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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Seminar 90/6

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L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

Also Present

African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; G. E. Gondwe, Deputy Director; R. G. Alter, S. Bah, A. Bio Tchane, R. O. Carstens, S. E. Cronquist, P. Dhonte, Y. Fassassi, M. G. Fiator, C. A. François, J. Harnack, E. C. Harris, A. Jbili, J. Kakoza, A. C. Kouvenaar, N. Krichene, C. Mulder, A. B. Petersen, J. T. Reitmaier, A. B. Taylor, U. Wilson. Asian Department: D. Burton, R. S. Teja. Central Banking Department: M. Quintyn. Exchange and Trade Relations Department: T. Leddy, Deputy Director; A. Basu, E. Brau, M. E. Edo, M. G. Gilman, S. Kanesa-Thasan, M. Precious. External Relations Department: G. V. Bhatt, S. W. Kane. IMF Institute: O. B. Makalou. Legal Department: P. L. Francotte. Research Department: J. A. Frenkel, Economic Counsellor and Director; M. Goldstein, Deputy Director; B. B. Aghevli, J. M. Boughton, J. H. Greene, N. M. Kaibni, B. E. Rourke, K. S. Warwick, P. Wickham. Secretary's Department: A. Tahari. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. O. Aderibigbe, A. Gronn, J.-C. Obame, A. Raza, B. A. Sarr, N. Toé. Assistants to Executive Directors: H. S. Binay, C. Bjorklund, S. B. Creane, A. Fanna, M. A. Ghavam, S. Gurumurthi, O. A. Himani, K. Ichikawa, L. I. Jácome, K. Kpetigo, R. Meron, F. Moss, M. Mrakovcic, S. Rouai, D. Saha, G. Serre, D. Sparkes, S. von Stenglin.

1. CFA FRANC ARRANGEMENTS - REVIEW

The Executive Directors considered a staff paper on the review of the CFA franc arrangements (SM/90/136, 7/9/90; and Cor. 1, 9/29/90).

Mr. Santos made the following statement:

I welcome today's seminar on the CFA franc arrangements. African countries that are members of the two monetary blocs form more than half of the total members of my constituency and, indeed, they are the core of the large group of African countries represented by this chair. These countries have had a prolonged, intense, and fruitful cooperation with the Fund. All of them are either implementing adjustment programs supported by the Fund under stand-by, structural adjustment, or enhanced structural adjustment arrangements or are at an advanced stage in the discussions for use of Fund resources. Therefore, we attach great interest to these discussions.

From the outset, it should be emphasized that the monetary arrangements between the CAMA, WAMU, and France are rooted in historical ties and well-established trade and financial flows and are the manifestation of a strong political will on the part of the respective member countries to pool their foreign reserves and steer their economies toward a sound and sustained growth. The franc zone must be viewed as the continuation of the monetary area of the French Union, which consisted of several federations, among which were the AEF (Afrique Equatoriale Francaise) and the AOF (Afrique Occidentale Francaise). The economy of each federation was to be integrated in a single market, and macroeconomic policies were designed and implemented at the federal level.

The franc zone was then a natural framework in which the economic development of the zone was to take place. When the French Union broke up into several balkanized states, the former constituents of the aforementioned federations formed two groups, signed monetary cooperation agreements with the French Republic, and adopted a common currency within each bloc. Under the aforementioned agreements, France, in the same spirit of cooperation and solidarity, agreed to extend its guarantee for the full convertiblity of the common currencies. The fundamental issue arising from such a situation is the extent to which other macroeconomic policies can be coordinated effectively with the common monetary policy.

These preliminary observations and the fact that the economies of the zone are specialized in the production of a few primary commodities might help one to understand why the monetary arrangements lack some of the characteristics of an optimal

currency area. Admittedly, the lack of significant intrazone trade and the low degree of factor mobility in the CAMA and WAMU run counter to the theoretical foundations of optimal currency areas. But, as stressed by this chair on previous occasions, the CAMA and WAMU are the expression of a strong political solidarity and cooperation among the countries belonging to these monetary areas. Their primary objective is to ensure an efficient allocation of the national monetary resources in order to achieve a sustainable and noninflationary growth of the member countries' economies.

