjustment enjoyed by countries under floating exchange rate regimes could lead to competitive devaluation and further undermine economic integration during the AfCFTA's implementation. Although the AfCFTA has been touted as a game-changer owing to its potential to accelerate the structural transformation of regional economies and boost both extra- and intra-African trade, its success depends on African monetary authorities. They must commit to the creation of a financial ecosystem that

fosters macroeconomic convergence and catalyzes the injection of patient capital to drive the diversification of sources of growth and trade.

In this special issue of Contemporary Issues in African Trade and Trade Finance (CIAT), distinguished contributors review existing monetary and exchange rate agreements, paying particular attention to the CFA franc, the monetary heritage of French colonialism in Africa. They offer insights into the monetary reforms that should be carried out to maximize the AfCFTA's development impact and deepen regional integration. The latter is especially important now amid the emergence of a polycrisis world and rising risks of fragmentation, which have been exacerbated by the return of beggar-thy-neighbor policies and caused policymakers around the world to reconsider the role of exchange rates and monetary policy as tools for competitiveness.

Helen Epstein from Bard College provides an overview of the CFA franc and discusses the political economy of the monetary zone as well as its implications in terms of welfare, economic growth, and structural transformation.

Ndongo Samba Sylla reflects on one of the most important aspects of the CFA franc—the French "guarantee" of the currency's convertibility, which has survived several reforms, including the transition from a peg to the defunct French franc to the euro. The paper provides an in-depth assessment of the modalities and workings of West and Central African reserves in the Operations Account.

Hippolyte Fofack and **Ali Zafar** investigate the competitiveness of CFA franc countries and establish an overvaluation of the common currency. They show that the coexistence of fixed and floating exchange rate regimes could undermine the AfCFTA's implementation, and specifically the quest for regional convergence, if proper reforms are not carried out to foster monetary integration and mitigate the risk of competitive devaluation.

Another geopolitical shift that has created both opportunities and challenges for African countries is Brexit. The UK's departure from the European Union gave back control of trade preferences awarded to developing countries, reducing or removing rates of duty on imports from eligible countries into the UK.

Brian Sturgess from the University of Buckingham reflects on the potential implications of the trade preference schemes for the UK's post-Brexit engagement with Africa in the AfCFTA era.

How, then, should the CFA franc monetary arrangement, which has delivered price stability albeit at the expense of growth, be reformed to

accelerate structural transformation and deepen regional integration to mitigate member countries' exposure to recurrent adverse commodities terms of trade shocks?

Ali Zafar argues for the evolution of the system to better respond to challenges, including the increasing frequency of adverse shocks and capital flows, as well as durable shifts in the patterns of trade of CFA member countries towards Asia. This evolution could include a move towards an alternative exchange rate framework, which would enable greater monetary flexibility while boosting member countries' competitiveness.

Effective and responsive monetary policy has always been key to growth and economic development. In a region where most countries lack fiscal space, monetary policy is even more important not only to fast-track the diversification of sources of growth and narrow competitiveness gaps, but also to position the AfCFTA as the rising tide that will lift overall growth and accelerate regional convergence.

The papers in this special issue reiterate the importance of monetary policy for growth and effective integration into the global economy, as well as outline options to accelerate monetary convergence and boost member countries' competitiveness under the AFCFTA. I strongly recommend them to our thoughtful readers and all those interested in the subject of monetary policy and Africa's development.

Théophile Azomahou from the University Clermont Auvergne makes the case for greater synergy between the two CFA franc monetary zones—BEAC in Central Africa and BCEAO in West Africa—to maximize the trade and development impact of their common monetary heritage in the AfCFTA era.

Professor Benedict Okey Oramah
President and Chairman
of the Board of Directors,
African Export-Import Bank

The Iron Grip of the CFA Franc[1]

Helen Epstein
Visiting Professor of Human Rights and Global Public Health at Bard College

The colonial-era currency limits the economic freedom of the African countries that use it and subjects them to continued French authority.

What is wrong with Africa? Of the world's twenty-five poorest countries, twenty-one lie south of the Sahara. Crowded streets and informal markets from Dakar to Mombasa teem with hawkers selling candles, batteries, matches, toys, condoms, plastic cups, nylon wedding gowns, fake jewelry, and other cheap imports, but the region itself manufactures almost nothing. Forty percent of the components in Samsung's phones are made in once-impoverished, war-torn Vietnam. None are made in Africa, even though some of the materials used to produce them are mined there. Factories, service companies, and other modern industries are scarce. Many African countries report impressive economic growth rates of 6 or 7 percent, but this largely benefits a tiny elite—mainly those involved in oil and mineral extraction and recipients of lucrative and often corruptly administered government contracts.[2]

The countries of the Sahel, the bone-dry expanse along the Sahara's southern edge, including Mali, Burkina Faso, Niger, and Chad, are among the world's most unstable. They are beset by jihadist terror attacks, kidnappings, and massacres, and have seen seven coups d'état and thirteen coup attempts since 2010. But these countries are also home to roughly 135 million ordinary people trying to live in dignity, raise families, and avoid succumbing to premature death. Roughly 80 percent of them live on less than two dollars a day. Sahelian children are almost thirty times more likely to perish than Western European children, mostly from malnutrition and easily curable diseases like pneumonia and diarrhea, and boys spend about three years in school, on average—girls even fewer.

Poverty in Africa, and the Sahel in particular, affects us all. Millions of migrants flee their communities each year, many heading for Europe, where nationalist politicians stoke populist rage against them in order to advance their own right-wing programs. Among those who remain,

1. This article was originally published in the New York Time Review of Books, May 26, 2022 issue and has been reproduced with the permission of the author and publisher.

2. I wish to thank Hippolyte Fofack for discussions of the CFA.
The CFA system was created in the 1940s, before any of these countries were independent, and the CFA franc was pegged to the French franc until France adopted the euro in 1999.

the Islamic State, Boko Haram, and al-Qaeda find eager recruits whose terrorist activities have drawn the armies of the US, Italy, France, Germany, and Belgium into the region. Meanwhile, the Wagner Group, a mercenary outfit linked to the Russian government, now supports the militaries of Nigeria, Chad, Sudan, and other countries, creating a neo–cold war checkerboard of Western- and Russian-allied forces across the continent. After the coup in Mali in 2021, the Wagner Group was invited in, and the French troops previously deployed there departed.

Africa's poverty and instability are typically attributed to causes internal to the continent: corruption, bad leadership, overpopulation, and insufficient entrepreneurial know-how. "Change…must come predominantly from within," wrote the Oxford development economist Paul Collier in his best seller The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It (2007).

He and others called for increased foreign aid, training of peacekeepers and military personnel, Christian faith, family planning, education for girls, anti-malaria bed nets, new economic incentives, and many other things. But like seeds thrown on the hardpan Sahelian landscape, these proposals, even when implemented, have failed to produce sustained and significant economic growth.

Two new books, Africa's Last Colonial Currency by the French journalist Fanny Pigeaud and the Senegalese economist Ndongo

Samba Sylla and The CFA Franc Zone by the former World Bank official Ali Zafar, address one factor most experts overlook: the CFA system, a monetary structure that governs the economies of fourteen African countries, most of them former French colonies. Not all troubled African countries are subject to the CFA system, but as Zafar concisely shows, those that are tend to have lower rates of economic growth, higher poverty rates, and worse corruption than other African countries. As a percentage of GDP, they invest less in public services, and they offer businesses far less private credit. African countries that aren't CFA members are subject to similar though slightly less draconian conditions imposed by the International Monetary Fund (IMF), so the CFA system provides a particularly clear illustration of a sub-Saharan Africa–wide problem.

The CFA countries—Mali, Niger, Senegal, Togo, Cameroon, Chad, Côte d'Ivoire, Central African Republic, Guinea-Bissau, Equatorial Guinea, Benin, Congo-Brazzaville, Gabon, and Burkina Faso—all use a currency called the Communauté Financière Africaine (African Financial Community) or CFA franc, the value of which is fixed at 656 to the euro.[3]

3. See Ty McCormick, "The Paradox of Prosperity," Foreign Policy, October 4, 2017.

Virtually all other world currencies fluctuate in value relative to others based on such factors as economic conditions in the country and political crises like wars. Central banks in rich countries like the US Federal Reserve, the Bank of England, and the Banque de France also adjust the value of their currencies by raising or lowering interest rates or printing additional banknotes. In an emergency, such as a drought or pandemic, countries with flexible currencies can print money to help people and businesses survive and keep public services running—as the US did when Covid-19 struck.

The CFA countries can't do this. Since its creation, the CFA franc has undergone a handful of sharp, painful devaluations, but otherwise its value has remained fixed from year to year. This ensures that the money these poor countries use to purchase oil and pay interest on loans from the IMF and other international banks maintains its value. However, it also makes it impossible for their governments to use the monetary system to raise money for improvements in health care, education, transportation, the power grid, and other public goods that might foster development. Joe Biden's infrastructure and Build Back Better bills would be inconceivable in these countries.

The CFA system does nearly eliminate inflation, which can be ruinous for the poor. But some economists argue that African economies can actually tolerate higher inflation rates than Western ones can. While high inflation tends to be harmful in rich countries where most people are consumers, inflation rates of up to 12 percent have been associated with economic growth in poor ones—where most people are producers—because they make exports cheaper. Strategic devaluation helped countries like Vietnam, where a dollar now buys 23,000 dong, stay competitive.

In the CFA franc's defense, The Economist notes that "over the past 50 years inflation has averaged 6 percent in Ivory Coast, which uses the CFA franc, but 29 percent in neighbouring Ghana," which does not. What The Economist doesn't mention is that today only 13 percent of Ghanaians live in extreme poverty, while nearly 30 percent of Ivorians do. Ghana has al o received far more foreign direct nvestment than Côte d'Ivoire, even though its currency isn't instantly :onvertible into euros, as the CFA fra nc is. That easy convertibility is alsc a liability: between 1970 and 2010 C)te d'Ivoire lost about $40 billion to ca pital flight, meaning that far less of what little was earned inside the country was invested in development. According to the UN economist Janvier Nkurunziza, keeping that money in Côte d'Ivoire could have sped poverty reduction by 10 percent each year.

The CFA franc's value is managed by two regional banks, the Central Bank of West African States (BCEAO), which governs the monetary policy

of Benin, Burkina Faso, Guinea-Bissau, Côte d'Ivoire, Mali, Niger, Senegal, and Togo, and the Bank of Central African States (BEAC), which does so for Cameroon, Central African Republic, Chad, Equatorial Guinea, Gabon, and Congo-Brazzaville. When a country's monetary reserves fall, perhaps because of a drop in the value of exports or a crisis necessitating increased public spending, the regional banks order its government to cut public spending and tighten credit. This means that just when a country needs money to cushion the effects of a shock, it's unable to raise it.

To maintain the exchange rate, the regional banks also ensure that commercial banks in the CFA countries set strict borrowing conditions, with high interest rates and steep collateral requirements for business loans. As a result, banks in Niger, one of the world's poorest countries, lend money at interest rates of up to 27 percent; according to USAID, only one percent of the population has access to financing from a formal lending institution.

Last year, I'd hoped to visit Niger to find out more about what it was like to live under such a restrictive financial system. Because of the pandemic, I was unable to travel, so I arranged video interviews with about a dozen Nigeriens of various backgrounds who testified to how lack of credit had been ruinous for them.

Rahanna, aged thirty-five, used to run a profitable food stall selling fried doughnuts and millet porridge in the farming town of Madarumpha. In 2017 locusts swept through, devouring entire fields overnight. The markets nearly emptied out and prices for what remained soared. To keep her business going, Rahanna borrowed oil, kerosene, and other supplies from a wholesaler, but he demanded repayment before her business recovered. She begged for more time to raise the money, but he refused, and a few days later, enforcers arrived at her door and took everything she owned—clothes, cooking utensils, bed. As famine set in, several of Rahanna's relatives succumbed to disease—even a simple fever can kill you when you're malnourished.

Today Rahanna lives in a garbage dump in a slum in Niger's capital, Niamey. She constructed a small hut from plastic sacking and other scraps and earns about two dollars a day sorting through heaps of trash for plastic to sell to recycling companies. She is able to send a portion of this to her family back in Madarumpha. When I spoke to her, she longed to go home and restart her business, but needed forty dollars to pay off her debt. (Sometime later I sent her the money.)

Abdulahi used to run one of Niger's largest travel agencies, arranging plane tickets for NGOs, sports teams, and government agencies.

He told me that in 2016, he'd won a government contract to fly three thousand pilgrims to Mecca for the annual Hajj, but for complicated reasons the government decided to cancel it. Unfortunately, he'd already chartered an airplane, hired the crew, and booked accommodation for the pilgrims—all with nonrefundable deposits amounting to over $1 million. While awaiting government compensation, he was awarded another contract to purchase plane tickets for the national soccer team. Having lost nearly all his capital in the Hajj fiasco, he borrowed money from an acquaintance and bought the tickets well in advance at a good price. A bank loan would have entailed 18 percent interest, collateral he didn't have, and weeks if not months of delay. But Abdulahi's acquaintance turned out to work for a rival travel agency, and he demanded payment on the loan before the soccer team paid Abdulahi. In Niger, people can be imprisoned for debt, and Abdulahi spent six months behind bars. Nearly everyone he met there had also been imprisoned for debt.

Between 2010 and 2017, nearly a million migrants left sub-Saharan Africa for Europe. Much of the blame for this has been placed on the effect of climate change on farming communities, but according to the American University geographer Jesse Ribot, who has studied such communities for decades, drought, locusts, and other natural disasters are not the primary reasons people flee the Sahel. Global warming is already creating unstable weather patterns, but the Sahel has actually become greener in recent decades, as the harsh droughts of the 1970s and 1980s have subsided and new forestry methods have been introduced.

Like the Joad family in John Steinbeck's The Grapes of Wrath, Niger's poor are being ruined not by nature but by bankers. The novel opens with the arrival of "owner men" who inform the Joads that they're being kicked off the land they've been working for generations. Tom Joad pleads with the owner men to let them stay. The drought won't last forever, he says; the land can be revived with crop rotation, and demand for cotton will surely rise. "Can't we just hang on?" No, the owner men say. The bank "has to have profits all the time.... It can't stay one size."

Europe pumps about $25 billion in development aid into Africa each year, and the US and other donors pump in billions more. Much of this money goes to vocational training, the creation of small and medium-sized businesses, sustainable agriculture, and other projects to stimulate economic activity. Unfortunately, the results tend to be dismal. Most projects supported by the EU Trust Fund for Africa have created very few jobs, according to its own website. One reason is that

the projects tend to be managed by Europeans, who seldom visit them. For example, an EU-supported cashew-processing project in Mali collapsed when equipment broke down and the cashews spoiled. The Malians weren't able to do anything about it because the finances were controlled by European managers whose attention was elsewhere.[4] Africa's volatile markets and supply chains can only be negotiated by people with a personal stake in a business's success. As Soviet economists learned the hard way, planning from above seldom works.

If the CFA system is so onerous, why don't African leaders scrap it? As Pigeaud and Sylla demonstrate, many tried and paid dearly, sometimes with their lives. France's iron grip on its former colonies and its corrupt and often lethal plots against popular left-leaning African leaders have been richly documented by such authors as François-Xavier Verschave[5] and in the film Françafrique (2010) by Patrick Benquet. Pigeaud and Sylla make the case that preservation of the CFA has been an overlooked but crucial motivation for France in these schemes.

The problems began early in the decolonization process. In August 1958, two months before independence, Guinea-Conakry's future president Ahmed Sékou Touré told French president Charles de Gaulle that he wanted Guinea to remain in the CFA system, but he also wanted the economy to be less subject to French control so its government could make independent trade agreements. France declined to negotiate the matter. That September, a referendum was held in which Guineans voted overwhelmingly not to join the Communauté française—or French Community—a new and short- lived alliance of former French colonies. As soon as the result was announced, the French withdrew Guinea's monetary reserves, cut pensions to soldiers who'd fought in World War II, and began dismantling the electrical grid. They even tried to block Guinea's membership in the UN.

Negotiations over the CFA went on for two years, until finally, in 1960, Touré created a new Guinean central bank and launched a new Guinean currency. France responded by backing local mercenaries to menace his regime and pouring fake Guinean banknotes into the economy, causing it to collapse. This exacerbated Touré's paranoia, and he embarked on a program of widespread torture and killing, particularly of intellectuals believed to be working for France.

4. See La Françafrique: Le plus long scandale de la République (Paris: Stock, 1998).

5. France also meddled in oil-rich non-CFA countries, including Angola, where it helped prop up José Eduardo dos Santos in the 1990s, and Nigeria, where it backed the Biafran rebels in the late 1960s, prolonging a conflict that killed over a million people— mostly children from starvation. In 1967 French forces installed President Omar Bongo in oil-rich Gabon without benefit of elections, and in Congo-Brazzaville, the French oil company Elf, now known as Total, has been accused of arming forces loyal to Denis Sassou Nguesso against those of Pascal Lissouba, who had been legitimately elected, leading to years of civil war.

Similar problems brewed in Mali when President Modibo Keïta, concerned that the CFA was stifling diversification of the economy, launched a new Malian franc in 1962. Other CFA countries restricted trade with Mali, and Malian merchants staged protests outside the French embassy, chanting, "Long live France! Long live de Gaulle!" They were arrested, accused of colluding with France—which they probably were—and imprisoned for life. Some were reportedly tortured and killed.

In Togo around the same time, President Sylvanus Olympio, a graduate of the London School of Economics and a former director of Unilever- Togo, also called for more flexibility in issuing credit. At first the French refused, but in September 1962 they seemed willing to accept this, and an agreement between Togo and France for a new Togolese franc and central bank was reached. But it was never implemented. Four months later, in January 1963, Olympio was shot dead by Togolese soldiers who had once served in the French army. Olympio's interior minister accused France of organizing his assassination. French and US archives concerning the matter remain closed. [6]

The 1987 assassination of Burkina Faso's president Thomas Sankara may also have been partly motivated by his criticism of the CFA franc;[7] Sankara's widow has accused France of complicity in his death. Niger's Hamani Diori and Ivorian president Laurent Gbagbo, both CFA skeptics, were also overthrown with French assistance in 1974 and 2011, respectively.

Few of these anti-CFA heads of state were model democrats, but the constant threat of French meddling and the hobbling of their countries' economies via the CFA system undoubtedly helped foster their tendency to resort to repression. In any case, the French cronies who came to power in their places also abused their people's rights with impunity, and some continue to do so today.

The strict CFA system, with its curbs on public spending and bank loans, might seem like a good way of controlling Africa's notorious corruption, but it actually makes things worse. In most sub-Saharan African countries, survival is virtually impossible without recourse to illegal string-pulling, bribery, skimming of taxes and customs fees, and extracting payment for public services like health care and

6. For more on Sankara's murder, see Howard W. French, "Enemies of Progress," The New York Review, October 7, 2021.
7. The opaque nature of the CFA system also saved France a fortune in energy costs. Most countries purchase oil, gas, and uranium in dollars on the world market, but France can source many of its energy needs directly from oil- and uranium-producing CFA countries, avoiding the transaction costs of dealing in dollars. France also negotiates secret concessionary deals for some commodities—such as Niger's uranium, and Senegal's peanuts, obtaining them much more cheaply than they would on the open market. For example, France generates about 70 percent of its energy from nuclear power plants, fueled largely by uranium from Niger extracted by the French multinational Areva. Niger supplies nearly 30 percent of Areva's uranium but receives only 7 percent of Areva's payments to producing countries..

education that are supposed to be free. These behaviors are facilitated by government officials who practice influence-peddling and favoritism in the awarding of contracts and positions; create ghost pensioners, phony tax collectors, and artificial shortages to extract bribes; forge official documents such as passports, medical degrees, and examination certificates; and facilitate the "escape" of items like stethoscopes and even ultrasound machines from hospitals. The Sahel is now a major hub for trafficking in narcotics and even babies for adoption.

"Corrupt transactions…have their codes and 'practical rules,' their skills, decorum and etiquette," write the anthropologists Giorgio Blundo and Jean-Pierre Olivier de Sardan in Everyday Corruption and the State: Citizens and Public Officials in Africa (2006). You have to bribe the midwife or you'll risk dying in childbirth; you have to bribe the government official if you want to be considered for a contract; you have to pay tribute to the chief if you want to benefit from development projects.

People seldom complain because everyone understands that corruption maintains the skein of relationships that keeps destitution at bay. If the underpaid government teacher or policewoman didn't take bribes, she would not be able to feed her children; if the rich judge didn't do the same, he would fail his large extended family and other hangers-on, who depend on him for handouts to pay for emergency health care, school fees, business start-up funds, and countless other expenses. In these societies, it's disgraceful for a rich person to have poor relatives. When Abdulahi's travel agency was flourishing, he told me, he supported about fifty people directly, plus the people who depended on those people, and so on.

