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ABSTRACT

The paper identifies and examines those factors that have affected growth in the CFA franc zone countries relative to the non CFA countries. It examines the special arrangements between franc zone countries and France, which give some advantages that seem not to have created a more rapid and sustained growth in the CFA franc zone region.

However, the most important factor (which seems to reflect other factors) is found to be the institutional rigidity imposed by the monetary and exchange rate arrangement. The rigidities have negatively affected the different aspects of economies of the CFA franc countries, and therefore affect their long-term growth prospects as an examination of the different factors strongly indicates.

For example the imbalances, particularly the external imbalances lacked the self-correcting mechanism. Most of the Non-CFA countries depended on external adjustment strategies by relying on the flexible exchange rate adjustment although with high inflation. The CFA franc countries tried to correct the imbalances by internal adjustment alone with much difficulty. A major difficulty is that the export base is mainly primary goods and the one time across-the-board (all countries the same rate) devaluation increase capacity utilization rather than capacity expansion in almost all the countries. Very thin trade within the zone and large trade between the zone and other countries, tend to generate much disequilibrium. Also a strong and unified monetary system has not been able to produce a strong financial and banking system in the zone. The weak banking sector has therefore encouraged capital flight. Hence for effective macro-economic policy for long-term growth, the factors and rigidities analysed in the paper must actually be taken into consideration and in some cases rigidities must be removed.

1 INTRODUCTION

African countries, including the CFA franc zone countries have had chronic low economic growth. Yet CFA franc zone countries like Cameroon, Gabon and Côte d'Ivoire were success stories for over the two decades of the 1960s and 1970s. The growth of Côte d'Ivoire was above that of Korea in the 1960s. But by 1987 Korea had become one of the highest performing developing economies in the world, while Côte d'Ivoire became one of the poorest performers (Bruno and Easterly 1996, Lindenberg 1993). By the mid-1980s the CFA franc economies collapsed despite the special arrangements these CFA franc countries have with France. Economic performance in the various countries of the CFA franc zone has been uneven since independence. They depend on varying degrees on agriculture where development has been quite slow.

Recently there has been considerable interest in the long-term growth of African economies. This has been partly because of the very poor performance starting in the 1970s for the Non-CFA franc countries and in the mid-1980s for the CFA franc countries (table 1). The serious domestic policy failures coupled with severe external shocks resulted to sharp decline of the African economies in the 1970s and 1980s. To revamp these economies in a sustainable way, we need to know and assess the determinants of long-term growth. In particular, what is the impact of the special arrangements of the CFA franc countries with France on the long-term socio-economic performance of the CFA franc countries relative to the non-CFA franc countries in Sub Saharan Africa? These countries faced similar initial structural constraints but might have later followed different policies mainly because of these special arrangements.

The CFA franc countries have the same characteristics as with other African countries especially their neighbouring countries but they differ in their monetary and exchange rate arrangements. This provides a sort of controlled experiment on which the experience of the CFA countries can show the effects of these arrangements on economic performance. The main objective of this paper is to identify the special arrangements between the CFA franc zone countries and France, and examine how each has affected the socio-economic development of the CFA franc countries relative to the non-CFA franc Sub-Saharan African countries.

Until this decade, the African French speaking countries' trade with France has been more important than with any other country. But of all the special arrangements, the ones that stand out clearly and uniquely with much economic implications for the African economies are the monetary and financial institution arrangements between the CFA franc countries and France. Because of these arrangements and historical ties, France also provides some technical and financial assistance to these developing countries. The analysis therefore focuses on the impact of these monetary and financial arrangements on the CFA franc countries. The effects of these arrangements may be reflected in the outcomes including the internal and external macroeconomic balances although difficult to isolate.

1.1 The Problem

Before the 1980s, the CFA franc zone countries' economies (with a few non-CFA franc countries-Botswana and South Africa, which were already exploiting and exporting minerals) performed very well. Their economic situation was relatively better than that of the non–franc zone (Devarajan and De Melo 1987, Amin 1997). But their economic situation reversed after the mid-1980s. There was suggestion that the same institutional arrangements that contributed to their good economic performance prior to the 1980s have also hindered them from adjusting timely to both internal and external shocks (Devarajan and De Melo, 1991).

Yet there was much discussion on the profitability that the CFA franc zone countries derived from the monetary union (Van de Walle 1991, Allechi and Naimkey 1994). The monetary arrangements included the CFA franc convertibility into the French franc backed by the French Treasury. The convention included strict fiscal and monetary rules, which provided much financial and monetary stability. But the advantages seem not to have created a more rapid and sustained growth in the region. Why have the advantages such as low inflation, greater stability and discipline, special arrangement not generated better outcomes in these economies? How have some of these arrangements affected the macroeconomic factors and consequently growth of this zone? What are the channels through which the monetary and fiscal policies work? How stable has the macroeconomic environment been because of these special arrangements?

It is crucial to ascertain those factors that can determine the long run growth and to find out those relevant policies necessary to accelerate growth and consequently the welfare of the people. With the emergence of the European Monetary Integration and the Euro, the question of the future of the CFA franc gains greater importance. By the year 2002, the European member countries' currencies would disappear. This becomes also important to examine the existing arrangements and see what insight could be gained for improved future policy making in the CFA franc zone economies. Furthermore, these countries are in the process of integrating their economies more through economic unions, which would require, among others, the co-ordination of some of their macroeconomic policies.

2 BACKGROUND

The CFA franc zone system has two regions and the Comoros - Central and Western Francophone Africa region and Comoros Republic – 15 countries altogether. The analysis is limited to the two regions, which maintain two separate identities, have separate currencies with separate central banks. CFA franc is Communauté Financiere Africaine in the West African Economic and Monetary Union (WAEMU), and Cooperation Financiere en Afrique Centrale in the Central African Economic and Monetary Union. The regional central banks are the Banque des Etats de l'Afrique Centrale (BEAC) and the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) for Central and West Africa respectively. Each central bank has an operation account with the French Treasury.

This franc zone has some features that are unique and stand out clearly in the developing world:

1) No member state has independent exchange rate and monetary policy. The monetary and exchange rate policies are set by the BCEAO and BEAC boards of governors, and the implementation of the policies is done by the national branches of the two independent central banks which are linked to France. Any policy change on these issues such as parity change must be in total agreement between France and the two central banks. Hence, member countries individually operate under fixed exchange rate regimes with no monetary policies of their own; since the central banks are independent of the national authorities. Accordingly, this minimizes inflationary tendencies. The fixed parity between the CFA franc and the French franc was at 1FF = 50 CFAF for the period 1948-1993 and 1FF = 100CFAF since 1994. However, France can unilaterally alter its rate relatively to other international currencies.

2) With the operation account opened in the French Treasury, there is full convertibility of the CFA franc into the French franc guaranteed by the special operation account and not by the French

Central Bank. Up till 1992, there was limitless transferability within regional members, and between region and France, free mobility of capital within the zone and between the zones and France. But in 1993 there was some restrictions imposed on currency convertibility – no repurchasing of CFA francs outside the zone of issue (BEAC and BCEAO). This has tended to create informal markets where changes are in parity between the two CFA franc areas and even with Non-CFA franc areas. In certain cases the CFA franc of one of the central banks may be over-valued relative to the other, partly because of the volume of transactions within this zone, including the strength of the economies in each of the two regions, and between the zone and the non-zone areas. Also, the convertibility of the CFA franc (as against the unconvertible Naira [Nigerian currency] or Cedi [Ghanian currency]) plays a very important role in cross-border trade within this regions.

3) Reserves are pooled together within the region, with the French Treasury and a common foreign exchange policy of franc zone with the rest of the world.

4) The principles of the arrangement are guided by a number of rules: 'each central bank, a) Maintains at least 65% of its foreign assets in its operation account with the French Treasury. b) Maintains a foreign exchange cover of at least 20 % for its sight liabilities, and c) Limits its credit to government of member countries to a ceiling equivalent to 20 % of that country's government revenue in the previous year' (Hadjimichael and Galy 1997, p. 8).

