

THE BANKER'S VIEW

The strong euro and the franc zone

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(finalised 11th April 2008)

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The strengthening of the euro is renewing debate about exchange policy in francophone Africa. The currency of these countries, the CFA franc, is of course tied to the euro - as it had been to the French franc until 1999 - by a fixed though adjustable parity link (re. the massive devaluation of 1994). Some predict, then, a further devaluation. Others - more numerous as well as more vociferous - feel that the exchange system should at the very least be changed, for example by linking the CFA franc not to the euro alone but rather to a basket comprising both the euro and the U.S. dollar. Or, all links could be severed, allowing the currency to float freely, ending the agreement with France and in the process ending the so-called 'franc zone'.

Devalue the CFA franc against the euro? Why not? Nonetheless, such a measure is not inconsequential. Attachment to a strong currency is a powerful disinflation factor; in particular it lowers import costs. In a context which promises to be durable of spiraling price hikes for raw materials and foodstuffs, the CFA franc system presents advantages for poor countries of which one must remain aware. Of course there are disadvantages, and some production activities are penalized. It is up to the authorities to adopt temporary measures that might help them. But, to take the example of the cotton chain, it appears that this suffers more from the grants that rich countries provide for their own production. Moreover, the results obtained by a producing country like Burkina Faso (production growth of 20% annually for ten years and a tripling of exports) show that the true factors of competitiveness and productivity do not lie in a devalued currency.

Let us now discuss the more radical measures that have been put forward. Linking the CFA franc to a euro/dollar basket may appear to be a sensible solution. But, the franc zone agreement is not a mere exchange agreement; it is a system of monetary cooperation through which France guarantees the convertibility of the CFA franc into any currency, via the euro (without exposing it to the risks of direct negotiability on exchange markets). This guarantee is evidenced by the existence of an "operations" account in the French Treasury's books, opened for the central banks of African countries which have an almost unlimited right of withdrawal to tackle possible imbalances in external accounts. France could not continue to guarantee the direct convertibility of the CFA franc in any currency other than its own. An apparently logical move - changing the CFA franc's anchoring currency - would pull down the whole cooperation agreement, and so it would be the African central banks which would have to try and maintain a possible link with a basket of currencies with only their exchange reserves.

In consequence, there is no half way choice between a devaluation which would respect the cooperation agreement (but there we have already explained the risks) and the relinquishment of the cooperation agreement, which would leave the CFA franc to its own resources in international markets.

Many African intellectuals and economists favour this more radical solution, one which, according to them, would foster growth.

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Translation by D. and M. Jouan-Cross

April 2008

A comparison of those various states' performances who have floating currencies - Nigeria, Ghana (let alone Zimbabwe) - with those of African countries which are members of the CFA agreement, shows that growth there is barely superior structurally, but that inflation is far higher.

And there lies the whole problem. In these circumstances, the danger is that the CFA franc could see its credibility melt away and that it could suffer, at least for some time, a savage and uncontrollable depreciation on the exchange markets. Stripped of the support of the exchange agreement with France, could the central banks of francophone states control inflation? It is doubtful. In these countries, commercial banks lend little and enjoy abundant liquidity, rendering them virtually insensitive to the central bank's monetary policy. Good performance in relation to inflation is therefore mainly due to the credibility and disinflationary effect of a currency linked to a great global one. Restoring the intrinsic efficiency of monetary policy seems then to be an indispensable preliminary to any modification of exchange policy if one wishes to avoid an uncontrolled inflation, particularly devastating in poor countries.

It is quite remarkable to note that although the great majority of intellectuals and teachers in these countries favour ending the franc zone system, it is fiercely defended by the governments, economic and financial authorities, banks and business circles. What do we make of this? That the system no doubt has rationality, but that this link maintained with the former colonial power creates an unfavourable psychological context. So, the franc zone agreement is definitely not eternal. Before this no doubt unavoidable evolution, it would be advisable that the economic and monetary authorities in these countries provide more efficiency to economic and monetary policy through actions upon structure.

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April 2008