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E. U. Olisadebe
Central Bank of Nigeria

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THE DEVALUATION OF THE CFA FRANC: IMPLICATIONS FOR THE WEST AFRICAN INTRA-REGIONAL TRADE AND THE NIGERIAN ECONOMY

By E. U. Olisadebe
Deputy Director of Research Dept.

E. U. Olisadebe

INTRODUCTION

The thirteen French-speaking countries of West and Central Africa, on 12th January, 1994, announced the devaluation of their common currency-the CFA Franc (CFAF)–by 50 per cent from IFF = 50 CFA to IFF = 100 CFA after a meeting in Dakar with France, International Monetary Fund (IMF) and World Bank. The Comoro Island, a member of the CFA Zone, however devalued the Comorian Franc by 33 per cent. The CFAF devaluation which was long-resisted became inevitable after France indicated her intention in September, 1993 not to assist the depressed economies of the CFA states if they backed out of IMF supported structural adjustment programme. The IMF had insisted on devaluation as a condition for supporting any adjustment programme in CFA countries arguing that the devaluation would encourage investment and make exports more competitive thereby improving the balance of payments of the CFA countries.

This short write-up reviews the main implications of the recent devaluation of the CFAF for West African intra-regional trade generally and the Nigerian economy in particular.

2. THE CFA IN HISTORICAL PERSPECTIVE

The CFA (Communaute Financier d'Afrique/African Financial Community) which is made up of 14 independent states of West and Central Africa, is a part of a franc zone that comprises France and its overseas territories. It operates two central banks, Banque Centrale des Etats de L'Afrique L'Ouest (BCEAO) for the West African Countries, and Banque des Etats L' Afrique Centrale (BEAC) for the Central African States. The West African states are Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal and Togo, while the Central African states comprises Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea and Gabon. Comoro Island has its own Central Bank which issues the Comorian franc. The committees of the two institutions on which France is represented, meet twice a year to map out financial policy, taking into consideration their balance of payments position and to harmonize their approach to international monetary problems. The benefits derivable from being a member of the community include the de-facto convertibility of the currency guaranteed by the French Public Treasury, and easy access to foreign exchange in the event of balance of payments difficulties. The countries are allowed to hold about 35 per cent of their external reserves in currencies other than the French franc but must, however, exhaust all "mobilisable assets" in a situation of foreign exchange difficulties before applying to the French Treasury for support. Since 1948, the CFA Franc (CFAF) had been fixed to the French franc (FF) in the ratio of 50 to 1. This rigidity led to overvaluation of the CFAF and the consequent adverse effects on the balance of payments of the Community countries. Being a convertible currency, the CFAF is widely held in the region by non-francophone countries, and recently there have been cases of counterfeiting. The result is that the West African sub-region has become awash with genuine and counterfeit CFA notes. This development is of particular interest to Nigeria given the fact that about 70 per cent of the total CFAF converted by the French Treasury annually is in respect of trade with Nigeria. The belated devaluation of the CFAF could be traced to the poor balance of payments position of the CFA countries and the pressure on the French Franc in recent times in the European Exchange Rate Mechanism (ERM). The misfortunes of the Franc in ERM was a clear signal that the convertibility arrangement could no longer be taken for granted.

3. OBJECTIVES OF CFA DEVALUATION

The devaluation was aimed at:

(i) restoring the competitiveness of exports and promoting economic recovery;

(ii) checking capital flight and encouraging international support from external creditors and multilateral institutions;

(iii) the promotion of national savings, development of domestic production capabilities and increasing the per capita income of member countries;

(iv) creating more job opportunities and reducing the level of poverty.

To cushion the effect of the devaluation of the CFA on member countries, France promised to write-off part of their debts, provide emergency assistance for their balance of payments and guarantee "absolute" protection of social expenditure especially in the fields of education and health. The IMF also indicated its willingness to help soften the effects of the devaluation through enhanced access to its resources.