2.1 Some Implications

These are distinguishing features in the adjustment process and have some implications on the economic growth of the zone. These countries individually or collectively cannot use nominal exchange rate as a policy without the agreement of France. With the regional central banks and France ensuring the monetary and exchange rate policies, and the strong commitment to the fixed exchange rate regime, pressure is then put on other macroeconomic policies. The price, interest rates and quantity of money are stable because of these arrangements. Individually the CFA franc countries can only use their fiscal policy to manage their economies, and collectively they can use both monetary and fiscal policies. Thus putting more pressure on their fiscal policy. Still the institutional rules restrict the government from borrowing domestically above 20 % of the tax revenues of the previous year. But the foreign borrowing is not institutionally restricted, instead foreign borrowing depends on the government's creditworthiness. The government's financial resources are a function of tax revenues and foreign borrowing. Rules and regulations are used to co-ordinate the monetary and fiscal policies in the zone, although each central bank sets monetary policy according to the sub-regional economic conditions. Using rules and regulations to merge monetary and fiscal policies is different from developing varying degrees of monetary and fiscal policy mix for proper macroeconomic management.

The full convertibility is not 'ensured' by the market system of demand and supply where CFA francs are bought and sold. Instead CFA francs are converted into French francs. This means that convertibility is based on administrative decisions that can vary according to economic and financial situations of either the member countries or France. Moreover because of the fixed exchange rate system these economies might not have responded rightly to the international changes; since the automatic adjustment might not have functioned appropriately.

Prior to 1980, the CFA franc zone countries were exporting greatly to the world market at fairly good prices. The situation was also helped by the fact that the French franc depreciated against the dollar. The very poor performance of these countries came after the mid 1980s. This period also

coincided with the world recession that was aggravated by many factors including declining terms of trade and oil price shocks, with the French franc also appreciated against the US dollar as the French government followed a policy of strong franc to keep up with the Deutsche mark. The imbalances, lacked the self-correcting mechanism.

2.2 Euro and CFA Franc

With the formation of the European Economic and Monetary Union, the CFA franc is pegged to the Euro with the support of the French Treasury-budgetary arrangement. In the medium to long run, the principal risks would be linked to how firm the Euro is with respect to other major currencies (Dollar, Yen, Swiss franc). The CFA franc zone produces and exports a limited number of basic products whose world prices are quoted in Dollars.

Although CFA franc countries carry out more than 50% of their trade with the European Union members, the trade is denominated in Dollars. Capital flows such as grants and loans with major international financial institutions (World Bank, IMF) are in Dollars. Japan too is rapidly increasing its transactions with the CFA franc countries with these transactions being denominated in the Japanese Yen. Also theoretical and empirical arguments (Devarajan and Rodrik 1991, Elbadawi and Majd 1992, Elbadawi and Soto 1997) show that adjustable exchange rate parity is much preferable to the fixed parity. Flexible pegging would tend to remove the CFA devaluation problems, which would occur under the fixed exchange rate in the long run.

The CFA franc may face the same problem as it did when fixed to the French franc. This is because the CFA franc and French franc arrangements remain basically unchanged, even the Maastricht treaty maintains that the arrangements remain unchanged. Even after 2003 when the French franc must have disappeared, but with the same arrangement the CFA zone countries will still keep their reserves under the operation account in the French Treasury to support its convertibility.

But they would have to sustain greater economic and monetary efficiency as demanded by the Maastricht agreement. That is the link between the Euro and the CFA franc is supported by the French Treasury - a budgetary arrangement with serious implication, taking into consideration the strict budgetary rules imposed by the European Union on its members. The European governments agreed on a ceiling on fiscal deficits of 3% of GDP. Public debt must not exceed 1.5% of the average of the most performing states. The interest rate must not exceed 2% of the average of the three countries having the most stable prices and government debt of no more than 60% of GDP among other convergence criteria. These European Union targets immediately imposed fiscal discipline on the CFA franc countries which must agree on implementing what constitute good economic policies, in order to continue pegging their currency to the Euro. These convergence criteria are therefore imposed directly or indirectly on the franc zone countries in such a way that their adherence to these criteria with proper economic management should significantly contribute in reducing perceived risk to investors, among other things.

Parties to the Maastricht treaty who fail to respect the convergence criteria, among others, will cease to be part of the monetary union. The CFA franc countries are no exception, they must respect these rules as well as maintain discipline and good governance. Hence, besides the CFA monetary and exchange rate constraints, additional fiscal and management constraints have been imposed on the CFA franc countries.

The zone, will likely guarantee stability against threats from other strong currencies. However there is still much uncertainty as to the exact future value of the CFA franc. Some scholars think it would still be devalued and this constant speculative attitude may likely lead to an outflow of capital from the zone for security reasons. There is also the possibility of frequent modification of the exchange rate of the CFA franc and this depends on the strength of the Euro. An increase in interest rate for example may affect the exports and debts of the CFA countries negatively. Where the CFA franc countries fail to meet up with the conditions of participation stipulated by the Maastricht treaty, there is also a possibility of the eventual collapse of the zone. The collapse will likely lead to the creation of independent central banks issuing domestic currencies. Political pressures on monetary authorities to print money needed to cover public finance deficits may lead to discrepancies in the management of domestic currencies (Yondo 1997). Another possibility is that the present monetary unions of the CFA franc zone can become independent as long as the issue of currencies is well adapted to the needs of the various economies.

3 PERFORMANCE DIFFERENCES

The differences in performance and timing between CFA franc and non-CFA countries are distinct. The crises of Non-CFA franc countries started as from the late 1970s and continued into the early 1980s; while the crises of the CFA franc countries started as from the mid 1980s. For the period 1986-1992 all the CFA franc countries had a negative growth rate with protracted macroeconomic imbalances. The severe adjustment problems occurred at different times in the two groups of countries (tables 2 and 3). Also the policy responses differed between the CFA and non-CFA franc countries. There has recently been greater stress on the stability and certainty of macroeconomic policy environment in promoting growth through investment and other factors (Ojo and Oshikoya 1995). For the period 1986-1993 and the early 1990s, majority of the CFA franc countries had protracted macro imbalances, with negative per capita growth which were not experienced by the Non-CFA franc countries. The investment and savings tendencies were different and closely linked to the group's macroeconomic imbalances. The CFA franc countries with large imbalances had low savings and investment to GDP ratios than the others (Hadjimichael et al 1996).

During the late 1970s, the CFA zone members had higher investment to GDP ratios than other African countries. The gap in investment to GDP ratios between the CFA countries and other African countries narrowed during the 1980s (Devarajan and Melo, 1991). The average growth rate of the GDP was 4.6% during 1975 - 1985 compared to 1.4% for non-CFA African countries. This rate became lower during 1986-93 where it was barely 0.1% compared to that of non-CFA zone countries of 2.5%. The investment rate fell sharply for the CFA franc countries during 1986-93 than in non-CFA countries (table 4). During 1986-93, the non-CFA franc countries had depreciated their exchange rates and became more competitive than the CFA franc countries. The increase in competitiveness of neighbouring economies undermined that of CFA countries which resorted to cuts in expenditure to reduce current account deficits (Devarajan and Melo, 1991). In the face of these cuts, investment expenditures suffered sharply thus reducing growth.

It seems the timing would have been the same but for the discipline imposed by the monetary arrangement on the CFA franc countries and the depreciation of the French franc relative to the dollar. With accumulation of huge fiscal deficits, the CFA franc countries could not depreciate their real exchange rate by domestic prices alone as their initial inflation levels were low.

During the later part of the 1980s the CFA franc countries were suffering from over valuation of the real exchange rate, which severely affected their competitiveness and caused serious recession. At this very period, the non-CFA franc countries with their flexible exchange rate regimes were able to successfully carry out the adjustments, which was found to be very difficult in the CFA franc countries. The 1994 devaluation of the CFA franc by 50% relative to the French franc helped the CFA franc countries to address some of their imbalances. The successful real exchange realignment improved the export competitive situation and seemed to have promoted growth. Most of the other countries depended on external adjustment strategies by relying on the flexible exchange rate to also adjust the current account but with high inflation. A question then arises as to why under the fixed exchange rate regime of the CFA franc countries, fiscal policy performance seemed to have been poor. The poor performance seemed to have impact on the poverty situation of these countries.

3.1 Human Development and Poverty

In 1997, UNDP produced the Human Poverty Index (HPI) which reflects different features of human deprivation in the quality of life. The Human Poverty Index (HPI) concentrates on three essential elements of human life reflected in the Human Development Index (HDI) - longevity, knowledge and a decent standard of living (UNDP 1997).

