

Is the time right for a single currency in West Africa?

By Iwa Salami 27 Feb 2020

The eight Francophone states that form the <u>West African Economic and Monetary Union</u> have agreed to drop the use of the <u>CFA Franc</u>. Benin, Burkina Faso, Guinea-Bissau, Ivory Coast, Mali, Niger, Senegal, and Togo will soon start using new currency, the 'Eco'. The currency is scheduled for launch in June 2020.



CFA franc countries will no longer have to keep 50% of their foreign exchange reserves at the French Treasury. Shutterstock

These eight states are members of the Economic Community of West African States (Ecowas), a wider regional economic community, which also has a plan to introduce a single currency in 2020.

The decision by the francophone countries marks a break with their colonial past. The CFA franc was <u>created</u> by France in 1945 as a single currency for its former West African colonies. Six other countries — Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon — also use the CFA franc. The six comprise the <u>Central African Economic and Monetary Union</u>. Of the six, Guinea-Bissau and Equatorial Guinea weren't French colonies.

Its value was originally pegged to the French franc which was subsumed into the Euro after France became a member of the Eurozone, a group of European countries belonging to a monetary union.

The CFA franc has since been pegged to the Euro, and underpinned by France. This requires that the Francophone countries keep 50% of their foreign exchange reserves with the French treasury. This is one of the reasons why the CFA franc has been <u>criticised</u> as exploitative.

The peg of the CFA franc – first to the French franc and later the Euro – has delivered some benefits for the Francophone states. For one, relative to other African countries, the CFA franc zone member states have had very low inflation and a stable currency, which was <u>devalued</u> once in 1994.

Over and above the foreign exchange reserves arrangement, France guarantees the convertibility of the CFA franc at a fixed rate. The French Treasury stands ready to lend to the <u>Central Bank of West African States</u> should the central bank not have enough foreign reserves. For this arrangement or guarantee, a French representative sits on the <u>board of directors</u> of the Central Bank of West African States as well as the central bank's various committees, including the <u>monetary policy committee</u>. This representative has a statutory right of veto.

But it's also been heavily criticised. And the launch of the new currency is aimed at breaking the current CFA arrangement that many view as being inherently unfair to African countries.

What complicates matters even further is that the choice of the name for the new currency for the West African Economic and Monetary Union has <u>angered</u> fellow member states of the <u>Economic Community of West African States</u> (ECOWAS). ECOWAS states decided last year on <u>Eco</u>, as the name for the regional block's new currency which they also planned to launch this year.

The case critics make

Critics of the CFA franc point to France's right of veto as one that deprives West African states of their monetary sovereignty. Monetary sovereignty refers primarily to three rights. These are:

- the right to issue currency (coins and banknotes) that is legal tender within its territory;
- the right to determine and change the value of that currency; and
- the right to regulate the use of that currency, or any other currency, within its territory.

The CFA franc arrangement has also been criticised for stifling industrialisation and economic development and has not facilitated trade among Member States of West African Economic and Monetary Union. Among the reasons for its failure to facilitate trade are inadequate transport infrastructure and costly border procedures.

The introduction of the 'Eco' will diminish France's influence in the monetary union. France will no longer have representation on the monetary union board. CFA franc countries will also no longer be required to keep half of their foreign exchange reserves with the French Treasury.

France maintains, however, that it will continue to support the peg of the Eco to the Euro. Should countries using the Eco not be able to pay for their imports, France will cover these payments. The catch though is that such an event will trigger France's return to the monetary policy committee.

Central bank independence is key

Announcing a break with the colonial past is one thing. The challenge will be maintaining the components of the monetary union – such as a stable currency and keeping inflation under control both of which require an independent central bank – once institutional arrangements change and the countries delink from France.

Will the Central Bank of West African States be able to maintain a stable currency and low inflation without France? This has been a huge struggle for other West African central banks.

West African states have been unable to achieve a stable currency and low inflation rates largely due to lack of independence of their central banks. <u>Indepedence</u> in this instance refers to the freedom with which a central banks controls the cost, supply and availability of money without political interference.

Achieving central bank independence across West Africa is likely to be a challenge without a robust legal framework protecting the regional central bank's independence. But even with a robust legal framework for central bank independence, the <u>European Monetary Union</u> experience shows that sustaining a single currency can be <u>a challenge</u>. Currently, some of the states of the Economic Community of West African States <u>don't comply</u> with the economic convergence rules for the proposed monetary union.

Rather than aiming to achieve a monetary union across Economic Community of West African States, West African states should in the immediate term focus on strengthening their economies. They can do this by bringing down budget deficits, government debt, and inflation rates.

They should also boost intra-regional trade, increase foreign investment and job creation. This would inevitably enable the achievement of the convergence criteria - the economic requirements for joining a monetary union - and make member states ready to achieve a monetary union.

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