4. IMPLICATIONS FOR WEST AFRICAN TRADE AND THE NIGERIAN ECONOMY

The devaluation of the CFA is no doubt expected to have far-reaching implications for West African trade and commerce generally and the Nigerian economy in particular. In assessing the implications of CFA devaluation for the West African trade and the Nigerian economy, a qualitative approach has been adopted in this write-up. It should also be recalled that at the time the CFAF was devalued, the Nigerian government, in its 1994 Budget, announced a fundamental shift in its interest rate and exchange rate policies. Specifically, the naira exchange rate and interest rate were pegged while black market operations in currency was to be severely curtailed through administrative and legal sanctions. The implications of these two policy events are simultaneously examined in relation to the Nigerian economy.

4.1 IMPLICATIONS FOR THE WEST AFRICAN SUB-REGION

In this section the implications of CFAF devaluation for trade, fiscal policy and monetary integration in the West African sub-region are examined.

(i) Volume of Intra-regional Trade

The essence of devaluation of a currency is to discourage imports which will become dearer and encourage exports, the price of which will be cheaper. The objective generally is to improve the balance of payments. However, the extent to which this can be achieved depends on the elasticities of demand for imports by the devaluing economy and the demand for its exports. Where demand for imports is inelastic, devaluation may merely increase their cost without decreasing volume. Similarly, where exports are price - inelastic, devaluation may not increase the volume of exports. The demand for imports and exports of most developing countries are generally considered to be inelastic. The Francophone countries are no exception. This is due to the fact that their imports consist of essential items needed for their development while exports consist of primary products which do not sufficiently respond to changes in price and income of consuming countries. Thus, in terms of inter-regional trade the devaluation of CFA may not reduce the level of imports from Anglophone West African countries but may indeed reduce export to non-CFA countries.

(ii) **Fiscal Policy Harmonization**

The low level of import tariff in Francophone West African countries coupled with the overvaluation of the CFA had facilitated the diversion, to CFA countries, of goods destined for Anglophone countries. Such goods were subsequently smuggled to the Anglophone countries including Nigeria. The devaluation of the CFA leading to increases in the cost of imports will reduce the disparity in the structure of fiscal incentives. Overall, the devaluation of the CFA and the consequent reduction in disparity in import tariffs could enhance the process of fiscal policy harmonization within the sub-region. However, the increase in the tariff structure in Nigeria would appear to have further widened the disparity in the structure of tariff thereby diluting the positive impact of CFAF devaluation on fiscal policy harmonization.

(iii) **Monetary Integration**

The removal, through devaluation of the subsidy enjoyed by the CFA and the possibility of further devaluation may accelerate the process of monetary integration in the sub-region. This is because it should be obvious to CFA countries by now that the benefits of promoting regional cooperation are more enduring than relying on the capricious extra-regional partnership. However, the historical, economic and cultural link between the CFA countries and France may limit the extent to which these countries would actively support sub-regional economic integration.

4.2 IMPLICATIONS FOR THE NIGERIAN ECONOMY

It should be noted at the outset that Nigeria is the single most important market in the West African Sub-region with active informal border activities. The incentives offered at the informal markets include the ease in settlement of transactions on cash-and-carry basis, the cheapness of Nigerian goods relative to imported substitutes in the Francophone countries and the international convertibility of the CFA Franc as well as the acceptability of the Nigerian naira for settling border trade transactions. Furthermore, the geographic position of Nigeria, bordered on all sides by the CFA countries results in a high incidence of cross-border transactions. All these had promoted international trade within the ECOWAS sub-region even though a large proportion of it is informal. Given these inter-relationships, the devaluation of the CFAF would no doubt have some consequences for Nigerian exports, imports and cross-border trade.