Compared with other developing countries, African countries performed poorer in the HPI. Among African countries, the CFA franc countries had higher poverty index than the non-CFA franc countries. From this index the non-CFA franc zone countries seem generally to perform much better than the CFA franc countries (table 5). This summarizes the extent of poverty in this region. As the ranking shows, the poorer the country, the lower (in terms of big numbers) the ranking. The CFA franc countries tend to rank lower than the non-CFA countries. This means their poverty level is higher. The higher poverty index is therefore not only due to income per capita, rather it is due to having the lowest life expectancy and the lowest level of combined educational enrolment.

In reducing or eradicating poverty the variables in the different components must be examined carefully. Then clear policies must be formulated and implemented with a key set of measurable targets within time limits. Some countries have examined the causes of poverty and attempted to develop appropriate strategies for eradicating poverty. In certain cases, much stress is put on the social sector - particularly on education and health. Some countries have tried to incorporate poverty into their structural adjustment programmes (SAP). Many countries have neglected poverty in theirs. But a comprehensive way of combating poverty is necessary. Whatever the strategies for poverty reduction and eradication, proper and efficient allocation of resources is essential. Proper budgetary allocation must be made mainly to enhance spending for the eradication of poverty. In short, sound economic management is critically important. A situation which, is badly needed in the CFA franc countries.

3.2 Some Important Aspects of CFA Franc Institutions on the Zone's Performance

There are some important factors that have had greater impact on the economies of the CFA franc zone: the exchange rate regime, convertibility of the CFA franc guaranteed by the French Treasury and the relative independence of the two regional central banks. The stability of the exchange rate is a unique characteristic of the zone. Stability reduces risk and uncertainty; and low risk and low uncertainty are conducive for economic growth. Studies have shown that fixed exchange rate regime of CFA franc countries has allowed these countries to maintain lower inflation rate than other non-CFA franc African countries. Yet their inability to adjust their exchange rates

individually means their economic growth is more vulnerable to terms of trade fluctuation. As it has been shown that flexibility is more adjustable to external shocks (Devarajan and Rodrik 1991).

Some studies have asserted that both exchange rates variability and misalignment have tended to dampen export growth and consequently economic growth. According to these studies, because of variability and misalignment resources are allocated to non-traded sector with increase in uncertainty (Ghura and Grennes 1993). Some authors have claimed that the zone members have suffered less from exchange rate instability than have other developing countries (Semedo and Villieu 1997), and this should have promoted economic growth. Instability of real and nominal exchange rates was lower for the CFA franc zone countries than in other African countries, the pegging of the CFA franc to the French franc reduces the risk and uncertainty in transactions in the CFA than other African countries. The CFA franc countries benefited from the lower nominal exchange rates instability without sacrificing higher real variability. The CFA franc countries have suffered despite this exchange rate variability partly because the exchange rate was misalignment but with lower instability.

The convertibility of the CFA franc and the guarantee given by the French Treasury reduces the risk of default. The zone therefore has access to foreign exchange, which can be used to finance capital goods necessary for development. The institutional rules made it easier to obtain foreign loans. This contributed significantly to higher public debts in the CFA franc zone countries than in the non-zone countries (table 2). For the period 1970-1984, the zone's debts increased 14 times as against 10 times for other African countries. One may therefore argue that the zone has not been very much constrained by capital for development purposes as much as the other African countries. However, having easy access to capital may not necessarily mean that the capital is used efficiently for productive activities. A country may increase its indebtedness without increasing its productive capacity.

The independence of the regional central banks and its relative monetary stability contributed in maintaining low inflation rate in the zone. Semedo and Villieu (1997) have shown that the higher the degree of the central bank's independence, the lower the inflation rates. After the mid 1980s, the inflation rate was still low compared to that in non-CFA franc countries but the growth rate of GDP of 1.1% was less compared to 2.5% in non-CFA countries. The poor performance of CFA franc countries on growth rates in spite of the low inflation was due to poor macroeconomic policies implemented in the different countries of the zone during the latter part of the 1980s (World Bank 1994).

Many studies have concluded that the effect of inflation on growth is negative, that is long term inflation tends to reduce growth. The adverse effect of inflation on growth is based on experience of high inflation. However, the magnitude of effect is small. This can be seen from Barro's cross country study that 'an increase in the average inflation rate by 10 percent points per year is estimated to lower the growth rate of real per capital GDP on impact by 0.3-0.4 percentage points per year' (Barro 1996 p. 68). Small as it is, could build up to large growth reduction in a longer period. Hence there should be a justified interest maintaining price stability- low inflation. Low inflation rate in the CFA franc zone should have been conducive to growth, although these countries don't seem to have benefited much from the low inflation rate.

3.3 Macroeconomic Management

Sound macroeconomic management promotes strong and sustained economic growth and development. A set of economic policies, are usually developed to attain and maintain both the

external and internal balances in order to achieve long-run economic growth and development. As these CFA franc countries show, there had been investment savings imbalances. Côte d'Ivoire shows that annual average savings have been more than investment while Cameroon and Senegal show the contrary for the 70s and 80s. The current account balances have large negatives for all the countries (Amin 1997).

Countries that have tended to adjust have outperformed those that have not. In this sense the 'commitment by a government to policies that achieve and maintain internal and external balance is both diagnostic and prescriptive. Countries without them do not' (Lewis and McPherson 1994, p. 102). Experience from the CFA franc zone have shown that these countries have initially tried to finance their fiscal deficit and then have been forced to carry out some form of adjustment without much success (Oussou and Bouabre 1996, Ekpo and Ndebbio 1996, Demery 1994). The adjustment process was delayed in the CFA France zone countries resulting to greater imbalances including unsustainable debt accumulation.

Public saving has been more important than private saving. According to Semedo and Villien (1997) low interest rate, weak banking sector and easy access to foreign banks have been partly responsible for low savings. So far the literature has stressed on the relationship between savings and investments, and the effects of investment and saving on growth and the impact of foreign aid.

3.4 Fiscal Balance

The main aim of fiscal policy is to balance the use of resources of the government and private sectors, so as to prevent imbalances in the economy. The longer the deficits continue the greater the debt accumulation and the need for fiscal retrenchment, which are never smooth. Although the sustainability of deficit may depend on the size and growth rate of the economy, there is general agreement on the positive effect of investment or capital formation in economic growth both in developing and developed economies. The question is how to improve and sustain investment's contribution to economic growth given the established link between public and private investment.. Evidence shows that investment expenditure suffered mostly during the adjustment period in the CFA franc Countries. In some countries, the investment expenditures were the first to be cut, thus reducing the productive capacity of the country.

The consumption theories imply that disposable income brings in fiscal issues. Consumption is an important variable, which has been extensively discussed in the literature. In the stabilization and structural adjustment programmes, the level and size of the public and private consumption is important. For the period 1980 - 1997, the ratio of total consumption to GDP was quite high in the CFA franc countries; it was above 85 % on yearly average, adjustment contributed in reducing it to only 83 % in 1997.

A continued internal deficit meant continued decline in foreign reserves or increase in external debt. Most of the CFA countries borrowed greatly for their fiscal operation. Generally, the result is inflation, as the growth of money demand is reinforced by money creation through fiscal deficit financing. Furthermore, when external financing is available, monetary control can slip away very easily. This happened in the 1970s in Côte d'Ivoire although in 1980s access to external financing was much difficult. It has been shown that the operation account is conducive for greater indebtedness in the CFA franc zone since the French treasury can intervene to give cash advance to support budgetary imbalances. M'bet and Niamkey (1993) have shown that debt moves with operation account with high correlation coefficient; and operation accounts with positive balance permits greater indebtedness. The high deficits, which have persisted in most African countries, are

due to high government spending when revenues were increasing and exogenous factors worsened the fiscal situation. Hence the differences in their fiscal balance or macroeconomic performance were due to their different policy strategy and implementation, as experience seems to be showing.

