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Problems of Currency Integration

by Dr Christian Uhlig, Bochum *

In recent years, the discussion on the forms of organisation of the Franc Zone has again grown more controversial. The present article explains the functional structure of this currency association, and discusses the arguments of its critics.

One of the instruments for economic cooperation, which is of particular importance for the francophone African countries and Madagascar, is the Franc Currency Zone¹. Members of the association are France, its overseas departments and territories, Monaco, and the former French colonies which are now the independent states of West and Central Africa, as well as Madagascar². The discussion about the effectiveness of this currency union has, of late, grown more heated again. It has also to be admitted that 1972 and 1973 have been years of a true crisis for the Franc association. Already in 1959, Guinea had disaffiliated from the Franc Zone, and in 1960, Mali followed suit, though it returned later and again became a fully-integrated member, but in 1972, it was Mauritania, and in 1973, Madagascar, who decided on a final break with the Franc community. Also in the remaining member countries much unrest could be felt³, which caused a voluminous flurry of diplomatic activities and, eventually, a reorganisation of existing institutions, giving the African members more autonomy and more rights to participate in decision-making.

To summarise briefly, the Franc Zone machinery operates on the basis of the following principles:

Internal relations:

- ☐ fixed exchange rates of national currencies against the French Franc;
- ☐ unlimited convertibility between the currencies of member states;
- ☐ free monetary and capital transfers within the community;
- ☐ close cooperation in the field of monetary and financial policies.

External relations:

- ☐ all the gold and currency reserves of the member countries' central banks to be held in Paris as a joint pool;
- ☐ a common foreign currency policy and, on principle, free convertibility of internal currencies against all the external ones;

- ☐ in case of need, coordination of external policies.

In the view of Sohnen, any currency zone must be equipped with the four following qualities:

- ☐ constancy of exchange rates;
- ☐ complete convertibility;
- ☐ absence of banking charges for currency conversions and
- ☐ common banking practices and legal statutes in money matters⁴.

The Franc Zone meets these conditions.

Pooling of Currency Reserves

The main foundation upon which the system rests is the unlimited guarantee by the French Treasury for the currencies of all member states. For each central bank a "compte d'opérations" is being kept. Member states have pledged themselves to convert the amounts of foreign currency and/or gold holdings which they have earned into French Francs, which will be credited to their operating accounts in Paris. Their foreign currency debts are also being regulated through the same account like all other transactions in French Francs.

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¹ For documentation on the Franc Zone cf. IMF Staff Papers, vol. 10 (1963), p. 380 f.; IMF: Survey of African Economies, vol. 1, Washington, 1968, p. 14 ff.; vol. 3, Washington, 1970, p. 71 ff.; vol. 4, Washington, 1971, p. 154 ff.; X. de la Fournière, La Zone Franc, Paris, 1971.

² Until 1972, the membership was as follows: (West Africa) Dahomey, Ivory Coast, Mauritania, Niger, Upper Volta, Senegal, Togo (the operating area of BCEAO — Banque Centrale des Etats de l'Afrique de l'Ouest), also Mali (Banque Centrale de Mali); (Central Africa) Gabon, Cameroon, the Brazzaville Congo, Chad and the Central African Republic (all using the BCEAEC — Banque Centrale des Etats de l'Afrique Equatoriale et de Cameroun). For Madagascar, it is the Institut d'Emission Malgache which serves as its central bank. The Territory of the Afars and Issas (Djibouti) is ruled under a special statute; Algeria, Morocco, and Tunisia are associated states with a special status.

³ Examples were the uncommonly frank complaints of Togo's President, during the official visit of the late French President, Georges Pompidou, in 1972, against the adverse effects of the Franc Zone, and several interventions of other African presidents.

⁴ cf. E. Sohnen, Remarks on the Project of a European Monetary Union. In: H. Giersch (ed.): Integration durch Währungsunion? (Integration through Monetary Union?), Tübingen, 1971.