The well-documented and very articulate staff paper submitted to the Board today provides an excellent insight into the functioning of the monetary arrangements governing the two monetary areas and an incisive assessment of the economic and financial situation of the countries composing the CAMA and the WAMU.

Undoubtedly, the monetary arrangements have been effective in containing inflation, preserving the foreign assets position of the central banks, and, more generally, creating a stable macroeconomic environment under which economic agents can make rational economic decisions. Although the international comparisons of country groups contained in the paper do not lend themselves to firm conclusions, it is evident that, on these three counts, the performance of the CFA franc zone countries has been outstanding. Moreover, the zone has also enabled its member countries to maintain an open trading system virtually free of restrictions. The authorities of the member countries recognize, however, that while the adoption of a common domestic currency standard has contributed somewhat to increased intrazone trade, much of which goes unrecorded, it has not yet contributed in a meaningful way to economic integration, principally because of the similarity of their production structures and the outwardness of their trade flows and distribution networks. The authorities recognize also that there have been lapses in the application of some of the rules of the monetary arrangements, and that the viability of the zone has come under increasing strain in view of the magnitude and duration of the external shocks, particularly the steady decline in commodity prices confronting the economies of the zone. They are keenly aware of this and have undertaken a number of reforms to address the situation.

When assessing the effectiveness of the CFA franc arrangements in providing an anchor for the implementation of a consistent set of macroeconomic policies, it should be borne in mind that there was not, until recently, a deliberate coordination of the budgetary policies of the member countries belonging to the monetary areas. Nevertheless, it is worth noting that the monetary arrangements provided a framework conducive to the

implementation of restrictive fiscal policies during most part of the period since their establishment. Indeed, one of the advantages of the CFA franc zone is the financial discipline it imposes on the member countries. A key rule of the monetary arrangements (the 20 percent rule) limits the monetary financing of a member government's financial operations. By restricting the monetization of fiscal deficits, this rule has contributed to the achievement of low inflation in the CFA franc zone, a performance that compares favorably with that of industrial countries. However, as indicated in the paper, the fiscal performance in the two monetary areas weakened significantly in the early 1980s.

This weakening of the fiscal performance stems largely from the drastic terms of trade shocks experienced by the economies of the union and the expansionary fiscal policies pursued in the face of deteriorating economic conditions. Indeed, following the first oil crisis, favorable terms of trade generated higher government revenues that were used to raise government consumption to unsustainable levels. As the favorable terms of trade shifted in the late 1970s and early 1980s the structural and financial disequilibria were brought to light. The limited revenue base and the resultant decline in revenue have constrained the efforts of fiscal adjustment of the member countries of the CAMA and WAMU. As indicated in the paper, for the CFA franc zone countries as a whole, total revenues fell by as much as 7 percentage points of GDP between 1985 and 1989. Moreover, the stickiness of current expenditure, in particular wages and salaries, and the constraint of debt service payments have contributed to reducing the flexibility of fiscal policy.

Despite the severe tests to which the monetary arrangements have been put during the past few years, the authorities of the CAMA and WAMU have reiterated their commitment to maintain the arrangements and have taken steps to match this commitment with concrete reforms. It should be underscored here that the monetary arrangements were not meant to be static, but instead are to evolve with changing circumstances. In the past, comprehensive reforms were introduced and this will continue to be pursued.

The reforms under way in the two monetary areas are aimed at restoring the viability of the banking system, rehabilitating the public sector broadly defined, and reducing structural rigidities and domestic factor costs in order to restore international competitiveness. The sustained implementation of these reforms should go a long way toward addressing the fundamental disequilibria faced by the zone.

To enhance the mobilization of domestic savings and improve the allocation of resources, the authorities have strengthened

further their monetary and credit policies in 1988. They have also launched a comprehensive reform program to restructure the banking sector and strengthen the financial sector. Following a symposium held in May 1989, the Council of Ministers of the WAMU (the governing body) decided to reform the monetary policy instruments and adopted in October 1989 new rules governing the intervention of the Central Bank and the distribution of credit. In this context, the preferential treatment accorded to crop credit has been terminated with such credit now included in the global ceilings on domestic credit, interbank operations have been deregulated with banks now required to report only expost, and the functioning of the money market has been streamlined to enhance the flow of resources among banks. In addition, studies are under way in order to move from the present direct instruments of monetary policy to indirect instruments. Similar reforms were adopted by the Board of Directors of the BEAC on October 16, 1990. The decisions included the elimination of the preferential discount rate, the adoption of the principle of unification of the central bank lending rates, and further liberalization of general banking conditions. More importantly, a supranational Banking Commission to strengthen banks' supervision was formalized.