Macroeconomic reform measures taken to restore fiscal balance have mainly required reduction in public expenditures. Many governments find it easier to postpone investment in the social sector than to cut current expenditures such as public workers' wages (World Bank 1994). Re-recurrent spending is often protected at the expense of capital spending (Amin 1996). Public investment as a percentage of GDP fell steeply in a majority of adjusting countries. The fall was steeper in the CFA countries than in other countries whose macroeconomic policies improved. Among the CFA countries, the fall in public investment was higher for oil producing countries (World Bank 1994). Gross investment also decline alongside public investment. The relatively low investment rate in the CFA franc countries is surely not the only obstacle to long-term growth in the region. Growth could be increased through efficient use of capital, which eventually make up for the low level of investment. An enabling environment having adequate infrastructure is necessary to encourage private investors.

4 PRIMARY EXPORT BASE

The declining terms of trade for primary product exports related to fall in relative prices of primary commodities, and the impact of volatility on export prices on investment are said to result in reduction in the growth of primary export producing countries. This is the case especially with the CFA franc zone countries. This thesis has been strongly supported by Prebisch and Singer in the 1950s. They hold that the long run downward trend of prices of primary products relative to the prices of manufactures have produced poor growth performance of primary producing countries. In the African context, investment and growth have tended to increase with improvement in the real exchange rate and terms of trade; although Bleaney and Greenaway (1998) recently found (using cross sectional data) that fluctuation in terms of trade and real exchange rate do not significantly affect growth. Also the argument that volatility of the prices of primary export products creates much instability of export revenue seemed not to have been supported in the current literature. Instead it is shown that the long run downward trend of price of primary exports is slow. Some argue that quality improvement in manufactures is hardly captured in price indices. At best the evidence for fluctuation in export revenue causing poor performance in investment is mixed (Maizel 1992, Krueger 1983).

Yet there is some evidence to suggest that specialization on primary exports is negatively correlated with growth (Sachs and Warner 1997, Sala-i-Martin 1997). The terms of trade decline were more pronounced in the CFA franc zone countries than in the non-CFA franc countries. At the same time the CFA franc zone countries faced high appreciation of their exchange rates. This is quite important because the combined two effects further reduced the CFA franc countries' competitiveness (particularly) in the international markets. As their resources shift to the non-tradable sector, their tradable sector become less competitive internationally. Both theoretical arguments and empirical evidence point to the fact that flexible exchange rates allow for efficient allocation of resources in the economy and consequently with a significant impact on growth.

At the macro level, the export price volatility can impact on the trade balance causing far- reaching policy adjustment problem. The depreciation of the US dollar vis-à-vis the French franc after 1985, led to an overvaluation of the CFA franc with respect to other currencies. This resulted in the loss in the external competitiveness of the economies of the zone vis-à-vis other non-CFA countries.

Adjustment to shocks in countries with flexible exchange rates has tended to be easier than in those with fixed rates. The long run effect of an overvalued exchange rate on domestic exports and revenue can be hurting. This is much felt in the agricultural sector, which are more vulnerable to international shocks and is the major source of income for countries of the zone. From experience, it is becoming increasingly clear that the interaction of the shocks with internal policy response is much more important than the shocks themselves. Better growth performance in Asia than in Africa in the 1970s and 1980s was as a result of sound and better macroeconomic management than purely trade liberalization. Countries, which attained high growth rates, did succeed in preventing large macroeconomic imbalances (Fischer 1993, Little et al 1993, Bleaney 1996). With a fixed exchange rate, the countries of the franc zone were unable to adjust their exchange rate, which had become overvalued, rendering exports less competitive. The internal adjustment measures used by all the zone members failed.

Following the 1994 CFA devaluation, many exporting producing units showed some increase in capacity utilization rather than expansion in capacity. Improvement in export of manufactured goods or exports in general could have boosted and sustained with more appropriate policies. On the question of diversification of exports, processed primary exports and manufactured exports, evidence shows very limited capacity. The average share of manufactured exports in total exports is very limited and remains very low both for CFA franc and Non-CFA franc countries (table 6) (Blackhurst and Lyakurwa 1998). For trade to act as a strong stimulus to economic growth and development, export composition must change. There be must be a shift from primary exports to more value added - processed goods and manufactured goods.

4.1 Transport Costs

One cannot neglect the problem of transport costs, which are very high in Africa as compared to other developing parts of the world (Blackhurst and Lyakurwa 1998).

A major hindrance to international trade is the lack of efficient trade infrastructure and trade-related services. This poses great risk of excluding most African countries from the global economy. In domestic transport infrastructure, the non-CFA franc countries tend to do better than the CFA franc countries. In 1992 there were more paved primary roads of kilometres per one million persons in non-CFA franc countries than in the franc zone countries (World Bank 1997). This reflects the extent of mobility of goods and persons in these countries.

By far, sea transport is the principal mode of moving goods from place to place. The expansion of cargo transport has meant a decline in freight rates from 6.64% in value in 1980 to 5.27% in 1997. But the average costs in developing countries particularly in Africa were much higher. In Africa the freight rates were higher by 8.3% in 1997. In the maritime sector, the CFA franc countries particularly Cameroon, Senegal and Côte d'Ivoire have serious problems with their infrastructure and policy framework. In Cameroon, the Douala port where 95% of traffic goes, there is reduced access partly due to poor maintenance, outdated equipment and congestion. The poor location of the port means continuous maintenance for enough depth for big ships to board. The required resources for this purpose is quite high and costly. Some companies seek other measures to avoid these constraints but this raises costs and reduces the competitiveness of the country's goods.

On average the CFA franc countries have very high charges. In September 1997, the charges paid by ships in Douala (Cameroon) were 11.4 million CFA franc, 3.7 million CFA francs in Dakar (Senegal) while 3.3 million CFA francs being the average in some other African seaports. Cameroon has the highest charges. And the other countries, except Benin, have charges above the

regional average. Considering tariffs, import duties on a ton of rice are 861 CFA franc in Douala, as compared to 666 CFA francs in Libreville, and 357 CFA francs in Dakar. This is coupled with poor institutional organization of the port, which increases the cost of doing business. There are many institutions operating with overlapping functions (Njinkeu and Momkam 1999) could be fused together.

One major problem is organizational and managerial, needing proper training and allocation of resources. Being competitive means being able to produce and sell at least cost or at competitive prices. The cost of doing business must be at bare minimum through input cost reduction, constant infrastructure development and transport cost reduction. Studies have shown that the CFA franc countries have poor quality of service. Increased competitiveness is essential for long run economic growth and development.

4.2 Cost of Production

High cost of production is partly due to high cost of labour input mainly because of downward rigid nominal-wage rate, rigidity in institution and labour market policies. Minimum wage legislation are particularly high in CFA franc countries, salary scales are set according to formal education and training. The employment and termination procedures are lengthy. There have been some reforms in recent years although much of the new employment has been concentrated in low remuneration activities (Njinkeu and Monkam 1999).

It is generally argued that in deciding whether to pursue a fixed or flexible exchange rate policy, it is whether nominal wage rage flexibility exists. If wage rigidity exits as it does in most CFA franc zone countries, then the flexible exchange rate is desirable. This is because an adverse shock could have large employment and output costs within a fixed exchange rate regime. The situation of many CFA franc zone countries after the mid-1980s was that of high unemployment and declined output. Most of the unemployed is being absorbed by the informal sector, which is characterized by wage flexibility. This has very strong implication for the franc zone particularly on the determination of the wage structures. Considering social (including poverty) concerns, the governments have to find ways in investing heavily in the physical and human capital in the respective countries in order to improve on their productive capacity and consequently on output, growth and wellbeing of the people.

5 REAL EXCHANGE RATE

The real exchange rate (RER) plays an important central role in an economy. It gives relative price signals for inter-sectoral resource transfers. The RER reflects the incentive structure that encourages the allocation of resources across sectors and gives an index to judge the extent to which a country's tradable sector is international competitive. Countries belonging to the franc zone have their currencies pegged to the French franc at a fixed rate. This has not, however guaranteed the stability of the nominal exchange rate against other currencies. It has also been difficult to avoid severe RER over-valuation relative the equilibrium level, thus causing serious stabilization and structural adjustment problems. RER depreciation has both short run and long run impacts. In the short run there is a tendency of contracting aggregate demand and in the long run the impact is on supply as resources are allocated from the non-tradable to the tradable activities. However, the impact of real depreciation on output growth (in the long run) would be influenced by the traded goods in the total output and the structure of the economy.