(i) **Nigerian Exports**

The devaluation of the CFA would, theoretically, make Nigerian exports to CFA countries dearer. This is expected since the sole purpose of a devaluation is to make imports to the devaluing economies more expensive and thus reduce their level. The extent to which the level of imports is reduced depends on the elasticity of demand for imports. Given that Nigeria's exports (recorded and unrecorded) to CFA countries (their imports from Nigeria) are inelastic as a result of the lower level of productive capacities in the CFA zone, their imports from Nigeria may not decline in the short-run. Other factors which could sustain a high level of imports include geographical proximity and cultural affinity between Nigeria and these countries. However, it may be recalled that the 1994 Budget in Nigeria pegged the naira exchange rate at a level that would appear to make the naira exchange rate over priced and less competitive with respect to the CFA rate after the devaluation of the latter. The implication of this is that the price of Nigeria's exports in foreign currency would rise (less will be exported from Nigeria because receipts in naira will also fall). Therefore, the demand for Nigeria's exports would fall as a result of two self-reinforcing policy actions (the CFA devaluation and pegging of the naira exchange rate). However, given the social, cultural, geographic and commercial bond that already exists between Nigeria and her Francophone neighbours it is not likely for exports from Nigeria to decline significantly. The complete elimination of the parallel market would appear to be the only situation as informal trade would be discouraged, thus leading to a substantial increase in recorded exports.

(ii) **Imports into Nigeria from CFA Countries**

The consequence of devaluation is to make exports cheaper and imports dearer for the country devaluing its currency. Consequently imports originating from CFA countries and consigned to Nigeria would, other things being equal, be cheaper. However, this may not be the case given the fact that a large proportion of imports into Nigeria from Francophone countries do not originate from CFA countries. In such a situation, the devaluation of the CFA would make imports which do not originate from the CFA countries more costly. However, the increase in the cost of such imports would be offset by the new relationship between the CFA and naira exchange rate thereby making imports, in naira terms, cheaper if imports into Nigeria are financed at official exchange rate. This will lead to increase in imports. The pegging of the naira exchange rate at N22 per US$ will further cheapen imports from CFA zone. However, since a large proportion of imports from CFA zone to Nigeria does not originate from the Zone, imports into Nigeria will be dearer thereby causing the level of aggregate imports from CFA zone to decline. Overall, imports into Nigeria from CFA countries may increase as a result of CFA devaluation and recent pegging of the naira exchange rate unless countervailing actions in terms of increase in import duties are taken.

(iii) **Smuggling**

Smuggling, a factor affecting cross-border trade, is two-dimensional. Imports are smuggled into Nigeria while exports are smuggled out. As already indicated, the cost of goods imported into CFA countries from Nigeria (Nigeria exports) would be expected to rise as a result of the devaluation of CFAF. All things being equal, smuggling activities would decline. This development will be further reinforced by the misalignment of the naira exchange rate given, however, that black market would continue to thrive. If the black market activities continue, exporters are most likely to avail themselves of the relatively depreciated rate by diverting their produce to the informal sector. This will lead to increase in informal activities. In the short-term, the shock effect of CFA devaluation may disrupt international trade and reduce the level of total trade between Nigeria and her Francophone neighbours. In the medium-term however, smuggling of produce may continue as a result of misalignment of the naira exchange rate, the inflexibility of CFA/FF exchange rate and the problem of reducing black market activities.

(iv) **West African Clearing House (WACH)**

The effect of CFA devaluation on the activities of WACH will depend on the extent to which devaluation affects the volume of transactions that originate in the sub-region and which also pass through official channels. As indicated earlier, non-oil exports from Nigeria may decline not only because the CFA devaluation makes them dearer, but also because the overpriced naira (in relation to the black market) may not offer sufficient incentive to Nigerian manufacturers to export more. On the other hand, imports into Nigeria through official sources may increase as a result of two reinforcing measures – the CFA devaluation and the overpriced Naira which make imports through official sources into Nigeria cheaper than would be the case if they were imported through the informal sector. The devaluation of the CFA will, in addition to its effects on trade transactions, have impact on capital transfers. The devaluation of the CFA and the overpricing of the naira in terms of foreign currency will in all probability accelerate capital flight from Nigeria. Intuitively therefore, the devaluation of CFA coupled with the pegging of the naira exchange rate at a level lower than what prevails in parallel market, may cause the diversion of trade transactions away from WACH. However, imports into Nigeria through WACH may increase. Nigeria's net position in WACH, may therefore worsen as a result of the expected increase in the level of import into Nigeria passing through official channels and the decline in Nigeria's exports to CFA countries.