If required, central banks are allowed to make overdrafts on their operating accounts. This means that the international solvency of member countries will be guaranteed at all times. Apart from national credit balances with the IMF, all the Franc Zone member countries thus pool their foreign currency reserves in a joint reserve fund which is managed by the Banque de France. Accounting for the international reserve position of member countries is being done in French Francs.

However, the operating account is not intended as a funnel, through which to canalise long-term credit finance, similar to the use of special drawing rights from the IMF which LDCs want to obtain, but as a machinery reestablishing equilibrium of international payments which is disturbed by short-term fluctuations, and in addition to which the usual IMF drawing rights will always be available. The credit balances of member states are earning interest at French Bank Rate; if there are overdrafts of over French Fr. 10 mn, these have to pay interest calculated according to a formula based on French Bank Rate. Making credits expensive in this way and reinforcing the restrictions by certain clauses operating automatically and/or by decisions made to the same end by central bank boards of directors are all serving a policy of making money scarce in deficit countries, in order to reduce the pressure to import. A machinery like this, naturally, has strong and direct impacts on national monetary and economic policies of the member states affected who, themselves, can hardly bring their own influence to bear upon the machinery.

One-sided Advantages for France?

Critics against the way the Franc Zone is operating mainly bring forward the following objections⁵:

☐ The argument goes that the system in force is of advantage mainly to France, because overseas member countries usually have been able to accumulate credit balances of trade with third-party countries outside the Franc Zone, whilst their trade with France remained in deficit. This means, so it is argued, that overseas member countries are earning a sizeable foreign currency surplus for the Zone, with France getting payment for its balance of trade surplus vis-à-vis its partners from the foreign currency which these partners have been earning in third-party countries.

☐ Complete freedom of money and capital movements within the Zone is countered with the argument that this is again mainly to the benefit of the private capital interests in the former "mother country". Payment balances on private capital account allegedly are mainly saddled with big deficits through the transfer home of high salaries

of French staff stationed in overseas countries and the transfer of French-earned profits and French-owned capital sums. To compensate all this, substantial transfers of public funds are necessary.

☐ Since massive funds have so far flown to overseas countries, their balances of payments, in most cases, tended to be in equilibrium or to show a surplus. And this means that the monetary guarantees provided are being used very rarely. In other words, France extends a guarantee which costs it almost nothing, but this guarantee secures it the markets in all the other countries of the Franc Zone.

☐ But above all, through being firmly tied to the Franc Zone currency system, its overseas members are prevented from pursuing national monetary and financial policies geared to their own economic development; the automatic treaty clauses designed to secure the medium and long-term equilibrium of their balances of payments, often impose on overseas member countries early deflationary monetary policies, whilst France itself is hardly fettered by such restrictions and can pursue a more expansionist policy. Moreover, under their statutes, central banks of overseas members enjoy little chance to use their currency reserves for active financing of development, including the launching of longer-term credits to national treasuries.

That is why critics clamour for a revision of the treaties, in some cases even for complete dismantling or regionalisation of currency cooperation with France. In examining these arguments, however, one quickly discovers that the effects of currency integration of the overseas countries into the Franc Zone are by far not so adverse as is alleged by their critics.

As to the development of the balances of trade, critics are right in describing the effects of the Franc Zone but it can hardly be thought that this is such grave disadvantage for overseas countries, for it is clear that they have to import goods and services, if not from France, then from third-party countries with adequate foreign exchange expenditures. It is true that French trade reaps a benefit from the treaties, through its very high share in imports of the overseas countries, but hardly doing them any harm thereby. The only sufferers from such arrangements are third-party countries whose exports to the member countries are thus being reduced. Just a short time ago, an agreement has been made that the central banks of overseas member countries may use at their

⁵ For criticism cf. especially S. Amin, *Pour un aménagement du système monétaire des pays africains de la Zone Franc*. In: *Le mois en Afrique*, No. 41 (1969); S. Diallo, *La Zone Franc et les Etats africains après dix ans d'indépendance*. In: *Présence africaine*, Paris, 1971. M. Diarra, *Les Etats africains et la garantie monétaire de la France*, Paris, 1972.