5.1 Measuring Real Exchange Rate

There is consensus among economists that maintaining long run equilibrium level of real exchange rate sends the correct signals to economic agents, permitting efficient resources allocation and this increase economic growth stability and increase in the country's welfare. But a major problem is how to determine whether the real exchange rate is at the long run equilibrium or it is misalign with respect to the long run equilibrium level. And if it is out of line what to do about it. There is a distinction between nominal exchange rate and real exchange rate. Nominal exchange rate is the concept of measuring the relative currency prices. The literature on real exchange rate gives many definitions. Currently we can cite about five definitions, which may give different implications and some confusion. Some writers define real exchange rate as related to relative prices without agreement on which relative prices should be used. Knowing the currency or currencies, which should be used in measuring the real exchange rate, is of great importance. In the case of CFA franc with the French franc or the Euro, the situation is clear.

There are difficulties in classifying commodities into tradable and non-tradable, and identifying real world price of tradable and non-tradable, partly because of high level aggregation in the national accounts with no sector in the economy not producing both tradable and non-tradable. All these make the application of the formulae difficult, such that proxies of these variables are used but each proxy also poses some problems. For most purposes the real exchange rate indexes have been constructed by using the foreign WPI or weighted average of foreign WPIs in the numerator and the domestic country's CPI in the denominator. For one reason, these indexes are easy to compute and possible to construct for many countries. As RER is an important index indicating the degree of competitiveness of a country's economy; the measurement should include the information which rational economic agents would use when making their choice among different resources or goods. This depends on the choice of proxies for tradable and non-tradable (Edwards 1988, Amin and Awung1997). There are many proxies each with advantages and disadvantages.

Different suggestions have been made on how to use these indexes. Both foreign and domestic consumer price indexes have been used for calculating PPP. However, the International Monetary Fund calculates the RER by using the real effective exchange rate (REER). The Fund defines the REER as 'the nominal effective exchange rate index adjusted for relative movements in national price cost indicators of the home country and selected countries' (IMF 1997 Px). This is done for comparability. An increase in the index reflects an appreciation. As shown in table 6 the countries in the table do not have the same level of appreciation. Prior to the 1994 CFA franc devaluation, Togo and Gabon had much higher levels of appreciation than the other countries. But nearly all the countries experienced much higher level of appreciation in the late 1980s. It is important if we take into consideration Nigerian's trade with the CFA franc countries. The official exchange rates show fewer CFA francs per Naira than the informal (parallel) exchange rates with the amount of CFA francs declining from 1970 to 1996 despite the 1994 CFA franc devaluation. In fact in both cases the Naira depreciated sharply relatively to the CFA franc as from the mid-1980s.

In all, despite the different measures of RER and the difficulties involved, we would tend to have approximately similar indexes in the CFA franc countries, because of their institutional arrangements fixing the nominal exchange rates and their domestic cost structures. The non-CFA franc countries with their flexible exchange rate (in the Nigerian case) tend to adjust faster than in the case of the CFA franc countries (table 7).

6 FINANCIAL MARKETS

Sub-Saharan African counties still have very weak financial markets, which pose problems of domestic resource mobilization, allocation and investment. Sound financial evolution is absolutely necessary for well-functioning financial markets, which are crucially important for market economies. Experience has shown that proper financial liberalization also depends on the timing and sequencing of the liberalization measures associated to the general macroeconomic conditions (Elbadawi and Soto 1997). The CFA franc countries were generally slow in adjusting and financial liberalization did not follow the correct timing and sequencing.

A large part of economic reforms have been focussed on the financial sector mainly to improve the autonomy of financial sector's authorities and the sector's, supervisory, regulatory framework and competitiveness. In CFA franc countries the financial sector crises were partly as the result of insolvency of the banking sector where public enterprises were also financed by bank loans or governments' subsidies drawn from the banking sector. Prolonged recession, substantial real exchange rate over-valuation and loss of competitiveness complicated the reform period. This might have been partly due to the rigid institutional arrangements. Because after the 1994 devaluation the CFA franc zone's problems were better addressed (Elbadawi and Soto 1997). With economic restructuring it meant that the governments could not pay their debts to the banks. With the insolvent banks, the issue of bad loans or debts was not properly addressed, even to ascertain which banks could be recapitalized. The institutional framework in the banks was weak. There was no appropriate institution as well as proper staffing, which made the liberalization process more difficult.

7 CAPITAL FLIGHT

Capital flight may be a big problem under the fixed exchange rate regime and where the financial markets are not functioning well. Under the fixed exchange regime, the holding of fixed exchange rate for as long as possible can pose some severe difficulties. This was the case of the 1994 devaluation before the day of announcement of devaluation there had been much capital flight. Some capital was repatriated after the devaluation but only generated inflationary pressures. The consequences of imminent devaluation known to the economic agents could seriously induce capital flight and reduce savings consequently investment. Therefore showing the necessity of keeping the exchange rate at an appropriate level, given real shocks. Although there supposed to be free mobility of capital within the zone, much more capital tends to flow towards France and out of the zone than within the CFA franc zone. In general, capital tends to move to well developed financial markets from poor financial markets.

7.1 Composition of Debt

There has been a growing literature on the debt composition – capital flows and debt stock. The indicators used mostly are portfolio flows, foreign direct investment (FDI), fixed-rate vs floating rate borrowing and domestic currency vs foreign currency denomination. Portfolio investment may not finance investment as much as FDI. Usually FDI involves direct investment in equipment and plant, infrastructures and buildings and knowledge, while money borrowed could easily go into direct consumption purposes, which may not increase the productive capacity. However, the literature on this issue is not quite clear. It is important to look at sources of these flows (such as bilateral, multilateral etc). It is equally important to examine if the type of debt including capital flows associated to CFA franc countries is different from that of Non-CFA franc countries because

of the special relation with France; and whether these flows have affected these groups of countries differently. Generally debt has tended to have a negative impact on economic growth.

8 LEGAL SYSTEMS AND GOVERNANCE

The legal systems of the CFA franc countries are, in most cases, inspired and have been based on the Napoleonic legal system which exults in the supreme authority of the state and those who represent the state. The state's authorities have discretionary powers. The state, therefore, excessively interferes in the functioning of the market economy. Also the paternalistic autocratic rule-making process tend to alienate those concerned with a highly bureaucratic hierarchy. This is closely intertwined and linked with the current issue of governance in African countries. Are the rule-making processes, the bureaucratic structures, governance systems and colonial inherited institutions different between the two groups of countries in such a way that they have influenced investment, savings, the accumulation of capital, and growth differently?

The institutions of governments in the CFA franc zone countries are highly centralized and bureaucratic. In this set up, all decisions affecting the social, economic, cultural and political life of the nation emanates from the top of the administrative hierarchy. The execution of these decisions is assured at the level of the provinces or regions by appointed administrators who may be discretionary in the execution of the government policies. Because of highly bureaucratic and administrative bottlenecks, decision-making and implementation process is very slow and costly particularly in terms of resources used up. The performance of the system depends highly on the individual appointed to exercise power. There is the absence of checks and balances as much as a serious system of sanction with little enforcement of the rule of law. This is partly resulting from the discretionary powers of the state authorities.

This leads to widespread interference of government officials in the functioning of the economy. Thus contributing in restricting individual liberty and posing a serious threat to the smooth functioning of the market. The government's inability to provide credible rules for the functioning of the market creates an atmosphere of uncertainty for business investors in the countries. Generally, investors are scared to invest where the legal framework does not efficiently enforce property rights and contracts. For example most governments especially in the non-CFA countries like Kenya, Malawi, Botswana, Ghana, Lesotho, Liberia, Sierra Leone, Somalia, Sudan, Uganda and Zimbabwe have given marketable property rights in place of traditional rights to landowners (Collier and Gunning 1999). This has been done to prevent the loss of output and stagnation resulting from traditional social institutions. While in some CFA franc zone countries as in Cameroon the land laws are written but partly because of elaborate bureaucratic procedures, making it very expensive and difficult to acquire property rights over pieces of land, thus contributing in reduced output. The poor management of publicly owned companies also explained the rampant bankruptcies particularly in banks common within the CFA franc countries during the period 1980-93.

9 REGIONAL TRADE

The present economic policies adopted by Sub-Saharan African countries also aim at a regional integration. Many reforms and treaties have been made especially after the 1994 devaluation to achieve this goal. This includes a common business law regime, a common insurance market and a unified social insurance system and reforms on commercial, fiscal, budgetary and monetary

policies, and also the creation of UEMOA in West Africa, and the transformation of UDEAC to CEMAC in Central Africa. But most of these institutions are still to be effective.

