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Towards A Monetary Union in the Economic Community of West African States (ECOWAS): Prospects and Challenges"

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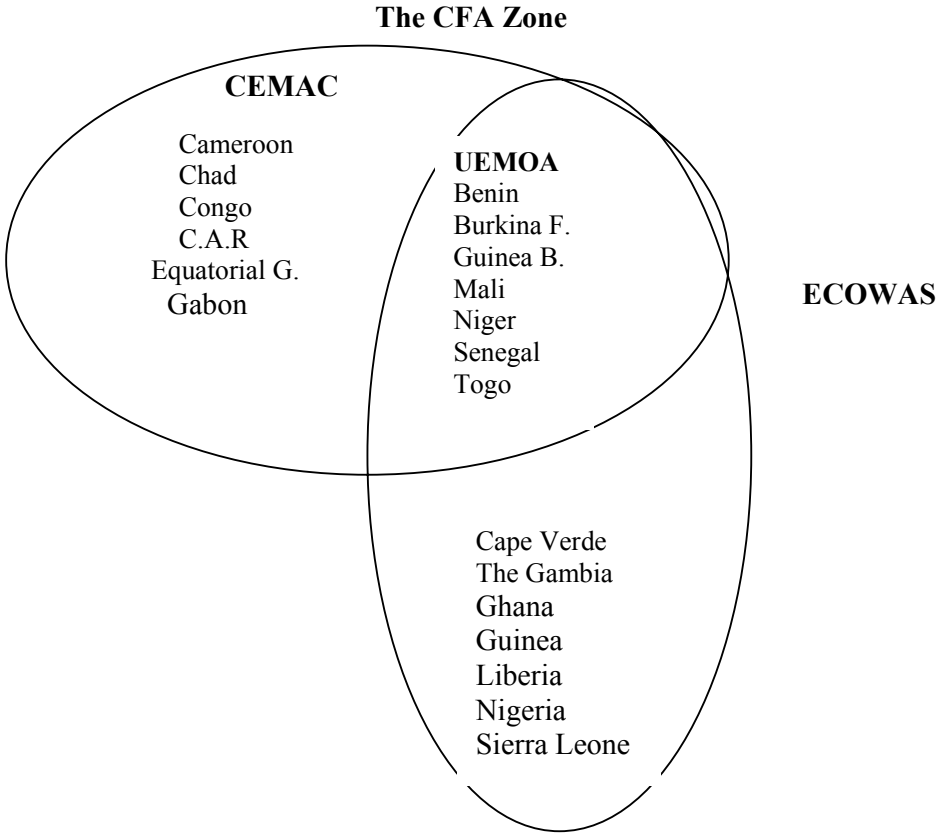
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Chapter 2

Historical Overview of West African Experiences with Monetary Integration

The experience of monetary integration in West Africa can be traced from the relations which existed between members of the region and their respective colonial masters. For colonies under British rule, monetary relations with Britain were cemented through the British West African currency board, which was dissolved immediately after independence when most colonies assumed unique currencies. The history of monetary integration in French West Africa is similar to that of their counterparts under British rule in that like the West African Pound in British West Africa, the medium of exchange in French West Africa was the Franc. But unlike former British West African colonies, French West Africa retained strong financial ties with France after independence and went further to consolidate monetary integration through the UMOA and UEMOA with staunch financial support from France.



British West Africa.

West Africa monetary history can be viewed as consisting of three periods. The pre-colonial era during which countries in the region had currencies used in exchange for goods. Colonialism, marked by the integration into the world economic system through regional links with the currencies of the European colonial powers and the first generation or more of independence which saw the disintegration of monetary links between several West African countries and their former colonial masters with the exception of French colonies. West Africa is now on the brink of a fourth period in which attempts are made across the board for monetary reintegration.

With the partitioning of Africa and the imposition of colonial rule, Britain and France emerged as the main beneficiaries of the territories in West Africa. A crucial element that came with colonialism was that existing monies were replaced with European currency. This was done principally with the imposition of taxes that had to be paid in European currency.[1] Over time, each colonial power took steps to exclude currencies other than its own. In British West Africa for instance, Britain moved quickly to put in place an economic and political system for the smooth functioning of her colonies. Britain then went on to exclude certain coins in circulation in an attempt to make British coins more prominent. The British colony of Lagos began by importing British coins systematically and continued doing so until the British West African colonies established their own coinage. Britain was however one of the few colonial powers that allowed free banking, as there was an existing banking set up in Nigeria. One of the note issuing banks in the free system of Mauritius failed as a

[1] Chibuike Uche, "The Idea of a Regional Currency for Anglophone West Africa," Paper Presented at the 10th CODESRIA General Assembly, Kampala, Uganda, 2002, 4.

result of a fall in the price of sugar, one of the islands' most important crops. In response, the British government began considering the creation of currency boards.[2]

A currency board is by definition an institution that issues notes and coins convertible on demand and at a fixed rate into a foreign currency or other external reserve asset.[3] Ordinarily a currency board does not accept high deposits though in some cases, it may accept those backed one hundred per cent by external reserves. As reserves, it holds high quality interests bearing securities dominated in the reserve asset. A currency board makes profit from the difference between the interest in the securities that it holds and the expense of maintaining its notes and coins in circulation. It remits to the government all profits beyond what it needs to pay as expenses and maintains its reserve ratio.[4] A currency board has no discretion in monetary policy, market forces alone determine the quality of notes in circulation.

The British West African Currency Board (BWACB)

A major motive behind the establishment of the West African Currency Board was based on the desire to raise currency issuance as a source of seigniorage while avoiding the dangers of depreciation against the Pound Sterling. During the first five years of the twentieth century, the use of British silver coins was widespread in her West African colonies. The British gold sovereign had too high a value to be useful to most Africans in trade. The Bank of Nigeria issued notes briefly around the turn of the century but ceased to do so after demand proved to be insufficient.[5] Demand for silver coins on the other hand was high in British colonies exceeding demands in Britain itself. The imperial government refused to share seigniorage from coins with

[2] Kurt Schuler, "Monetary Institutions and Underdevelopment: History and Prescriptions for African Users," *http://www.crols.com/kurrency/af/ust.htm.*
[3] Ibid.
[4] Kurt Schuler, Currency Boards, George Masson University *www.users.erols.com/kurrency/web/diss/htm.*
[5] Ibid.

West African governments. At the same time, the imperial government was worried about the possibility of a potential West Africa demand to redeem the silver coins in gold.[6] Silver coins were legal tender only up to 2 pounds in Britain and the royal mint was not required to exchange more than 2 pounds of silver per person for gold. In British West Africa, although silver coins were unlimited legal tender, colonies were legally entitled to redeem them in gold at the royal mint without limit.[7]

In 1898, the British colonial secretary proposed to the British Treasury that there be a separate West African currency, or that the royal mint share some degree of seigniorage with West African governments. The Treasury rejected the idea of sharing seigniorage but the colonial office appointed a committee to investigate the possibility of establishing a West African currency. The chairman of the committee, Sir David Barbour who had also been a member of the Indian Currency Reform Committee of 1893, was later appointed as head of the Straits Settlements Reform Committee of 1902.[8] The committee proposed retaining British silver coins but suggested that half of the seigniorage be given to West African governments and the other half be used to build up a gold reserve. The Treasury equally rejected the committee's proposal. The economies of coinage were such that the colonies decided not to issue coins. Northern and Southern Nigeria for example used penny and half penny coins in 1908, but did so more to promote the use of money as a medium of exchange among Africans than to gain seigniorage.[9]

The price of silver fell during the early years of the twentieth century increasing the seigniorage for silver coins. By 1912, the gross seigniorage of British silver coins

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[6] Benjamin Cohen, "Monetary Unions, University of California, Santa Barbara," *http://www.eh.net/encyclopedia/?article=cohen.monetaryunions.*

[7] Roy Davies and Glyn Davies, "A comparative Chronology of Money: Monetary History From Ancient Times To The Present Day," *http://www.ex.ac/uk/~Rdavies/arian/amser/chrono.3/html.*

[8] "The Colonial Economic Legacy, Early British Imperialism, World ReferenceCountry Reports, 1991" *http://www.countrystudies.us/nigeria/53.htm.*

[9] "Central Bank of Nigeria ," *http://www.cenbank.org/currencymgt/notes-and-coins-.htm*

was 165 per cent of the value of their silver content. The monetization of the West African economy increased and there was talk of the advantages of a local currency not issued by the government or banks. Another committee was subsequently set up and was chaired by Lord Bill Emmot, Undersecretary of state for colonies. It interviewed several witnesses and presented its report to the British parliament in October 1902. The Emmot committee recommended that the British government establish a currency board to issue coins and notes in West Africa.[10] West African governments had to pay the start up costs of the board and had to back it with their full credit should its own resources prove insufficient. The board was to keep reserves in gold and securities in London. The committee recommended that the board should exchange West African Pounds which became legal tender in the region for the Sterling or the reserve at the rate of one to one. It equally stated that the board should have offices in each West African colony, with headquarters in London.[11]

The report of the Emmot committee was however unclear on several vital points. It did not state whether the currency board for example should be allowed to hold reserves in domestic assets. For most of the existence of the board however, officials interpreted the report to mean that all reserves be held in external assets. Furthermore, the report was not clear on whether the West African Pound would always be equal to the Pound Sterling. The committee seemingly assumed that the sterling would remain convertible into gold at a constant rate, so there would be no differences between the currency board's gold reserves and its securities.[12] When Britain suspended convertibility of the sterling at the outbreak of World War One, the Sterling fell against gold. The West African Pound remained fixed to the sterling rather than to the

[10] Michael Ojo, "Regional Currency Areas and the Use of Foreign Currencies, The Experience of West Africa," *http://www.bis.org/pub/bppdf/bispap17.pdf.*
[11] Ibid.
[12] Ibid

gold parity of the Sterling. The West African currency board would then move quickly towards a pure Sterling exchange standard.