The political scientist Jean-François Bayart has likened Africa's interlinked and interdependent corrupt relationships to rhizomes—the dense underground networks of roots that sustain bamboo, ginger, and other plants that appear separate above ground. What he didn't mention is that the corruption rhizome extends to France itself. French investigators have revealed that dictators from Gabon and other oil-rich CFA states funneled bribes to French politicians, including former presidents Jacques Chirac and Nicolas Sarkozy. After being overthrown in a French-backed coup, Jean-Bédel Bokassa, who called himself emperor of Central African Republic, revealed that in 1973 he'd given then French finance minister (and later president) Valéry Giscard d'Estaing a "plate of diamonds" as a birthday gift. Giscard claimed he sold them and donated the money to a hospital in Central African Republic.

Opposition to the CFA system has grown in recent years, leading to street protests in many countries. French-owned businesses in West Africa have seen their windows smashed and buildings torched. To divert popular outrage, French president Emmanuel Macron and

Ivorian leader Alassane Ouattara announced in December 2019 a plan to reform the CFA system in eight West African countries, including Niger, Côte d'Ivoire, and Senegal. Until then, 50 percent of the monetary reserves of these countries were held in "operations accounts" in the French treasury, an apparently profitable arrangement for France.

For example, in 2014 France paid the CFA countries interest of 0.75 percent on their operations accounts, well below the prevailing base rate in France—then between 0.92 percent and 2.38 percent. So the Africans were effectively paying France to hold their money. It's possible that France reinvested that money and then pocketed the profit. We don't know for sure because French policy forbids disclosure of this information, even to the leaders of the countries whose money it was. Nor were CFA governments allowed to invest this money elsewhere or use it as collateral for loans. It functioned as if it were French money. Sometimes the paltry interest the Africans did receive was repackaged as a development loan, which the countries were then required to repay to France.[8]

The Wall Street Journal celebrated the Macron-Ouattara reforms when they were announced three years ago, but others saw them as part of yet another devious French operation. The value of the CFA franc is still pegged to the euro, and bank loans are as hard to get as ever. West Africa's monetary reserves are no longer held in the French treasury, but it's not clear where they are or whether they are earning anything, and if so, how much. For the dollar, pound, and euro, this is public information, but when I asked BCEAO officials in Paris and Dakar, Senegal, where the organization's CFA reserves were and how much they were earning, I received no reply.

In The CFA Franc Zone, Ali Zafar outlines a novel alternative to the CFA system. The details are complex, but the gist is that the countries of the current CFA zone could be split into groups with similar types of economies—say, oil producers in one group and oil importers in another. Each group would have its own currency, whose value would fluctuate relative to other world currencies. The fluctuations would be managed by African economists in ways that would benefit their group of countries. Inflation might increase somewhat, but freer lending would open up opportunities, so economies could grow and fewer entrepreneurs like Rahanna and Abdulahi would end up in garbage dumps or behind bars.

As more businesses survived, the tax base might increase, enabling more public investment in infrastructure, which would help attract foreign investment. This is essentially what

8. See Morten Bøås, Abdoul Wakhab Cissé, and Laouali Mahamane, "Explaining Violence in Tillabéri: Insurgent Appropriation of Local Grievances?," The International Spectator, Vol. 55, No. 4 (December 2020).

happened in Germany after World War II and in China in the decades after 1980, when cheap credit drove expansion throughout the economy.

Higher tax revenues would also enable the state to pay teachers, police, and nurses more, which might reduce corruption. People might feel sufficiently empowered to confront corrupt officials and institutions as Upton Sinclair, Ida Tarbell, and other muckrakers did during the Progressive Era in the US.

This rosy scenario is obviously speculative, but continuing to do nothing is extremely dangerous. West Africa's military coups are partly driven by popular anger over the failure of civilian governments to stanch a surge in jihadist violence, despite enormous American and European military assistance. It isn't clear that the coup leaders will succeed either, but perhaps it's time to think about the problem differently.

A major driver of jihadist recruitment is injustice. In Niger, for example, the ranks of the Islamic State are swollen with pastoralists whose animals were taken with impunity by soldiers, police, and militias—some backed by French forces. Niger's underfunded, corrupt courts seldom do anything about this. Courts run by the Islamic State administer harsh justice but are generally seen as fairer and less corrupt than the government ones.[8] If the Niger government had the resources to properly pay and discipline its own security forces, and to run a less corrupt justice system, young people might find jihadism less attractive. Scrapping the CFA system—and the IMF's similar austerity constraints in other countries—might not lead to a virtuous cycle of economic growth and reduced corruption and violence, but Africa's beleaguered people have nothing to lose by seeing if it does.

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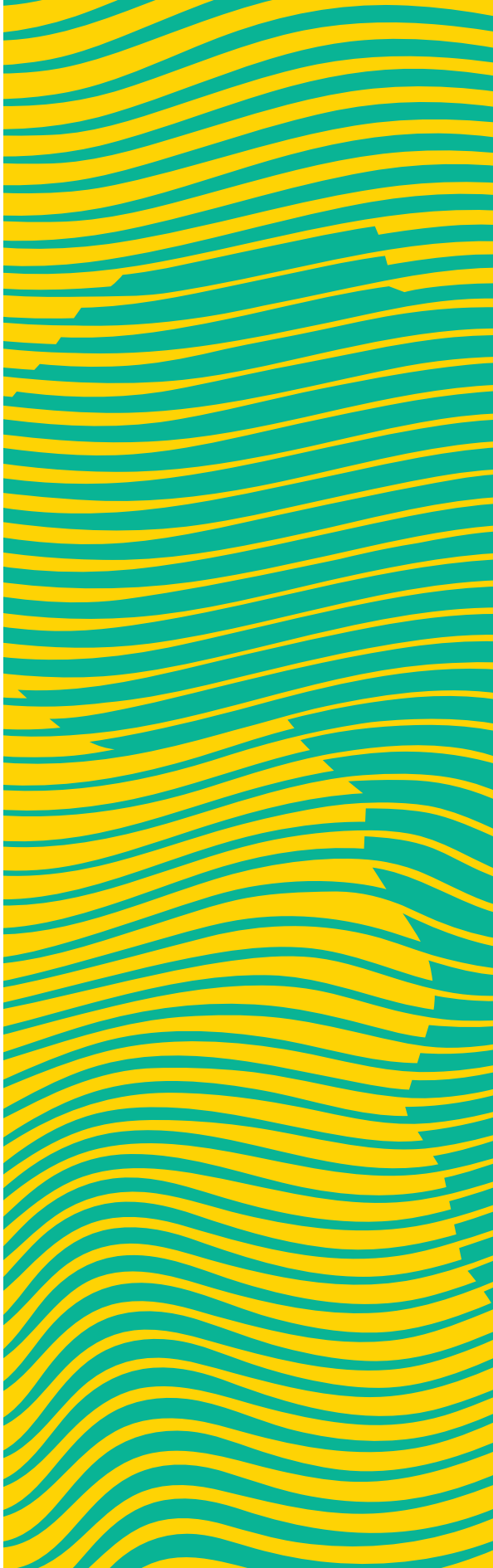


The French "Guarantee" of CFA Franc Convertibility: Political and Economic Aspects of a Myth

Ndongo Samba Sylla

Abstract: Most experts seem to take for granted the view that the central banks issuing the CFA franc benefit from an "unlimited guarantee" from the French Treasury. This article argues that the so-called guarantee is a "convenient myth" that legitimizes the French government's interference in the economic and monetary affairs of African countries. Some of the political and economic benefits that France gains from this putative "guarantee" are discussed, along with the constraints it implies for CFA countries, especially the choice of a euro peg that cannot be justified on pure economic grounds.

Keywords: CFA franc, convertibility, exchange rate regime, exorbitant privilege, franc zone, monetary union
JEL Classification: F31, F54, F55, N17, O23, O24

1. Introduction

"The guarantee of the value of the CFA franc is [...] a logical absurdity" *Joseph T. Pouemi*

At its birth in 1945, the franc des colonies françaises d'Afrique (franc of the French colonies in Africa, or CFA franc) circulated in the French colonial empire in sub-Saharan Africa. It survived the wave of African countries that gained independence in the 1960s and most of the global economic and geopolitical upheavals that came afterward. Throughout the continent, monetary decolonization implied adoption of national currencies by newly independent states and the gradual dismantling of the colonial currency zones (the sterling zone, the peseta zone, the escudo zone, the Belgian monetary zone).

The francophone countries south of the Sahara were the exception to this trend, as most of them maintained their membership in the franc zone (Mensah 1979). In fact, France conditioned their access to independence on the signing of cooperation agreements covering sovereign domains such as raw materials, foreign trade, defense, currency, and others.[1]

1. For more details on these cooperation agreements, see Journal Officiel de la Communauté. Recueil des actes et Informations, August 15, and December 15, 1960, République Française.

Some countries, such as Guinea in 1958 and Mauritania and Madagascar in 1973, were able to leave the franc zone. For the other former French colonies in West and Central Africa, Togo and Cameroon, a long history of political co-optation of elites still justifies the use of the CFA franc (Pigeaud and Sylla 2021a).

In recent years, popular protests against the CFA franc have fueled economic debates about its advantages and disadvantages, as well as its distributive impact. This article does not address this aspect. Instead, it tackles the relatively unexplored issue of the "unlimited convertibility guarantee." Indeed, many experts seem to take for granted the view that the central banks issuing the CFA franc benefit from an unlimited guarantee from the French Treasury. This article argues that this so-called "guarantee" is a convenient myth that legitimizes the French government's continued interference in the economic and monetary affairs of African countries in the post-independence era.

The paper is organized into six sections. The next section provides a brief description of the functioning of the CFA system, the benefits it is supposed to create for France, and the recent developments. Section 3 shows that the French "guarantee" is putative because the CFA system is set up in a way that makes it superfluous. The fourth section points out that the central banks of the franc zone make financial resources available to the French Treasury rather than the latter providing a "guarantee." Section 5 emphasizes that the CFA franc peg against the euro is the corollary of this guarantee and as such has no compelling economic justification. The last section concludes.

2. The CFA System

The acronym CFA refers to two denominations: the franc of "the African financial community" and the franc of "financial cooperation in Central Africa." The former is issued by the Central Bank of West African States (BCEAO) for the eight countries that make up the West African Monetary Union (WAMU) created in 1962: Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo, and Guinea-Bissau, a former Portuguese colony that joined in 1997. The second is issued by the Central Bank of Central African States (BEAC) for the six countries that make up the Central African Economic and Monetary Community (CEMAC), namely, Cameroon, the Central African Republic, Chad, Gabon, the Republic of Congo, and Equatorial Guinea, a former Spanish colony that joined the group in 1985.

These 14 countries plus the Comoros constitute the franc zone in Africa. CFA banknotes are printed by the Bank of France, while CFA franc coins are manufactured by the Monnaie de Paris. According to a Bank of France executive, the BCEAO and BEAC are the "two main clients [of the Bank

of France] outside of the euro zone and represent more than 40 percent and even nearly half of its future workload. [They are both] important clients for the future of this activity in France" (Pigeaud and Sylla 2020).

Four principles govern the operation of the CFA francs (and the Comorian franc). The first is the peg against the French franc, which was replaced by the euro in 1999. The second principle is the freedom to transfer capital and income between the two CFA blocs and France on the one hand and within each bloc on the other. The third principle concerns the "unlimited convertibility guarantee" of the French Treasury, that is, the promise of the French Treasury to lend the BCEAO and the BEAC the desired amounts in euros when the level of their foreign exchange reserves is insufficient.

It should be noted that this is a budgetary commitment that falls under the prerogatives of the French government, as opposed to a possible monetary commitment that would involve the Bank of France. In return for this "guarantee," the BCEAO and BEAC have French representatives on their bodies, who control monetary and exchange rate policy with a veto power, previously statutory but now implicit. In fact, for decisions involving statutory changes, unanimity of members is required within the Monetary Policy Committee and the Board of Directors. Another counterpart is the obligation for the BCEAO and the BEAC to deposit half of their foreign exchange reserves in an operations account, a special account of the French Treasury, in accordance with the fourth principle, namely the centralization of foreign exchange reserves.[2]

This institutional arrangement, which dates from the colonial period, was originally designed to serve metropolitan interests. Among the indisputable advantages of the franc zone are access to privileged and stable outlets for French firms and the guarantee that they can repatriate their capital and income without exchange rate and transfer risk . France also can also purchase its imports from the franc zone in its own currency, which allows it to save its foreign exchange reserves and indirectly support the value of its currency. This advantage was particularly significant during the period of the franc, a relatively unstable currency that was subject to ten devaluations between 1948 and 1986. In addition, France gains foreign exchange through its possible trade surpluses with CFA countries and through the mandatory deposits of foreign exchange reserves of these countries in the operations

2. They were required to deposit 100 percent of their foreign exchange reserves in the French Treasury until the mid-1970s. Since then, with the Africanization of the two central banks and the relocation of their headquarters in Yaounde and Dakar, the mandatory deposit rate was lowered to 65 percent. From 2005 (for BCEAO) and 2007 (for BEAC) it was lowered further to 50 percent. For more details, see Guillaumont and Guillaumont (2017) and Pigeaud and Sylla (2021a).

accounts/with the French Treasury (Conseil Economique et Social 1970). In sum, France enjoys within the limits of the franc zone a kind of "exorbitant privilege."

Over the decades, the monopolistic dominance of France and its banks over WAMU and CEMAC economies has gradually eroded as a result of global trade liberalization and increased international competition. However, these developments do not appear to have altered the French appetite for the CFA system. According to most recent estimates, 49 percent of French companies operating in the franc zone consider it an "extremely favorable asset for business." For 47 percent of them, it is "a plus, without being decisive compared to other factors." Only 4 percent consider it a handicap (Gaymard 2019, 222). The French Ministry of Foreign Affairs report that cites these figures optimistically anticipates that the franc zone will not disappear anytime soon: "Thus, the most likely scenario is not its abandonment, but the continuation of its mutations" (Gaymard 2019, 63).

In contrast, African populations are increasingly critical of the special monetary relationship with France. In addition to the acronym FCFA, which reminds them of its colonial origins, they wonder why France is represented in the bodies of the BCEAO and BEAC, why the latter must deposit part of its foreign reserves with the French Treasury, and why they entrust the Bank of France with the manufacture of their banknotes. For example, according to a survey conducted by Afrobarometer (2019), two-thirds of Togolese think that the CFA franc mainly benefits France and that it should be abolished.

In December 2019, in a context of mounting criticism, France, along with Côte d'Ivoire, decided to modify the operation of the CFA system in West Africa. The BCEAO itself seems to have received the news at the same time as the broader public. As a French parliamentary report notes, the announcement of this reform in Abidjan by Presidents Emmanuel Macron and Alassane Ouattara "came as a surprise to everyone—elected officials, economic operators, the central bank and the population" (emphasis added) (Mbaye 2020, 26).

This reform put an end to the obligation for the BCEAO to deposit half of its foreign exchange reserves with the French Treasury. In place of the French representatives, one person is designated by France and the WAMU countries. As a counterweight, the French government has pushed through measures that allow it to continue to have oversight and control over the BCEAO's monetary and exchange rate policy by virtue of its "guarantee," and to bring back its representatives in the event of a (perceived) crisis.

The announcement by Ouattara and Macron that the CFA franc in West Africa would be renamed eco

in June 2020 was not very credible. For technical and legal reasons, the time frame was too short to allow for the introduction of a new unit of account. Moreover, eco, short for ECOWAS (Economic Community of West African States), is the name the ECOWAS has chosen for its project of a single regional currency for 15 countries, including the eight WAMU countries.

In principle, the latter cannot use this name because none of them has yet met the entry criteria into the future ECOWAS monetary zone. The attempt by CFA countries to appropriate the name eco, in violation of the ECOWAS roadmap, was criticized by Nigerian President Muhammadu Buhari. "It's a matter of concern that a people with whom we wish to go into a union are taking major steps without trusting us for discussion." Without trust, he pursued in a twitter feed dated on June 23, 2020, "our ambitions for a strategic Monetary Union as an ECOWAS bloc could very well be in serious jeopardy."

Actually, the Macron-Ouattara reform is more administrative than monetary in nature. It did not put an end to the CFA franc, as some of the international press has suggested. The peg against the euro has been maintained, as is France's legal and political control over WAMU, which has been formalized in a new cooperation agreement and a guarantee convention (Pigeaud and Sylla 2021b).

3. The Myth of the French "Guarantee"

The so-called "unlimited convertibility guarantee" provides the main legal justification for France's dominant position and prerogatives within the CFA system. Without the guarantee, the French government would have had great difficulty justifying its role as monetary guardian for most of its ex-colonies south of the Sahara.

Interestingly, this guarantee is rendered superfluous by the rules to which the BCEAO and the BEAC are bound (Tinel 2016). As part of their monetary agreement with the French government, they must each maintain a monetary issuance coverage ratio (the ratio of total official foreign exchange reserves to the monetary base) of at least 20 percent. Below this limit, they must tighten monetary policy and try to rebuild their stock of foreign exchange reserves. This alert system thus makes it possible to prevent a possible activation of the French Treasury's "guarantee." In practice, the two central banks generally maintain relatively high coverage ratios for monetary issuance.

Over the period 1960-2022, the "guarantee" was only activated for the BCEAO and BEAC during the 1980s (Veyrune 2007, 7-8). At that time, African countries were experiencing a debt crisis. The fear of a devaluation of the CFA franc, which France had opposed despite IMF recommendations, fueled capital

flight from the franc zone. The overdrafts granted by the French Treasury to the BCEAO and the BEAC occurred in this context. In the case of the BCEAO, they represented an annual average of around US$100 million (32 billion CFA francs) between 1980 and 1989 (BCEAO 2000, 41), a relatively insignificant figure compared to an estimated US$2.2 billion (750 billion CFA francs) of capital flight from the franc zone in 1988-89 alone (van de Walle 1991, 395).[3]

In 1994, France could have used its "guarantee" to prevent the devaluation of the CFA franc, which it decided on in concert with the IMF, despite the opposition of most African heads of state. The immediate effect of the 50 percent devaluation of the CFA franc against the French franc was to increase the monetary issuance coverage ratios to over 90 percent (BCEAO 2000, 41). The French government's support measures to cushion the consequences of this harsh nominal adjustment were self-financing, as the CFA franc value of the French Ministry of Cooperation's budget doubled overnight.

The putative nature of the French "guarantee" did not escape the attention of informed African politicians and economists. In a book on this topic, Mamadou Diarra, formerly the Director of the Senegalese Foreign Exchange office, remarked:

> If there is a guarantee, one wonders why this limit was set at 20%, since monetary intervention should only come into play when the external assets of states fall to zero. The real monetary guarantee can only come into play from that moment on. Indeed, as long as an individual still has a credit balance on his current account, the banker will not grant him any help. (Diarra 1972,13-14)

French officials themselves acknowledge that the "guarantee" has not been used during the last three decades. "The bet is that it will be the same in the future" according to a French parliamentary report (Mbaye 2020, 84). For its part, the IMF noted in a report on the CEMAC that "there is uncertainty about the capacity of the French Treasury, itself embedded in the wider rules of the euro area, to provide such a guarantee on a large scale for an indefinite period." (Zamaróczy, Fleuriet, and Gijón 2018, 37).

Actually, France has two guarantees that allow it to evade its convertibility guarantee. First, it can ensure that the BCEAO and BEAC build up adequate stocks of foreign exchange reserves by virtue of its representation in their bodies and of the fact that it usually holds half of their foreign exchange reserves. On

3. The author used historical (average) exchange rates to convert CFA francs to US$ for the relevant period. See for example: https://fxtop.com/

this point, it should be noted that 72 percent of the BCEAO's monetary gold stock is on deposit with the Bank of France (BCEAO 2022, 43). Second, instead of playing its contractual role as lender of first resort, France can always fall back on the IMF when CFA countries encounter balance of payments problems—that is, when there is an objective need to activate its guarantee.

Since the French guarantee is not effective, the BEAC and BCEAO are usually obliged to build up relatively large stocks of foreign exchange reserves to sustain the peg against the euro. They achieve this in two ways: through the rationing of domestic credit (low growth of the monetary base) and through the issuance by States of foreign currency debt instruments that often offer yields that are much higher than those applicable to their foreign exchange reserves. The IMF 2019 report on WAMU made a similar observation:

> Between early 2017 and end-2018, the BCEAO reduced its refinancing volume to banks by about 24 percent. Regional liquidity nonetheless gradually improved in the wake of Eurobonds issued by Côte d'Ivoire and Senegal [...] which led to a substantial reduction in sovereign bonds issuance on the regional market. (IMF 2019, 4)

Indeed, in 2018, Côte d'Ivoire and Senegal issued Eurobonds of various maturities offering yields between 4.75 and 6.75 percent (Bonizzi, Laskaridis, and Griffith 2020, 41-42) that helped boost BCEAO foreign reserves, which in turn were partly held at the French Treasury for rates below 1 percent.

4. An Advantageous System for the French Treasury

Since the operations account balances of the BEAC and BCEAO have been in credit for five of the last six decades of the post-independence period, it follows that African countries have generally made financial resources available to their "guarantor," the French Treasury. One of the few publications to have addressed the issue of the use of these foreign exchange reserves by the French Treasury is a 1970 report by the French Economic and Social Council.