5. Conclusion

The main purpose of CFA devaluation is the improvement in the balance of payments by switching demand from imports to domestic import substitutes through higher import prices and promoting exports by lowering their prices in foreign currency and increasing their value (income to producers) in local currency. This merchantilist approach to trade relations had, in the past, provoked retaliatory measures from trading partners because it is essentially self-centred. Thus, countervailing actions in the form of competitive devaluations and upward revision of the tariff structures have often been put in place to neutralize the adverse repercussions on affected countries. In the Nigerian context however, the competitive devaluation of the naira exchange rate can be ruled out under prevailing circumstances. Of the other options available, it would appear that increase in tariff is the most viable given that quantitative restrictions are considered too drastic. In the light of the above, the upward revision of tariffs in Nigeria would be considered an appropriate policy action. However, considering that a large part of imports from the CFA zone does not originate from the zone itself, the effect of the upward revision of tariff in Nigeria on imports from CFA countries may be limited. In the case of Nigeria's exports to the Community, devaluation of CFA would hurt the Nigerian exporter since the prices of his products would increase. The profitability of the Nigerian export industry is further reduced by the pegging of the Naira exchange rate. Consequently, the Nigerian exporter is literally crushed between two stones. On a comparative basis, the flow of foreign direct investment would be more in the CFA countries as a result of the more relaxed exchange procedures and the preservation of the CFA–French Franc (FF) direct convertibility. This is because the stringent exchange control measures required to manage a fixed exchange rate mechanism would reduce Nigeria's attraction to international investors.

To reduce the adverse consequences of the CFA devaluation on the Nigerian economy, the following policy options are advocated.

(a) **The naira exchange rate should be made competitive**
To maintain the exchange rate differential between the CFA and Naira before the devaluation of the former, the naira, instead of being pegged should be allowed to fluctuate within a narrow band. This is to ensure that there is no perverse flow of capital.

(b) **Differential Exchange Rate for Non-oil Exports**
The pegging of the naira exchange rate would discourage non-oil export production and accelerate the incidence of capital flight and other sharp practices. Therefore, export proceeds for non-oil commodities should be converted to naira at a more competitive exchange rate so as to encourage continued investment in the export sector.

(c) **Application of stringent exchange control**
In the event that the exchange rate would remain fixed at the current level, the authorities should as a matter of urgency commence the formulation of stringent and comprehensive trade and exchange control regime. This move entails the imposition of stringent penalties for trade and exchange offences apart from controlling the volume of imports and exports. In the alternative, tariffs may be reviewed upwards to reduce the overall level of imports and foreign exchange disbursement. In applying trade and exchange control, it should be remembered that controls are often cumbersome, corruption-prone and difficult to police and administer. Consequently, controls may prove counter-productive. Therefore, a long-term solution lies in ensuring macro-economic stability. This will ensure an enabling environment for productive investment.

(d) Overall, the devaluation of CFA has the potential of adversely affecting Nigeria's balance of payments by reducing the level of Nigeria's exports and encouraging the flow of imports from the CFA zone. The pegging of the naira exchange rate at a time when the CFA is devalued would further accentuate the deterioration of Nigeria's balance of payments by encouraging imports and discouraging exports. To counter these adverse tendencies, the naira exchange rate should be as flexible as possible. If this cannot be done, then the level of tariffs should be raised. Finally, the reduction or complete elimination of parallel market activities is crucial to the success of the proposals enumerated above.