Based on the Emmot committee's report, the British colonial government established the West African Currency Board in 1912. It began operations in 1913 and served Ghana, Gambia, Nigeria and Sierra Leone. The board, which was headquartered in London, was mandated to provide for and control the supply of currency to the British West African colonies, protectorates and trust territories. The currency board supplied West African Pounds passively in response to demand without undertaking a strong monetary policy and held at least 100 per cent assets in Pound Sterling against its notes and coins in circulation.[13] Liberia though not a member of the currency board used the West African Pound as its currency until it switched to the Dollar in 1943. The West African Currency Board became a model for all subsequent British colonial currency boards including the East African Currency Board, the Southern Rhodesian Currency Board as well as Currency Boards in Libya and Somaliland.

The currency board was based on the West African Pound which in turn was linked at par to the Pound Sterling. The West African Pound was backed by the Sterling on a 100 per cent Sterling exchange system. As a result, it shared in the strengths and weaknesses of the Sterling, appreciating and depreciating with it in value, passively and automatically. This characteristic ruled out an independent monetary policy in various countries in the region during that era.[14] The system in short was nothing more than a currency supply system issuing West African Pounds against Sterling and vice versa.

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[13] Chibuike Uche, *The Idea of A Regional Currency for Anglophone West Africa,* CODESRIA General Assembly, Kampala, 2002, 2.
[14] David Carney, *Government and Economy in British west Africa* (New York: Bookman Associates, 1961), 63.

The management of the currency was vested in the currency board based in London, with local agents in the West African region. A change not exceeding ¾ per cent was levied for effecting currency transfers to and from West Africa, and constituted a source of income for the board. Since the board usually held a substantial sum of West African currency in store, physical transfers were rarely made except when meeting a seasonal or permanent rise in circulation in excess of its store of unissued currency in West Africa, or in renewing worn out coins and notes. Nevertheless, the charge was always levied, when converting one form of currency into the other.[15]

The Board invested its sterling funds for up to 110 per cent in assets chosen at the discretion of the Secretary of State for Colonies. The extra ten per cent came from its profits and was used to provide adequate cover against a loss by depreciation of its assets. Any income from such investments in excess of 10 per cent of the value of its funds plus administrative expenses was distributed to the four colonies as profits.[16] The governments of these colonies had anticipated substantial sources of income from this source prior to the establishment of the board. The outcome was however not what they expected. In the first 38 years of its existence (1912-1950), the board distributed as profits to the four colonies the following sums derived principally from seigniorage on minting of West African coins. Nigeria received 4.5million pounds, the Gold Coast 3.3 million Sierra Leone 0.7 million and the Gambia 0.2million giving a total of 8.7 million pounds.[17]

The currency board was therefore tied to the monetary system of the UK. Because the West African Pound was freely convertible to the British Pound, people had

[15] Ibid., 63.
[16] Ibid.,64
[17] David Carney, Government and Economy in British West Africa (New York: Bookman Associates, 1961), 64.

confidence in the stability of the local currency. The mechanism of the currency board was cheap to administer than for example, central banks. A major disadvantage of the system was that the quantity of currency in circulation was determined mainly by the volume of exports, but the gradual growth of domestic trade and production could not exercise an appropriate influence on the volume of currency. Reserves in excess of current need were invested in the London money market where they were available to meet emergencies but were consequently not available for loans to the local banks in the territories concerned.[18]

In the aftermath of the Second World War, and with the wind of change blowing across Africa, British economists debated whether British colonies moving towards independence should establish central banks or continue with the existing currency board. Critics of currency boards pointed out that currency boards held excessive foreign reserves representing a loss of income to the colonies, that the currency board system unnecessarily forced the money supply to shadow the account balance; that they did not allow a discretionary monetary policy for promoting economic growth and that banking systems would be more stable if they had central banks to act as lenders of last resort.[19]

On the other side of the debate, some economists and colonial officials questioned the wisdom of establishing central banks in African colonies. They feared that the central banks might become instruments of inflationary deficit finance and pointed to the practical problem of training sufficient numbers of African officials to operate central banks. They asserted that central bank policies in countries without well developed domestic bond markets such as existed in West Africa would be

[18] A.G Hopkins, *An Economic History of West Africa* (London: Longman Group ltd, 1973), 207.
[19] "West African States, "All About this Economic and Monetary Community" *http://www.wbcc.fsnet.Co.uk/af-was.htm#about.*

impotent.[20] Even World Bank missions to Nigeria recommended retaining the currency board system temporarily or indefinitely. Central banks, it was pointed out were more expensive to run than currency boards.

By 1950, proponents of central banks had won the theoretical debate. Economists and policy makers eventually realized the error in the claim that a central bank needed a domestic bond market to conduct an effective monetary policy which was one of the principal arguments made against the establishment of central banks. By 1960, supporters of central had won the practical debate as well, and central banks were established in one country after the other. Even before most countries established existing monetary authorities, a number of British West Africa colonies had begun to operate more and more like central banks, although the necessity of maintaining a rigid exchange rate restricted their independence in monetary policies.[21] The conservatism of British currency boards was often a matter of administrative practice, rather than of legal statute since most currency board constitutions allowed considerable latitude of action.[22]

The West African currency board statute, which as mentioned above became the model for currency board statutes elsewhere, set no reserve requirements nor did it restrict the type of assets the Board could hold. The Statute pointed out that "the Board may invest its funds, Sterling securities of the government of any part of his majesty's dominions or in such other manner as the British Secretary of State for Colonies may approve."[23] The Statute added that "when the board is satisfied and shall have satisfied the Secretary of State that its reserves are more than sufficient to secure the convertibility of the notes and coins into Sterling, and to provide a

[20] A.G Hopkins, *An Economic History of West Africa* (London: Longman Group ltd, 1973), 208.
[21] Chibuike Uche, "The Idea of A Regional Currency For Anglophone West Africa," Paper Presented at The CODESRIA, General Assembly, Kampala, 2002, 6.
[22] Ibid.
[23] "The West African Currency Board Statute," Lynnes, 1962, 422.

reasonable reserve against depreciation, the board may pay over the whole or part of the surplus amount in aid of the revenues of the British West African governments."[24]

In the 1960s, the British colonial administration began allowing currency boards to reduce their holdings of foreign assets from the orthodox level of 100 per cent to monetary liabilities. The West African Currency Board remained orthodox to the end. In particular it refused to act as a lender of last resort. As far back as 1952, a motion had been proposed in the Nigerian Legislature to establish a central bank precisely because supporters of existing local banks desired a government rescue. Ghana became the first member of the West African Currency Board to achieve independence in 1957. The year after, the Bank of Ghana took over the functions of issuing notes from the Accra branch of the currency board and began operating as a central bank.[25] Nigeria opened a central bank in 1959 and became independent in 1960. Sierra Leone became independent in 1961 and established a central bank in 1964. The British West Africa Currency Board remained as the Gambian currency board until Gambia established a central bank in 1971.[26]

These central banks were charged with the general functions of controlling the supply of money within their territories and of advising their governments about financial aspects of economic policy; to maintain the external value of the currency and undertake the administration of any measures of control in the markets of foreign exchange. Central Banks were generally given greater scope for discretion than was allowed to the former currency board. From its institution in 1959, the Central Bank of Nigeria for instance allowed a fiduciary issue amounting to 40 per cent the total

[24] The West African Currency Board Statute, Lynes, 1962, 423.
[25] Chibuike Uche, "The Idea of A Regional Currency For Anglophone West Africa," Paper Presented at the CODESRIA General Assembly, Kampala, 2002, 8.
[26] Roy Davies and Glyn Davies, " A comparative Chronology of Money: Monetary History From Ancient Times to the Present Day," *http"//www.ex.ac.uk/~rdavies/arian/amser/chrono17.html.*

volume of currency in circulation and in 1962 this limit was raised to 60 per cent, only 40 per cent of the currency after this date had to be covered by reserves of gold or other assets held by the Central Bank.[27]

The policy of breaking colonial monetary links enabled political leaders of newly independent nations to create institutions to promote their personal visions of economic development. Ghana and Guinea were particularly influenced by socialism and experienced financial repressions, compulsory lending to specific sectors or state enterprises, interest rate ceilings, high reserve requirements for banks and myriad controls on financial institutions.[28] In 1973, Nigeria introduced the Naira, while the Dollar, Cedi, Leone and the Dalasi were taken up by Liberia, Ghana, Sierra Leone and the Gambia respectively as national currencies. It can therefore be said that as a regional rule, former British colonies moved from the currency board system to flexible or adjusting exchange rate regimes after independence.