This report noted that "[t]he credit balances of the operations accounts are one of the resources used by the French Treasury to finance the liabilities resulting from overdrafts in the execution of the Finance Acts and from the amortization of the public debt." (Conseil Economique et Social 1970, 208) In other words, the financing made available by BCEAO and BEAC could be used by the French Treasury to finance its public deficit. In 2019, this observation was confirmed by a French Treasury official: "What is factually true is that these sums [on the operations account], which are very limited, very marginally mitigate the volume of debt issued each year by the State,

since de facto they are held in cash on the State's account" (Deutsche Welle 2019).

The foreign exchange reserves of the BEAC and BCEAO held at the French Treasury are relatively marginal when compared to the stock of French public debt, which is amortized over a long time horizon. However, they are quite significant when compared to the French public deficit, a far more relevant indicator. They accounted for 15 percent of the French government's deficit in 2017 (Pigeaud and Sylla 2020) and more than doubled France's official development assistance to sub-Saharan Africa in 2016 (Pigeaud and Sylla 2021a, 96).

Of course, the French government has no problem financing itself. It can probably do without the foreign exchange reserves of African countries, even if it seems to benefit from them. In 2021, when the French parliament was about to ratify the Ouattara-Macron reform, Jérôme Bascher, rapporteur for the French Senate's Finance Committee, candidly noted, "On the foreign exchange reserves held at the French Treasury, for a long time, certainly the Treasury, and thus the French Republic, earned some money on the return on deposits" (French Senate 2021).

Even in the absence of financial benefits, the prerogatives associated with the guarantee allow the French Treasury to have significant political control over CFA countries. Indeed, the CFA franc system can be used to bring to heel the leaders of member countries that are in conflict with the French government. The usual way to weaponize the CFA system is to organize a financial embargo: restrict the dissident government's access to its bank accounts at the central bank, or stop the refinancing of the domestic banking system and financial operations with the outside world. This was the case with the Laurent Gbagbo government in 2011 in Côte d'Ivoire and in early 2022 with the Assimi Goita government in Mali. These repressive measures constitute a violation of the texts that govern the functioning of the BCEAO and WAMU (Pigeaud and Sylla 2021a, 96-97; Pigeaud and Sylla 2022).

The CFA system, as a potential sword of Damocles over dissident leaders, has the virtue of not incurring significant management costs for the French Treasury. Indeed, the interest rates it offers to the BEAC and the BCEAO deposits have often been negative in real terms (i.e., the nominal interest rates are lower than the inflation rate). As Cameroonian economist Joseph Tchundjang Pouemi (2000) observed in the early 1980s, this means that these two central banks have been paying the French Treasury in real terms to hold on their behalf part of their foreign exchange reserves.

Following the Great Financial Crisis, unconventional monetary policies (quantitative easing, zero interest rate policies) often resulted in negative real returns from one year to the next. The assets held in the operations accounts were remunerated based on the ECB's marginal lending facility rate, which fell from 5.25 percent in July 2008 to 0.25 percent in March 2016. Given the negative real returns earned between 2010 and 2013, CFA countries negotiated a floor rate of 0.75 percent with the French government (Pigeaud and Sylla 2021a).

In the case of the BCEAO, with the closure of its operations account, this floor rate no longer applies. One can suspect that it was no longer economical for the French government to pay an interest rate of this magnitude in a context where it could issue debt at zero or negative rates on the markets. Since, the BCEAO invested most of the assets it previously held in the operations account in euro-denominated sovereign debt instruments (BCEAO 2022, 45-49). Due to a lack of transparency, the hypothesis cannot be excluded a priori that these assets left the left "pocket" of the French Treasury to land in its right "pocket" under different contractual, or "market-mediated," arrangements.

5. The Euro Peg as a Political Arrangement

One point often overlooked in discussions on desirable exchange rate regimes for CFA countries is that Paris can only provide a "guarantee" in its own currency. In other words, as long as African countries stick with the French "guarantee," they will have to settle for the peg against the euro. The euro peg and the guarantee are two sides of the same coin.

The CFA franc peg against the euro is essentially explained by political considerations, in particular by France's desire to maintain the franc zone at all costs and to continue to exert its influence by arguing its role as guarantor.

The franc zone could have disappeared with the 1994 devaluation. At that time, it was clear that the degree of overvaluation of the CFA franc varied significantly from one country to another. Therefore, a uniform devaluation rate of 50 percent was not economically justified, as some IMF economists pointed out (Parmentier and Tenconi 1996). Such a move was a "premium for laxity and macroeconomic mismanagement" (Conte 1994, 36). But this was the price to pay for maintaining the franc zone. As a result, some countries were imposed higher inflation levels and an increase in the CFA franc burden of their external debt.

The abandonment of the franc for the euro as of 1999 was also an opportunity to end the franc zone or to reform it. At the time, many African economists discouraged a pegging of the CFA franc to the euro, fearing a greater loss of monetary autonomy and competitiveness than before (Ben Hammouda and Kassé 2001). But their voices were not heard. France took it upon itself to negotiate with its European neighbors to peg the CFA franc against the euro. The compromise reached was formalized in the decision of the Council of the European Union of November 23, 1998,[4] which since then has put the CFA and Comorian francs under the dual tutelage of France and the political and monetary authorities of the euro zone (Pigeaud and Sylla 2021a, 76-79).

It goes without saying that the choice made until now in favor of the euro peg has not been motivated by economic considerations such as the correlation between business cycles, trade patterns, and the identification of the reference currency for trade and financial flows.

Business cycles in the euro area are not necessarily synchronous with those faced by franc zone countries, which are often dependent on the evolution of commodity prices (Coburger 2021). With the euro as a nominal anchor, franc zone countries inherit the ECB's rigid monetary policy, which has mostly focused on keeping inflation low. Such a macroeconomic framework is not adapted to the context of developing countries, with predominantly young populations, which must prioritize the structural transformation of their economies.

Similarly, the evolution of trade relations between the euro zone and the franc zone countries points to the need to delink from the euro. Between 2012 and 2020, the shares of France (13-14 percent) and the euro zone (34 percent) in WAMU imports remained relatively stable. In contrast, their respective shares of WAMU exports declined: from 7.1 to 4.9 percent for France and from 24.3 to 20 percent for the euro zone. This relative decline has been offset by the increase in exports to European countries outside the euro zone.

This is the case of Switzerland, which has become the leading destination for WAMU exports to Europe. Its share rose from 12.1 to 24.5 percent between 2012 and 2020 (BCEAO 2021, 35-36). It is worth noting that France's current share of WAMU imports (13-14 percent) is four to five times higher than its share of world exports (2.8 percent) (UNCTAD 2021). In this respect, the fixed parity can be analyzed as a form of trade preference for products from the euro zone insofar as it implies that CFA countries renounce using the exchange rate as an instrument to potentially boost their price competitiveness and as a shock-absorber.

4. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31998D0683

In addition to the changing geography of CFA countries' trade relations with the rest of the world, there is the crucial aspect of the monetary space in which they operate. CFA countries have chosen the euro as their nominal anchor, even though the products they export are denominated in US dollars, as are most of their imports. They suffer from having to guarantee an "exorbitant privilege" to France in a world dominated by the "exorbitant privilege" of the US dollar. This results inevitably in a big monetary split. CFA countries find themselves permanently at odds with the US dollar-driven global trade and financial cycles. When the euro appreciates against the US dollar, as it did between 2002 and 2008, CFA countries lose price competitiveness. When the euro depreciates, as has been the case in the recent period, CFA countries gain nominal price competitiveness but suffer from imported inflation and the increased burden of dollar-denominated debt in CFA francs.

The inadequacy of the CFA franc peg against the euro is particularly evident in the case of the five oil-producing countries of the CEMAC. As oil is priced in US dollars, most oil exporters operate on a floating exchange rate (Russia, Norway, etc.) or opt for a basket of currencies (Libya, Kuwait) when they are not on a fixed exchange rate with the US dollar (Saudi Arabia, Qatar, etc.). The CEMAC countries are the only oil-producing countries in the world to maintain a fixed parity with the euro. In general, apart from the 14 CFA countries and Comoros, there are only 10 other countries in the world whose currency is pegged to the euro (Sao Tome and Principe, Cape Verde, and eight European countries, generally small countries such as Kosovo, Montenegro, and San Marino) (IMF 2022, 10-11).

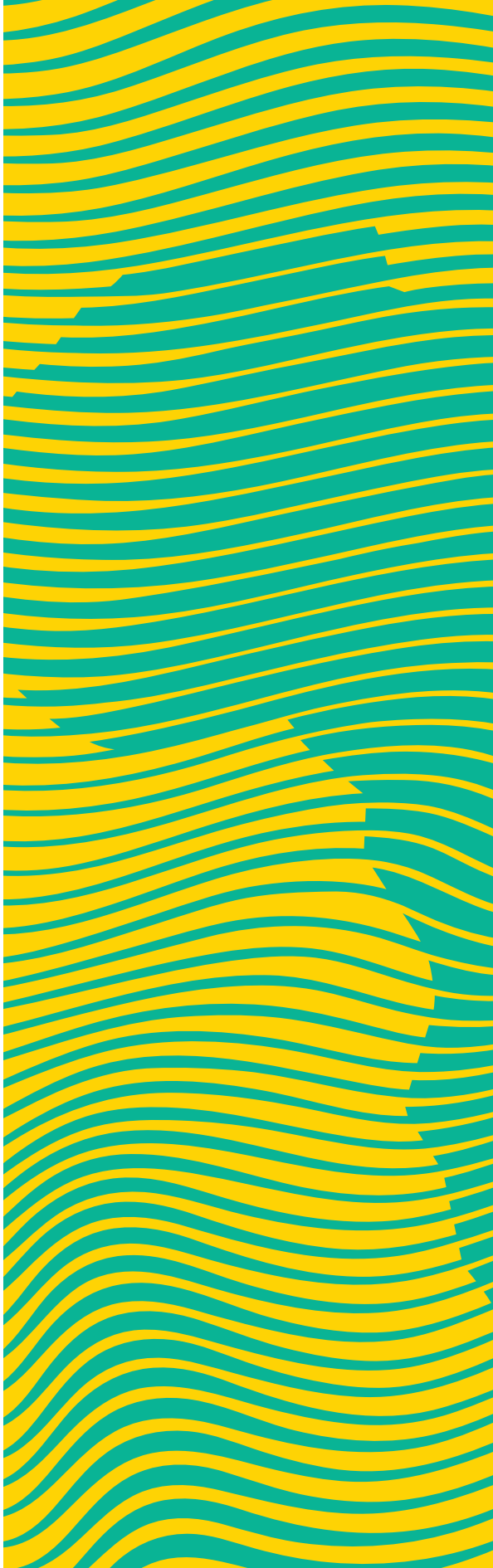
Given the cooperation agreement and the operations account agreement between the CEMAC countries and the French government, BEAC is required to deposit half of its foreign exchange reserves with the French Treasury. Since deposits on the operations account are in euros, the BEAC must often convert a significant proportion of its US dollar reserves on the Paris foreign exchange market. This undoubtedly creates unnecessary financial burdens for CEMAC countries that are the counterpart of the rents obtained by the French financial sector.

6. Conclusion

Though the French "guarantee" is purely nominal, it helps to legitimize the interference of the French government in the economic and monetary affairs of most of its former African colonies. It should be analyzed as an institutional guarantee for French interests. Any project of reform of the CFA

franc exchange rate regime will require ending this myth. In practical terms, this will necessitate that CFA countries, either individually or collectively, decide to end the monetary cooperation agreement with France and the accompanying operations account agreement/ guarantee convention. It is time that CFA countries remember the wise words written by Mamadou Diarra 50 years ago:

> The monetary guarantee implies for these States the renunciation of an essential means of action, better still: of a sovereign power, that of organizing and orienting, as they see fit, their economy, according to their own needs, and of equipping themselves with structures which would allow them, in particular, to protect themselves against the consequences of the fluctuations and imbalances occurring in others (Diarra 1972, 3).



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Competitiveness of CFA countries and implications for convergence in the AfCFTA era

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Abstract: The African Continental Free Trade Agreement (AfCFTA) is a game-changer with the potential to accelerate the transformation of African economies to boost both extra—and intra-African trade. This paper outlines a serious constraint on this potential in that the CFA franc currency area countries have joined the continental integration process with an overvalued currency. The implementation of the AfCFTA could be undermined in a world where exchange rates are increasingly targeted to boost competitiveness and the coexistence of fixed and floating exchange rate regimes hinders the process of regional convergence. Inequality could widen and trade induced growth will be restrained unless proper reforms are carried out to foster monetary integration and mitigate the risk of competitive devaluations in response to trade imbalances.

Keywords: AfCFTA, CFA franc, competitiveness, fixed exchange rate, floating exchange rate, inflation
JEL Classification: E00, E42, E52, F15, F45, N17

1. Introduction

Following the collapse of the Bretton Woods system, the world's leading economies adopted a floating exchange rate regime in the early 1970s. Many other countries followed this move away from fixed rates in subsequent decades (Frankel, 2023; Velasco, 2023). There is a range of intermediate options between the extremes of firm fixing and free-floating rates, but the global shift towards the latter has been so overwhelming that exchange rate flexibility has become the norm. Fixed exchange rates is now the exception in the arcane world of central banking and monetary policymaking,[1] while the currencies of all advanced economies float according to the most recent report on Exchange Rate Arrangements published by the International Monetary Fund (IMF, 2022a).

1. In between the two extremes there are several intermediate options, including target zones, currency baskets, crawling pegs, escape clauses, and systematic managed floats.

Flexible exchange rates have also been adopted by lower-income countries. In 1975, 87 percent of developing countries had some type of pegged exchange rate, while only 10 percent had flexible exchange rates (IMF, 1997).[2] In contrast, by 2021, less than 25 percent of emerging and developing economies had a fixed peg, but more than 75 percent had some form of more flexible arrangement (soft peg, intermediate, floating, free-floating) (IMF, 2022a). The fixed ratio is even lower when the large group of CFA Franc countries that have their currency pegged to the Euro are excluded from the sample (Pouemi, 1980; IMF, 2023a, 2023b).[3]

The increase in the countries with exchange-rate flexibility in the post-Bretton Woods era reflects the potential benefits of floating over fixed exchange rates. The increased integration of the global economy exposes countries to the transmission of external shocks to their domestic economies through volatile cross-border capital flows. The flexibility of floating exchange rates can insulate countries from such shocks while setting interest rates according to their domestic policy objectives. Floating exchange rates can avoid the speculative attacks that sometimes afflict countries with pegged exchange rates (Frankel, 2023; Velasco, 2023). A growing body of empirical research supports this view with a recent study finding that macroeconomic aggregates (such as Gross Domestic Product and investment) are less affected by US dollar appreciation in countries with flexible exchange rates (Obstfeld and Zhou, 2022).

Competitiveness can also be boosted by the flexibility associated with floating regimes. Countries have targeted exchange rates to weaken their currency, effectively subsidizing exports. This distorts the relative valuations of currencies impacting international trade and countries' balance of payments (Dominguez, 2019). So effective and prevalent is exchange rate targeting, that the US Congress has mandated the Treasury to release an annual report on the practice. The aim is to pressure those trading partners perceived to be artificially holding down their exchange rates to gain a competitive advantage (Dominguez, 2019; Condon, 2023).[4]

No African country has entered the US currency manipulator watchlist which primarily targets trade behemoths enjoying a significant bilateral trade surplus and a current account surplus equivalent to at least 3 percent of

2. For more details, see https://www.imf.org/external/pubs/ft/weo/weo1097/pdf/octweo04.pdf

3. Initially, the CFA referred to the colonies francaises d'Afrique—or French colonies of Africa. Their currency, the CFA Franc was pegged to the French Franc after independence and has been pegged to the Euro since 1999. For more details on CFA Franc, see Pouemi (1980), Pigeaud and Sylla (2021), Zafar (2021).

4. In one of the most dramatic moves the US administration proposed to use countervailing import duties against countries that subsidize their exports by manipulating their exchange rates. For more details, see https://www.bloomberg.com/news/articles/2023-06-16/us-keeps-china-on-fx-watchlist-without-designating-manipulators#xj4y7vzkg

GDP (Condon, 2023).[5] Most African countries, including the CFA Franc members, are marginal players in the global trading arena, with the region's combined contribution accounting for less than 3 percent of global trade (Afreximbank, 2023; Fofack, 2020). But they do face competitiveness challenges during times of heightened macroeconomic instability and global volatility which can result in regular periods of painful internal adjustments (by internal devaluations) imposed on households. In addition CFA countries will face a new set of challenges during the implementation of the African Continental Free Trade Agreement (AfCFTA) which entered into force in 2021 (Fofack, 2020).

The first challenge is a competitiveness deficit which could affect their performance in the competition for foreign direct investment. Inward investment with technology transfers is critical for the development of regional value chains and to effect the structural transformation essential for effective integration into the global economy (Fofack, 2020; Afreximbank, 2023). In recent years, the regional distribution of foreign direct investment has been heavily tilted towards non-CFA countries. The second challenge is that any required competitive devaluation, in the absence of the automatic adjustment enjoyed by countries under floating exchange rate regimes, could further erode the competitiveness of the CFA countries widening their current account deficits.

This paper reviews the competitiveness challenges of Francophone CFA countries in the AfCFTA era and discusses the potential implications for economic convergence at the regional level. Section (II) assesses the dynamics of African currencies post-Covid-19 when the sharp depreciation of currencies in those countries with a flexible exchange rate emerged as a shocks absorber while creating currency misalignments with the CFA group. The most recent regional estimates of exchange rate misalignments, contrasting pegged with flexible exchange rate countries, are provided in Section 3. Section 4 discusses the competitiveness challenges facing the CFA countries in the AfCFTA era and reviews the potential implications for convergence or a lack-of it. The last section concludes.

2. Dynamics of African currencies post-Covid19

The COVID-19 pandemic outbreak and the policy responses opened a floodgate of crises, setting the stage for what has been termed a 'polycrisis' world of overlapping geopolitical, health, financial and economic crises. For instance, the persisting supply chain disruptions triggered by COVID-19, later exacerbated

5. The most recent update, the US Treasury's "monitoring list" of economies that merit close attention to their currency practices and macroeconomic policies include China, Germany, Malaysia, Singapore, South Korea, Switzerland, and Taiwan. For more details, see https://www.bloomberg.com/news/articles/2023-06-16/us-keeps-china-on-fx-watchlist-without-designating-manipulators

by the Ukraine crisis, added to the inflationary pressures stemming from the large fiscal and monetary stimuli of the advanced economies. These factors combined to put the world on course for sharp price increases and for record-high inflation (Fofack, 2023b). Furthermore, the policy response by systemically important central banks to bring inflation back to target and prevent it from becoming entrenched was very aggressive. This tightening - - the US Federal Reserve raised interest by 475 basis points in the space of a year— produced a sharp appreciation of the US dollar creating further challenges for emerging and developing market economies, including the African economies (IMF, 2023c).

Tightening global monetary conditions triggered massive capital outflows from emerging and developing market economies as investors flew to safety and in search of higher yields (Fofack, 2023b).[6] This capital flow reversal impacted macroeconomic economic management and reduced growth in emerging and developing market economies. In Africa, Egypt one of the most integrated countries into the global economy and financial system was particularly negatively affected with global investors pulling out around $20 billion dollars held in local debt in the first quarter of 2022. This outflow put even more pressure on the country exchange rate which depreciated by more than 55 percent over the course of last year (FT, 2023).

Most emerging and developing market economies' currencies depreciated against the US dollar in 2022 serving to throw more fuel on the inflation fire (Fofack, 2023a). This was particularly the case in Africa where most countries are price-takers and depend heavily on international trade for foreign exchange earnings.[7] According to IMF research a percentage point increase in the rate of depreciation against the US dollar in the region leads on average to an increase in inflation of 0.22 percent within the first year. (Kemoe et al., 2023). Furthermore, African countries which are also heavily exposed to the 'original sin' of denominating external debt in foreign currencies (Hausman and Panizza, 2003; Fofack, 2023a) were affected by the aggressive tightening of global financial conditions which pushed the US dollar's effective exchange rate to a 20-year high.