The deterioration in the fiscal performance during the past several years and its "spillover effects" on the monetary situation and the banking system of the CFA franc zone have brought to the fore the critical importance of fiscal coordination in the two monetary areas in order to lend credibility to the common monetary policy. To this end, the Council of Ministers of the WAMU held a seminar in February 1990 on the harmonization of national budgetary policies and the common monetary policy of the WAMU. The Council adopted a set of recommendations that establish a blueprint for the coordination of budgetary policies in the WAMU. Some of the measures recommended are for immediate application and the others are of a medium- to long-term nature. Similarly, within the CAMA there are steps being taken toward the coordination and surveillance over the economic policies of the member countries. In the meantime, most of the countries in the two monetary areas have initiated reforms to improve tax administration, rationalize the tax system, restructure government expenditures, and strengthen budgetary control procedures. The public enterprise sectors have also undergone comprehensive reforms, and the authorities have taken, whenever necessary, the decision to reduce producer prices in order to improve the financial position of the crop marketing boards.

Given the nature of the exchange rate arrangements maintained by member countries in the CFA franc zone, the implementation of sound financial policies along with the reduction of structural rigidities and factor costs are considered the best alternatives

for achieving and maintaining competitiveness in the two monetary areas. Reforms are being undertaken in the labor markets to introduce flexibility and reduce the stickiness of factor costs. Efforts are also being made to increase private sector participation in the economy. Finally, it should be noted that substantial progress has been achieved in the liberalization of foreign and domestic trade systems. As underlined by the staff, these reforms, together with the reductions in public utility and tax rates, should contribute to economic efficiency and improve the competitiveness of the economies of the zone.

To conclude, the various reforms being implemented by the member countries of the CFA franc zone are indicative of their strong political determination to maintain the monetary arrangements with France and adapt them whenever necessary to the evolving conditions of the economic environment. There is no doubt that for the authorities of the CAMA and WAMU, the advantages of the monetary arrangements far outweigh the constraints resulting from their forfeiture of the use of the exchange rate instrument. In addition to the financial discipline and the benefits to each member from participating in regional monetary arrangements, they consider that these arrangements have the advantage of encouraging regional economic integration, an objective that is gaining considerable political support among African countries. Although in the recent past the monetary areas have been confronted with severe difficulties, which have raised the issue of the sustainability of the corrective measures implemented, the members of the two blocs have reiterated their strong attachment to the present arrangements and their willingness to undertake the necessary measures in the context of these arrangements. They will spare no efforts in the use of other available policy instruments to achieve the desired result. The intensification of their efforts to lower domestic factor costs, the implementation of comprehensive reform programs, and the steps taken toward increased coordination of their economic policies should be sufficient evidence of their political commitment. However, they are of the view that the restoration of growth momentum should not be viewed exclusively as an issue of competitiveness. The problems of market access, the provision of adequate external financial resources, and the mobilization of domestic savings are also important constraints to reckon with.

Mr. Peretz made the following statement:

It is I believe very useful to have this opportunity to discuss the CFA franc zone. This chair originally requested this discussion, and the staff paper is thorough and very interesting. The subject raises a number of fundamental issues on both exchange

rate policy generally and Fund surveillance, as well as issues relevant to programs in the CFA zone in particular. So I am disappointed that it has not proved possible to take this paper at the same time as the two staff papers on exchange rate policy (SM/90/198 and SM/90/200).

Perhaps, nevertheless, I could preface my remarks on the CFA zone arrangements with some brief general points about exchange rate policy. Like other Directors, I agree that a stable exchange rate can have an important role to play as a nominal anchor to any country's economic policy. It imposes a valuable and simple discipline, which--so long as the reference currency is itself stable--in most circumstances will force policymakers to adopt the right domestic policies. By the right policies, I mean policies that tackle the real underlying problems of costs, competitiveness, and the level of domestic demand. Devaluation, on the other hand, always risks making matters worse: it can seem an easy way out, allowing the authorities to avoid necessary adjustment policies; and it risks entrenching inflationary expectations.