The Formation of the West African Clearing House (WACH).

The establishment of ECOWAS in 1975 was the first attempt to unite the Anglophone and Francophone countries in the region. The ECOWAS currency/payments arrangements evolved with the establishment of the West African Clearing House in 1975.[29] At a meeting of governors of the central banks of the region held in Accra in May 1974, a draft agreement was approved. Subsequently, comments on the original draft necessitated a redrafting of the agreement and on March 14, 1975 the definitive text was signed in Lagos by governors of the Central

[27] "Commanding Heights: Nigeria Overview," *http://www.pbs.org/wgbh/commandingheights/lo/Countries/ng/ng-full.html.*
[28] Ibid., 9.
[29] Abbas, Bundu, "Strategic Visions and Prospects in Real Laverne's Regional Integration and Cooperation in West Africa: A Multidimentional Perspective," *http://web.idrc.ca/en/ev-68325-201-1dotopic.html.*

Banks of Gambia, Ghana, Liberia, Mali, Nigeria and Sierra Leone, in collaboration with heads of central banks from the Francophone West African states of Benin, Ivory Coast, Niger, Senegal, Togo and Upper Volta (Burkina Faso). Following the ratification of the agreement, the Clearing House came into legal existence on 25th June 1975 and started operations in July 1976.[30]

The basic objectives of the clearing house as laid down in the Agreement were to promote the use of currencies of member states for intra-regional trade and other transactions, encourage members to liberalize trade among themselves and to promote monetary cooperation and consultation.[31] In order to simplify the exchange arrangements involved in the larger number of currencies, and ensure an efficient clearing arrangement, in view of currency differences and different exchange rates, the West African Unit of Account (WAUA) was introduced. The WAUA was the benchmark for determining the relative strengths of the currencies in the WACH's payments mechanism and was equivalent to one Special Drawing Right (SDR) of the IMF. The smooth operation of the WACH depended on the guarantee by member countries to convert their currencies freely into the WAUA for eligible transactions. The adoption of this requirement resulted in the elimination of the currencies that were not convertible, in respect of transactions undertaken through the WACH. Although transactions were channeled through central banks, the WACH as the final link to the system settled debit balances between member countries.[32] It also aimed at providing a facility through which participants could utilize national currencies for

[30] Uka Ezenwa, *ECOWAS and the Economic Integration of West Africa* (London: C. Hurst and Co, 1983), 124.
[31] Ibid,
[32]"West African Countries Long For Monetary and Currency Integration" *http:www.english.people.com.cn/2002/0/10eng.*

imports from the West African sub-region thereby economizing in the use of foreign exchange reserves and transfer costs.[33]

Regarding the exchange rate, the daily exchange rates of each member country was stated in the amount of their particular currency per one West African Unit of Account (equivalent to one Special Drawing Right). WACH subsequently managed the rate of each country's currency from daily information received from banks of member states and the IMF.[34] The currencies involved included the CFA Franc (for the Franc zone), the Gambian Dalasi, Ghanaian Cedi, Liberian Dollar, Malian Franc, Nigerian Naira and the Sierra Leonean Leone.

Among the institutions of the WACH were the Association of African Central Banks with the Governors of the central banks and heads of financial institutions serving as members. The principal objective was to promote cooperation in the monetary, banking and financial spheres, and to assist in the formulation of guidelines for member countries. The eligible instruments through which payments were made via the Clearing House facility were telegraphic transfers, bank drafts and bills of exchange. The Clearing House provided a medium for all payments relating to current account transactions within the sub-region and between countries of the member banks.[35]

The financial resources of the WACH were generated from the budget contributions of member states and other investment ventures. In its transactions between July 1976 and August 1977, the volume of payment orders received amounted to 51,267,428 West African Unit of Account. Payments effected for which

[33] "West African Countries Long for Monetary and Currency Integration," *http:www.english.people. Com/cn/2002/0/1oeng.*
[34] Ibid.
[35] Franklin Vivekananda and Wilfred Ndongko, *Bilateral and Multilateral Economic Cooperation in West Africa: Self Reliance Through Putting Resources Together* (Stockholm: Bethany Books, 1009), 87.

the Clearing House was informed amounted to 554,642 WAUA. The above figures included capital transfers of WAUA 19,409,480. Settlements during the period amounted to 38,041,095 WAUA which represented 74.96 per cent of its total transactions.[36]

It must be emphasized that although a high percentage of clearing was recorded for several months, the net average was comparatively low. A suitable example was the total transactions for May 1976 which was 2,134,889 WAUA of which 1,272, 438 WAUA was cleared. This gave a percentage of clearing of 59.6 per cent in comparison to the net average of 25.04 per cent.[37] For the year 1977-1978, transactions channeled through the Clearing House for the 12 months ending August 1978 totaled 43,791,787 WAUA compared to 50,921,786 WAUA for the foundation for the period ending August 31, 1977. Monthly transactions ranged between a high of 5,843, 177 WAUA and a low of 2,318,875 WAUA.[38] Clearing figures indicated the extent to which the transactions of members offset one another thus alleviating the need to transfer funds from one country to another. Despite fluctuations in total transactions, the trends improved after several years. Whereas the percentage clearing above the total transactions for the first fourteen months of operation was 25. 04, the average for the year 1977-79 was 32.43.[39]

The West African sub-region nevertheless remained divided, as there were differences between the CFA zone and former British colonies. The plurality of this type of system represented a negative element in the growth of external trade. In practice, trade settlements were carried out in major reserve currencies which included the French Franc, the Dollar and the Pound, while payment orders were

[36] Ibid.,89.
[37] Lewis H.W, *French Speaking Africa, the Search for Identity* (New York: Walker and Co, 1965), 90.
[38] Ibid.,90.
[39] Ibid.,91.

processed by foreign banks stationed in the US, London and Paris. The disadvantages of such a practice caused delays in settling payments for the high cost of services performed by intermediaries and the imprudent use of foreign exchange reserves for non-parity items. The existence of exchange controls in the different countries within the sub-region introduced a certain amount of rigidity in transactions.[40]

In 1995, the WACH metamorphosed into the West African Monetary Agency because of operational inadequacies and the fact that the objectives for its establishment were not fully realized after more than twenty years of operation. The operations of the WACH had been undermined by a number of factors. These included; delays in the crediting of exporters accounts due to cumbersome documentation requirements by central banks, and the absence of short term financing facility.[41] The WAMA is expected to facilitate regional trade through the maintenance of close surveillance over the monetary, fiscal and exchange rate policies of member states so as to promote a stable intra-regional exchange market conducive to the expansion of trade. The agency is equally charged with the task of assisting member states in procuring external financing for settling intra-regional trade related balance of payment problems, the establishment of an "early warning system" that will provide the necessary signals and therefore encourage member states to take pre-emptive measures to forestall the accumulation of arrears in the clearing and payment system.[42] Anglophone West African states by this time reinvigorated their interest for the consolidation of a West African Monetary Union, by forming the West African Monetary Zone with the ultimate aim of merging with the existing monetary set up in

[40] Nelson, Magbagbeola, *The Quest For A West African Monetary Union: Implementation Issues, Progress And Prospects,* National Centre For Economic Management and Administration, Ibadan, Nigeria, 2.
[41] J.O.Sanusi, "On Going Efforts Towards A Monetary Union In The West African Sub-Region" Paper Presented at the MEFMI Central Bank Governors Forum, Basel: Switzerland, June 2003.
[42]"Synoptic Report on The Proceedings of the Trade and Development Board," Twenty Third Executive Session,*United Nations Conference on Trade and Development,* Geneva, 1999.

Francophone West Africa. We now look at the history of monetary integration among French speaking West African states.

French West Africa

The Francophone West African countries have a somewhat similar history of monetary integration like their sister states who were ruled by the British. For most of French colonial rule, her colonies were organised under the French West African Federation. By 1935, France had undertaken to issue currencies in each colony that would be firmly linked to the French Franc. Most of these currencies were subsequently consolidated into *La Franc des colonies francaise d'Afrique*.[43] The French set up this broad Franc zone because they wanted convertibility into the French Franc at fixed parity, free capital mobility throughout the zone, pooling of most foreign exchange reserves at the French Treasury, and guarantee of convertibility by France through the establishment of the *compte d'operations* or "operations account" for each colonial central bank with the French Treasury.[44]

In the aftermath of World War Two, the French renamed her empire the French Union. This remained a unified economic zone, with a common external customs duty and in 1948 it officially became a monetary union. The CFA Franc officially came into existence in 1945, the day the French ratified what became known as the Bretton Woods Agreement and concerted with the International Monetary Fund (IMF) to align the gold standard for the first time.[45] The acronym CFA originally stood for, *Colonies Francaise Africaine,* or French colonies of Africa. However in 1958, the meaning was changed to *Communaute Financiere Africaine*, or French Community of Africa. The members of the West African Zone used CFA to refer to Financial

[43] Chibuike Uche, "The Idea of a Regional Currency for Anglophone West Africa," Paper Presented at the 10th CODESRIA General Assembly, Kampala, December 2002, 8.
[44] Ibid.,9.
[45] "The West African Monetary Union, Springboard for economic development in West Africa," compiled by the Club Bruxelles, Bruxelles: 1996, 13.