The globally synchronized nature of headwinds shaping the 'polycrisis' provides an opportunity to assess the impact of these crises across the region in terms of exchange rates and monetary conditions. Consistent with the global trend, most African currencies depreciated

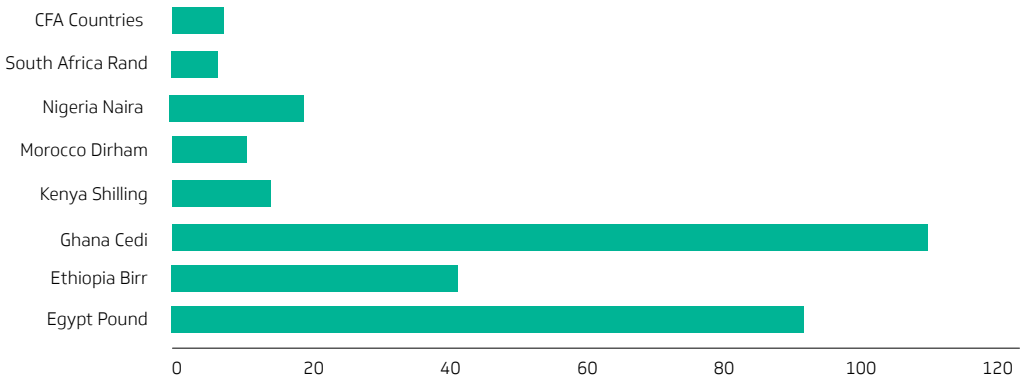
6. For more details, see https://www.project-syndicate.org/commentary/svb-collapse-could-lead-to-dollar-depreciation-silver-lining-for-global-south-by-hippolyte-fofack-2023-05?barrier=accesspaylog

7. The inflation effects of the challenging global environment are further exacerbated by the fact that most commodities are priced in U.S. dollars which despite the push for de-dollarization remains the main currency of trade. More than two-thirds of imports are still priced in US dollars.

sharply against the dollar between October 2020 and January 2023. Out of 36 African countries reviewed 29 depreciated against the US dollar (AfDB, 2023) over the review period (see Figure 1). However, as expected floating currencies recorded stronger depreciations than fixed exchange rate currencies and most notably the CFA franc countries with currencies pegged to the euro.

For instance, the Ghanaian cedi lost more than 100 percent of its value, significantly above the CFA franc which depreciated on average by less than 10 percent. The difference in the scale of depreciation perhaps reflects both the automatic adjustment under flexible exchange rates and the intensity of global headwinds. In theory, countries with widening trade deficits experience real depreciations of their exchange rates. To quote Milton Friedman, one of the most enthusiast advocates of a floating regime, "changes in the exchange rate occur rapidly, automatically and continuously and so tend to produce corrective movements before tensions can accumulate and a crisis develop." This conjecture is backed by empirical studies differentiating between the degree of exchange rate flexibility across various trading partners which show that trade imbalances under both direct and indirect pegs adjust significantly more slowly than imbalances under floats (Ghosh et al., 2014).[8]

Figure 1: Percent depreciation between October 2020 and January 2023



Source: AFDB Africa and Global Economic Trends – January 2023

8. The study also finds that the speed of adjustment to be faster under indirect pegs than under direct pegs. For more details, see https://www.imf.org/external/pubs/ft/fandd/2014/06/pdf/ghosh.pdf.

Most countries across the region saw their fiscal and current account deficits widen considerably in the face of the overlapping external shocks. The region's current account deficit (including grants) increased to reach 3.7 percent of GDP in 2020, up from 2.6 percent in 2018 before the Covid-19 pandemic downturn. Forecasts show that the current account deficit will remain very large in the near term, at about 2.7 percent of GDP in 2024. For the CFA franc member countries of the West African Economic and Monetary Union (WAEMU), the current account deficit widened considerably as well, reaching 7.7 percent of GDP in 2022, up from 4.9 percent in 2019 (IMF, 2023). It is expected also to remain high in the near term, decreasing slightly to over 6.4 percent of GDP in 2023 (IMF, 2023a).

Unlike floating nations, the CFA franc member countries which are pegged to the euro cannot adjust their currency automatically in the face of heightening global volatility and adverse shocks. As a result, most resorted to the painful consolidation of public finances to preserve fiscal sustainability and reduce external imbalances. Fiscal consolidation, projected to represent one percent of GDP this year, is expected to continue in the medium term in countries where public investments have already been dismally low. In the most vulnerable CFA franc countries with large twin deficits, governments are phasing out food and fuel subsidies (Cameroon and Senegal) amid record-high inflation already eroding household purchasing power. Other austerity measures to ensure fiscal sustainability and external viability, especially in the WAEMU countries, include reintroducing regional fiscal rules, controlling stock-flow adjustment operations, and adopting a credible medium-term fiscal framework (IMF, 2023a).[9]

3. CFA franc misalignment

In this section the exchange rate misalignment in the CFA countries is examined given the large differential in the rate of depreciation of non-CFA currencies against the CFA franc over the last few months. Conceptually, exchange rate misalignment refers to a situation when the exchange rate is out of balance with economic fundamentals which is why some countries target their exchange rate to boost competitiveness and enhance their integration into the global economy. In this section we draw on trade-weighted real effective exchange rates to assess the extent of misalignment of or lack of competitiveness of fourteen CFA franc countries members - eight belonging to the West African Economic and Monetary Union (WAEMU) and six

9. "Stock-flow adjustments" are a prominent feature of debt dynamics in many countries across Africa and refer to the discrepancies between the annual change in public debt and the budget deficit. For more details, see https://www.imf.org/en/Publications/REO/SSA/Issues/2023/04/14/regional-economic-outlook-for-sub-saharan-africa-april-2023#:~:text=Growth%20in%20sub%2DSaharan%20Africa,the%20region's%20longer%2Dterm%20outlook.

to the Central African Economic and Monetary Community (CEMAC).

There are four general approaches in the academic literature to measure exchange rate misalignment: (i) using purchasing power parity (PPP) estimates; (ii) the behavioral equilibrium exchange rate (BEER) time-series econometric approach; (iii) the macroeconomic balance and trade elasticities method, and (iv) computable general equilibrium models. Drawing on the seminal work by Edward (1988), Hinkle and Montiel (1999) and Zafar (2021), the methodologies are further described below.[10]

The purchasing power parity (PPP) exchange rate is the rate at which the currency of one country would have to be converted into that of another country to buy the same basket of goods and services in each country. It is based on the idea that exchange rate movements equalize the prices of identical goods in different countries. While the PPP approach provides a first order approximation of overvaluation it fails to hold over time as the equilibrium rate changes. Due to trade barriers and shocks, imperfect competition, and fluctuations in nominal exchange rates, the PPP approach does not provide a dynamic assessment of an economy.

The BEER model is used to obtain a measure of the equilibrium exchange rate and compare it with the actual real exchange rate to measure the degree of misalignment. Unlike the PPP approach the behavioral equilibrium exchange rate analyzes the equilibrium exchange rate as a vector of fundamentals. To a certain extent the BEER can be very effective, provided there is an abundance of reliable data. However, accessing reliable data has been a major constraint in the application of the BEER model in less developed countries.

The macroeconomic balance and trade elasticities approach determines the exchange rate misalignment as the extent of real exchange rate adjustment that is needed to correct the imbalance and to move towards a more sustainable current account position. Hence, the equilibrium value of the exchange rate is the one which achieves both internal and external balance. The current account norm is defined in an arbitrary and ad hoc manner or as an estimation of the current account norm in relation to macroeconomic variables. This approach has the virtue of being elegant. However, it is sensitive to the choice of elasticities and the current account norm chosen. The EBA-lite (External Balance Assessment) methodology employed by the IMF since 2013 is a variation of this approach, IMF, (2022b).

10. The real exchange rate can be conceptualized as the relative price of non-tradable to tradable goods, expressed in domestic currency. For more details, see https://www.elibrary.imf.org/display/book/9781557753649/ch004.xml

Computable general equilibrium belongs to the class of open economy macro-models that assess the impact of shocks on equilibrium exchange rates and analyze how the long-run equilibrium real exchange rate is affected by changes in the relative prices of imports and exports. The (Devarajan, Lewis, Robinson) DLR computable general equilibrium approach has three main advantages. First, it is conceptually simple to understand. Second, it does not require much data. Third, it explores the impact of trade shocks on equilibrium exchange rates, an important phenomenon in developing countries and hence, provides a more accurate assessment of overvaluation. The DLR method which shows what happens to exchange rate equilibrium when the nominal exchange rate does not adjust to terms of trade shocks has been widely used in the literature and will inform the analysis carried out within the context of this study assessing the dynamics of the CFA franc area in both WAEMU and CEMAC monetary zones.[11]

The CFA has a long history. Born overvalued, its fortunes were tied to the French franc in its early years and then to the euro since 1999. By the late 1980s and early 1990s, adverse terms of trade shocks due to a decline in world commodity prices and the appreciation of the French franc led to a growth of average real exchange misalignment. This led to the devaluation of the CFA franc in January 1994 which improved the competitiveness of the economies. One study finds that prior to the devaluation, the real exchange rate was about 30 percent overvalued on average with significant differences across the 12 countries (Devarajan, 1997).

According to this assessment, the larger oil producers, such as Cameroon and Gabon were the most overvalued, while some of the smaller, landlocked countries, including Chad and Burkina Faso) were much less so. One year after the devaluation, the Real Exchange Rate (RER) was undervalued in most countries. By the early 2000s, the overvaluation of the CFA had increased (Sturgess, 2013). One study finds that the real effective exchange rate appreciated by close to 8 percent in the WAEMU and by 7 percent in the CEMAC, from volatility in the euro-dollar bilateral exchange rate (Zafar, 2005). By 2011, half of the franc zone countries (Benin, Burkina Faso, Congo, Guinea Bissau, Equatorial Guinea, Mali, and Niger) were in a situation of real overvaluation (AfDB, 2012).

An empirical analysis based on the DLR approach shows that the CFA franc appreciated significantly within the WAEMU monetary zone over the last few years. Specifically, between 2009 and 2022 it appreciated by over 30 percent on average. Although

11. It provided the analytical foundation for the 1994 devaluation of the CFA franc. For more details, see Devarajan (1997).

there have been differences between countries and across years, this pattern has persisted. This sharp appreciation means that had the exchange rate been flexible, the CFA would have depreciated by 30.2 percent in the aftermath of adverse negative shocks (see Figure 2). These results are consistent with estimates derived from other models. For instance, using the EBA-Lite Current Account (CA) model the IMF estimated a minor overvaluation of 2.9 percent at the end-2021, that is before the sharp appreciation of the US dollar which reached a 20-year high in 2022 (Fofack, 2023a). This assumed an elasticity of the real exchange rate to the CA deficit of -0.2.[12]

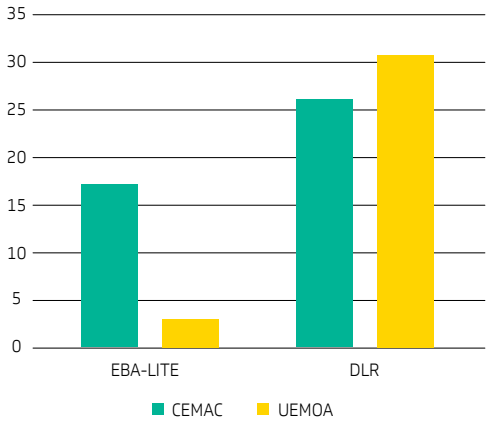
The heterogeneity of shocks and their magnitude means that their impact on the overall current account will not be uniform across countries within the region. Nevertheless, the inability of domestic prices to automatically adjust under a fixed exchange rate regime amplified the cumulative effects of shocks on the terms of trade. The worsening in the terms-of-trade caused by global food and energy price increases contributed to a widening of the regional current account deficit by 0.9 percentage points of GDP in the first half of 2022 relative to the same period in 2021 (IMF, 2023a). The external reserves in the WAEMU fell by 20 percent in response to the shocks and the growing imbalance between imports and exports.

Similarly, an empirical analysis based on the DLR methodology points to a 25 percent overvaluation of the CFA franc within the CEMAC region, largely driven by the volatility in oil prices (See Figure 2). Except for the Central African Republic (CAR) all CEMAC countries are net-oil exporters. In line with the WAEMU countries, the results are consistent with an assessment based on other empirical results. For instance, the EBA Lite CA model applied to 2021 data estimates a CA norm of 0.3 percent of GDP against a cyclically adjusted CA of -3.5 percent of GDP. This implies a gap of -3.9 percent of GDP, under current policies, equivalent to an overvaluation of the currency of 16.8 percent (IMF, 2023b).

Despite the differences between countries, since the application of the DLR method of calculating RER rate misalignment explicitly incorporates terms of trade shocks and distinction between trade and non-tradable goods, the results point to RER overvaluation in the two CFA monetary zones. Furthermore, while overvaluation appears to be relatively more pronounced within the WAEMU, the estimates appear to be robust to the choice of base year.

12. The drawback of the IMF approach for UEMOA is the tolerance of a relatively high current account deficit which ignores the possibilities of expansion of tradable sector in the event of a depreciation. Currently, UEMOA countries have among the highest current account deficits in sub-Saharan Africa.

Figure 2 Estimates of Misalignment of the CFA Franc 2010-2022



Sources: Authors' calculations; IMF (2023) Note: The EBA Lite is applied to end -2021 data.

4. CFA countries competitiveness challenges and implications in the AfCFTA era

The establishment of the African Continental Free Trade Agreement (AfCFTA) is one of the most important developments in Africa in recent years. The continental trade integration reform underpinned by the AfCFTA, which entered into force on January 1st, 2021, creates the world's largest free trade area by membership since the establishment of the World Trade Organization (WTO). It brings together 55 African countries creating an integrated market of about 1.4 billion people with a combined GDP of over $3.4 trillion, making it the fifth largest economic area globally in terms of GDP (Afreximbank, 2018; World Bank 2020; Fofack 2020).[13]

The central pillar of the AfCFTA is the envisaged phased negotiation and implementation of commitments to reduce or eliminate as many as 97 percent of all tariff lines and reduce nontariff barriers to trade within Africa. The aim is to accelerate the process of structural transformation and boost both extra—and intra-African trade (Fofack, 2018). Preliminary results from computable general equilibrium models are very encouraging. They show that the continental trade integration reform would increase Africa's exports by over US$506 billion within the first decade of full implementation, mostly in manufacturing, with the rules of origin acting as an industrialization accelerator. They also show that the AfCFTA would boost Africa's income by $450 billion by 2035 while adding $76 billion to the income of the rest of the world (World Bank, 2020).

However, an empirical analysis also shows that gains from the continental trade integration reform, both in terms of trade and household income, are not likely to be uniform (Songwe et al., 2021).[14] Manufactured goods account for the lion's share of intra-African trade, suggesting that the more industrialized economies will reap the maximum benefits from the AfCFTA, potentially creating

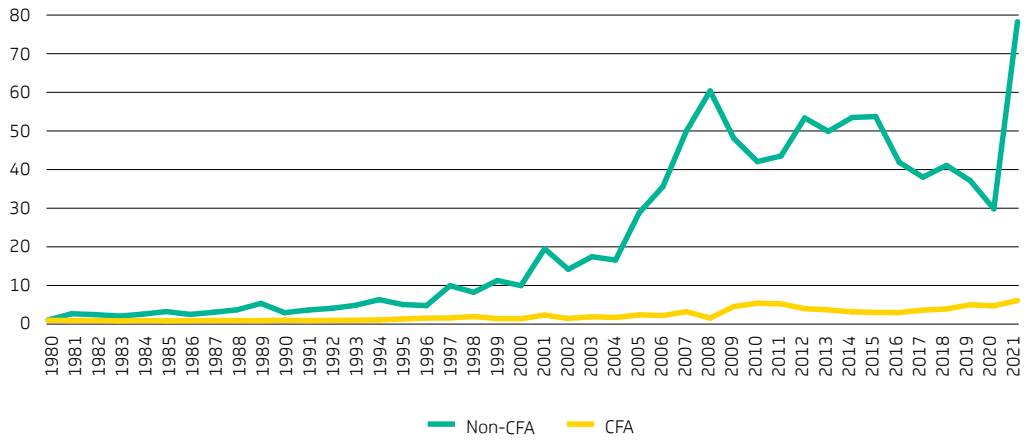
13. For more details, see https://www.brookings.edu/wp-content/uploads/2020/12/20.12.28-AfCFTA_Fofack.pdf and https://www.worldbank.org/en/topic/trade/publication/the-african-continental-free-trade-area.
14. The more advanced countries such as South Africa and Egypt which have a complex economy are likely to benefit more from the AfCFTA than weaker ones, especially the landlocked economies in the Sahel.

huge adjustment costs for the most vulnerable countries (World Bank, 2020; Fofack, 2020). The AfCFTA has one of the highest levels of income disparity among members of any free trade agreement.

Broadening the distributional gains of the AfCFTA to foster regional convergence requires closing the gaps between the least developed African countries, which are also the least industrialized with the most industrialized ones. This hinges on boosting the competitiveness of least developed countries, including most CFA franc countries, to improve their chances in the competition for foreign direct investment and access to long-term capital. As Figure 3 shows, the current distribution of FDI inflows into the continent is heavily skewed towards non-CFA countries, the destination of 90 percent of total inflows in 2020. Tellingly, up to 2016, Ghana alone had a higher stock of FDI than the 8 WAEMU countries combined (UNCTAD, 2022).[15]

The coexistence of both fixed and floating exchange rate regimes within the continent is also likely to affect implementation of the AfCFTA in several other ways besides the risk of exacerbating income inequality. Without flexibility facilitating external adjustment the CFA franc countries could see their current account deficits widen considerably. Changes in the value of floating countries occurs automatically and continuously to sustain their

Figure 3: FDI Inflow Trends: CFA versus non-CFA Countries



Source: UNCTAD (2022) and Afreximbank Research (2023)

15. For more details, see https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=96740.

competitiveness. Therefore, the natural path to be considered by the CFA countries might have to be outright external devaluation. But such a measure is not risk-free and can be particularly challenging in the presence of "balance sheet" effects, especially in a region where most countries are heavily exposed to the 'original sin' of denominating external debt in a foreign currency (Hausman and Panizza, 2003; Fofack, 2023a).

The external devaluation option with a large amount of foreign currency-denominated debt is probably the least preferred option for these CFA franc countries. It could undermine the process of economic growth and the quest for convergence within the AfCFTA area ultimately forcing these countries off the peg. The second option for these countries constrained by the fixed nominal exchange rates is domestic price flexibility. The key here is to remove structural rigidities in labor and product markets and to pursue supportive monetary and fiscal policies to help prevent an overvaluation of the real exchange rate. Perhaps another track—a transitional one that reduces excess volatility of the nominal effective exchange rate—is to move from a hard peg to a single currency to a peg to a basket of currencies reflecting their trade weights (Ngouana, 2012; Nubukpo, 2021; Zafar, 2021).

Even with this option, the challenges associated with broadening the inter-country distributional effects of the AfCFTA where a currency zone is not optimal remain daunting. Despite the colonial monetary arrangements tying countries together in two different currency blocs the level of trade integration within the CEMAC and WAEMU remains very low compared to other regions and has been consistently lower than the continental average (Fofack, 2020). For instance, while trade within the CEMAC sub-region accounted for less than 3 percent of its total trade in 2022, the share within the Southern African Development Community (SADC) region was significantly higher close to 25 percent in 2022. Total intra-African trade is near 15 percent of total exports and imports.

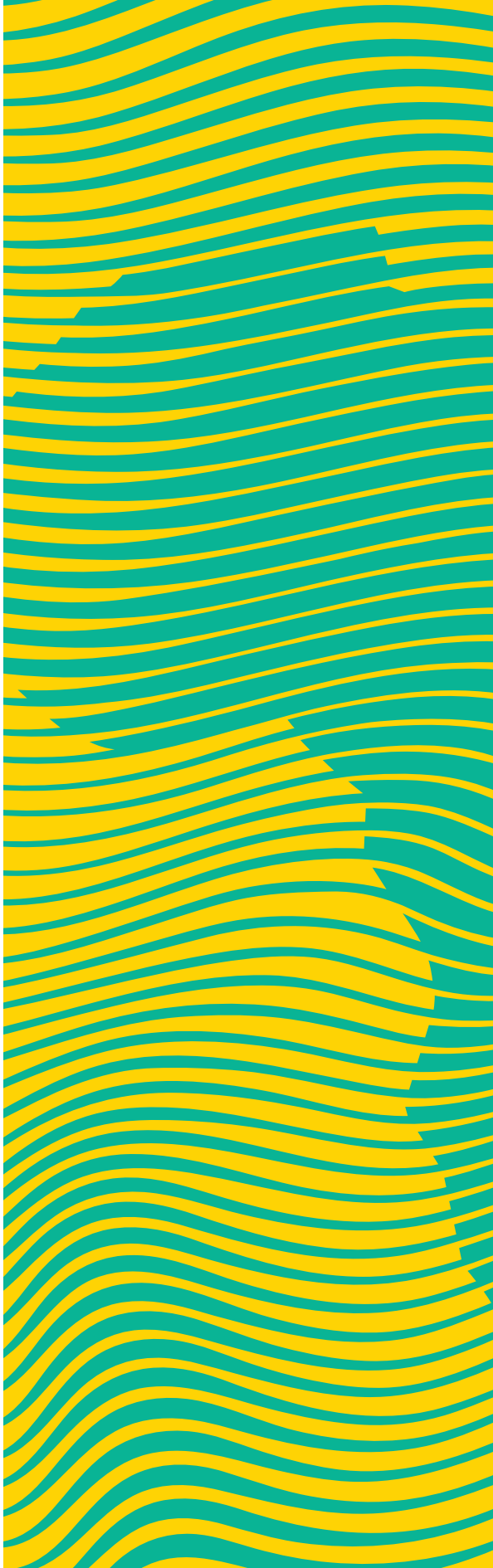
Since manufactured goods dominate intra-African trade (Fofack and Mold, 2021; Songwe et al., 2021) the stronger trade integration performance in Southern Africa is partly due to the critical role played by South Africa, the most industrialized and complex economy in the continent. The degree of complexity contained in most of the CFA countries' exports, already very low, has fallen further since 2016 (Harvard University, 2022). The main implication is that the monetary authorities need to overcome the financial repression (Pigeaud and Sylla, 2021) of a colonial monetary system to strike the optimal

trade-off between inflation and growth. Only these reforms will accelerate the process of structural transformation within the CEMAC and the WAEMU for a successful implementation of the AfCFTA, broad-based economic growth and convergence within the region.