But this is not to say that exchange rates should be fixed for all time. There are instances when a step change in the external value of the currency is the right policy, so long as it is accompanied by the appropriate domestic policy measures. There are cases, except perhaps in the most flexible of economies, where it is clearly unrealistic to expect the degree of downward adjustment required in domestic costs without major economic and social disruption. I have in mind cases in which there has been a large and permanent exogenous disturbance, a major structural change, or the scale of the imbalances in an economy has built up over time to such a point that it is not realistic to expect correction to occur through domestic cost adjustment alone.

I should add as a rider to these remarks that, where stability of the official exchange rate is achieved by exchange controls and restrictions, I would not regard that as real stability at all. Typically, there will be a parallel unofficial exchange rate. To the degree the authorities pay attention to the controlled official rate, it will not give the right signals for policy. A currency has to be freely convertible if the exchange rate is to play a useful role of policy anchor. This is not a point that applies in the case of the CFA zone, where the two currencies are freely convertible with the French franc; and where exchange restrictions between the French franc and other currencies have now been lifted. But it does of course apply in other cases.

How do the CFA arrangements measure up to these general considerations? They have provided a long-lasting form of exchange rate stability which for many years yielded considerable benefits, giving domestic policy in member countries a clear and in practice useful framework. More recently, however, I believe that the form of the arrangements has contributed to the intractability of the problems experienced by some--not all, but some--countries in the CFA zone.

Why has this come about? I note first the particular form of currency stability pursued in these countries: not an exchange rate target, but a single currency--or rather two single currencies (one for each area) linked with each other and with the French franc. The staff paper includes an interesting discussion of how this monetary union measures up to the usual criteria for optimal currency areas. The economies are diverse in size and character, affected by external shocks in quite different ways, and have very limited trade links or labor mobility between them. It is a familiar proposition that currency union clearly brings advantages over, say, a system of fixed but adjustable rates, in terms of credibility of the exchange rate commitment. But the circumstances of the individual economies of the CFA franc zone are such that, I believe, most economists would not advocate currency union--were it advanced as a theoretical proposition--unless the countries concerned had remarkably flexible cost and wage structures.

For we must be very clear about what the absence of the devaluation option implies for such countries when coping with adverse external shocks or the consequences of a period of inappropriate domestic policies. Unless they have sufficient downward flexibility in domestic costs and prices, they are effectively condemned to a prolonged period of low or even negative growth, which may not be consistent with the Fund's objectives of growth-oriented adjustment.

As the paper makes clear, the effectiveness of the CFA arrangements have over the years been eroded in several respects. First, it is clear that some of the economies have not demonstrated the required degree of flexibility. Indeed, as the staff paper notes, there are signs of increasing rigidities, for example, in domestic wage structures.

Second, the monetary disciplines of the system have not been matched by an equivalent adherence to sound fiscal policies; member governments have found it relatively easy to circumvent the rules governing the monetary financing of deficits by recourse to external borrowing, running up payments arrears, and shifting expenditures to public enterprises and agricultural marketing

boards. As a result, the stance of monetary policy has frequently been undermined by lax fiscal policy. These weaknesses in the CFA system have limited the central banks' ability to contain credit growth, and there was for a time an increased reliance on direct controls, such as credit ceilings on individual banks, reinforcing the selective and discriminatory way in which credit is allocated. However, I very much welcome the recent moves toward market-based policy instruments.

In reading the staff paper, I found it hard to resist the conclusion that the particular arrangements of the CFA franc zone and its apparent immutability may, in fact, have weakened the disciplines normally associated with the use of the exchange rate as a nominal anchor for domestic policy. Normally in such arrangements, a degree--however small--of uncertainty is present. I am therefore left wondering, as a theoretical proposition at least, whether the member countries would not have been better off with a system of fixed but adjustable exchange rates, rather than full monetary union. For the domestic authorities, the sanction of the foreign exchange markets has been effectively removed, while for those lending to public sector bodies, including overseas lenders, the risk of default may have seemed appreciably diminished. It is perhaps not entirely surprising, then, that membership of the CFA zone has not been a firmer deterrent to the pursuit of inappropriate fiscal policies, indirect monetary financing of deficits, and heavy foreign borrowing.