Community of Africa while those of the Central African Zone conveniently spoke of the CFA Franc as the Currency of Financial Cooperation in Central Africa. There are therefore two types of CFA Francs, and both are of equal value, and during the early days had identical parity with the French franc, a vital point for ensuring the internal stability and external credibility of the currency and for promoting trade.[46]

The parity of the CFA Franc was fixed at 0.05FCFA to 1FF in 1948 and its nominal parity was changed during the French Currency Reform of 1968 at 50FCFA to 1 FF. This parity to the FF remained unchanged until the devaluation of the CFA in 1994. After 1994, 100CFAF became equivalent to 1FF, a change of 50 per cent. Aside form Guinea Bissau and Mauritania, all the countries that formerly comprised French West and Equatorial Africa are members of the Franc Zone. The former West and Equatorial African countries are still grouped within the currency areas that existed prior to independence. Equatorial Guinea, a former Spanish colony joined the Franc Zone in 1985, while Guinea Bissau a former Portuguese protectorate joined the zone in 1997.

The CFA was initially issued by the Banque de France but this responsibility was later transferred to regional issuing banks created in 1955 and consolidated in 1962 after most of the states had gained independence. Both banks were initially based in Paris but were later given greater autonomy and were moved to Africa in the reforms of 1972.[47] The regional issuing banks which are mentioned in chapter one are the BCEAO headquartered in Dakar and issues the *Franc de la Communaute Finaciere,* and the BEAC which is headquartered in Yaoundé and issues the *Franc de la Cooperation Financiere en Afrique Centrale.* Although they are officially different

[46] Patrick Manning, *Francophone Sub-Saharan Africa: 1880-1995,* (Cambridge: Cambridge University Press, 1998), 123.
[47] Anthony Kirk and Daniel Bach, *State and Society in Francophone Africa since Independence* (London: Macmillan Press, 1995), 162.

currencies and are only legal tender in their respective zones, they are commonly referred to interchangeably as the CFA Franc. The current members of these banks and their official regional organisations are shown in table 1 below. Mali left the zone in 1962 and re-entered in 1973, and as mentioned above, Equatorial Guinea joined the BEAC in 1985 while Guinea Bissau became part of the BCEAO set up in August 1997.

Table 1, Composition of the African Franc Zones.

BCEAO issues currency for the UEMOA Zone. Members.	**BEAC issues currency for the CEMAC Zone. Members**
Benin	Cameroon
Burkina Faso	Central African Republic
Cote d' Ivoire	Congo Republic
Guinea Bissau	Gabon
Mali	
Senegal	Chad
Togo	
	Equatorial Guinea

Table 1 above shows member states of the CFA Franc zone and their respective regional groupings. The BCEAO issues currency for the UEMOA countries in West Africa while the BEAC issues the currency for the CEMAC countries in Central Africa.

The CEMAC, Communaute Economique et Monitaire de L' Banque Centrale (The Central African Economic and Monetary Community)

In 1956 shortly before independence was granted to the Congo, Central African Republic and Gabon, the four members of the former *Federation de L'Afrique Equatotrial Francaise,* (FAEF), signed a convention creating the Equatorial African customs union. The *Union Douaniere Equtoriale,* or Equatorial Customs Union (UDE), which existed at the time, was a necessary bridge between the colonial federation and a more extensive customs and economic union. In 1964 the UDE and Cameroon signed a treaty creating the *Union Douaniere Economique de L'Afrique Centrale,* the Central African Economic and Customs Union (UDEAC).[48] The UDEAC Treaty, like the UDE Convention before it, fundamentally created a customs union within which trade was envisaged as the main engine of industrial and economic development.[49]

Reflecting the inward-looking regionalism of the 1960s, UDEAC maintained policies that coupled trade liberalisation within the region with protectionism towards the rest of the world in order to improve industrialization through scale economies made possible by the creation of larger regional markets. UDEAC's policies turned protectionist in the early 1970s. High oil and other commodity prices had led some member countries to undertake ambitious investment projects which had to be protected from competition from outside and from within the sub-region.[50] In 1974, free trade within the union was restricted to raw materials and unprocessed agricultural products. Intra regional trade on manufactured products in the union was taxed like external trade unless the manufacturer had special tax status and was often

[48] Dominico Mazzeo ed, *African Regional Organisations* (Cambridge: Cambridge University Press, 1984), 132.
[49] 'The Central African Economic and Customs Union, (UDEAC), WGC, *http://www.wgzavocats.com /articles/guidecameroun.html.*
[50] Ibid.

subjected to non-tariff barriers.[51] The high official tariff rate did not raise substantial revenues but encouraged behaviours that had the opposite effect, including widespread tax exemptions, smuggling and customs fraud.[52]

The common trade policies of UDEAC had the ironic effect of limiting the possibilities for reform at the national level. By 1994, three decades after its creation, the entire UDEAC tariff and indirect tax system required overhauling. Member states adopted an "internal adjustment" strategy in response to severe external shocks that struck the region in the mid 1980s. In 1986, the crude oil price collapsed as did other commodity prices. As a consequence, terms of trade for member states plunged by 40 per cent in 1986-88 and remained depressed until 1993. There was an urgent need to restore competitiveness and to resume growth as well as regain internal and external balance.[53] A combination of expenditure switching and expenditure reducing policies were generally required to achieve such goals. Expenditure switching policies are needed to alter relative price and shift demand and resources towards the production of goods that are vital for trade, while expenditure reducing policies primarily monetary and fiscal in nature, are necessary to reduce domestic absorption and increase domestic savings.[54]

Expenditure switching policies normally rely on exchange rate depreciation to reduce imports and boost exports, but UDEAC initially refused to devalue. The internal adjustment strategy embarked upon by member states was aimed at deflating domestic prices to achieve the required depreciation in the real exchange rate. The strategy involved a combination of deflatory macro economic policies, internal

[51] Ali Zafar and Keiba Kubota "Regional Integration in Central Africa, Key Issues," *African Regional Working Paper* No 52, 2003.
[52] Ibid.
[53] Ibid.
[54] "The IMF and World Bank Approaches to Macroeconomic Management in Developing Countries," *http://www.ceterisparibus.net/arsiv/h-sens.pdf.*

structural reforms and "second best" trade policies. These adjustment programmes were introduced as early as 1986, though they were not implemented uniformly across countries in the zone over time. As it turned out however, the required real depreciation proved to be too large to be accomplished without a normal devaluation.[55] In effect, the currency was devalued on the 12 of January 1994 after much reluctance from members of the zone. Following the implementation of reforms and restructuring of existing regional economic arrangements on both sides of the CFA Zone, after the devaluation, the Central African Customs and Economic Union was replaced by the Central African Economic and Monetary Union (CEMAC).

The five countries of the CEMAC grouping have BEAC as their central bank. The principles governing the functioning of the monetary system of these five countries are contained in agreements concluded with France. These arrangements specified that members of BEAC will maintain the existing monetary system within the framework of the French Franc area arrangements, but they also formally recognise the individual rights of these countries to establish at any time their own independent central banks. The agreement further specified that the exchange rate of the CFA in terms of the French Franc (now the Euro) can only be changed with the consent of both France and the member countries of the central bank and that France will consult them if she finds it necessary to change the rate of the French Franc in terms of third currencies.[56] If France or the member countries of the Central Bank decide to put an end to the existing monetary arrangement, they will enter into consultations for the purpose of reaching an agreement on new arrangements. The BEAC like the BCEAO

[55] Ali Zafar and Keiba Kubota, "Regional Integration in Central Africa, Key Issues," *African Regional Working Paper,* No 52, 2003.
[56] Boughton J.M, "The CFA Zone, Currency Union and Monetary Standard," Washington: *IMF Working Paper No wp/91/133, 1991, 48.*

holds its exchange reserves in an operations account or "compte de operations" with the French Treasury.[57]

The UMOA, Union Monitaire Ouest Africaine (West African Monetary Union)

The West African Monetary Union (UMOA) which became the West African Economic and Monetary Union (UEMOA) on the 10th of January 1994 is a major example of monetary integration in Africa and the world. The union's monetary arrangements which remained unchanged by the expansion of the UMOA's functions into the economic sphere under the UEMOA makes it a complete monetary union in the sense that its membership share a fully convertible common currency issued by a supranational central bank that oversees the operations of an external reserve pool.[58]

On May 12th 1962, a treaty establishing UMOA and providing for a common Central Bank was signed by member states of the West African CFA Zone who are under the BCEAO. On 13th October 1962, the old BCEAO was dissolved and was replaced by a new Central Bank of the same name but with enlarged responsibilities and as an intergovernmental organisation. On the same day, the BCEAO countries like those of BEAC concluded a cooperation agreement with France in which France guaranteed the convertibility of the CFA Franc issued by BCEAO into French Francs and the members of the UMOA undertook to keep their external reserves in the operations account opened by the new BCEAO at the French Treasury and a special relationship was established.[59] From the outset, the printing of the common currency and the administration surrounding it were entrusted to the BCEAO. There were also two agreements signed simultaneously between the countries concerned and France.