5. Conclusion

The relative success in terms of lower inflation and exchange rate stability achieved by the CFA rigid peg first to the French Franc and then to the Euro since 1999 has been deceptive and has occurred at the expense of growth and structural transformation. The overvaluation of the CFA franc, the underlying feature of the monetary system in francophone Africa, has undermined the competitiveness of these economies. Financial repression has undermined the sustained injection of patient capital into these economies which could have driven the diversification of sources of growth The result has been to restrain the growth-accelerating and poverty-reducing power of trade.

The distortions to trade caused by the demonstrated misalignment of the CFA franc have caused significant economic problems for some years. The implementation of the AfCFTA, in contrast, is associated with both challenges and opportunities and is intended to support growth and trade across the continent, but unless steps are taken to boost the competitiveness of CFA countries, the continental trade integration reform could further widen inequality and undermine the quest for regional convergence.



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UK Trade Preference Schemes for Developing Nations Post-Brexit

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Abstract: This article reviews the trade policy of the United Kingdom since it officially left the European Union (EU) on 31 January 2020 with respect to its amendment of the Generalised Scheme of Preferences (GSP) for developing economies with a focus on Africa. The paper will review the government's replacement, the Developing Countries Trading Scheme (DCTS) due to come into practice in early 2023, and contrasts it with the EU trading system which the United Kingdom adhered to. The comparison between the schemes is made in terms of Rules of Origin, Product Specific Rules, Cumulation Conditions, Product Graduation Criteria, and Tariffs. The DCTS is more liberal in many ways than the previous GPS, although it could have gone further. Outside the constraints of the EU has a unique opportunity to use trade policy to deepen its engagement with the African Free Trade Agreement (AfCFTA).

Keywords: AfCFTA, Cumulation, DCTM, FTA, Goods Graduation, GSP, Rules of origin, Tariffs
JEL Classification: B17, F02, F13, F18, N94, N97, O19

1. Introduction

The United Kingdom officially left the European Union (EU) on 31 January 2020 and has been free to pursue its own international trade policy in line with the global Britain dream of the Brexiteers. The Department of International Trade has used this freedom so far to sign new free trade agreements (FTAs) with individual countries and trading blocs such as Japan, Australia, New Zealand, and the EU while applying to join trading agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). In Africa, the United Kingdom has signed a new Economic Partnership Agreement (EPA) with Kenya which came into force in March 2021 and has quickly signed continuity agreements with several trading partners including the South African Customs Union and Mozambique (SACUM), the Eastern and Southern Africa Trade Bloc (ESA), Cameroon, Morocco, Egypt, Côte d'Ivoire, Tunisia, and Ghana. Leaving the European Customs Union also gave back control of the system of trade preferences awarded

to developing countries reducing or removing rates of duty on imports from eligible countries into the UK.

At present eligible developing countries can receive trade preferences through the UK Generalised Scheme of Preferences (GSP), rolled over from the EU scheme, which will be replaced by a new Developing Countries Trading Scheme (DCTS) early in 2023.[1] The DCTS will apply to 65 countries in 2023, including 38 African countries already benefitting from the existing GSP scheme, and will offer lower tariffs and simplified rules of origin beyond what is currently offered by the European Union and by the UK's transitional arrangements. Unfortunately, despite a major consultation with trading partners and interested bodies, the UK's new system has only partially dealt with some of the problems of the system it replaces which has been criticized for the obstacles it has placed in the way of exporters in developing countries.

This article will focus on the significance of the UK's previous and new preference trading system for Africa given the chance for the UK to deepen its post-Brexit engagement with the African Free Trade Agreement (AfCFTA).[2] The next section of this article provides an overview of DCTS. Section 3 provides a reflection and contrast between the UK's post-Brexit preferential trading system and the EU-based trading system, with emphasis on Rules of Origin, Product Specific Rules, Cumulation Conditions, Product Graduation criteria, and Tariffs. The last section concludes.

2. The Developing Countries Trading Scheme

The new DCTS was developed after a review of evidence and following the Department of International Trade's period of public consultation from 19 July until 12 September 2021 which asked businesses and other interested parties to fill in a detailed questionnaire about what a post-Brexit system of preferences should look like. In total, the government received 300 individual submissions, divided into five categories: individuals, businesses, business associations, non-governmental organisations, and public sector bodies. The author of this article submitted a detailed response to this consultation exercise on behalf of the Initiative for Free Trade (IFT) arguing for a much more liberalised and extended preference system to help the growth and export diversification of developing countries. This expansion of preferential access with the ease of access would also offer British consumers and businesses a greater choice of products at lower prices.

The new DCTS scheme is more generous than the existing GSP. It applies to 47 countries in the Least Developed Country (LDC) set and to 18 additional countries or territories classified by the World Bank as low-income (LIC) and lower-middle income (LMIC), but it does not apply to countries classified by the World Bank as upper-middle income for 3

1. For more details on the DCTS, see https://www.gov.uk/government/publications/developing-countries-trading-scheme-dcts-new-policy-report

2. For more information on the AfCFTA, see https://au-afcfta.org

consecutive years, or to LICs and LMICs with a free trade agreement (FTA) with the UK. The main objective of the Developing Countries Trading Scheme (DCTS) according to the Department of International Trade is to improve access to the UK market for developing countries in line with the government's International Development Strategy.

The UK's Generalised Scheme of Preferences (GSP) had been in place since 1 January 2021, a year after Brexit, and it mainly replicated the EU GSP to provide continuity of trade access to UK markets for developing countries. This GSP system is divided into three tiers: a Least Developed Countries (LDC) Framework, a General Framework, and an Enhanced Framework. For LDCs, as categorised by the United Nations, the most favourable terms are available which are zero import tariffs on all products excluding arms and ammunition. The General Framework provides reduced tariffs on two-thirds of product lines for LIC and LIMC countries as defined by the World Bank. Finally, vulnerable LIC and LIMC nations who have signed certain international conventions are eligible for zero tariffs on two-thirds of product lines. The precise eligibility criteria and preferences available for these schemes and the 38 African beneficiary countries most of which fell into the LDC category as of January 2022 are shown in Table 1 in the Annex. The DCTS renames the tiers of preferences within the GSP and modifies the eligibility conditions: the LDC Framework will become the DCTS Comprehensive Preferences; the GSP General Framework will be the DCTS Standard Preferences and the GSP Enhanced Framework will be named the DCTS Enhanced Preferences. Compared to the EU GSP, the UK government is granting access to enhanced preferences based purely on the economic vulnerability of LICs and LMICs which makes three African countries (Algeria, Congo, and Nigeria) and five from other parts of the world becoming immediately eligible for enhanced preferences.

This approach also creates a more gradual increase in tariffs for countries that graduate from LDC status by ensuring that all economically vulnerable LDCs graduate to DCTS Enhanced Preferences. However, the DCTS retains powers to suspend a country on the grounds of human rights and labour rights violations and broadens these powers to include violations in relation to anti-corruption, climate change, and environmental conventions. Climate change and international trade issues will become increasingly topical and controversial in relations between developed and developing economies following the decision made by the EU to set up a Carbon Border Adjustment Mechanism, in effect a tariff, from October 2023.[3]

3. https://www.europarl.europa.eu/news/en/press-room/20221212IPR64509/deal-reached-on-new-carbon-leakage-instrument-to-raise-global-climate-ambition

3. Contrast between Post-Brexit Preferential Trading System and EU-based System

The following sections contain a description of how the UK's post-Brexit preferential trading system will differ from the EU-based system it replaces by discussing: rules of origin and Product Specific Rules (PSRs); cumulation conditions; product graduation criteria and tariffs.

3.1. Rules or origin

Rules of origin are an important aspect of trade policy. They identify where products are from based on how much work has been done on them or the value added created by specific countries. They determine eligibility for preferential tariff rates, access other preferential arrangements and whether any trade sanctions apply. The main rationale for having restrictive Product Specific Rules (PSR) to determine origin is to minimize transhipments and trade deflection, but some authors have suggested that the need to prove origin should be put in place only if external tariffs of preferential agreement members differ by some minimum amount which is not marginal. This threshold could be product-specific to reflect different transportation costs and actual tariffs should be periodically evaluated against it, since applied tariffs may change over time.

The effect of rules of origin has concerned trade economists for some time. In the view of some leading economists, they are "inherently arbitrary" and make "the occupation of lobbyists who seek to protect by fiddling with the adoption of these rules and then with the estimates that underlie the application of these rules ... immensely profitable at our expense" (Bhagwati, 1995).[4] Another more recent study noted that the concept of origin is increasingly problematic given the growth in complex international value chains meaning that the proliferation of preferential agreements facilitates protectionist tendencies (Baldwin, 2016).

Furthermore, non-standardised rules of origin requirements fragment multilateral trading systems and reduce economic welfare. The WTO notes that currently there are 36 separate schemes operated by 24 members offering non-reciprocal preferential market access for products originating from developing countries and LDCs (WTO, 2021). This is leading to a proliferation of complex product origin requirements due to trade agreements with many agreements becoming tailor-made and specific with more restrictive rules of origin increasing trade costs and reducing the appeal of the preferences (Estevadeordal and Suominen, 2006).

The potential negative impact of rules of origin requirements on investment and trade has been explored for some

4. Bhagwati (1995) p5.

time (Krishna and Krueger 1995) and their role has been explored in trade theory (Krishna, 2006). The additional costs can be broken down into distortionary costs, arising from sub-optimal impacts on production or supply chains, and administrative costs that are incurred to prove origin. Empirical evidence suggests that depending on the restrictiveness of rules, compliance costs can vary between 3-15% of final product prices (Felbermayr et al, 2018). The distortionary costs are more difficult to measure, but it is generally believed that restrictive rules of origin have a negative impact on the utilization rates of preferential trade agreements reducing their purpose as stimulants of trade and development (Kech and Lendle, 2012). One study comparing US and EU imports of clothing from African LDCs found that trade between Africa and the latter had stagnated as a result of more restrictive European rules of origin (Brenton, 2006).

Certainly, a multilateral trading system in which rules of origin proliferate can be inferior in welfare terms to one in which there are no preferential agreements in place. One simple model demonstrates that even when every country has an agreement with every other country with rules of origin, the level of economic welfare can be lower than in the multilateral situation where only MFN tariffs apply (Deardorff, 2018). In 2015, the WTO's preference-granting members made a commitment in Nairobi to ensure that "preferential rules of origin applicable to imports from least developed countries (LDCs) are transparent and simple and contribute to facilitating market access."[5] The WTO recently produced a note on the utilization of trade preferences by LDCs covering the period 2015-2019 and found that volatility in trade and underutilization was significant for LDCs during the period under review and that there was scope to improve preference utilization across schemes.[6]

The EU's preferential access rules of origin scheme, which the UK applied, is needlessly complex. Under the EU preferential rules of origin scheme, a product must be wholly obtained in the partner country concerned or it must comply with several product-specific rules (PSR) that detail the criteria by which a product has been deemed to have been sufficiently transformed if the product contains non-originating materials). The EU's GSP has a number of criteria for measuring product transformation: value-added rules - the value of all non-originating materials used cannot exceed a given percentage of the product's ex-works price; change of tariff classification rules - if the production process results in a change in tariff classification between the non-originating materials and

5. https://www.wto.org/english/thewto_e/minist_e/mc10_e/l917_e.htm
6. https://www.wto.org/english/tratop_e/roi_e/overview_marti19may21.pdf

the final product; and finally specific operations rules - if a specific production process is required.

It is possible to measure the degree of restriction of rules of origin requirements in a preferential agreement using an ordinal index, the R index, first compiled to measure rules of origin in NAFTA (Estevadeordal, 2020). The evidence suggests that agreements involving the EU have high values for R, implying tighter restrictions on trade and that higher values for R impact negatively the rate of utilization of preferential agreements, (Cadot et al, 2006). One study found that fears of the incidence of trade deflection are exaggerated implying that most rules of origin are unnecessary. It found that that in nearly 80% of tested country pair × product combinations, trade deflection was not profitable. There were two reasons: either the country through which third countries could potentially cross-haul sets a higher tariff than the destination country, making trade deflection unprofitable or the additionally arising transportation costs from cross-hauling turn outweigh the tariff savings. The study recommended a new approach to the use of rules of origin in agreements and argued that the requirements to prove the origin of goods in many FTAs could be significantly eased without risking any trade deflection (Felbermayr et al, 2018).

Most respondents to the DTI's consultation process on preferential access post-Brexit favoured increasing the permitted levels of non-originating content, but opinions were balanced on whether existing PSRs should be liberalized. The UK could have fully liberalized PSR rules which would have been of great benefit to developing countries but chose not to. The government did consider removing all processing rules and replacing them with changes in tariff classification and value-added rules, in line with the requests of LDCs, but UK businesses argued that processing rules, particularly for textiles, are helpful where it is difficult to calculate value-added content and that any change could disrupt existing supply chains. Under the new arrangements, the government did decide to move away from the EU's complex system and will liberalise PSRs at least for LDCs which will be easier for importers into the UK to understand and to utilise than previously. The new PSR schedule reflects in part the principles of the WTO's Nairobi. Eighty HS Chapters have a single set of rules that apply, while at the highest HS2 level, half of all chapters allow 75% non-originating content in the PSRs at the highest HS2 level since many LDCs find it hard for their products to meet higher non-originating thresholds. Furthermore, almost all PSRs allow for alternative 'or' rules. This can help businesses to meet UK requirements if one of the rules is difficult to meet or measure.

The main highlights of the product level changes are summarised in Table 2 in Annex.[7]

3.2. Cumulation

The rules on cumulation ease access to a developed market by allowing countries to comply with non-originating content limits in some PSRs. Cumulation allows a material from a country to be considered as 'originating' if used in the production of a product. The Institute of Exporters in the UK recommended that the DIT should explore the potential for expanded cumulation or even cross-cumulation in its GSP rules.[8] Cross-cumulation, or expanded cumulation, allows the cumulation of rules of origin between three or more countries which need not be joined by a trade agreement, unlike diagonal cumulation, or are joined by agreements with disparate rules of origin.

It has been suggested by trade lawyers that cross-cumulation carries many benefits by assisting in the facilitation of global value chains and acting as a de facto free trade area (Kim, 2020). Expanded cumulation would allow companies more flexibility in terms of the choice of the supplier by extending the originating status for specified products to selected countries such as all LDCs or all signatories to the African Continental Free Trade Agreement, for example. Expanded cumulation increases the preference beneficiaries for the purpose of determining the origin of goods.

With cross-cumulation, originating inputs from one LDC country in Africa, for example, could be counted towards the originating status of goods produced in another country in Asia when they are exported to a third country such as the UK even when the rules of origin under the Asia- African countries and Asian country to UK trade agreements differ. In other words, production in a country in Africa can be counted towards determining whether the rule of origin is met under the Asian-UK agreement. Under the new arrangements, the UK government will permit extended cumulation for LDCs with DCTS countries and Economic Partnership Agreement (EPA) countries on materials that are duty-free and quota-free when traded between the cumulating partner and the UK.

The UK's new rules on cumulation will allow companies to participate in global value chains using materials from 95 countries while still exporting their final products to the UK duty-free if certain conditions are met. Under the new rules, for example, an Ethiopian exporter will be able to use materials from Kenya (an EPA country) and treat those materials as originating in Ethiopia if they are duty-free in the EPA between the UK and Kenya and meet the EPA

7. product-specific-rules-schedule-for-least-developed-countries.ods (live.com)
8. https://www.export.org.uk/news/460503/Brexit-and-origin-a-case-for-the-wider-use-of-cross-cumulation-.htm

PSRs. This expansion of cumulation benefits those African LDCs that did not previously benefit from extended cumulation. The change should support regional integration in Africa, encourage exports and allow more goods to qualify for preferential tariffs. As most countries in Africa trade largely on duty-free, quota-free terms with the UK, the proportion of materials that can be used for cumulation purposes is very high.

3.3. Tariffs

Tariff Reductions and Product Extensions: All importers face UK Global Tariff rates when accessing the UK markets unless preferential rates are applied through the new DCTS or a bilateral free trade agreement. The IFT and most other respondents to the public consultation argued in favour of reducing tariffs for goods from LICs and LMICs to advance the UK's broader policy goals of trade liberalisation. There is also evidence that expanding the preferential market access offered through an expanded UK GSP would produce substantial trade benefits since the existing framework only covers roughly 66% of product lines and the UK GSP had only favoured a relatively small cluster of developing countries that are already well integrated into the multilateral trading system. The consultation process gave support for greater tariff reductions on eligible goods making more goods from LICs and LMICs eligible for tariff reductions.

Restricting the proportion of eligible products in a scheme provides a disincentive effect since exporters are faced with tariff escalation if they move into producing higher-value products which inhibit their capacity to process natural agricultural products. One study which was based on a 6-digit level analysis limited to agricultural products revealed that only about 28% of the dutiable imports from developing countries are offered duty-free access in the UK (Akinmade et al., 2020). The study noted several significant coverage gaps: two exports from Ghana (bananas and yams) and four of Eswatini's main exports were not covered under the previous United Kingdom GSP regime. This reduces GSP utilisation rates, or the proportion of goods eligible for GSP treatment that use it, which conveys information about the economic value of the range of products included in a GSP programme and the extent to which exporters also face non-tariff barriers restricting market entry (Persson and Wilhemsson 2016).

The new policy is based on an analysis undertaken by the DIT to identify additional tariffs which could be lowered or removed in the DCTS Enhanced Preferences group. Goods with global exports from countries in this group of over $1 million have been prioritised for tariff reductions and the government is lowering or removing tariffs on an additional 156 products including tomatoes, olive oil

and pet food. According to the DIT, the result will be that over 85% of eligible product lines will benefit from zero tariffs in DCTS Enhanced Preferences with a trade value of approximately £2 billion.

Customs duties up to 2 per cent often cost more to collect than they raise in revenue and are known as nuisance tariffs. A recent analysis of tariff schedules using WTO data reveals around 2,000 tariff lines that G20 countries have set a rate of 2% or less.[9] The European Union, United States, and China accounted for more than half of those, with Australia, Canada, Japan, and Korea accounting for most of the rest. The value of trade covered by these tariff lines in 2016 was almost $1 trillion (Elliot, 2020). In the UK GSP, tariffs ranging from 1.2 to 1.6 percent were associated with 33 commodity codes and which are too low to protect any domestic supplier. Respondents to the consultation generally supported the removal of nuisance tariffs for GSP General Framework countries, except where this might result in preference erosion for GSP Enhanced Framework countries. In response, the DCTS set all 33 nuisance tariffs to 0% for DCTS Standard Preferences. These tariffs are already 0% in the GSP Enhanced Framework and continue to be 0% in DCTS Enhanced Preferences.

Seasonal tariffs have different tariff rates applicable according to the time of year. In the existing GSP and Enhanced framework, these tariffs impose additional costs to importers and there is some evidence that seasonality in tariff rates produces market inefficiencies and welfare losses (Hillen, 2019).Furthermore, the existing schedule of seasonal rates are rarely relevant to the UK economy and raise prices for domestic consumers. The IFT position was that seasonal tariffs should be either reduced, abolished, or simplified by averaging over the year. The DIT's public consultation identified 15 seasonal tariffs for potential simplification and public submissions generally found strong support for removing seasonal tariffs.

The tariffs relate mainly to citrus fruits like satsumas, mandarins as well as grapes, peaches, strawberries, artichoke, and cucumbers. Almost all these lines have significant interests from LDCs and EPA countries for whom the UK is an important market. This includes the SACUM-UK EPA members, particularly South Africa and Namibia, as well as Zimbabwe, which are major exporters of some of these products to the UK.

Inspecting the schedule of tariffs documented under the existing framework, most of them appear to be designed to protect the EU's agricultural sector rather than promoting development through trade. For example, fresh or dried

9. https://www.wto.org/english/tratop_e/roi_e/overview_marti19may21.pdf

Satsumas (Code 8052110) face a tariff of 12.5% from 1 March to 31 October in the GSP framework and 0% for the Enhanced Framework which rises to 16.0% in both categories from 1 November to 28 February. The same seasonal hike in rates applies to other fruits consumed during the festive season (Codes 8052190, 805220, 8052900) which are all inherently protectionist aimed at shielding producers in countries such as Spain from lower cost exports from Southern Africa.