A study of market integration based only on official data would be insufficient because a considerable amount of external trade goes on informally and hence is not captured in the official data. Such exchange is important in external trade and can weaken the effect of policies if not consider in the policy making process. There is crucial important informal trade between Cameroon and Nigeria and between Nigeria, Ghana, Gambia and other CFA franc zone countries, than within the CFA franc zone. It appears the differences in the monetary regimes and economic policies existing between these countries have encouraged the development of black market between these countries and the franc zone African countries. An important factor influencing these differences is the non-convertibility of the Naira or the Cedi while in the African franc zone countries we have the convertibility of the CFA franc, the absence of rationing or the access in the financial goods and service markets.

Before the measures of inconvertibility and devaluation were implemented, the Nigeria Trans-frontier trade was such that excesses in CFA franc resulted from their trade with Cameroon. Excess franc from Chad and Niger were being used to pay for imports coming from Benin, and part was used for capital flight. Hence Nigeria collected the required currency through the black market. With the new measures of inconvertibility along side the 1994 devaluation, this transfer of the CFA has stopped. While trade within the CFA franc zone countries is low, trade with Non-CFA franc zone countries is much higher. This type of trade can generate disequilibrium in the parity between BEAC CFA franc and BCEAO CFA franc and even between the franc zone and non-franc zone. Adjustment of macroeconomic imbalances in the CFA franc zone must take into consideration the exchange rate regimes and trade relations between the CFA franc zone countries and their neighbouring countries and within the franc zone itself

10 LIMIT CONVERGENCE IN THE CFA FRANC ZONE

Convergence - poorer countries grow faster and could catch up with richer ones given government policy, initial physical and human capital. Even in a country, there is a tendency for poorer areas to grow faster than richer ones. In neo-classical model the concept of capital can be extended to include human capital. When a country begins with a high human to physical capital ratio, its growth rate would tend to be rapid, as capital goods are more amenable to expansion than human capital. The prospects for income convergence (Barro and Sala-i-Martin 1992) are one of the major issues that have dominated the growth in income per capita. Studies carried out by Romer (1986, 1994) and Lucas (1988) on endogenous growth mechanisms have increased the interest on convergence.

One of the basic assumptions of the neoclassical model on the production side is that lower income countries have similar saving rates than rich ones; it also assumes diminishing returns to capital as well as free access to a common technology by all countries. Countries could incur no cost in trying to get access to identical technology, it assumes the ratio between labour force and population to be fixed and population growth being exogenous. The parameter of preference and technology in this case determines the steady state growth of output. The assumption of endogenous population growth requires free movement of people, this is going on in the West African Economic and Monetary Union because of ECOWAS' (Economic Community of West African States) larger grouping but not the same in the Central African sub region.

Besides these assumptions, a certain number of factors affect the rate of convergence. In the neoclassical model, it depends on the productivity of capital and the willingness to save. In the presence of exogenous technical progress, as capital stock is accumulated, the marginal product of capital falls because of diminishing returns to capital. In this case, the incentive to save reduces and the contribution of investment to output falls. Where the capital stock is small, increase capital will generate large increases in output. The problem with the CFA zone is that some countries have grown poorer than others. The neoclassical model prediction that poor countries will turn to grow faster if initially the difference between them was only their initial level of capita does not hold in the zone.

The rate of convergence is equally affected by the nature of openness of an economy (Barro and Sala-i-Martin 1992), and this depends on the ease with which capital and labour can move. In the CFA franc West African zone, there is free movement of capital and labour but not in Communauté Economique et Monétaire de l'Afrique Central (CEMAC) nor between the two regions. The borders of the various economies are not opened to the movement of capital and in the presence of similar technology between countries, convergence to per capita output and capital stocks are more rapid in an open economy than in a close one. The nature of labour mobility, redistribution in favour of poorer regions, freedom of technological advancement from richer to poorer regions equally determines the rate of convergence. In the CFA franc zone, these features have generally not been met and the countries have grown differently because of the presence of forces in some countries within the zone that create the potential for explosive growth. This is the case with Cameroon, Côte d'Ivoire and Gabon. In others such as Mali, Niger and Chad, strong forces of stagnation have reduced growth rates to even negative values. What has been witnessed in the zone is divergence.

Within the CFA zone, there are therefore limits to convergence among the economies. The zone consists of heterogeneous economic sizes and per capita income, demographic and geographic differences that are quite important for convergence analysis. In terms of income and economic size, at one extreme there are the poorest countries of Niger and Chad and at the other extreme the richest countries of Gabon, Côte d'Ivoire and Cameroon. One objective of forming an economic and monetary union is to promote economic and financial convergence. The monetary and price stability supposed to significantly contribute in mobilizing internal savings for investment in members' countries for economic growth and development of the zone. However, a strong and unified monetary system has not been able to produce a strong financial and banking system in the zone. The zone still has a weak financial sector with the major commercial banks still having their head quarters in France which has about 5 % of money supply as fiduciary money. While capital markets - stock exchange- are in advanced stage in the Non-CFA franc zone countries, the zone is just beginning to start its own capital markets -Abidjan Stock Exchange.

Trade within the zone is very thin, and this is not conducive for economic convergence. This may also explain why economic integration remains very marginal relative to monetary integration. For the zone's major trading partner as a group, the European Union, the process of their economic and monetary union has been gradual and simultaneous. The process in CFA franc zone is faced with many constraints, which need to be removed for convergence.

11 LITERATURE ON GROWTH

The main purpose of growth theories is to explain developing economies and reveal those factors that can influence the growth of these developing economies. The role of public policy has become

very important as it can greatly promote growth. The Solow's neo-classical growth model (1954) gave the theoretical framework for quantifying the contributions of traditional inputs and their total factor productivity to the national output with focus on the process of capital formation. If the marginal product of capital falls continuously, this means that the savings which is generated by the income from the new capital would also fall, and consequently may just be enough to replace worn-out machines and 'equip new workers'. At this stage the economy is at a stationary state with falling welfare of the people. Because of exogenuity, the determinants of the rate of growth of productivity and income per capita are not explained within the model.

Hence, relying on the technological advances rather than on the properties of aggregate production function is an important means of ensuring persistent growth. This is endogenous growth. Both neo-classical and endogenous growth theories are complementary as both stress on how the whole economy behaves. Investment in the different types of capital generates high productivity that leads to sustained growth. In short, the extension in neo-classical growth model to endogenous growth model has made it more responsive to policy, where technological changes tend to be endogenously amenable to policy, which can affect (physical and human) capital investment. The right policy regime of a country could greatly influence the growth rate of the economy. 'Knowledge' and factor accumulation interact such that they generate non-decreasing returns to scale. This means that economic conditions, institutions and policies strongly influence factors accumulation and factor productivity.

Recent studies that have linked growth to different macroeconomic variables such as fiscal and monetary policy variables have stressed the importance of economic conditions and appropriate public policies implementation. Fischer (1993) focused on the role of macroeconomic stability on growth. Within the growth accounting framework, Fischer regressed growth on several key macroeconomic variables using a set of panel data. The coefficients of the variables were all significantly different from zero. According to Fischer, countries which had some macroeconomic stability tend to perform much better than those that face macroeconomic instability.

Studies on African economies, including the CFA franc zone economies, have shown a strong positive relationship between the private sector investment and economic growth. This means the private sector most be promoted and encouraged to play a more important role than it has been in the CFA franc zone countries where the public expenditures have been more important. And in most cases the public expenditures have tended to crowd out private investment (Amin 1998). The conclusion, from most studies, show a strong relationship between growth and macroeconomic environment.

Studies (Gapinski 1996, Easterly and Levine 1997) on African economic performance have been based on cross sectional data and to some extent not taken into consideration the special characteristics of the countries or regions concerned. In investigating the determinants of economic growth, Ghura and Hajimichael (1996) studied the case of 29 African countries including CFA franc countries. The conclusions arrived at include a stress on the important role of private investment in economic growth; and macroeconomic policies which enhance the volume and efficiency of investment. Emphasis is also put on those public policies that lower the budget deficit, maintain external competitiveness, encourage structural reforms and enhance human capital development. Theoretical and empirical analyses have shown that macroeconomic stability promotes and stimulates private sector savings and increase efficiency in private investment; all with the net effect of accelerating sustainable economic growth.