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[57] J.M, Boughton, "CFA Franc, Zone of Fragile Stability in Africa," *Finance and Development* vol 29 No 4, 1992, 34.
[58] Real Lavergne ed, *Regional Integration and Cooperation in West Africa; A Multidimensional Perspective* (Ottawa: International Development Research Centre, 1997), 215.
[59] UKA Ezenwa, *ECOWAS and Economic Integration of West Africa* (London: Hurst & Company, 1983), 86.

One was a cooperation agreement by which France guaranteed the free convertibility of the CFA to the French Franc, and the second involved an operational account convention, setting out the working rules governing the account which was opened in the books of the French National Treasury.[60]

It must be noted that the treaty establishing the UMOA and the agreement for cooperation are two separate documents; indeed the treaty providing for a monetary union and a common central bank could continue in force even if the agreement for cooperation were to be abrogated.[61] Furthermore, the UMOA was headed by a conference of the Heads of State and the BCEAO is headed by a Council of Ministers comprising of the finance ministers of each member country. Each member country has input into the BCEAO's decision making process and nominally, all members including France have one vote each. In practice, however, decisions are made through consensus.[62]

The BCEAO is therefore a closely knit but simple organisation run at two levels. Although its headquarters was initially in Paris, this central bank maintained an agency in the capital of each member country and established sub-agencies in some other places within the UMOA territory. The overall management of the BCEAO was entrusted to a Board of Directors in which each member country had two appointees one of whom was appointed president, and France, under provisions of the Cooperation Agreement appointed several directors or the equivalent of half of the total members appointed by UMOA countries.[63] As a general rule, the decisions of the Board were taken by a simply majority but in practice, certain important decisions had

[60] "The West African Economic and Monetary Union, Springboard for Economic Development in West Africa," Bruxelles: Prepared by the Club Bruxelles, 1996.
[61] Felix Nankasse, "La Reforme Institutionnelle de la BCEAO et de L'Union au Menu du Conseil des Ministres," *Le Soliel* December 15, 2004.
[62] "Organization of the Banking and Financial System," *http://www.bceao.int/internet/bcweb.nsf/pages /usys?opendocumentclick=*.
[63] Rohinton Medhora, "Lessons From UMOA,"*http://webidrccaes/ev-68400-201-1-dotopic.html.*

to be adopted by a two-thirds majority. Indeed Uka Ezenwa points out that amendments of the statutes required the unanimous decision of the board.[64]

Below the board, a five-member National Monetary Committee appointed in each member country by the government, and including the two national directors, implements the general credit and rediscount policy decisions taken by the Board of Directors. In general, the division of responsibilities between these two levels of administration was that the Board for its part was responsible for fixing the overall supply of short term credit in the light of resources and needs for adjusting the discount rates and for determining the ceilings to be granted by the local branches of the central bank to each economy in respect of rediscounts and advances.[65] The national monetary committees were responsible for advising the Board from time to time about the credit limits in the individual BCEAO countries and when these had been fixed, for determining the ceilings for each local bank and for individual enterprises. Also the central bank could sometimes delegate some power to the monetary committees to act on its behalf on certain matters.[66]

Accordingly in 1973, a new UMOA treaty was signed and new instruments of administration put in place, including a new cooperation agreement and a new operational account convention with France. In addition, for the first time, an African, Adoulaye Fadiga, was appointed governor of the BCEAO and a further signal of intent was sent out as the bank's headquarters was transferred from Paris to Dakar. The BCEAO was given the role of implementing monetary policy as defined by the UMOA council of ministers under the supreme authority of the "conference of

[64] Uka Ezenwa, *ECOWAS and Economic Integration in West Africa* (London: Hurst and Company 1983), 87.
[65] Ibid., 89.
[66] " African Development Bank Group, Central Bank of West African States," *http://www.afdb.org/en /adb/links/African-institutions/centra-bank-of-west-african-states.*

heads of state."[67] In fulfilling this task, the bank had to act in accordance with the basic mission assigned to it; guaranteeing total freedom of transfers within the CFA zone, adjusting overall liquidity in order to ensure price stability in each of the member states and helping to finance their economies.[68]

In line with its mission, the BCEAO decides on an annual basis the total amount of currency to be allocated to each member country. In order to do this, it takes into account movements in production prices, the monetary situation, and the state of each country's balance of payments as well as the other objectives that had been set by the UMOA council of ministers as regards external assets and liabilities held by the union and by each member state. However, the revised accord provided for a ceiling to be set on the amount of liquidity made available both to the individual states and to the banking system as a whole.[69]

Three most important functions of the BCEAO can be distinguished. These include holding the monopoly of issue, being a depository for external reserves and credit creation. BCEAO in its capacity as a Central Bank has the sole right to issue the CFAF to each member country. In 1972, the official rate of the CFA when fully converted to the French franc was CFAF1=FF0.05, 1FF=CFAF 50. The effectiveness of the UMOA in overcoming internal payment problems was remarkable. Because notes and coins issued by BCEAO were legal tender in all member countries, and circulated freely within UMOA, statistics based on issuance of each country's notes and withdrawal of notes of other countries revealed a very large inter-country

[67] John Chipman, *French Power in Africa* (Oxford: Basil Blackwell ltd, 1989),209
[68] William Zartman, *Europe and Africa: The New Phase* (London: Lynne Reinner Publishers, 1993), 133.
[69] Ibid.,134.

circulation of notes, particularly between Mauritania and Senegal, between Benin and Togo, and within the Cote d'Ivoire, Niger and Upper Volta (now Burkina Faso).[70]

The other function of the BCEAO was that it acted as the depository for UMOA's external reserves. These reserves were held in the operations account at the French Treasury. An amendment to this convention which came into force in 1967 made it possible for BCEAO to invest part of its exchange reserves in certain types of negotiable bonds, which matured within two years and was issued by international financial institutions of which all BCEAO states were members. After the amendment, member states began investing part of their foreign reserves in short term bonds issued by the International Bank for Reconstruction and Development.[71] Because of the Cooperation Agreement which concerned the operations account, BCEAO could apply specific measures in cases of continuous and sizeable reduction in exchange reserves. For example its discount rate and changes on advances had to be increased by 1 percent if the operations account for the area as a whole with the French Treasury showed a debit for sixty days.[72]

Furthermore, in the event that the deposits in this account were exhausted, BCEAO could require public and private organisations to surrender their French Francs or other foreign currency holdings to it against the CFA. It should be noted here that the French Treasury paid interests to BCEAO on balances in the operations account at an annual rate equal to the rediscount rate of the Banque de France but never less than 2.5 per cent. In 1967/1968, the effective rate was 5.3 per cent.[73] The BCEAO on the other hand paid interests to France on any overdraft balance at an annual rate between

[70] Rohinton Medhora, "Lessons From the UMOA," *http://web.drcca/es/ev-68400-201-1-do-topic.html.*
[71] "The West African Economic and Monetary Union: Springboard for Economic Development in West Africa," Bruxelles: Paper compiled by Club Bruxelles, 1996.
[72] Plessz N.G, *Problems and Prospects of Economic Integration in West Africa* (Montreal: Mccull University Press, 1968), 41.
[73] Ibid., 42.

1 percent and a rediscount rate to the Banque de France depending on the amount. But BCEAO at its discretion could restrict that requirement solely to public institutions and banks and could implement it only in countries whose external transactions through the operations account showed a deficit.[74]

The third major role of the BCEAO was and is still related to credit creation within the framework of rediscount ceilings, which were the principal means used to control BCEAO to extend both short term and medium term credit. Short term credit was extended in the form of rediscount of short term paper and temporary advances against private and government paper as well as direct advances secured by either gold or foreign exchange and securities acceptable to BCEAO. The period for which short term credit could be granted was six months but could be extended for an additional five months for financing public contracts.[75] Medium term credits were granted by BCEAO for periods not exceeding five years.