During the festive season there is no inherent advantage between GSP and Enhanced preference producers. To provide another example, importers of Fresh pears face four rates with no difference between the tariffs for GSP and Enhanced producers: 8% from 1 January to 31 January, 4% from 1 February to 31 March, 0% from 1 April to 31 July and 10% from 1 August to 1 December. In some cases, the value of being on the Enhanced list is marginal. For example, for Fresh Plums (Code 8094005), the GSP and Enhanced Tariff is 6% from 11 June to 30 June and 12% from 1 July to 30 September while from 1 October to 10 June Enhanced beneficiaries face a 0% tariff compared with 2.5% for the GSP group.

After considering these tariffs on a case-by-case basis and taking account of LDC and EPA sensitivities in the new DCTS framework the government is still maintaining all but 4 of the seasonal tariffs. For DCTS Standard Preferences, the seasonal tariff on cucumbers (0707005), globe artichokes (07099100), wilkings (08052900) and strawberries (08101000) are set to 8.5%, 6.5%, 12.5% and 6.5% respectively for the entire year which is the lower tariff of the two-tariff structure for GSP General Framework countries. For DCTS Enhanced Preferences, the tariff for these products is set to 0% for the entire year.

3.4. Goods Graduation

Goods graduation involves suspending preferential customs rates of customs on imports that are deemed to be highly competitive within the UK market. If the imports of a particular group of products in a country are graduated, they lose their preferential status without affecting the treatment of other groups of products from the same country. This means preferences are removed from products that no longer need them which provides greater opportunity to other countries in greater need of preferential market access. The IFT submission argued that ideally, it would be optimal to continue to offer low or zero tariffs to developing countries as trading partners without a system of goods graduation. This would allow them to exploit comparative advantage, to enhance export diversification promoting development while allowing domestic customers the benefits of lower-cost imports. The concept of graduation does not fit within this narrative as

it implies freeing trade for only a temporary period and then penalising success.

The products eligible for graduation within the European Union's preferential access schemes which Britain followed while it was a member are reviewed every three years and this period will not be changed under the DCTS. The EU's rules for graduation assessments have changed over the years of its operation and currently are based upon a definition of competitiveness calculated on product import share of total GSP imports from one country. Currently, there are three graduation thresholds by chapter: 57% for most products covered in the GSP scheme, 47.5% for textiles, and 17.5% for live plants, animal and vegetable fats and oils, and mineral products. There is little economic logic in the value of these import ratios and in the goods covered apart from implicit protectionism. Countries such as Japan, the United States and Canada operate different thresholds.

If the UK had simply rolled over the EU graduation criteria it would have caused problems for both some countries and products. A static analysis based on the impact of the EU's existing graduation criteria on past trade flows found that the existing uneven distribution of trade between the UK and the EU would cause the loss of preferences even without any change in competitiveness for some countries and products.[10] The graduations would have been a mechanical outcome of the separation of the UK from the EU27 block which will change the import concentrations in both regions. The study estimated that in 2016, the sectors likely to be subject to mechanical graduations accounted for €1.27 billion of UK imports, corresponding to approximately €31.6 million in tariff preferences. To avoid this loss the UK would have to change the import-share thresholds upwards for graduation to maintain unchanged market access post-Brexit for all current GSP beneficiaries.

However, the DCTS has changed how enhanced preferences are accessed meaning that the only DCTS Standard Preferences countries subject to goods graduation are India and Indonesia. Furthermore, the government is graduating goods for DCTS Standard Preferences countries based on the more objective data from Harmonized System (HS) chapters, categories which are more homogeneous, instead of GSP sections. For example, the graduation calculation is based on an assessment of imports of goods from a country at the HS chapter level as a proportion of total UK imports.

The threshold is reduced and set at 6% of total UK imports, but for chapters

10. The calculation of import shares is based on data available in 2015, exploiting the preceding three years, 2012-14 and included most of the countries which are GSP, GSP+ and EBA beneficiaries. The calculation is at the level of the 32 "sections", which are the sectors the EU exploits to aggregate products in its GSP programme.

that are deemed to be sensitive for other developing countries and EPA partners, the threshold is set at 1%. Using the threshold as a proportion of all UK imports means that graduated products must be more competitive in the UK market and using HS chapters also avoids the problem of graduation 'overshoots' which involves removing preferences from some uncompetitive products which happen to be included in a section including different very competitive products often from a different industry.

4. Conclusion

The new preferential trading arrangement the DCTS is meant to be easier to understand and use for trading partners to support export-led growth with a unilateral offer more generous than the GSP it replaces with provisions to reduce tariffs, liberalize rules of origin requirements, expand cumulation possibilities and simplify the eligibility conditions attached to the scheme. The United Kingdom has the avowed aim of encouraging free trade and the participation of developing countries in global value chains. However, Britain's engagement with the visionary AfCFTA could still be expanded considerably.

In March 2022 the Foreign Commonwealth and Development Office (FCDO), not the DIT, agreed to provide the small sum of £35 million to enhance trade facilitation and trade policy support to the AfCFTA Secretariat and Member States through TradeMark East Africa (TMEA), the Overseas Development Institute (ODI) and other regional partners. The UK has also supported Nigeria's AfCFTA objectives by building the capacity of Nigerian government institutions to engage in trade negotiations and developing a framework for Nigeria's AfCFTA National Action Committee to monitor AfCFTA implementation. The UK is also supporting the AfCFTA implementation process in Nigeria through technical assistance to develop regional automotive value chains, and to support Nigerian services firms to benefit from the new trade opportunities that AfCFTA will deliver.

The United Kingdom has of course been experiencing a period of political turmoil and since January 2020 there have been three Prime Ministers and three Secretaries of State for Trade in the Cabinet: Liz Truss, Anne-Marie Trevelyan and now Kemi Badenoch, who at least is of a Nigerian background and may pay more attention to the potential of the AfCTA. As the UK struggles to realize its global Britain dream the question must be asked what the country can learn from the progress and ambitions of the architects and builders of the AfCFTA?[11]

11. For more details, see https://bylinetimes.com/2022/05/06/african-trade-deal-exposes-brexit-britains-myths/

Annex

Table 1: GSP Frameworks and African Beneficiaries 2022

	Least Developed Countries Framework	General Framework	Enhanced Framework
Eligibility Criteria	LDCs as categorised by the UN	LICs and LMICs as classified by the World Bank	LICs and LMICs which meet the GSP criteria for economic vulnerability and have ratified or are implementing 27 international conventions
Preferences	0% import tariffs on all products excluding arms and ammunition	Reduced tariffs on two-thirds of product lines	0% import tariffs on two-thirds of product lines
African Countries	Angola, Benin, Burkina Faso, Burundi, Central African Republic, Chad, Comoros, Congo (DR), Djibouti, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauretania, Mozambique, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Somalia, South Sudan, Sudan, Tanzania, Togo, Uganda, Zambia.	Algeria, Congo, Nigeria	Cape Verde

Source: DIT

Table 2: New PSRs in DCTS 2023

Product Coverage	New PSRs
48 Chapters	75% non-originating content in the PSRs at the highest HS2 level. This new threshold responds directly to the requests of LDCs and recognises the limitations faced by LDCs when participating in global value chains – low labour and other costs can make it hard for LDC products to meet higher non-originating thresholds.
80 Chapters	a single set of rules that apply to the whole chapter. This means that there are fewer exceptions, rules and variations depending on the type of product. This helps businesses to meet the rules of origin required to qualify for preferential tariffs.
16 chapters	some rules at the more detailed tariff heading level (HS4 rather than the HS2 chapter level) where the chapter rule is not suitable for all goods in the chapter or where a degree of protection is needed for these goods.

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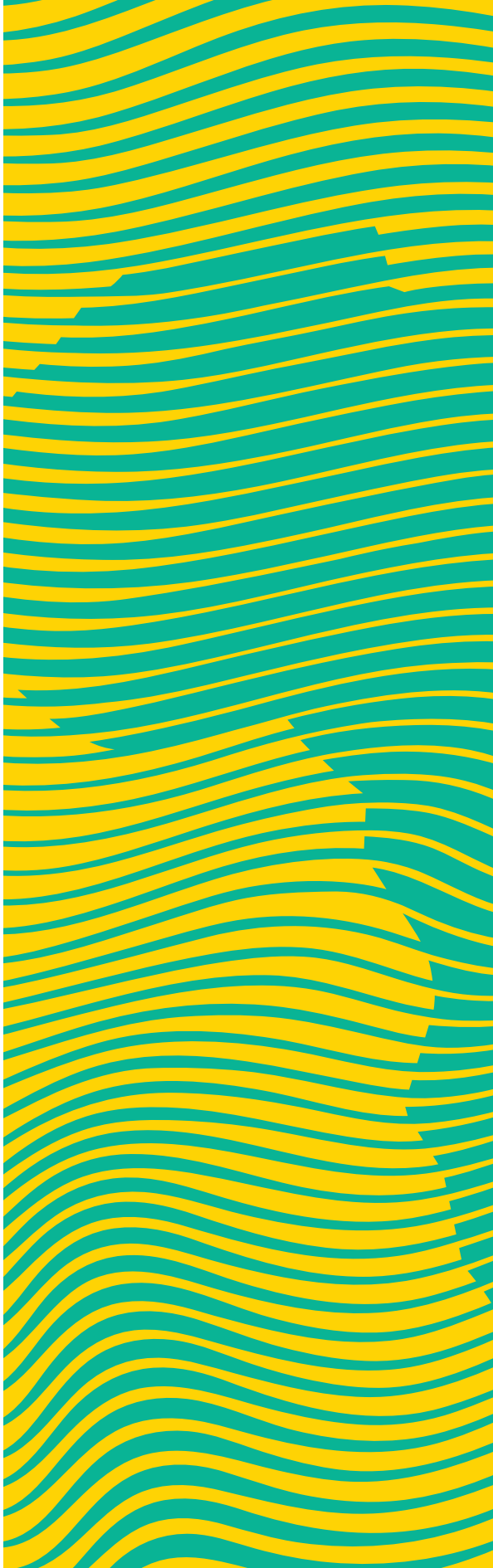

The CFA Franc Zone: Fixing the Outdated System

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Abstract: The CFA franc zone is one of history's anachronisms. Its core institutional features have not changed in many decades despite a changing world. The franc zone reflects a political economy of elites, and the zone has underperformed in terms of growth and development. The zone has four fundamental problems: an overvalued exchange rate undermining private sector competitiveness, the lack of mechanisms to adjust to shocks, the discrimination against the rural sector and commercial agriculture, and the lack of financial intermediation. The paper discusses macroeconomic policy options to modernize the system to enable greater exchange rare flexibility while improving competitiveness, opening the door to export-led growth, realigning incentives for agricultural producers, and supporting credit for the economy.

Keywords: CFA franc, competitiveness, fixed exchange rate, fiscal policy, monetary policy, finance
JEL Classification: E00, E52, E61, E62, O1

1. Introduction

The CFA franc zone is one of history's anachronisms. In a world where currency arrangements have modernized and where there has been a consistent move among both advanced and developing economies toward flexible exchange rates, the CFA franc zone remains anchored to the euro.

The CFA was born in December 1945 and anchored to the French franc. It was overvalued from the start, with its parity quite high (Pigeaud and Sylla 2020). In 1994, it was devalued by 50 percent in foreign currency terms. In 1999, it was pegged to the euro. Not much has changed since then. In a world where many of the other zones of colonial vintage have disappeared—such as the sterling zone and the escudo zone—the persistence of the CFA franc zone for more than 70 years has been a puzzle, especially considering advances in macroeconomic policy and changes in the global economy. It is even more of a puzzle in an era where policymakers are deploying exchange rate, fiscal, and monetary policies to address the multiple shocks affecting the global economy.

In recent years, academics as well as the public have expressed concerns about the CFA franc. There has been a chorus of public protest in countries such as Senegal, Mali, and Burkina Faso against a currency perceived as externally imposed and not suited to the development realities of the continent.[1] West Africa saw the Macron-Ouattara reforms of 2019 and movement toward an Economic Community of West African States (ECOWAS) single currency project that would include Anglophone countries such as Nigeria and Ghana by 2027. The Central African Economic and Monetary Community (CEMAC) held a summit in November 2022 in Libreville, Gabon, to explore policy options for the future of the CFA.

The institutional architecture of the CFA franc zone has four elements: the peg to the euro, free capital transfers between the zone and France, a pooling of member states' reserves in an operations account, and a guarantee of convertibility. These features have remained relatively the same despite other changes in the West African Economic and Monetary Union (WAEMU) and CEMAC. Together, the four elements are the defining features of the monetary and exchange rate system for the eight WAEMU countries and the six CEMAC countries.

One reason for the persistence of the CFA franc zone is the political economy of the elites who benefit from the current setup. At the heart of the CFA arrangement are three forces: France and the French Treasury, the Francophone African political elites, and the International Monetary Fund (IMF). France supports the zone for historical, political, and economic reasons. The peg benefits foreign companies and local importers who face no exchange rate risk, while the Francophone African elites favour the stability of the peg, the ability to obtain relatively cheaper imports from overseas, and the possibility of sending their financial assets abroad. The IMF, generally a believer in exchange rate flexibility, has supported an arrangement that is at odds with its economic philosophy.

However, in practice, the quest for stability has not translated into better development outcomes. While the colonial monetary arrangements and specifically the peg to the euro have contributed to price stability and minimized exchange risks, the region's record has been dismal in terms of growth and welfare. The deficit of structural transformation within the two monetary zones has undermined macroeconomic management and exposed member countries to recurrent adverse commodity terms of trade shocks.

The objective of this paper is to reflect on policy options to reform the CFA franc monetary zone. The next section assesses the development impact of the monetary zone. Section

1. In the Central African Republic (CAR), the government decided to adopt Bitcoin as an official currency to compete with the CFA. This raised concerns at the Bank of Central African States (BEAC), which set up an ad hoc committee to work on the new monetary framework established in the CAR.

3 outlines a comprehensive set of reforms and policy options to enhance the effectiveness of monetary policy within the zone. Section 4 outlines the contours of a fiscal policy that will advance the pro-growth agenda of CFA member countries. Section 5 concludes.

2. Development Record

There is a growing literature on the development successes and failures of the CFA zone. The consensus is that it has underperformed, especially compared to better-performing African economies. None of the CFA franc zone countries has emerged as a successful economy that has achieved significant poverty reduction. Per capita income in the CFA franc zone is low, and poverty rates in the CFA franc zone average more than 40 percent. In a recent book, Zafar (2021) finds that compared to many of the better performing Anglophone and other economies in Africa, such as Rwanda, Kenya, Ghana, and Mauritius, the CFA countries have generally had lower inflation but also significantly lower per capita growth, poverty reduction, and human development. A review of the history of the CFA franc zone examines whether membership in the zone has supported economic growth and reduced the need for economic adjustment and concludes that the zone is not an optimal currency area and that the costs of belonging to it outweigh the benefits (Tchatchouang, 2014).

Examining the costs and benefits of the CFA franc zone in the 1990s, Devarajan and Rodrik (1991) find that fixed exchange rates have been a bad bargain for CFA member countries. Under reasonable trade-offs between output and inflation, these countries would have been better off having the flexibility to adjust to external shocks. There are strong limits on macroeconomic policy options available to its member countries. Since CFA countries' currency is pegged to the euro, they relinquish both exchange rate management and independent monetary policy to deal with shocks. In their review of international experience, Céspedes and Velasco (2012) look across 107 major-country commodity boom-bust cycles and find that the output loss from a given price decline is smaller the more flexible the exchange rate.

The zone has failed to deliver on development for multiple reasons. First, the anchor to a strong currency leads to an overvalued currency and reduces private sector competitiveness by effectively subsidizing imports and penalizing exports (Zafar, 2021). As measured by computable general equilibrium (CGE) model, in 2020 the CFA franc in the WAEMU was overvalued by 20 percent, and in CEMAC, it was overvalued by 30 percent (Zafar, 2021).

The literature confirms the impact of overvaluation on the tradable sector. Examining 92 episodes of export surges, one study finds that export surges in developing countries tend to be preceded by a large real depreciation—which leaves the exchange rate significantly

undervalued—and a reduction in exchange rate volatility (Freund and Denisse 2012). A study of the 1994 CFA devaluation finds a significant supply response, especially among non-traditional exports, and a growth surge (Pritchett and Ghei, 1999). Avoiding significant currency overvaluation is an imperative that can be gleaned from the global experience with economic growth. Empirical evidence finds that undervaluation spurs production of tradables, structural transformation, and economic growth, especially for low- to middle-income developing countries (Rodrik, 2008).

Second, exchange rate rigidity forces adjustments to trade shocks on the fiscal side via cuts to public investment or additional debt accumulation. Countries in the CFA franc zone cut public investment during shocks, with adverse long-term impacts. The CFA franc zone limits policy options of member states in a world where governments in both the advanced and the developing world are deploying fiscal and monetary measures to help their economies recover from the twin shocks of the pandemic and the Ukraine crisis.

Third, the system exacerbates inequality between urban elites and the rural poor because it hinders the profitability of commercial agriculture. The chronically overvalued currency, coupled with the lack of credit, fertilizer, and inputs for farmers, ensures that the CFA franc zone will be perpetually a food-importing zone.

Fourth, monetary policy acts as a mechanism of financial repression (Pouemi, 1979). The tight rules on the money supply and the excessive conservatism of the central bank prevent financial intermediation. The currency union has failed to accelerate growth for the poorest members, as seen in the lack of economic convergence, and there are no fiscal transfers from richer to poorer countries, as there were in the European Union. Anchoring poor economies to a strong currency translates into an economy of perpetual imports, credit shortage, and underperformance of the tradable sector.

Finally, the challenges associated with the CFA franc arrangements, and specifically the rigid peg, are also reflected in the dynamics of debt management and restructuring in times of crisis. The CFA countries are facing a debt build up in the aftermath of the pandemic. In parallel with debt restructuring, an adjustment of currency (devaluation) will help provide more growth and give authorities more fiscal space in local currency terms. This could lead to inflationary pressures, which will have to be addressed by both monetary policy and measures to improve the supply side bottlenecks.

The zone is guided by an outdated macroeconomic framework which focuses only on low inflation and fiscal consolidation and less on

growth and development. This austerity model contrasts with a more developmental model whereby fiscal and countercyclical monetary policies have been used both in advanced and emerging economies to address shocks and to improve supply-side constraints, such as a strong food and energy production, rather than through tight controls on credit. In countries such as China, India, Indonesia, and Vietnam, there were strong efforts to create food self-sufficiency and a robust rural sector. The CFA zone can learn from this international experience.

3. CFA Exchange Rate Reform Policy Options

The system should evolve to respond to the growing challenges. Modernizing the system includes an analysis of alternative exchange rate frameworks that would enable greater monetary flexibility while improving competitiveness, opening the door to export-led growth, realigning incentives for agricultural producers, and supporting credit expansion. A less rigid monetary and exchange rate framework can provide more room for fiscal policy to deliver social progress, support the local private sector, and address some of the domestic/supply-side issues. In addition, a pro-poor agricultural policy and a selective industrial policy should be part of the new approach. The following are the key elements of a reform.

West African Economic and Monetary Union

- First, the WAEMU exchange rate must be overhauled in two stages, moving from a fixed arrangement to an intermediate and then a managed float arrangement (Zafar, 2021).
- Within two years, the CFA franc can be pegged to a basket of currencies that reflect the country's trade weights. Since a growing share of trade is with Asia, this should be reflected. One proposal is to have a basket peg that is one-third renminbi, one third dollar, and one third euro. The central bank can calculate the exact coefficients.
- Over five years, WAEMU should evolve to a managed float. The Central Bank of West African States (BCEAO) will allow market forces to determine the fluctuations in exchange rates but will intervene if the currency gets too strong or too weak. A band can be defined where BCEAO can intervene. An important goal of the reform is to help West African economies adjust to shocks and support tradable sectors by not allowing the currency to become too overvalued.
- A swap line that could replace the French guarantee should be set up with the European Central Bank (ECB), the US Federal Reserve, and/or the People's Bank of China to ensure support during times of macroeconomic volatility. They would be formal arrangements between two central banks allowing for the exchange of foreign currency

during liquidity crises. These arrangements can help both BCEAO and BEAC have sufficient buffers to adapt to macroeconomic shocks.

- The management of reserves should be based on keeping a certain percentage for contingencies. The decision to invest should be purely a member state decision and not dictated by outside countries. Like other central banks, reserves should be managed using a portfolio diversification approach.
- In the WAEMU zone, the countries can embrace economic integration with specific Anglophone countries like Ghana and create a stronger economic space. A peg with Nigeria seems risky, as Nigeria is an oil exporter and WAEMU countries are mostly oil importers.
- Some countries, such as Senegal or Mali, may decide to exit in the coming years. A dollarized CFA or a national currency may have advantages since Senegal is becoming an oil and gas exporter and may benefit from an alternative parity.