FRANC ZONE

Balance of Payments and Reserve Positions of Central Banks and/or Issuing Banks in Africa and Madagascar

(In French Francs mn)

Area of Bank's Operations	1 Balance of Trade (Surplus/ Deficit)	2 Public Monies Transfer within Franc Zone ¹	3 Other Trans- actions ²	4 Total Balance (1-3)	5 Reserve Position	6 of which: Public Sector
(A)						
B.C.E.A.O.						
1968	+ 268	+ 346	— 528	+ 86		
1969	— 72	+ 389	— 107	+ 210	1,103	— 94
1970	— 73	+ 391	+ 132	+ 450	1,553	— 67
1971	— 598	+ 345	+ 231	— 22	1,531	— 69
B.C.E.A.E.C.						
1968	+ 1	+ 148	— 90	+ 59		
1969	+ 135	+ 204	— 362	— 23	115	— 63
1970	— 76	+ 257	— 49	+ 132	247	— 81
1971	— 123	+ 289	— 126	+ 40	287	— 107
(B) ³						
Mali		One-Sided Transfer	Balance of Capital Payments			
1969	— 130	+ 108	— 5	— 80	— 336	— 41
1970	— 76	+ 109	+ 7	— 68	— 342	— 35
1971	— 120	+ 131	+ 19	— 77	— 373	— 32
Madagascar						
1969	— 360	+ 178	+ 44	+ 10	137	49
1970	— 142	+ 158	+ 38	+ 64	270	83
1971	— 370	+ 170	+ 60	+ 114	267	83

¹ except financial transfers of Treasuries. ² all other transfers, especially for services. ³ for columns 2 and 3 the statistics of the areas (A) and (B) are not strictly comparable, because their principles of estimating subdivisions under main headings are different.
Source: Secrétariat du Comité Monétaire de la Zone Franc: La Zone Franc en 1971. In: Ministère de l'Economie et des Finances. Statistiques et Etudes Financières, No. 293, May 1973, pp. 167-179.

discretion 35 p.c. of their foreign currencies for trading with third-party countries.

Capital Tending to Flee

On the other hand, it is doubtful whether it was wise to retain the full freedom of movement for capital within the Franc Zone (in relations to third-party countries, this freedom is restricted by a number of regulations designed to protect the balance of foreign exchange payments of the Franc Zone as a whole). To establish statistical records of such movements is exceedingly difficult but it can be shown that there is a strong trend for capital leaving the overseas member countries and, remaining within the Franc Zone, for gravitating towards Paris. As can be well understood, this trend is particularly strong in times of trouble, e.g. immediately after the member countries had become independent in 1960, and after political coups, like those in the Congo People's Republic and Madagascar. The governments involved, as a rule, are not capable of introducing suitable measures of defence against their capital losses. On the other hand, the situation became more stabilised in the late sixties, after many countries had set up stronger incentives for investments. Thus, the Ivory Coast managed to report an average annual surplus of Fr. CFA 4 bn on capital payments account in 1963-68.

Also Gabon and Mauritania, by that time, had achieved to become net capital earners, whilst Cameroon and Senegal suffered from a net capital outflow, and Madagascar's surplus on capital account declined from FMG 2.2 bn in 1965 to FMG 127 mn in 1969. At the same time, it was striking how big were repatriated yields from investments. In Madagascar, this outflow reached an annual average of FMG 4 bn throughout 1965-69, and in the Ivory Coast it amounted to nearly Fr. CFA 10 bn, which represented 29 and 19 p.c. respectively of the gross investments of these countries⁴. Yet most of the balances of payments on private capital account were in surplus with third-party countries outside the Franc Zone, a consequence of the opening of the Zone for non-French capital.