More so, the Bank could grant the Treasury of any UMOA country short term advances for a period not exceeding 240 days consecutively and in an amount not exceeding 10 per cent of the government's fiscal receipts during the preceding budgetary year.[76] On December 10, 1968 however, the BCEAO statutes were amended to enable the Board of Directors, after reviewing developments in the currency issue, and evaluating the effects of its decision on the developments of the currency issue to raise the maximum amount of short-term advances to an amount equal to 15 per cent of the fiscal receipts.[77] In addition, BCEAO could discount

[74] N.G P leaaz, *Problems and Prospects of Economic Integration in West Africa* (Montreal: Mccull University Press, 1986), 44.
[75] David Fielding, and Kalvinder Shields, "The Impact of Monetary Union and Macroeconomic Integration: Evidence From West Africa," *World Institute For Development Economics Research,* Research Paper no 2004/7, 2004.
[76] Real Lavergne, *Regional Integration and Cooperation in West Africa:A Multidimensional Perspective* (Ottawa: International Development Research Centre, 1997), 220.
[77] Ibid., 221.

treasury customs duty bills provided such bills had a maturity of less than six months, and it could either be rediscounted or accepted for temporary advances, accepted as collateral for an advance within the limits fixed by the Board of Directors, or bought from or sold to banks without endorsement, provided the banks did not act as intermediaries for the treasuries.[78]

In spite of these credit facilities, the BCEAO's position on credits in general was on a modest scale. Although all UMOA governments had at one stage or another taken advantage of the Banks' ways and means of advances, only Benin, Niger, and Upper Volta (Burkina Faso) could be said to have made intensive use of the facility since they had experienced the most severe fiscal problems. Similarly, short-term credits in the form of advances secured by either gold or foreign exchange were not provided. Apart from technical factors, one probable reason for the limited use of credit facilities of BCEAO was connected to the fact that UMOA member governments were able to obtain any needed short-term advances from the French Treasury at reasonably low rates of interests. [79] It should also be noted that the primary objective of BCEAO's credit policy was, and is still to facilitate orderly economic growth in member countries, while maintaining an appropriate balance between financial and real resources. Given this policy constraint, the Bank's credit expansion had to be constantly kept in check. It was in this regard that the recorded annual rates of credit expansion of 17 per cent in 1962-64, 6 per cent in 1964-66 and 13 per cent between 1966 and 69 could be regarded as reasonable.[80]

Aside from the three main functions mentioned above, BCEAO has a variety of other responsibilities usually associated with a central bank. They include supervision

[78] "Banque de France "Rapport Annuel de La Zone Franc 1999 *www.banque-france.fr.*
[79] Paul Robson, *Economic Integration in Africa* (London: George Allen and Unwin, 1968), 432.
[80] Ibid.,433.

of the national credit institutions in accordance with the national regulations, giving expert advice to the treasuries and maintaining deposits for commercial banks.

By conventional definition, the UMOA was a complete monetary union. Not only was there complete pooling of monetary reserves and the issuing of a common currency among the participating countries, there was also a substantial integration of their financial markets and obstacles to internal payments and transfers were removed. In this way, intra-regional balance of payment were to a certain extent alleviated since union members could add to their foreign currency holdings that portion of their foreign exchange which could otherwise have been spent on settling intra-regional trade accounts.[81] Furthermore, UMOA through the operations of BCEAO facilitated the coordination of other economic policies of its members with regard to trade and economic development in general.

However, one can pick out several weaknesses from the advantages mentioned above. In the first place it has been argued that a monetary union of the UMOA variety robs its members of the power to pursue different monetary policies which their different economic problems warrant. In particular the limitation on freedom of individual members to alter their competitive positions through exchange rate manipulations vis-à-vis other members and the outside world can prove disadvantageous to the weaker members. Indeed specific actions may sometimes be needed to deal with the problems of such disadvantaged members. Thus unless all members are content to keep in line with each other, in most or all aspects of monetary policy, problems of credit expansion and exchange control measures are bound to arise.[82] Ironically, while the economies of some UMOA members were

[81] "The West African Economic and Monetary Union: Springboard for Economic Development in West Africa," Bruxelles, Compiled by Club Bruxelles, 1996.
[82] UKA Ezenwa, *ECOWAS and Regional Economic Integration in West Africa* (London: Hurst and Company, 1987), 90

doing relatively well between 1962 and 1969, others were not. The latter group could not be completely satisfied with union-inspired common policies which did not allow for individual initiatives. This can be observed in table 2 below.

Table 2

BCEAO Countries' Net Foreign Exchange Holdings, 1962-1969 In billions of Francs, end of fiscal year.)

Central Bank(net)[83]	**1962**	**1963**	**1964**	**1965**	**1966**	**1967**	**1968**	**1969**
Benin	2.47	2.45	2.44	2.51	2.27	1.98	2.35	2.18
Cote d' Ivoire	8.67	9.79	9.34	14.62	14.92	16.97	18.21	15.57
Mauritania	1.96	2.32	2.57	2.41	1.92	2.17	1.84	1.44
Niger	2.31	2.10	1.75	0.73	0.94	0.15	0.58	1.78
Senegal	17.97	11.83	8.41	8.25	11.27	8.47	3.64	4.17
Togo	2.12	2.22	2.83	4.32	4.48	5.46	6.22	6.41
Upper Volta	3.38	3.52	3.30	3.44	4.01	4.50	5.58	5.95
Total Central Bank	40.49	35.94	32.55	38.28	42.28	43.37	42.24	45.02

Source: Uka Ezenwa ECOWAS and Regional Economic Integration in West Africa, 91.

[83] Aggregate net holdings of the central bank do not equal the sum of the shares allocated to each member country because small amounts of the bank's assets could be allocated to any UMOA member

In table 2 above it can be observed that between 1962 and 1969, while the net assets of Ivory Coast rose steadily (except in 1964), that of Senegal showed a steady decline (except in 1966). The asset positions of Togo and Upper Volta also steadily improved from 4.32-4.58 and 3.44-4.50 respectively, while those for Benin, Mauritania and Niger declined. Perhaps the freedom to adopt the necessary monetary measures in a given situation could have helped the reserve-scarce UMOA countries to improve their reserve positions. Thus, one may be tempted to weigh the advantages of the UMOA against the pressures which were brought to bear upon it by the divergent development policies of different member countries and by the effects of such policies.

By 1969, there were two strong stabilising factors at work within the UMOA. The first as noted above was the existence of alternative sources of finance from the French government outside the union which mitigated the foreign exchange pressure. The second factor was the flexibility and vigilance as exemplified in the 1968 amendment which the BCEAO demonstrated in its credit operation. As mentioned above, the amendment brought an increase from 10 to 15 per cent (of each member's fiscal receipt), the maximum amount of short term advances each member could receive from BCEAO.[84] This therefore shows that the BCEAO watched closely the credit problems of its members in their process of development and was willing to accommodate them within its own limitations.

In this respect, one can question the ability of a monetary union to meet the credit requirements of all its members given the possibility of differences in level and rates of economic development among member states and internal pressures which such differences could generate. But viewed from the standpoint of a particular case, as in

[84] Uka Ezenwa, *ECOWAS and Regional Economic Integration in West Africa* (London: Hurst and Company, 1983), 86

the UMOA, and the stabilising factors which were at work within it, it can be concluded that the advantages outweigh the disadvantages.

Central Bank Independence

The importance of central bank independence can be appreciated in the notion advocated by Finn Kydland and Edward Prescott which is based on "time consistent" and "time inconsistent" policies that changed the tone of the rules versus discretion debate in monetary policy.[85] In this regard, an announced rule will not be credible (time consistent) if it is merely announced and not underpinned by forces that make it irrevocable. On the other hand, policy announcement may still be time consistent despite the lack of an explicitly stated rule if they are always seen to be enforceable. Such arguments have been used to explain why some central banks that tried switching to strict money rules failed, for example, those of the US and Canada in the 1980s, whereas others that have no explicit money rules have been more successful in managing inflation such as Germany and Japan. The reason according to Real Lavergne is that credibility cannot be acquired by simply announcing a rule. It has to be earned, either through reputation or through fundamental statutory changes.[86]

Many countries have adopted or made progress toward adopting legislative proposals removing central banks from government control, thus making them independent. The 1992 treaty on European Monetary Union (Maastricht Treaty) required European community members to give more independence to their central banks as part of establishing the EMU. As a result, European Community members

[85] Finn Kydland and Edward Prescott, "Rules Rather than Discretion: The Inconsistency of Optimal Plans," *Journal of Political Economy*, Vol 85, No3, 1977, 475-477.
[86] Real Lavergne *Regional Integration and Cooperation in West Africa; A Multidimensional Perspective* (Ottawa: International Development Research Center, 1997), 220.

that did not have strongly independent central banks introduced legislation or announced commitments to make their central banks more independent.[87]

In this light it might be reasonable to suggest that there are links between economic performance and the degree of central bank independence. Interestingly, the two post World War Two countries that experienced economic miracles (Japan and Germany) have had different levels of central bank independence. The German Bundesbank was viewed as one of the most independent central banks in the world whereas the Bank of Japan was regarded as subject to a greater degree of government control. Thus the move to grant central banks more independence across major economies raises some pertinent questions. Among these are; why is the idea of an independent central bank popular? And secondly, are there economic benefits from having an independent central bank?[88] As a broad generalisation, interest in central bank independence was motivated by the belief that if a central bank was free of direct political pressure, it would achieve lower and more stable inflation.