Central African Economic and Monetary Community

- CEMAC should move from a euro peg to a basket peg that includes the euro, the dollar, and price of oil. Since CEMAC is oil-rich, this arrangement will reflect oil price changes. As economist Jeffrey Frankel has argued, a currency-commodity basket will have the virtues that for a commodity-exporting developing country, it can deliver the best of floating, an automatic accommodation of trade shocks, together with the best of fixed rates—a stable and transparent anchor (Frankel, 2018).
- The coefficients can be calculated based on trade weights, with the numerical weights publicly announced to avoid uncertainty.
- A decrease in oil prices will lead to a depreciation of the new CEMAC CFA franc, for example. This will help countries adjust to oil price volatility.
- Like WAEMU, CEMAC should do a swap line with the US FED, ECB, and PBOC. CEMAC may have to pool more reserves given oil volatility.
- As opposed to WAEMU, a difficult political economy and lack of consensus among countries will make it very difficult to operate a managed float.
- Agbor (2012) argues that a dollar peg for the single CEMAC franc is the most realistic option going forward. By allowing CEMAC zone countries access to US capital market instruments, a dollar peg would ensure the stability of the single CEMAC franc if there is a depletion of oil resource and foreign reserves. A dollar peg helps ensure stability of income flows from abroad, considering that almost all CEMAC exports are denominated in US dollars and access to US financial instruments through the dollar peg may be instrumental in hedging against dollar-related exchange rate risks.

CFA countries must adapt their monetary policy to the current context and should target an inflation rate higher than the current approach. BEAC and BCEAO should revise their mandates to include not only price stability but also employment, as is the practice of many central banks. Moreover, BCEAO and BEAC should be prepared to delink from the ECB monetary policy, as the economies in Europe are at different stages of development and have different economic needs. In line with this, BCEAO and BEAC can revise their 3 percent inflation target, which has three flaws: it is too low for the contemporary high inflation environment, it does not reflect the new world of climate change and food shocks, and the trade-off in terms of growth and unemployment is too high. Blanchard et al (2010) suggests that policymakers could aim for a higher target inflation rate of 4 percent in normal times to increase the room for monetary policy to react to such shocks.

As a general principle, countercyclical monetary policy is possible when the exchange rate is flexible. Like other central banks, in the world, with greater monetary policy independence comes greater responsibility. BCEAO and BEAC will have to help expand the money supply and selectively use interest rates, reserve requirements, and open market operations. Of course, there will be times when monetary policy will have to be tightened to protect reserves and shield the CFA economies from the perils of inflation. From the evolving IMF perspective, in countries where reserves are adequate, foreign exchange intervention, macroprudential policy measures, and capital flow measures may be used as short-term measures to help enhance monetary policy autonomy, improve financial and price stability, and reduce output volatility. (Adrian et al., 2022)

In operational terms, the three restrictive rules governing the central bank—maintaining 50 percent of its reserves in the operations account, maintaining a foreign exchange cover of at least 20 percent of its liabilities, and limiting the credit to each government of member countries to a ceiling equivalent to 20 percent of the government's revenue in the previous year—should be amended.[2]

There is excess liquidity in the banking system, as measured by traditional prudential ratios. The money base growth is controlled to not jeopardize the peg. Excess liquidity is compatible with low commercial bank credit creation, as the reserves/central bank money cannot be lent out to households or enterprises. Limiting the credit to governments in need of urgent development financing is anachronistic but should be decided on a case-by-case basis rather than governed by a rigid rule. It is no accident that CEMAC

2. The first and third rules are no longer applicable to BCEAO but still apply to BEAC.

offers the least credit to the private sector, averaging 10 percent of GDP.

4. Pro-Growth Fiscal Policy

Fiscal policy will have to be revisited. This is particularly necessary in the climate change era, which calls for large-scale and long-term investment, including in green infrastructure. While monetary policy can manage fluctuations across the zone, fiscal policy will have to be tailored to deal with asymmetric shocks and meet country-specific situations. The requirements of Gabon vs Central African Republic and Mali vs Cote d'Ivoire will vary according to their economic situations. Under a reform scenario, fiscal policy will have to fulfil three objectives: help support the currency union, promote fiscal sustainability, and help support growth and development. At times, these objectives may be in contradiction, but a compromise will have to be found. Revenue mobilization and debt restructuring can strengthen fiscal space.

The current solution in CEMAC and WAEMU is to have fiscal rules and macroeconomic convergence criteria. Unfortunately, this has not worked well in practice. There has been slippage in macroeconomic convergence, and the WAEMU countries have had difficulty complying with the key fiscal convergence criterion of limiting the fiscal deficit to 3 percent of the GDP. Moreover, fiscal policy in the CFA franc zone tends to be pro-cyclical, spending more in boom times and cutting back in bad times. Moreover, the impact of fiscal spending has been unclear. The IMF's push for gradual fiscal consolidation to bring the aggregate fiscal deficit in WAEMU to 3 percent of GDP by 2024 seems unrealistic and inadequate to deal with shocks in the Sahel.

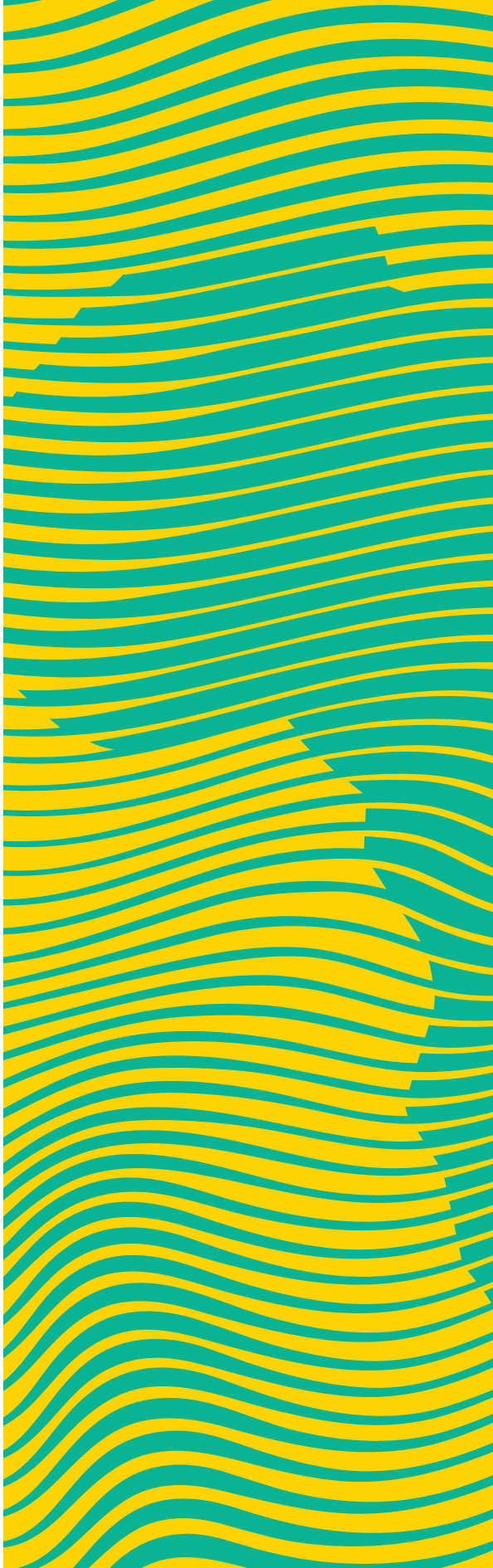
First, there is scope for better fiscal rules in the CFA zone, which have more relaxed numerical limits on budgetary aggregates. The CFA zone design can heed the warning of Professor Stiglitz that rules in the EU fail to make the distinction between consumption expenditure in the present and growth-enhancing investment expenditures which improve a country's economic potential in the future.

Second, one suggested approach would be to create a solidarity fiscal fund that would be capitalized on the strengths of risk-sharing arrangements in fiscal federalism (Dessus et al., 2012). This fund would be financed by contributions from all members and could provide transfers to countries adversely affected by shocks, which could withdraw funds to cover revenue shortfalls, spending emergencies, or other fiscal risks. The more asymmetric the shocks that affect union members, the greater the gains from pooling resources or from contributing to the solidarity fund. This approach is similar to fiscal transfers, particularly structural funds, from the North to the South in the European Union that helped

the poorer countries converge with the richer countries. With these reforms, WAEMU and CEMAC will be in a stronger position to handle increasingly complex challenges.

5. Conclusion

The CFA franc zone, which underpinned the monetary arrangements between Francophone countries in Africa, has contributed to macroeconomic stability, especially keeping inflation in check. But it has achieved and sustained price stability at huge economic and social costs. The deficit of structural transformation has increased the frequency of boom-bust cycles and the recurrence of balance of payments crises, which has sustained the rise of external liabilities and the risk of debt overhang. The overvalued peg is distorting price signals in the economy and impeding efficient resource allocation. After a review of the challenges that have undermined the performance of the monetary arrangement in West Arica and Central Africa, most notably the overvalued exchange rate, this paper provides a set of reforms and policy options for the emergence of a system that could promote greater policy flexibility and raise competitiveness



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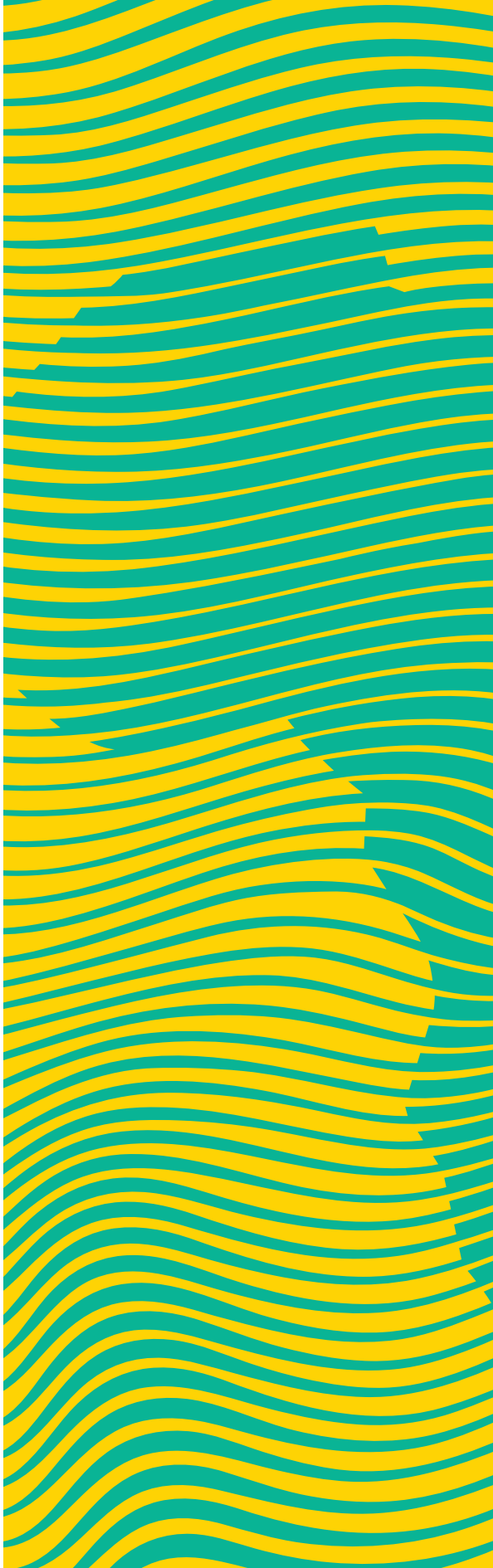

The CFA Franc in West Africa and Central Africa: The Political Economy of Two Noncommunicating Vessels[1]

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Abstract: The CFA franc zone encompasses two currencies, the West African CFA franc (XOF), used by the eight countries of the West African Economic and Monetary Union (WAEMU), and the Central African CFA franc (XAF), used by the six countries of the Central African Economic and Monetary Community (CAEMC). This article analyzes trade within and between the WAEMU and the CAEMC. It begins by reviewing the historical reforms that have shaped the two monetary unions. It shows that, despite a common monetary heritage that, along with language, could have boosted trade within and between the two, the opportunity has largely been missed. Intra-WAEMU trade has averaged 13 percent over the past 20 years, while intra-CAEMC trade has averaged 3.3 percent over the same period. WAEMU's share of CAEMC imports average 3 percent, while CAEMC's share of WAEMU imports is less than 1 percent. With implementation of the African Continental Free Trade Area (AfCFTA) accelerating and significant changes underway in both monetary communities, key reforms are needed to the CFA franc zone for its member states to reap the full benefits of their common heritage, the CFA franc.

Keywords: CFA Franc, WAEMU, CAEMC, AfCFTA
JEL Classification: E02 ; E58 ; E60 ; F02 ; F10

1. Introduction

The CFA franc zone, with its origins in the era of French colonialism in Africa, remains an atypical monetary construction, unique in the world. Created in December 1945 when the French provisional government ratified the Bretton Woods Agreement as "the franc of the French Colonies of Africa," and renamed after its member states achieved independence. Today, the CFA franc zone is made up of the eight countries of the West African Economic and Monetary Union (WAEMU)—Benin, Burkina Faso, Côte

1. Acknowledgements: I greatly acknowledge the research assistance and contribution of Mahamady Ouédraogo.

d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo—the six countries of the Central African Economic and Monetary Community (CAEMC)—Cameroon, Chad, the Central African Republic, Equatorial Guinea, Gabon, and the Republic of Congo.[2] Contrary to integration theory, which suggests a step-by-step transition from Free Trade Area to Economic and Monetary Union, passing successively through Customs Union, Common Market, and Economic Union, the construction of the CFA franc zone proceeded in the opposite direction. While the CFA franc has existed since 1945, it was only in 1994 that the WAEMU and the CAEMC were created to promote economic policy between member countries. In contrast to other colonial era currencies, the CFA franc has remained in place, first after the French colonies achieved independence, and more recently despite the disappearance of the French franc, the currency to which the CFA franc was pegged. The CFA franc seems to resist "institutional and political reforms, economic and technological transformations, evolutions in mentalities, geopolitical collapses, etc." (Nubukpo et. al. 2015). As noted development economists Guillaumont and Guillaumont (2002) wrote "what strikes one at first glance when considering the franc zone is the permanence of its operating rules. For more than 50 years, these rules have only been marginally modified." (author's translation) The history of the CFA franc, however, has not been smooth. It has undergone, among other shocks, successive devaluations, the decision by some countries to abandon its use, and turmoil at the beginning of the current century, when France negotiated the pegging of the CFA franc to the euro following its adoption of the euro as one of the founding members of the European Union.

As a vestige of the colonial era, the CFA franc today is the subject of passionate debate among monetary experts, politicians, and increasingly, leaders from civil society organization. The positions of the participants to the debate can be categorized into three groups: the reformists, who call for the revision of certain provisions of the CFA franc agreements; the abolitionists, who call for an end to the CFA franc by embarking on a new monetary approach; and the extensionists, who wish to build a continental currency by extending the franc zone (Nubukpo et. al. 2015). Defenders of the CFA franc, the reformists, often invoke the argument of stability, a guarantee of seriousness in the conduct of monetary policy on a continent where some countries have gone through episodes of high inflation. Indeed, from 2003 to 2022, the average inflation rate was a modest 2.7 percent in the WAEMU and 2.8 percent in the CAEMC, compared with 9.2 percent in sub-Saharan Africa over the same period. Defenders argue that continued franc zone membership will bring sustained economic growth in the region

2. In this paper, the term CFA zone refers to the 14 African countries that make up the WAEMU and CAEMC. These 14 countries plus the Comoros are usually known as the "African countries of the franc zone".

while reducing the need for fiscal adjustments and will stabilize the investment climate through a fixed exchange regime and convertibility guarantee. (Tchatchouang 2015).

However, promises of stability and growth do not seem to be materializing. The member countries of the franc zone did not escape the need for structural adjustment programs in recent years, with most contending with structural current account deficits. They also experienced the devaluation of the CFA franc in 1994. In exchange for supposed monetary stability that benefits only a small portion of the population, the countries in the franc zone endure economic underperformance that has fueled political instability. Over the last 20 years, GDP growth averaged 3 percent in the WAEMU and CAEMC, compared with 4.4 percent on average in sub-Saharan Africa and 5.3 percent in developing and emerging economies overall. So, it is perhaps not unrelated that five of the seven countries that have experienced military coups over the last three years are in the franc zone.

Despite the common heritage of currency in the CFA franc, cultural similarities, and language that most of the countries of the WAEMU and the CAEMC share, economic integration, which could have helped address this plethora of problems, has remained weak (Fofack 2018; International Monetary Fund 2018). Indeed, trade between WAEMU and CAEMC has stagnated over the past 30 years. WAEMU's share of CAEMC imports average 3 percent, while CAEMC's share of WAEMU imports is less than 1 percent. The two CFA francs have not been convertible since 1993, despite their institutional ties to the French Treasury. Both parties negotiate separately with French Treasury and communicate very little between each other. In the context of the implementation of the AfCFTA, the two blocs within the franc zone risk marginalization if they fail to expedite reforms that enable them to enhance their competitiveness, undergo structural transformation, and form linkages to each other. Without implementing sorely needed trade integration, the countries of the WAEMU and the CAEMC will be at a significant disadvantage to nations with more competitive economies, most of which have full control over their own policy instruments, particularly the monetary policy tool.

To advance this argument, this paper presents a descriptive analysis of trade between the CFA zone and France and of trade within the two monetary unions that make up the franc zone. It then explores the question of integration in the context of the AfCFTA and, in a final section, integrates the analyses to draw conclusions.

2. Trade performance in CFA Franc Zone

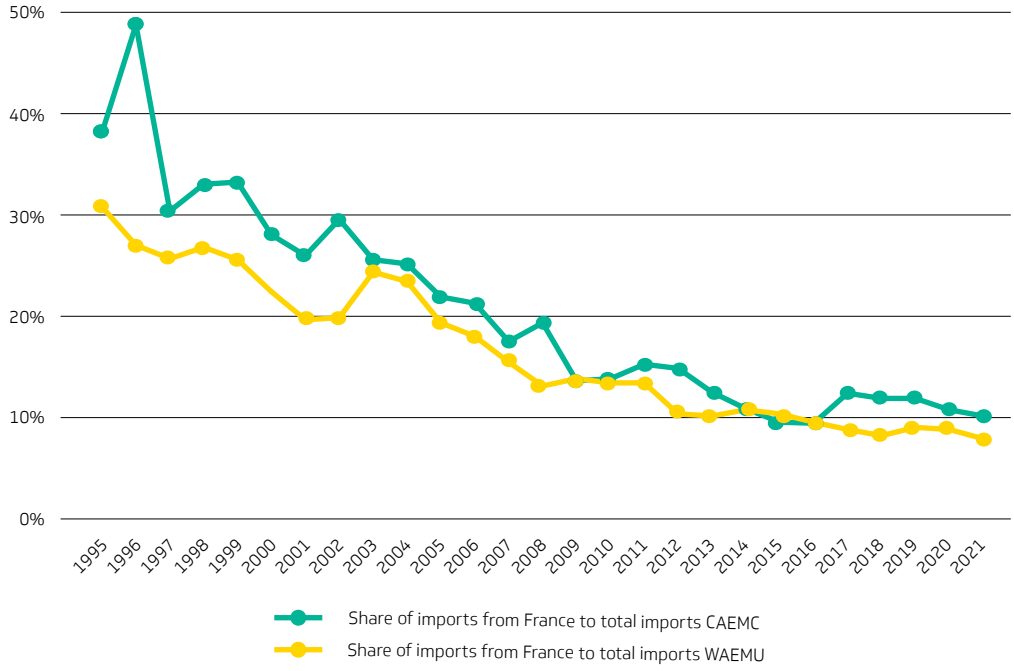
2.1. Fading Commercial Ties with France

One objective behind the creation of the CFA franc was to strengthen

trade ties between France and the countries that had been its colonies and that later achieved independence. Nevertheless, it is evident that France's share in the trade of the franc zone countries has been declining for at least the past 30 years. Figure 1 shows the evolution of imports from France to CAEMC and WAEMU countries. The trend is similar for both. France's share of imports to WAEMU countries declined from 30 percent in 1995 to less than 10 percent in 2021. Similarly, Frances's share of imports to CAEMC countries has fallen from 37 percent to 10 percent over the same period. This loss can be explained by the rise of emerging countries, particularly China, as Africa's leading economic partners in recent decades.

None of the countries in the franc zone are among France's main African trading partners. In 2021, in terms of exports, France's primary trading partners in Africa were Morocco (0.96 percent of France's total exports), Algeria (0.75 percent), Tunisia (0.57 percent), Egypt (0.33 percent), and South Africa (0.33 percent). In terms of imports, the top five were Morocco (0.98 percent of France's total imports), Algeria (0.71 percent), Tunisia (0.64 percent), Nigeria (0.46 percent), and Libya (0.30 percent). As the data demonstrates, trade links between France and its former colonies

Figure 1: Share of imports from France to total imports



Source: UNCTAD (2022) and Afreximbank Research (2023)

are crumbling, despite the CFA franc. Unfortunately, this decline in French imports has not served to strengthen trade links within and between the CAEMC and the WAEMU.