12 A THEORETICAL FRAMEWORK

The national income identity shows that the Gross Domestic Product (GDP) is the sum of private consumption and investment, plus government expenditure and exports minus imports. From this we can obtain an equation which shows the relationship between the fiscal balance on one hand, and the investment-savings balance and current account balance on the other hand. In this relationship, fiscal balance is reflected in the investment-savings and current account balance. In other words, fiscal balance could affect or be affected by domestic output and prices, exchange rate, current account balance, terms of trade, interest rate, inflation and other relevant macroeconomic variables. Increasing domestic demand for foreign exchange may appreciate the exchange rate, thus favouring imports. This will have a negative effect on the trade balance, and consequently on the balance of payment

It is important to pay particular attention in the selection of the variables. The variables selected could include the variables influenced by economic policies. Besides individual motivation, variables selected are derived from empirical and theoretical literature. The dependent variable is therefore the growth rate of output in our case. We use econometric method to estimate separately for CFA franc zone countries and non-CFA, countries and compare the two sets of results.

12.1 Empirical Results

The discussion in this section therefore includes an econometric analysis, identifying some of the most important determinants of growth in the CFA franc zone (table 8). The choice of the independent variables has also been based on the availability of data. There are some critical variables such as the variables reflecting human capital and the bureaucratic/legal systems or variables reflecting the structural and institutional changes and uncertainty, which have not been included for lack of data. Rates or charges were used and in certain cases the variables were deflated with relevant variables like the GDP.

Analysis of the growth paths of the GDP of both CFA franc zone and non-CFA franc zone shows the instability of Non CFA franc countries before 1986. But the growth was much better than that of the CFA franc countries on average. There has been a clear difference in their inflation rate with lower inflation rate for the CFA franc countries. This difference is not quite distinct in their growth paths although the non-CFA franc countries on average performed better. We use data for the period 1971-1998 covering the CFA franc countries and 16 non-CFA franc countries (Botswana, Congo Democratic Republic, Ethiopia, Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Nigeria, Sudan, South Africa, Tanzania, Uganda, Zambia and Zimbabwe).

Government expenditure or consumption is used to examine its impact on growth. The coefficients are not significant although it is seen that its impact on growth is negative. The problem with this variable is that it is all inclusive-total government expenditure, which includes spending on highly bureaucratic administration including defence. But some components of this expenditure such as health and education and road network, may be growth enhancing. This has to be distinguished even the intra sectoral spending. Interest rate seems to have positive impact on growth. But inflation has negative impact on growth of the non-CFA franc countries. It is not so clear in the case of CFA franc countries although the sign is negative.

Debt service/export ratios show a negative impact on growth in the both groups of countries. The outflow of critical resources from these countries is harmful to growth. Terms of trade change are positive to both groups of countries. That is, improved terms of trade including diversification of

trade and products, improving the value added to goods exported would enhance growth. This goes together with the openness of the countries to international trade including removing all those obstacles to international trade.

It is interesting to see the real exchange rate variable (measured by real effective exchange rate) showing negative for CFA franc countries and positive for non-CFA franc countries. It only goes to confirm the negative impact of the overvaluation of the CFA franc on these countries' economies. May be instead of having a fixed exchange rate even to the Euro, the pegging could be made flexible for easily adjustment to international market forces. Another situation is that of foreign aid or capital inflow which seems to be productive in non-CFA franc countries but not so in the CFA franc countries. This may also reflect the legal and government problem in the use of resources. There may be more accountability and proper use of resources in one group of countries than in the other. Private investment/GDP ratio seems to be an important variable, which strongly enhance economic growth. We would therefore expect much stress to be put on private investment. More important, is for government to create an enabling environment for the private sector to grow very well. More so for the government to get out of the activities it can not do very well and shift the responsibility to the private sector. We hope the privatization process continue in a good path.

13 SOURCES OF DATA

We collected data from various sources; with major sources from public institutions - the main provider of data on these economies. Other secondary data sources are from International Institutions Publications (UNDP, World Bank, IMF, UNESCO, World Resource Institute [WRI], FAO, ILO, African Development Bank [ADB], Bank of Central African States [BEAC]).

Also other sources are from various studies on these countries and region. These sources also include data anchored by the Penn World Table, and Nehru and Dhareshwar. Because of various data sources and the weakness of the data base of these countries, the reliability and comparability of the data could be affected by many factors – hence the collection of the relevant and appropriate data for the study has involved some judgement and creativity.

14 CONCLUSION

The main aim of this paper was to identify some of those factors that have affected growth in the CFA franc countries relative to the Non CFA franc zone countries. Or rather to identify the special arrangements between the CFA franc zone countries and France and examine how each of the identified arrangement have affected the socio-economic development of the monetary zone countries relatively to the others. The most important factor (which reflects other factors) has been the institutional rigidity imposed by the monetary and exchange rate arrangements. The rigidities have tended to negatively affect other aspects of the economies of the CFA franc countries, and therefore affect their long-term growth prospects. Hence long-term growth and development including poverty reduction or eradication would depend on how these obstacles are removed and the wrongs corrected. That is the weakness of the system removed and the strengths of the systems improved and enhanced.

The imbalances, particularly the external imbalances lacked the self-correcting mechanisms. Most of the non-CFA countries depended on external adjustment strategies by relying on the flexible exchange rate for adjustment although with high inflation. The CFA franc countries tried to correct the imbalances by internal adjustment with much difficulty. The regression results among other

things show the negative impact of over-valuation and thus suggest a pegging flexibility exchange rate rather than fixed one.

The export base is mainly primary goods and the devaluation increase capacity utilization rather than capacity expansion. Very thin trade within the zone and large trade between the zone and other countries, thus generating much disequilibrium. Hence Macro-economic policy must take into consideration the different exchange rate regimes of its trading partners.

A strong and unified monetary system has not been able to produce a strong financial and banking system in the zone. The weak banking sector also encourages capital flight. The zone can learn very much from its major trading partners the European Union whose process of Economic and Monetary union has been gradual, simultaneous but effective.

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Table 1: Per Capita Income in US Dollars

YEAR	CAMEROON	CÔTE D'IVOIRE	GABON	SENEGAL	TOGO	GHANA	KENYA	NIGERIA	TANZANIA	ZIMBABWE
1980	587.17	1221.56	5285.25	521.13	442.49	414.26	435.81	1219.31	276.53	754.23
1981	737.01	1272.93	5914.07	540.99	453.95	381.39	395.33	1090.71	309.18	872.69
1982	861.66	1329.80	6394.47	675.58	472.78	351.87	356.82	1113.73	317.09	915.24
1983	1006.78	1326.22	6865.53	733.33	494.89	340.35	318.81	1040.33	310.04	804.26
1984	1191.29	1480.27	7252.04	743.25	505.18	356.66	316.89	996.73	276.02	637.97
1985	1409.81	1494.18	7534.64	814.01	528.29	354.09	301.57	942.96	317.72	518.97
1986	1454.81	1454.63	7378.00	865.75	554.16	438.54	342.20	474.82	217.41	591.68
1987	1349.95	1338.55	4706.01	946.82	546.65	378.64	345.64	241.20	146.81	621.76
1988	1232.57	1341.70	4999.95	1016.00	585.50	369.87	352.55	283.35	130.71	663.51
1989	1120.30	1255.77	5732.54	983.88	597.31	360.88	333.09	359.85	115.52	644.52
1990	1064.24	1088.40	6080.12	1006.52	595.51	375.77	380.98	284.07	102.18	641.30
1991	1030.84	1149.33	6113.26	978.10	592.15	426.36	314.63	295.08	158.90	647.20
1992	959.13	1084.79	5790.37	991.24	558.27	401.88	319.42	228.08	151.58	521.87
1993	912.09	1058.11	7172.22	1057.52	429.76	344.19	204.66	238.15	133.01	517.07
1994	979.25	1428.97	8603.44	1250.39	628.91	305.43	252.61	220.44	117.09	521.88
1995	1180.81	1673.43	9119.38	1367.94	718.53	354.10	298.00	275.21	138.17	572.94
1996	1280.37	1752.90		1456.86			291.57			

Source: Author's calculation with data put together from World Bank (ADI 92&97), IMF (IFS year book 97) and ADB (ADR 98).