A study was conducted on twelve Organisation for Economic Cooperation and Development (OECD) countries, in the post-Bretton Woods era, by measuring the degree of central bank independence according to the extent of government influence over the finances and policies of the central banks. The study was based on the notions that; the degree of financial influence on the central bank was determined by the government's ability to set salary levels for members of the governing board of the central bank to control the central bank's budget and to allocate its profits. It was equally based on the assumption that the degree of policy influence was determined by the ability to appoint the members of the central bank's governing board, government representation on this board, and whether the government or the central

[87] Patricia Pollard, "Empirical Studies: Central Bank Independence and Economic Performance," *Federal Reserve Bank of St Louis Review,* 1993.
[88] Ibid.

bank was the final policy authority.[89] Countries were given a rank of one through four in each category with four being the highest level of central bank independence.

It was realised that the degree of financial independence of central banks was not a significant determinant of inflation in the post-Bretton Woods era. Policy independence however was seen as an important determinant of inflation because the two countries with the highest degree of policy independence, Germany and Switzerland, had inflation rates significantly below those of all other countries in the sample. Monetary announcements are deemed to be credible if they are made of an authoritative source that is an independent, apolitical, technocratic central bank, preferably with a history of statutory commitment to a single achievable goal such as low and stable inflation. In situations where the time consistency problem arises, it can be desirable to appoint policymakers whose preferences or incentives differ from those of society as a whole.[90]

To further pursue the debate revolving around central independence, Grilli Masciandara and Guido Tabellini created two indices of central bank independence, one based on economic measures of independence with a scale ranging from zero to eight, and the other based on political measures of independence with a scale ranging from zero to seven. The economic factors considered where the ability of the government to determine the conditions under which it can borrow from the central bank and the monetary instruments under the control of the central bank. The data set was composed of eighteen OECD countries over the period 1955-1989.[91] For the period as a whole, the authors found that economic independence was negatively

[89] Patricia Pollard, Empirical Studies: Central Bank Independence and Economic Performance," *Federal Reserve Bank of St Louis Review,* 1993.
[90] Peter N. Ireland, 'Rules Rather Than Discretion, After Twenty-Five Years, What Have We Learned? What Can We Learn?" *Boston College Working Papers in Economics,* No 530, 2002, 8.
[91] Grilli D. Masciandaro and Guido Tabellini, "Political and Economic Institutions and Public Finance Policies in the Industrial Countries," *Economic Policy, vol, 13, 36.*

related to inflation. Political independence also had a negative correlation with inflation, but the relationship was not statistically significant. Breaking the data into four decades, they found out that neither measure of independence had a significant effect on inflation in the first two decades. In the 1970s, both measures of independence were significant whereas in the 1980s, only the economic measure was significant.[92]

Alex Cukierman for his part provided an extensive analysis of central bank independence and its relationship to inflation performance using data from 1950 to 1989. Cukierman used legal measures of central bank's independence as well as practical measures of the level of independence. One such measure was the frequency of turn over of central bank governors. Another measure of practical independence was based on answers from a questionnaire completed by qualified individuals at central banks. It has been suggested that Cukierman's analysis is the most comprehensive to date, not only because it incorporates information about the actual level of independence a central bank enjoys in practice but also because it includes a sample of seventy countries. After completing his analysis, he concluded that "central bank's independence affects the rate of inflation in the expected direction."[93]

The application of this analytical framework to the BCEAO shows that it has a certain degree of independence and therefore credibility. The BCEAO lies above the average of several OECD central banks largely because of its freedom from pressure from any single fiscal authority and the statutory limits on government borrowing. This degree of independence has delivered lower inflation in previous years. Central bank's independence can be sub-divided into political independence, defined as the

[92] Grilli D. Masciandaro and Guido Tabellini, "Political and Economic Institutions and Public Finance Policies in the Industrial Countries," *Economic Policy* vol 13, 351-359.
[93] Alex Cukierman, "Central Bank Strategy, Credibility and Independence: Theory and Evidence," *Journal of Economics and Management Strategy*, *http://mitpress.mit.edu/catalog/item/default.esp?/type=2&tid=4225*.

capacity to choose the final goal of monetary policy, and economic independence seen as the capacity to choose the instruments with which to pursue the goals.[94] We now look at these differences and make an attempt to apply them to the BCEAO case.

Political Independence

The Governor is not appointed by government, The Governor appointed for more than five years, all members of the board not appointed by government, board appointed for more than five years, no mandatory participation for government in board, no governmental approval of monetary policy formulation required, statutory requirement than central bank pursues monetary stability among its goals and legal provisions that strengthen the central banks position in conflict with the government

Economic Independence

The Government's access to direct credit facility of the central bank not automatic, direct credit facility available at market rates of interest, direct credit facility explicitly temporary, direct credit facility limits amounts loaned, central bank does not participate in primary market for public debt, discount rate set by central bank and banking supervision not entrusted to central bank (two points) or not entrusted to central bank alone (one point).[95]

For its political independence, the BCEAO gets three points for the first three criteria because no individual government controls such decisions and one half points for the fourth because its board comprises ministers of finance, some of whom have better tenure and credibility than others. No points are given for criteria 5, 6 and 8, but a point is given for 7 as the bank has a statutory obligation to maintain the internal and external value of the CFA Franc. The total here is four and a half

[94] Real Lavergne, *Regional Integration and Cooperation in Africa: A Multidimensional Perspective* (Ottawa: International Development Research Centre, 1997), 232.
[95] Real Lavergne ed, *Regional Integration and Cooperation in West Africa: A Multidimensional Perspective* (Ottawa: International Development Research Centre, 1997), 234.

For its economic independence, the rules governing the BCEAO's direct credit facility are such that points are given for criteria 2, 3 and 4, but not for 1 and 5. The discount rate is set by the bank and since 1989, a separate agency has been established to oversee the financial system in the union, thus one point is given for each of criteria 6 and 7. Such an index cancels the subtleties of the monetary policymaking process in countries, and there is equally the issue of whether the experience of a statute necessarily means that its intent is carried out in practice. In our case, this framework represents well the position of the BCEAO in such matters slightly above the OECD norm and well above the norm of several developing countries.

The double Shocks of the 1980s and the Devaluation of the CFA Franc

Until the 1980s, the economies of the Franc zone outperformed the rest of sub-Saharan Africa in terms of both growth and controlling inflation. The underlying structure established for the Franc zone appeared to be solid. The underlying economic philosophy of the Franc zone arrangements was always that of an open and competitive market. Although consolidated at independence and not drastically consolidated since then, the institutional arrangements appear modern in appearance. Economic growth was in fact moving at a faster pace than population growth in the region prior to the 1980s. This resulted in improved living standards for the peoples of these countries.[96] Monetary stability made possible by the union was largely responsible for attracting international investors from both the public and private sectors of the Francophone West African states. There is no doubt that monetary stability together with the guarantee of convertibility enjoyed by the CFA Franc boosted trade of each of the states with their external partners.

[96] Patrick Honohan and Philip Lane, "Will the Euro Trigger More Monetary Unions in Africa?" *The World Bank and CEPR,*2000. 4.

One expert from ADE (Aid for Economic Decision Making) was quoted as saying that "The fact that UMOA did not use exchange rates as de facto form of protectionism opened up trade to a certain extent, in spite of the existence of both tariff and non-tariff barriers."[97] Due to these virtues demonstrated by the UMOA currency, member countries were able to import vital supplies needed for production in difficult times, while other countries experiencing the same short-term problems found their supplies cut off. The fixed exchange rate with France appeared to remove macro economic uncertainty and encourage external investments. Given their unwillingness to devalue and give up fixed parity with the French Franc, countries in this zone experienced low rates of inflation, which averaged 5.1 per cent in the late 1970s. In comparison, their non-CFA counterparts in a sample of comparable states averaged 26.2 per cent during the same period.[98]

However in the 1980s the Franc Zone countries had to cope with severe external shocks. Commodity prices fell sharply and the French Franc appreciated vis-à-vis the Dollar which is the denomination used for international commodity purchasing. As a result, products from the zone became uncompetitive both to emerging Asian producers and Anglophone countries in West Africa. In effect countries in the zone contracted significant debts during this period. Furthermore, most countries in the zone had entered negotiations with the IMF and World Bank leading to Structural Adjustment Programmes (SAP) at the beginning of 1980, and tensions emerged between structural adjustment and currency rigidity. From the late 1980s the International Financial Institutions clamoured for devaluation.[99] Experts reiterated

[97] "The West African Economic and Monetary Union; Springboard for Development," Bruxelles: Paper Prepared by the Club Bruxelles, 1996.
[98] Nicholas Van de Walle *African Economies and the Politics of Permanent Crisis1979-1999* 9Cambridge: Cambridge University Press, 2001), 252.
[99] Julius Emeka Okolo and Stephen Wright, *West African Regional Cooperation and Development* (Boulder; West View Press, 1990), 56.

that holding to a strong currency had become very expensive for the national economies of the countries within the franc zone. A report from the ADE pointed out that, "Up until 1984, these countries were doing relatively well as world markets for their exports rose and the dollar exchange rate went up simultaneously. Increases in revenue from duties on foreign imports added up to the growth factor. Then the subsequent collapse in trading conditions which followed the drop in the value of primary materials on the one hand, and the slide of the dollar on the other, threw the entire Franc zone into its worst economic crisis since independence."[100]

The shock waves caused by the sharp decline in the prices of raw materials in the world severely affected those countries which were highly dependent on export revenues although the blow struck some of the Franc zone countries harder than others. Then in 1985, there was a substantial rise in the value of the CFA Franc due to the combined effects of two external factors namely; the French Franc to which it was closely linked increased in value, while the exchange rates of other trading currencies simultaneously decreased. As fiscal imbalances accumulated, countries of the zone were unable to achieve a real depreciation through reduction of domestic prices alone given their initial low inflation levels.[101]

One glance at comparative GDP figures shows the extent to which the countries in the region steadily went downwards economically between 1987 and 1995.