The balances of public sector capital transfers were greatly in surplus, which meant that, in virtually all cases, the overall balances of payments of overseas member countries' central banks could be kept in equilibrium. Only Mali, since the financial reorganisation in 1967, suffers from a chronic deficit in its balance of payments. Also currency reserve positions are rather satisfactory — again with the exception of Mali. Yet it must not be overlooked that this situation and its sta-

⁴ Cf. Surveys of African Economies, op. cit. vol. 1, p. 33 ff.; vol. 3, p. 91 ff.; vol. 4, p. 175 ff. (Fr. CFA: FMG: French Fr. 0.02).

bility largely depends on the inflow of public sector monies and not exclusively on the national efforts and/or private capital movements (see Table).

Because of the relatively favourable currency reserve positions in central banks, the guarantee clause of the operating account has been, in fact, put to use rarely and temporarily. Only in Mali's case, this clause has been playing an important part for years back. It is just this example which proves how great are the advantages of this system in bridging periods of economic tension. At any rate, as long as the foreign exchange pool is sufficiently filled, the international solvency is assured, which is a great help for steadying the process of development and for defending Franc Zone countries against runaway inflation.

Unused Possibilities

It is true that the blessings of a currency union have to be paid for through a loss of national sovereignty and through a certain dependence on the country with the group's key currency, for in order to safeguard the ability of the overall system to operate, the scope for monetary and fiscal policies of individual member countries must obviously be narrower than in a system with full autonomy. Nevertheless, it is a fact that in the Franc Zone the central banks and national credit committees hold considerable authority for financing medium and long-term credits and also, within a carefully demarcated realm, for making cash lendings to public sector agencies. It is interesting that these possibilities quite frequently have not been used fully within the framework of the overall economy.

Assessment of the efficiency of given measures will, of course, also depend on the fundamental belief of the assessor as to how a given development process may be optimally steered. Those critics of the Franc Zone as Amin obviously base their objections on a structuralist credo, which supposes that an expansive monetary and financial policy may accelerate structural changes in national economy. The practical bankers and economically interested politicians who watch over the destinies of the Franc Zone prefer a cautious and non-inflationary policy under the leadership of a strong central bank. Judging by results, it may safely be stated that average economic growth in Franc Zone countries has not been inferior to that in other countries with more independent national monetary policies. The frequently cited comparison with countries that have been operating more expansively, e.g. Guinea, Ghana, and also Mali, up to date shows the more conservative members of the Franc Zone definitely in a more favourable light.

With all the advantages enumerated here for the system of the Franc Zone — an assured international solvency, risk-sharing, and shock absorption through pooling of currency reserves, together with relatively ample freedom of manoeuvre in external policies, and access to French and European capital markets — why is there such deep dissatisfaction among Franc Zone members?

Apparently, the Franc Zone system is beset with a deep structural short-coming. The country whose currency serves as the key currency becomes the metropolitan centre of the whole system and, politically and economically, it occupies a superior position vis-à-vis the more peripheral member countries, which resent their position as that of dependents and the situation of the metropolitan country as that of a ruler.

It is not only the case that virtually the entire machinery of the currency zone is being set in motion from Paris, but also French influence on economic, financial and development policies of overseas member countries is still considerable after the latter have become independent, and after some degree of decolonisation has been reached. France dominates private banking, most economic activities and even a large part of public administration. The system of the Franc Zone strengthens this position, because economic freedom and free movement of money and capital mainly benefit French interests and those of other industrialised countries.

National capital can hardly hold its own against the superior "competition of money and of brains" coming from the old "mother country". This leads to the danger that economic growth will mainly be outward-directed, which contributes little to strengthening national population groups and to integrating better the national economies. That capital transfers are unlimited in such a system creates an undefended open flank of a dependent economy tied to an international currency union and incapable of fighting effectively against undesirable capital flight. On the whole, the Franc Zone is — with regard to the assessment of the advantages and disadvantages of the currency union — situated approximately as H. G. Grubel describes the problems of regional associations:

"First, many gains from regional associations are diffuse and their appreciation requires a significant understanding of technical economic analysis. The losses on the other hand, are much more specific and direct and are likely to arouse greater organised political opposition than do gains... Second, the welfare losses from most forms of regional association are due to the need to adjust domestically preferred income and ex-

penditure patterns and due to the perceived risk that a group of people is at the mercy of another group, on whose compassion and sympathy it cannot rely⁷."