Table 2: Some Basic Indicators as a Percentage of GDP for the Period 1980-97, Yearly Average

NON-CFA countries

	EXP	IMP	TED	TDS	GDS	GDI	GE	GR	FB
GHANA	20.73	27	60.54	5.04	6.05	11.58	18.43	12.43	-4.52
KENYA	16.43	25.63	73.36	8.31	19.31	21.96	27.06	20.92	-3.16
NIGERIA	32.24	23.9	77.89	7.32	19.02	17.12	22.32	14.86	-7.03
TANZANIA	9.88	28.58	127.92	3.54	4.84	24.34	23.36	15.42	-3.92
ZIMBABWE	25.63	26.43	51.21	7.73	18.69	20.5	40.54	30.89	-10.98
NON-CFA AVG	*20.982*	*26.308*	*78.184*	*6.388*	*13.582*	*19.1*	*26.342*	*18.904*	*-5.922*
CFA countries									
CAMEROON	22.44	14.6	31.8	2.8	24.33	19.57	20.63	16.9	-3.22
CÔTE D'IVOIRE	32.4	24.38	89.36	8.35	17.95	14.13	32.45	24.17	-7.72
GABON	46.64	18.88	37.08	3.32	43.01	28.54	33.46	30.58	-1.82
SENEGAL	17.05	27.09	47.89	3.8	3.84	12.92	20.82	18.23	-1.9
TOGO	19.48	33.64	64.2	3.1	12.78	20	29.52	22.62	-1.69
CFA AVG	*27.602*	*23.718*	*54.066*	*4.274*	*20.382*	*19.032*	*27.376*	*22.5*	*-3.27*

Source: Authors calculation from data put together from World Bank (ADI 92&97), IMF (IFS year book 97) and ADB (ADR 98)

Where

EXP= export as a percentage of GDP

IMP= import as a percentage of GDP

TED= total external debt as a percentage of GDP

TDS= total debt servicing as a percentage of GDP

GDS= gross domestic saving as a percentage of GDP

GDI= gross domestic investment as a percentage of GDP

GE= government expenditure as a percentage of GDP

GR= government revenue as a percentage of GDP

FB= fiscal balance as a percentage of GDP

Table 3: CFA Franc Zone and Non-CFA Franc Zone

	1975-1985		1986-1993	
	FRANC ZONE	NON FRANC ZONE	FRANC ZONE	NON FRANC ZONE
Real growth rate of G.D.P. (annual average %)	4.6	1.4	0.1	2.5
Real growth rate of G.D.P/ habitant (annual average %)	1.7	-1.3	-2.8	-.03
Rate of Inflation (annual average %)	11.2	17.8	1.1	22
Budgetary balance (average G.D.P %)	-5	-6.1	-7.6	-5.6
External current account (average G.D.P %)	-6.5	-1.9	-7.4	-0.8
Products exports (average G.D.P %)	28	20.7	22.3	24
Products imports (average G.D.P %)	23.8	18.9	18.7	20.9
External debt (average G.D.P %)	38.2	25.2	73.7	57

Source: I.M.F 1994, and Semedo & Villieu 1997.

Table 4: Public Investment in some African Countries (% GDP)

Country	1981-86	1987-91	Difference between 1981-86 and 1987-91 (per point)
Countries with fixed exchange rates	*10.6*	*7.4*	*-3.3*
Côte d'Ivoire	10.0	3.5	-6.5
Congo	18.7	5.0	-13.2
Gabon	16.7	6.0	-10.7
Niger	8.7	8.2	-0.5
Senegal	3.8	2.8	-1.0
Cameroon	10.6	8.6	-2.0
Countries with flexible exchange rates	*6.8*	*6.8*	*0.0*
Ghana	1.7	3.2	1.5
Uganda	2.2	5.0	2.8
Zambia	4.9	5.4	0.5
Tanzania	6.8	5.3	-1.5
Zimbabwe	6.0	8.0	2.1

Table 5: Human Poverty Index

CFA franc countries			Non-CFA franc countries		
Country	Value (%)	HPI Rank	Country	Value (%)	HPI Rank
Congo	29.1	38	Zimbabwe	17.3	17
Cameroon	31.4	41	Botswana	22.9	29
Togo	39.3	49	Kenya	26.1	32
C.A.R	41.7	56	Lesotho	27.5	35
Guinea Bissau	43.6	58	Ghana	32.6	43
Côte d'Ivoire	46.3	63	Zambia	35.1	45
Mauritania	47.1	65	Tanzania	39.7	50
Senegal	48.7	68	Uganda	41.3	53
Burkina Faso	58.3	76	Nigeria	41.6	54
Niger	66	78	Sudan	42.2	57
Average	45.2		Average	32.7	

Source: UNDP (HDR), 1997.

Table 6: Share of Manufactured Exports in Total Exports

	Country	1980-84	1985-89	1990-95
CFA ZONE	Burkina Faso	5.73	5.22	6.22
	Cameroon	2.75	2.76	2.64
	Congo	5.97	8.58	20.89
	Côte d'Ivoire	6.11	7.63	10.43
	Mali	10.45	12.39	12.84
	Senegal	12.63	14.19	12.52
	Togo	10.53	4.67	7.86
NON CFA ZONE	Ghana	5.65	8.77	18.24
	Kenya	17.17	14.49	18.57
	Madagascar	7.14	9.62	18.04
	Malawi	7.98	4.86	7.01
	Mauritius	32.36	59.46	67.61
	Nigeria	0.42	1.27	2.00
	Tanzania	11.39	10.41	13.74
	Zambia	3.23	3.99	4.47
	Zimbabwe	30.42	28.29	31.29

Source: Blackhurst and Lyakurwa 1998.

Table 7: Real Effective Exchange Rate (1990=100)

Year	Cameroon	Nigeria	Côte d'Ivoire	Gabon	Togo
1979	89.8	329.2	104	111.8	126.2
1980	88.2	350.7	106.1	113.4	126.6
1981	80.9	388.7	90.9	100.7	125.2
1982	79.2	399.1	82.9	101.7	120.1
1983	82.2	471.5	79.8	99.8	119.5
1984	83.4	649.4	76.4	95.8	106.7
1985	87.1	689.4	76.3	98.3	102.1
1986	96.5	376.3	91.8	107.1	110.1
1987	108.1	120.2	102.1	105.4	109.4
1988	105.1	120.5	104	90.7	103.7
1989	97.1	107.5	98.5	92	96.5
1990	100	100	100	100	100
1991	95.7	85	96.5	87.1	95
1992	96.4	70.5	100.8	87.2	96.6
1993	89.8	77.2	99.2	84.1	93.3
1994	57.6	142.8	60.9	56.5	62.1
1995	66.4	120.8	70.2	62.5	71.9
1996	67.3	149.2	70.5	63.9	71.5

Source: Data put together from World Bank (ADI 92&97), IMF (IFS year book 97) and ADB (ADR 98).

Table 8: Growth Equation

Dependent variables: Output Growth rate ($\hat{Y}$)

	Variable used	CFA countries	Non-CFA countries
C	Intercept	119.287	147.783
		(6.8196)	(4.889)
GOVEXP	Government	-0.209	-0.315
	expenditure/GDP	(1.590)	(0.957)
INTR	Interest rate	0.041	0.0981
		(0.021)	(0.415)
INFL	Inflation	-0.015	-0.357
		(0.56)	(2.189)
DEBTS	Debt service/export	-5.168	-1.287
		(4.145)	(3.689)
TOT	Terms of trade charge	0.217	0.305
		(0.415)	(2.567)
OPEN	(Import +export)/GDP	0.148	0.245
		(1.581)	(2.891)
REER	Real Exchange Rate (RER)	-0.0641	0.0963
		(2.965)	(1.819)
FORAD	Foreign aid	-0.214	0.467
		(2.111)	(2.09)
FISBAL	Fiscal balance/GDP	-0.5182	-0.318
		(1.971)	(2.108)
DEBT	Debt/GDP	-1.847	-0.981
		(3.714)	(2.895)
INV	Private investment	0.681	0.561
		(3.137)	(2.984)
	R^2	0.378	0.452
	F-statistics	14.5	13.06
	DW statistics	1.91	2.02