The economies of the WAEMU and CAEMC are increasingly oriented towards Asia. The countries of the CAEMC trade mainly with China, India, Spain, the United States, Germany, and the United Arab Emirates. China and India account for 53 percent of Gabon's exports, for example, representing 38.3 percent and 14.7 percent, respectively. The top export partners for Equatorial Guinea are China (24 percent), India (17 percent), Spain (16 percent), and the United States (6 percent). Of Cameroon's total exports, 31 percent of Cameroon's exports go to China, compared with less than five percent to France. Of Chad's exports, 35.5 percent go to Germany, 25.5 percent to the United Arab Emirates, and only 6.7 percent to France. The United Arab Emirates, China, and India together account for over 65 percent of the Republic of Congo's exports, while less than one percent of its exports go to France.

Similar trends exist for imports, but the partners are more diversified compared with exports. The Republic of Congo primarily imports from China (22 percent), France (10 percent), and the United Arab Emirates (five percent). Equatorial Guinea's main imports come from Spain (22 percent), China (14 percent), and Nigeria (13 percent). Chad's imports are dominated by China (55 percent), and the United Arab Emirates (23.2 percent). France remains the top importing partner for Gabon (22 percent), followed by China (20 percent). Within the WAEMU, commercial exchanges are more diversified. The top import partners for Cote d'Ivoire are China (22 percent), France (12 percent), and Nigeria (9 percent). Senegal's primary import partners include China (21 percent), France (7.55 percent), and India (6.75 percent). China, the United States, and Nigeria are the major import partners for Niger. Mali's leading trade partner is Senegal (22.42 percent), followed by China (13 percent), and France (10 percent). The top import partners for Burkina Faso are China (10 percent), Cote d'Ivoire (8.5 percent), and France (7.6 percent). Regarding exports, the trend is similar, with India and China holding significant weight in WAEMU exports.

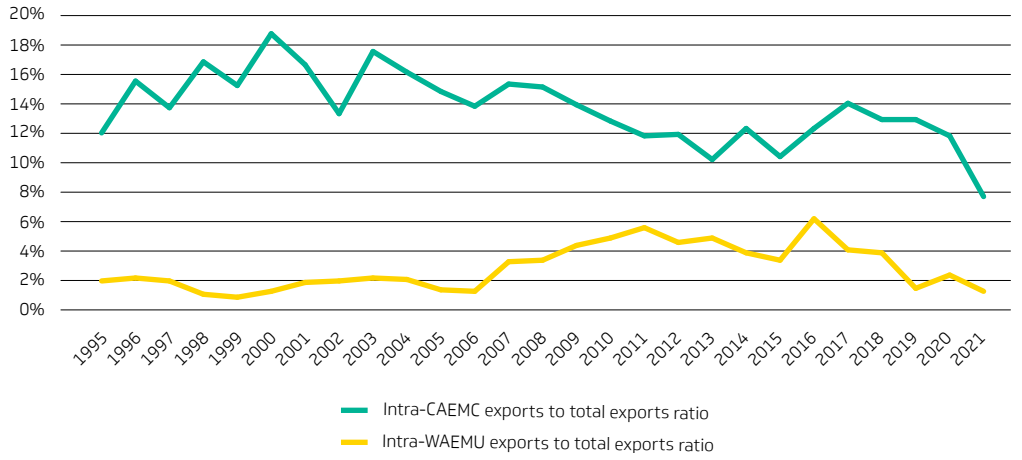
2.2. Stagnant Intra-Union Trade

Intra-community trade has not advanced within the WAEMU and CAEMC regions over the past few decades. In contrast to intra-African trade, which has grown from 5 percent in 1990 to 20 percent in 2022, it has remained stagnant. Figure 3 shows the evolution of exports from CAEMC to other CAEMC countries, and from WAEMU to other WAEMU countries. Several lessons can be drawn from the data. First, intra-community trade is stagnant or even declining in both blocs. Second, intra-community trade in the WAEMU far outstrips that of the CAEMC. From 1995 to 2021, intra-CAEMC trade was 1.5 percent, while intra-WAEMU trade was nine times higher, at 13.6 percent. Third, the evolution over time shows a decline in intra-community trade since 2016 for CAEMC and, 2017 for WAEMU, with an accentuated trend between 2020 and

2021, probably linked to the COVID-19 pandemic. The COVID-19 lockdown entails the greatest trade reduction since World War II[3]. The dominance of natural resources, notably oil, among exports of CAEMC countries limits the potential for economic integration.

evolution of domestic credit to the private sector as a percentage of GDP in CFA franc zone and non-CFA franc zone African countries. While domestic credit to the private sector in Africa outside the CFA franc zone has been trending upward since the 1960s, the situation is quite different

Figure 2: Intra-CAEMC and intra-WAEMU exports



Source: BACI database (2023).

The reasons for the stagnation of intra-Union trade are diverse, with characteristics specific to African economies in general and the CFA franc zone in particular. However, one of the distinctive features of the franc zone compared with other countries is the financial repression which constrains investments in high-value-added sectors, thereby impeding structural transformation and trade. Figure 2 shows the

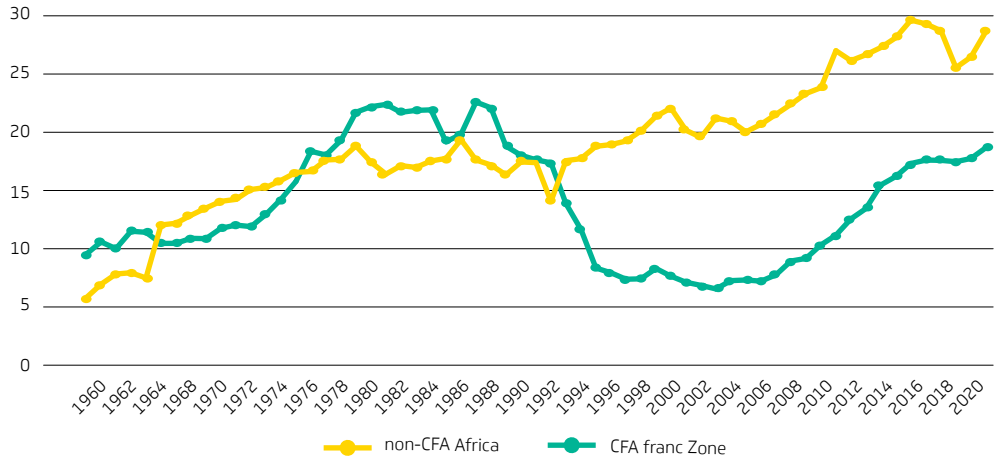
in the franc zone. The figure shows that credit to the CFA franc zone stalled from the late 1980s through the 1990s. The franc zone countries were on a good trajectory, with a level of domestic credit comparable to that of the average of other African countries, from independence until 1986. However, even though credit growth has resumed within CFA franc countries, the gap between the CFA franc zone and non-franc

3.https://www.oecd.org/coronavirus/policy-responses/international-trade-during-the-covid-19-pandemic-big-shifts-and-uncertainty-d1131663/

Africa remains large. Moreover, bank loans in CFA franc zone countries are mostly short term (less than one year) and primarily directed towards a few companies (BCEAO, 2022). For instance, within the WAEMU, 31 percent of all bank loans accrued to 50 companies between 2021 and 2022. The financial repression in the CFA franc zone—a reflection of the monetary framework—is a major handicap to structural transformation and economic integration.

WAEMU fares better than the CAEMC. The WAEMU's share of CAEMC imports is on average almost four times greater than the CAEMC's share of WAEMU imports. The WAEMU's share of CAEMC imports averaged 3.34 percent from 1995 to 2021, while CAEMC's share of WAEMU imports was 0.91 percent over the same period. However, the evolution of the WAEMU's share of CAEMC imports is more volatile than that of the CAEMC in the WAEMU. Furthermore, trends

Figure 3: Domestic credit to the private sector (percent of GDP)

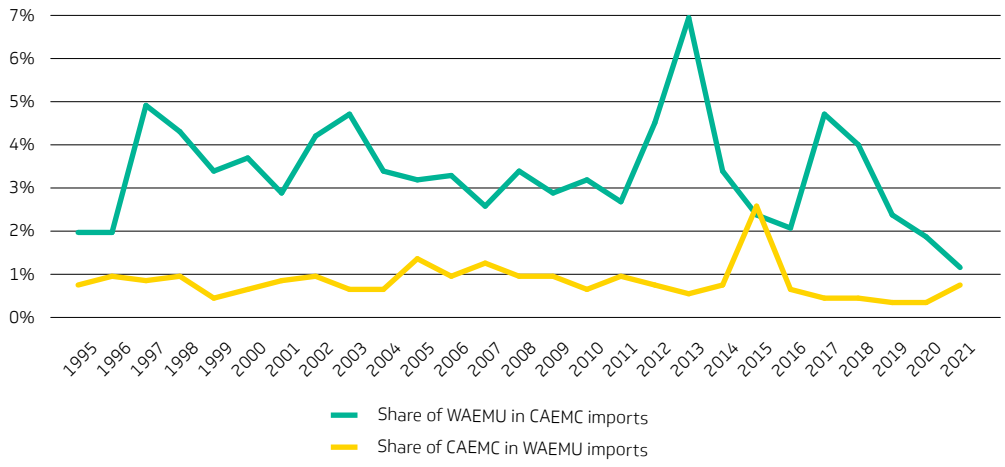


Source: World Bank World Development Indicators (2023).

2.3. Two Noncommunicating Vessels

Trade patterns demonstrate that the two monetary unions that make up the franc zone are two noncommunicating vessels. Figure 4 shows the evolution of imports between the WAEMU and the CAEMC, and vice-versa. In absolute terms, the over time show no improvement for either region. On the contrary, there has been a deterioration since the peaks of 6.9 percent for the WAEMU in 2013 and 2.63 percent in for the CAEMC in 2015.

Figure 4: Share of imports between the two monetary unions



Source: BACI database (2023).

Several factors explain the weakness in trade between the two blocs of the CFA franc zone. These can be classified into two types: those related to the structure of the economies, including the lack of structural transformation, and those related to trade-supporting infrastructure, both physical and institutional.

The economies of the WAEMU are primarily focused on raw materials and primary agricultural products, while their counterparts in the CAEMC region primarily export natural resources, particularly oil. In 2021, crude oil accounted for 30.61 percent of Cameroon's exports, 56.6 percent of Congo's exports, 61.38 percent of Gabon's exports, 61.87 percent of Equatorial Guinea's exports, and 68 percent of Chad's exports. Among countries of the WAEMU, cotton accounted for 32.75 percent of Benin's exports, cocoa accounted for 30.75 percent of exports from the Ivory Coast, gold accounted for 76.36 percent of Burkina Faso's exports, 96.8 percent of Mali's exports, and 68.7 percent of exports from Niger in 2021. Coconuts and cashew nuts made up 80 percent of exports from Guinea-Bissau, while 40 percent of Senegal's exports were agricultural products. Refined petroleum accounted for 28.63 percent of exports from Togo. The absence of value-added processing of these raw materials limits trade between these two blocs. The recent discovery of oil in some West African countries, especially in Côte d'Ivoire and Senegal, and the mining boom may change this specificity, but it won't alter trade flows as long as the countries remain focused on exporting raw materials.

The undeveloped physical infrastructure between the two regions also restricts the movement of people and goods. Institutional infrastructure is nearly nonexistent, and there is limited institutional cooperation between the two blocs.

Lastly, the non-convertibility of the two CFA francs is perplexing to users. The decision to suspend conversion between the two CFA francs was a significant mistake, according to Azam (1996) and Azam and Samba-Mamadou (1997). Despite the fact that trade between these two zones was not pronounced before this suspension, convertibility between the two currencies would certainly have contributed to strengthening economic integration of the two monetary unions. This measure even helped to destabilize the zone and accelerate the devaluation of the CFA franc (Azam 1996; Azam and Samba-Mamadou 1997).

3. Implications of the African Continental Free Trade Area on the Two Monetary Unions

The year 2023 has been designated "Year of the AfCFTA: accelerating the implementation of the African Continental Free Trade Area" by the African Union. Adopted in 2018 and in force for two years, it aims to boost intra-African trade by eliminating tariffs on most goods, liberalizing trade in key services, reducing non-tariff barriers, and creating a single continental market where labor and capital can move freely. The most ambitious goal of the AfCFTA is to eliminate tariffs on 90 percent of existing trade flows, which would increase regional intra-African trade by around 16 percent (International Monetary Fund 2020). The entry into force of the AfCFTA is a real boost to regional integration. Indeed, it is the second largest free trade agreement in the world, with a market of 1.4 billion people and a combined GDP of US$ 2.500 trillion. According to the International Monetary Fund, the AfCFTA has the potential to boost intra-African trade, raise incomes and lift 30 million Africans out of extreme poverty.

Regional economic communities have been the real driving force behind integration in Africa. They account for two-thirds of intra-African trade (International Monetary Fund 2020). Article 19 of the agreement establishing the AfCFTA governs its relations with the economic communities and provides a basis for managing multiple trade regimes (United Nations Economic Commission for Africa 2021). Unlike other regional blocs, the WAEMU and the CAEMC have the advantage of suffering less from divergent financing mechanisms, disparate institutional and organizational capacities, and high coordination costs associated with less heterogeneity. For the Economic Community of West African States (ECOWAS) and the Economic Community of Central African States (ECCAS), the two CFA franc monetary unions could be the locomotives for accelerating integration in regional economic communities within the framework of the AfCFTA.

The entry into force of the AfCFTA represents a major boost to integration within and between the WAEMU and CAEMC. They are the continent's leading integration areas, at least in institutional terms. They can be the locomotive of integration within and between West and Central Africa. In addition to sharing institutional and regulatory similarities because of their common colonial heritage, their common use of the CFA franc represents an opportunity to strengthen cooperation between the two monetary unions. This will involve setting up a framework for discussion between them, harmonizing reforms, and resuming the repurchase of the two CFA francs by the respective central banks, which could make a significant contribution to facilitating trade between the two monetary unions. Indeed, the repurchase of the CFA franc XOF has been suspended by the Bank of Central African States since September 17, 1993. Following this decision, the Central Bank of West African States in turn suspended the redemption of the CFA franc XAF on December 20, 1993.

4. Conclusion

The WAEMU and the CAEMC, which today make up the franc zone, encompass 14 countries with a combined 15 percent of the population of sub-Saharan Africa. The colonial era stigma associated with the CFA franc has unduly limited discussion of how to institute reforms that might improve living conditions of the millions of people who use the two currencies that together are known as the CFA franc. Even though both currencies have the same equivalence to the euro, their holders have been obliged to use another currency, such as the dollar and the euro, to convert them, and have done so for the past 30 years.

This paper demonstrates that the costs associated with deficit of coordination and multinational arrangements between the two zones have been significant. Intra- and inter-CAEMC and WAEMU trade has stagnated over the last 30 years. At the same time, the entry into force of the AfCFTA represents both opportunity and challenges for the CFA franc countries. To harness the potential of AfCFTA in terms of diversification of sources of growth and trade (IMF 2018; Fofack 2020) those nations need to undertake courageous reforms that will boost trade between the two monetary unions.

Four policy reforms are essential to better link the two CFA franc monetary unions and harness the full potential of the AfCFTA.

i. **The countries of the CFA franc zone should fully embrace their monetary sovereignty by courageously undertaking reforms that empower them to regain control of the monetary policy tool that has been relinquished for decades to the French Treasury and subsequently to the European**

Central Bank. Some progress towards such reforms is already underway. On December 21, 2019, with protests against the CFA franc mounting and leaders of ECOWAS member states proposing a future common currency to be called the eco, president of France and his Ivorian counterpart announced three measures regarding the operation of the CFA franc: the eventual transition from the CFA franc to the eco currency; the cessation of the centralization of foreign exchange reserves at the French Treasury, the closure of the operations account and the transfer to the Central Bank of West African States of resources in the account and; the withdrawal of all French representatives from the decision-making and management bodies of the WAEMU, notably the Central Bank of West African States Board of Directors, the Banking Commission, and the Monetary Policy Committee.

In August 2020, CAEMC agreed to carry out similar reforms. CAEMC will also switch to a new unit of account pegged to the euro based on a fixed parity, and France will no longer have a seat on CAEMC decision-making bodies.[4] Unlike the WAEMU, centralization of foreign exchange reserves in the French treasury has not been discontinued.

These reforms are a start. They can serve as preparation for the launch of the ECOWAS eco currency and for similar projects in Central Africa. But they remain marginal and do not address the core issues of the CFA franc, including the need to transition towards a more flexible exchange rate.

ii. **The franc zone countries should make substantial investments in both physical and digital infrastructure** Digitization of payment methods and administrative procedures requires the establishment of secure digital infrastructure. Such technological advances would not only enable franc zone countries to bridge the infrastructure gap but also reduce risks and transaction costs associated with cross-border trade, especially informal cross-border trade (African Export-Import Bank 2020). Physical infrastructure projects should be conceived at the supranational level to facilitate interconnection and adherence to international standards. This would also reduce the costs of financing and implementing infrastructure projects.

iii. **The WAEMU and CAEMC would benefit from establishing a framework for permanent dialogue to strengthen cooperation.** They could, for example, set up joint technical teams to work on specific themes and propose reforms, both for

4.https://www.lepoint.fr/afrique/franc-cfa-les-chantiers-de-la-reforme-ouverts-20-12-2019-2354246_3826.php

dialogue with France and as part of the integration process between the two monetary unions. They could also lift the suspension of the purchase of the two CFA francs. The franc zone countries not only share a common currency, they also, to a large extent, share the French language, they share common borders with Chad at the junction point, and under the Organization for the Harmonization of Business Law in Africa, they share a more or less harmonized legal, fiscal, and regulatory system. As part of the implementation of the AfCFTA, the two monetary unions have an intangible infrastructure on which they can draw to reap the benefits of economic integration. However, they also face challenges that should be addressed.

iv. **Innovations such as cryptocurrency and Pan-African Payment and Settlement System implemented by the African Export-Import Bank[5] should be taken into consideration.** The Central African Republic adopted Bitcoin as legal tender in April 2022, making it the second country in the world after El Salvador to do so.[6] While the Central African Republic's decision was suspended for a year, this experience should encourage further discussion on the topic, especially considering the growing importance of digitization in cross-border payment and settlement and interest generated by Central Bank Digital currency in terms of investing in education and training.

The long history of the CFA franc, a legacy of French colonialism in Africa, has had a profound impact on the 14 countries of the franc zone. While the CFA franc has mitigated inflation and heightened exchange rate stability in the region, it has also engendered economies that remain stubbornly resistant to needed reforms. The establishment of the AfCFTA provides a golden opportunity to institute such reforms - harnessing the power of the franc zone to spur development, investment, and cooperation across a critical swath of the African continent.

5.https://www.afreximbank.com/pan-african-payment-and-settlement-system-launched-by-president-akufo-addo-foreseeing-5-billion-annual-savings-for-africa/

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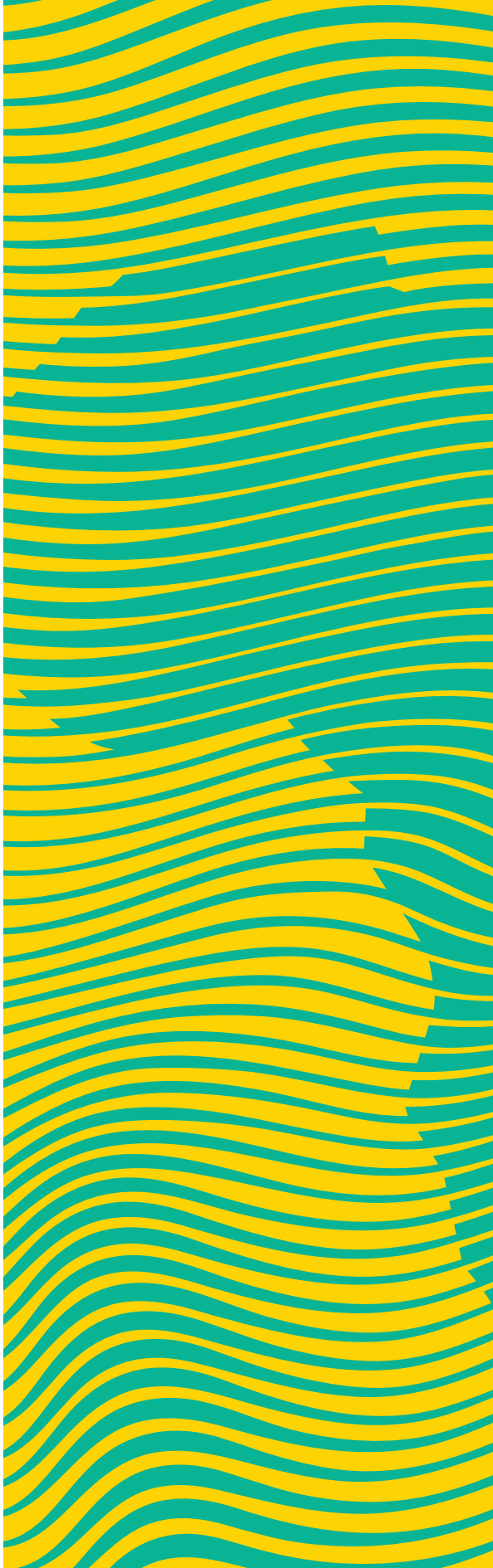

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