These, then, are the reasons for my unease about the CFA franc arrangements. Stable exchange rates have a great deal to offer, but it is not clear to me that the particular form of stability pursued in this case (i.e., currency union) is necessarily the best strategy among such a disparate group of countries with inadequate convergence.

Let me conclude with some remarks about the Fund's attitude to the CFA arrangements. Of course, I recognize that discussion of the exchange rate is, for any country, a matter of great sensitivity, and the staff is right to be very careful in what it says. But where Fund resources are involved, I believe that there should be some examination of all policy instruments. In practice, the implications of the present exchange rate arrangements in CFA zone countries are seldom given the attention they deserve in the papers that come to the Board. Where a CFA member is embarking on a Fund-supported adjustment program, the Board should be in a position to assess the implications of membership of a currency union for the operation of policy. Our original purpose in requesting this seminar will have been fulfilled if staff papers in future address these questions a little more fully--but, of course, in suitably guarded terms--than they have in the past.

Mr. Bossone made the following statement:

This chair welcomes the staff paper on the CFA franc arrangements as well as the initiative to make it the subject of a Board seminar. I am glad that the Board has been given today the opportunity to discuss this issue, since the review undertaken by the staff clearly indicates that important economic aspects are involved in the CFA arrangements and need close consideration by this institution.

In my following remarks, I will make some general comments on the study, I will take up a number of issues relating to the benefits and the costs of the CFA arrangements, and I will conclude by posing a few questions to the staff.

Review studies, such as the one today under discussion, are always difficult exercises in that they necessarily require delicate assessments of costs and benefits which most often do not lend themselves to straightforward quantification procedures. The staff must be commended for having undertaken such a difficult task and for the effort made to come up with a comprehensive description of the CFA characteristics and problems. Yet, I have the impression that something is missing from this review. More should have been said, for instance, about the historical background of the CFA arrangements, as well as the reasons that originally led to their establishment. Also, consideration should have been given to both the economic significance that CFA member countries today attach to the arrangements, and to the objectives that each member aims to pursue through them. Similarly, something could have been mentioned on the role currently played by the pivotal country of the areas and its responsibilities toward the other members. All this would have offered a stronger reference framework against which to assess the benefits and the costs of the arrangements.

But where I think the study has left major questions unsettled is in its concluding part, where the analysis should have led the staff to draw some (at least tentative) normative propositions. In fact, a clear assessment by the staff of the validity of the current technical and institutional structure of the CFA arrangements is missing, and the lack is felt of the staff's views on how, in perspective, the authorities of the regions should consider to manage the evolution of the arrangements themselves. It would be important to know, for instance, whether the staff envisages at this stage any adjustment or institutional change to improve the content of the arrangements and to make them more conducive to economic restructuring and growth in the participating economies.

In evaluating the usefulness of the CFA arrangements, the review clearly shows that they have been successful in guaranteeing member countries a fair degree of monetary stability, as well as the full convertibility of their currency, for quite an already extended period; they may have also generated considerable economies of scale in terms of reserve saving and risk pooling. These achievements, per se, would seem to provide solid justifications to the existing arrangements.

However, one should look at the cost side of the picture as well and evaluate such arrangements in their dynamic dimension too. One would then wonder whether the creation of the CFA currency areas has somehow interacted over time with the process of growth of the national economies involved, for instance, by altering their unemployment-inflation trade-offs. In this connection, the comparison of the CFA economies with other similar African countries seems to indicate that during the 1980s lower inflation has been attained in both the CFA areas at the cost of significantly lower rates of output growth. The comparison would suggest the need to reassess the opportunity cost of price stability, in the context of developing countries with large unutilized resources and poverty, in terms of forgone output growth. This, of course, brings us back to the very fundamental issue of whether money is a veil and, above all, whether it is so in developing economies where perhaps the Phillips curve is not so vertical after all!

Another important question on the long-term effects of the CFA arrangements is whether the establishment of these areas has given rise to (or has exacerbated) intraregional imbalances through dynamic increasing returns mechanisms. But a most crucial issue has to do with the long-term trade and resource allocation costs that the fixed conversion rate of the CFA currencies with the French franc may have imposed upon the regions' member economies: irrevocably fixed exchange rate relations with one country in a world context otherwise characterized by flexible rates may well have induced primary commodity-producing economies, such as the CFA countries, to rely too heavily on trade flows with the pivot country as well as on traditional exports, thus forsaking the development of both alternative market outlets and products. Unfortunately, the review does not address these important questions.