The feeling of economic and political dependence upon the former "mother country" is strengthened by the view that frequently-praised advantages of currency cooperation are being reduced by further disadvantages: The structural weakness of the key currency devalues these countries' own currency reserves, which are accounted for in Francs. And against the substantial French development aid, whose effects are described as useful, it is held that a large part of such aid serves financing the cost of French experts entrenched in the national administration and of the educational system which is closely tied to that of France, strengthening dependence on France.

New Forms of Organisation

During recent months, criticism against the forms of the Franc Zone organisation has led to important reforms, which all aim at increasing the autonomy of overseas central banks and member countries. Thus, the Central African Central Bank has been reorganised and renamed "Banque des Etats de l'Afrique Centrale (BEAC)". From now on, its president will always be an African, the first one being the Gabonese Minister of Finance. Its board of directors will also be more strongly Africanised. Its seat is to be transferred to Cameroon in 1975. A reconstruction of the administration of the West African Bank is also in train. In future, France will be represented on its administrative board by two members only, which is no more than each single one of the other member states sends there. Its Board of Management will become more Africanised, and the newly-created position of Bank Governor will be filled by an African, to be elected by the member states of the West African Currency Union.

Both banks have been given wider authority to make available more credits for development financing. Permissible lending periods for private credits have been lengthened, and central banks will be able to grant more direct development credits, e.g. for improving the infrastructure, or for acquiring an interest in a development bank. Financing of adverse budgets has been made easier by extending the ceiling for cash credit to national treasuries which was raised from 15 to 20 p.c. of annual budget estimates of revenue, available for a lending period of no more than 240 days or to the end of the budget year. In order to safeguard their currency reserves against losses

conditional on devaluation, central banks may now convert part of them into other currency, without depriving the Franc of its preferential position. For the area served by BCEAO the new rule was made that the value of its reserves must henceforth be expressed in quantities of gold, and that 35 p.c. of these reserves will be freely available for financing trade with third-party countries.

In the case of Madagascar, there were negotiations running in 1973, but it was not possible to hammer out a solution acceptable to both negotiating parties. This really seems strange in view of the evolution in other areas. The main stumbling block was Madagascar's demand to be able to control capital transactions independently, which France refused to concede as a matter of principle. France also was against any form of Madagascar's association with the currency zone. In Mauritania's case, it may be taken for granted that its disaffiliation from the Zone was partly caused by its ties with the Arabian countries. Moreover, Mauritania's rich natural resources provide a solid basis for that country being able to maintain its independent currency stable.

Currency Union and Oil Crisis

For the long-term viability of the Franc Zone, its future ability to hold together in face of the rising foreign currency demand originating from the inflated prices for crude oil imports will be crucial. Will a currency union, whose key currency has swiftly come to grief under the pressure of the crude oil crisis, be able to overcome difficulties more effectively than a regional association, or individual nations going it alone?

In spite of contemporary problems, a number of arguments seem to speak in favour of the currency union: Firstly, among the member countries there is at least one (Gabon) that is a crude oil exporter, which means that it has foreign currency earnings that lighten the burdens weighing upon the joint balance of payments. Moreover, other natural resources and their value must not be underestimated — for example, those of uranium and manganese. Secondly, choosing the Zone's imports to a higher degree to come from member countries, and directing a higher export volume to third-party countries, might help to strengthen foreign currency reserves to pay for energy imports. Apart from all that, however, it will become much more important for overseas member countries than it has been so far to be able to finance temporary deficits of the balances of payments in relation to France via their "compte d'opérations". This will, however, be possible only on condition that members preserve solidarity among themselves.

⁷ See H. G. Grubel, *Optimum Regional Associations*. In: H. G. Johnson and A. K. Swoboda (eds.): *The Economics of Common Currencies*. London, 1973, p. 110 ff.