[100] "The West African Monetary Union: Springboard for Development," Bruxelles: Paper Compiled by the Club Bruxelles, 1996.
[101] Ibrahim Elbadawi and Raimundo Soto, "Real Exchange Rates and Macro Economic Adjustments in Sub-Saharan Africa and other Developing Countries," *Journal of African Economies* vol 6 No 3, 74 - 75.

Table 3

Macro Economic Performance of the Franc Zone Countries 1987-1995

	Growth Rate in Gross Domestic Product					**Inflation**		
Country	**1987**	**1992**	**1993**	**1994**	**1995**	**1993**	**1994**	**1995**
Benin	3.2	4.1	3.1	3.6	5.8	0.5	38.6	5.1
Burkina Faso	3.6	2.5	-0.8	1.2	4.5	0.6	24.7	7.8
Cote d' Ivoire	2.4	-0.2	-0.2	1.8	6.5	2.1	26	14.2
Mali	1.6	8.4	-2.4	2.3	6	-0.6	24.7	12.4
Niger	1.4	-6.5	1.4	4	3	-0.4	35.6	10.5
Senegal	2.3	2.8	-2.1	2	4.5	0.6	32.1	8
Togo	1.3	-6.3	-15.5	13.9	8.3	-0.1	40.6	14.7
Cameroon	7.4	-3.3	-33	-37	3.1	-3.7	12.7	26.6
C.A.R	0.9	-2.5	-2.2	7.4	3.5	-2.9	24.5	19.2
Congo	7.7	2.4	-1.2	-6.7	0.9	0.3	56.6	8.9
Gabon	-3.9	0.7	3.2	1.7	2.8	0.6	36.1	10.9
Equatorial Guinea	1.2	14	7.1	6.8	10.7	1.6	38.9	6.3
Chad	0.6	8.1	-12	41	5.4	-7	14.3	5.6
Comoros	4.3	1.6	1.3	0.8	2.2	1.9	25	4.8
Sub-Saharan Africa	2.9	1	1.2	1.7	4.8	6	50.9	29.5

Source: IMF World Economic Perspectives, May 1996

The Comoros also had a fixed exchange rate with the French Franc (now with the Euro), and enjoys external guarantee from the French Treasury. The Comoros Franc was also devalued in 1994, but unlike the CFA it was devalued by 33 per cent because of its remoteness. The exchange rate became FF1=CF75.

As can be seen in Table 3, the growth rate in GDP in countries of the CFA zone fell between 1987 and 1994. For example, the growth rate of GDP of Burkina Faso fell from 3.6 in 1987 to 0.8 in 1994, and that of Cote d' Ivoire fell from 2.4 to 1.8 in the same period. The economy of Cameroon experienced a fall in the growth rate of its GDP from 7.4 in 1987 to -37 in 1994. As far as inflation levels are concerned, levels in Equatorial Guinea rose from 1.6 in 1993 to 38.9 in 1994, while that of Senegal rose from 0.6 to 32.1 within the same time frame.

The Historic Devaluation

French experts explained that although the monetary crisis was not the only problem facing the Franc zone nations, a readjustment in the parity of the CFA Franc looked more likely. This became inevitable as the IMF, never very keen on the idea of fixed parities became more and more insistent. Moreover the restrictions placed on free convertibility in 1993 designed to break capital flights showed the limits of such fixed parities. Repurchasing the CFA bank notes were suspended on August 2 1993 and no further inter-exchange of CFA currency between the zones was allowed from September of the same year. Against this background, the fourteen heads of state and government of the Franc zone decided on January 12 1994 to devalue the CFA Franc by 50 per cent vis-à-vis the French Franc.[102] In effect, the parity of the CFA Franc to the French Franc became 100 CFAF equal to 1FF. The decision which ended the parity that was nearly fifty years old was however accompanied by substantial

[102] "The Fabric of Reform, An IMF Video Exploring Economic Change in West Africa, IMF," *http;//www.imf.org/external/pubs/ft/fabric/index.htm.*

external support for adjustment policies which each of the fourteen governments were obliged to undertake. France cancelled all arrears and half of the future maturities on official development assistance debt amounting to $3billion. In all, between 1988 and 1995, over $13 billion of bilateral debt was forgiven, in a bid to help the zone cope with its financial problems.[103]

The devaluation was intended to ease budgetary problems by increasing the relative value of export earnings and aid receipts. The danger of inflation which was apparent as a result of increased import costs and wage demands was contained after initial fears. The consensus is that the devaluation was a necessary but insufficient solution to the areas economic problems.[104] A small increase in the commodity prices in 1995-1997 gave a boast to the region's economy and rather embellished the outcome of the devaluation.

The countries of the Franc zone took the opportunity after the devaluation to restructure their two regional organisations. The UMOA and the CEAO (*Communaute Economic de L'Afrique de L'Ouest,)* were fused into the UEMOA the *Union Economique et Monitaire Ouest Africaine,* or *the* West African Economic and Monetary Union. The Treaty of the UEMOA was signed in on 11 January 1994 but ratified by all members in July 1994. The UEMOA has financial autonomy over the union's institutions. It also aims at creating a common market through a common external tariff structure and the gradual elimination of internal tariffs between member states and to move towards free movement of capital, services and persons.[105]The bodies of the UEMOA are a replica of the EU, and this is because the treaty was

[103] Nicholas Van De Walle, *African Economies and the Politics of Permanent Crisis1979-1999* (Cambridge: Cambridge University Press, 2001), 222.
[104] "Growing up with the Umbilical Cord Attached: Developments in the African Franc Zone 1994-2001" London: Common Wealth Office, Africa Research Group, 2001, 5.
[105] "Growing Up With the Umbilical Cord Attached: Developments in the African Franc Zone 1994-2001" London" Common Wealth Office, Africa Research Group, 2001, 6.

inspired by European integration, and written with assistance from the European Commission.

In order to pursue the aims of convergence, surveillance and harmonization in the UEMOA, a wide range of policies were adopted and several bodies were set up. The *L' harmonisation en Afrique des Droits de Affaires,* (OHADA) was set up in 1993. In principle, it is open to all members of the OAU now the AU. Its current membership is the Franc zone countries, and its aim is to elaborate and enforce a common regulatory framework for investors.[106] Although UEMOA is officially committed to supporting the aim of integration within ECOWAS, relations between the two remain a source of tension. These tensions are not unconnected with historical differences between Anglophone and Francophone states in the region. In addition to this historical division, the Ivorian economy loses out in the ECOWAS "rules of origin." This rules discriminate in favour of African owned businesses whereas most of the industries in Cote d' Ivoire are owned by French companies. This has been a major hindrance for ECOWAS market integration. But of course the existing set up is bound to change as a result of tensions between the French and the Ivorians that has resulted in the expulsion of French citizens from the country. Fundamentally, UEMOA has decided to move ahead with its own integration in the light of the slow progress made by ECOWAS.

The experiences in the Central African zone have considerably been less fruitful. The Treaty instituting CEMAC which replaced the UDEAC is a replica of the UEMOA Treaty. However the CEMAC Treaty was not ratified by member states until July 1999. Despite support from France, the institutions of CEMAC have made

[106] "Growing Up With the Umbilical Cord Attached; Developments in the African franc Zone" London: Common Wealth Office, Africa Research Group, 2001, 7.

little progress. The poor state of regional infrastructure and conflict in several states of the community also hinders attempts to integrate their markets.

It can therefore be argued that colonialism fostered the integration of West African countries into the world economic system through regional links with the currencies with the two main colonial powers Britain and France. With the attainment of independence in the late 1950s and early 1960s, the British West African currency board that was dissolved and the various countries took up different currencies, and to an extent severed the financial ties with Britain. The French colonies on the other hand maintained links with France and were consolidated into the financial community of Africa with explicit support from France. The situation at this point is clear for all to see, French speaking states in West Africa have since maintained an economic and monetary union, while their counterparts now show increased determination to regroup into a monetary union and as a result have formed the West African Monetary zone and established the West African Monetary Institute. The aim of all this is to subsequently merge with the existing arrangements in Francophone West African and eventually form a West African Monetary Union with a single currency. It is against this background that the vision for monetary union and its operationalization would be viewed in the next chapter.