Nor does it allow us to assess whether enough efforts have been made by the CFA national authorities to improve the beneficial effects of the existing arrangements by carrying on and deepening the process of mutual integration of their economies and economic policy frameworks. In this respect, one fails to see if and how the monetary integration within the two areas has somehow

served to strengthen their internal economic and financial cohesion.

The traditional approach to optimal currency areas has identified a number of key factors which, individually or in combinations, constitute the root of such areas. I refer, of course, to international labor mobility, openness to trade, production diversification, financial integration, similarity of inflation rates, and economic policy integration. Now, even though the role attributed to each of the above factors as unique and sufficient criteria to judge the optimality of a currency area has been strongly criticized, it is nonetheless reasonable to expect that, after a currency area has been established, the use of only one currency might in due time lead participating countries to pursue greater integration. In fact, no significant progress toward greater integration seems to have been achieved by the CFA countries since the arrangements have come into existence. In particular, intraregional labor mobility and trade flows are still rather limited.

At the policy level, effective coordination of national fiscal policies is usually seen as an essential ingredient for a stable monetary area: it may help lessen regional imbalances, above all when interregional factor mobility is limited, and can be flexibly adopted when member countries are subjected to asymmetrical external shocks requiring different degrees of domestic adjustment. Allocative reasons also suggest that coordination should possibly evolve into harmonization and eventually develop into full integration of national fiscal policies. Some steps have been taken recently by the CFA member governments in the direction of coordination. The paper states very clearly, though, that regional surveillance in the context of the CFA arrangements has not played a sufficient role in restraining members' fiscal policies. It would thus seem manifest that, with a common monetary policy and the need to restore financial internal and external stability, the budget policy of each member country should be subjected to multilateral coordination. Furthermore, the desirability should be considered of pursuing the objectives of harmonization and integration.

I would like to address to the staff a few questions. An important one arises in connection to the costs of the monetary arrangements in the CFA areas and has relevant theoretical implications. The question is the following: can a monetary union lead its peripheral members to sustained output and trade growth and stability when it is centered on an economy whose production and external trade structures differ so considerably from those of the other union members as in the case of the CFA areas? In such circumstances, the monetary standard adopted

necessarily reflects a national policy strategy--that of the pivot country--which is tailored to objectives that do not necessarily coincide with those of the peripheral members. The risk is that of forcing upon the latter suboptimal price tendencies which might affect their domestic equilibrium and penalize their competitiveness. As a result, the union's currency may turn out to be significantly misaligned with respect to the currencies of the competitor countries, thus affecting the external trade position of the union members. Indeed, this might have actually occurred to the CFA countries, which during the last decade seem to have suffered intense competition on exports and import penetration from neighboring countries which were free to move the external value of their currencies. More generally, in the presence of strong dualisms a fixed exchange rate might not be sustainable; sustaining it might impose large costs on the weaker regions of the union; these costs must in turn be somehow financed; and the result is, of course, a less than optimal situation. Such a question, then, is crucial to understanding whether the attained conditions of relative monetary stability in the CFA zones have allowed member countries to best exploit their growth potential.

The very same question leads me to address two other important policy issues: first, the appropriateness of the CFA's current reference currency as against a basket peg which would better reflect the trade patterns and relations of the member countries; and, second, the desirability of adjusting the exchange rate in the CFA, with the aim to realign domestic relative prices with those of major competitors and to correct members' structural external imbalances. In fact, at several points in the paper the staff seem to suggest that, given the current persistent imbalances, relative price corrections through exchange rates realignments may be warranted should downward adjustments in domestic costs and prices prove to be unworkable. I would appreciate staff's comments on these subjects and I would very much like to know from the staff what would be the position of the CFA monetary authorities in these respects.

Mr. Landau made the following statement:

Since the adoption of the CFA franc arrangements, the two monetary unions have faced difficult situations and many challenges. But they always have proved sufficiently adaptable to maintain the principles of cooperation and monetary stability among the member countries. It is especially worth noting that, despite their disparities, and by displaying a high degree of cooperation, the members of the arrangements have been successful in organizing a joint response to their present economic

difficulties. This development clearly demonstrates the potentiality and the strength of a coordinated answer to the present crisis.

The franc zone arrangements are undoubtedly a source of progress in providing an operational framework for regional cooperation and a collective approach to economic problems that undermine developing countries. They also are a proof of the possibility of having a North-South dialogue on an institutional basis, as France is fully part of the system.

The staff paper provides us with a comprehensive and fair overview of the present situation. It contributes significantly to a better understanding of an original and long time-based mechanism of cooperation. The paper is also a good way to improve the reflection and the dialogue on very difficult issues. I can assure the Board that it has been thoroughly examined and appreciated by my authorities and has been of a great help in framing and assessing the different policy options.

Article IV consultations provide the best opportunity for discussing the situation of individual countries. Hence, in the framework of this seminar, I would like to concentrate on systemic issues regarding the franc zone, its organization, its operations, and its consequences for the economies of its members. In assessing the present situation and future prospects of the franc zone, several points deserve consideration, on which I will successively elaborate.

First, as clearly underlined in the staff's study, the CFA franc arrangements have proved very successful, both in ensuring monetary discipline and improving the effectiveness of monetary policy. But, second, it is clear that these benefits have been undermined in recent years by the general slippages in fiscal policies. These, in my view, are at the root of the difficulties encountered both in the financial system and the real economy in many member countries. Therefore, third, the efforts of the members of the zone should aim at broad financial reform with the objective of restoring a satisfactory degree of fiscal discipline, together with increased private savings. Both efforts are currently under way and could be expected, pending no further external shock and adequate external support, to produce significant results in the period to come.

Finally, I will comment on the question of competitiveness, which is raised in the staff paper as a main issue for the future.

Monetary policy has been very successful on the whole in the franc zone, although procedures for controlling money supply had

to be recently reinforced and reoriented in favor of market-based mechanisms. It is also clear, unfortunately, that monetary discipline did not extend far enough in the direction of prudential surveillance to prevent a deterioration in the quality of credit.

The success of monetary policy both in WAMU and CAMA rests on the common discipline accepted by all members of the arrangement. Let me recall briefly the main institutional features which characterize the area: two common central banks, which operate independently of any national--including the French--governments; strict statutory ceilings on the monetary financing of fiscal deficits (through the so-called 20 percent rule), and, finally, the "compte d'opérations" (operations account with the French Treasury) through which international reserves are pooled and external financial relations are settled. On this occasion, one can recall that the fears sometimes expressed that this account would serve as a permanent source of external financing have proven widely unfounded. In fact, the overall position of the operations account improved rapidly since 1988 and is today positive, even though it remains slightly negative for two individual countries.

The achievements of the monetary arrangements are very clear in the conduct of monetary policy and the control of inflation. On inflation, the report demonstrates the impact of the arrangements in comparison with other sub-Saharan African countries. Thus, during the period 1982-89, average annual inflation was 5 percent for franc zone countries, instead of 30 percent for the whole sub-Saharan countries.

This success of monetary policy has produced two important and very beneficial results. Confidence in the currency is the first one. I would like to underscore, in this context, that contrary to widespread perceptions, franc zone countries have been better protected against capital flights than other comparable developing countries. A study of the period 1973-87 made by the Bank of France demonstrates an interesting fact: by comparing the cumulative current account deficits and the evolution of net external debt, the Bank has been able to assess the extent of capital flight in different groups of countries. It appears that capital flight is responsible for only 28 percent of the net indebtedness in the franc zone countries versus 52 percent for other sub-Saharan African countries. In our view, the increase in CFA banknotes repatriated from throughout the franc zone has wrongly been interpreted as proof of capital flight. In reality, this development has been the result of the role played by CFA franc as a trade and reserve currency for the whole subregion: in countries outside the zone, where exchange rate flexibility has

introduced a degree of uncertainty, CFA banknotes have been in effect used as parallel transaction and private reserve assets.

A second--and essential--by-product of monetary discipline lies in the fact that members of the zone have always kept with the Fund--and its fundamental rules--an impeccable track record. It goes without saying that no arrears have occurred, even when some external financial situations have been very difficult. But it should also be remembered that members of the franc zone have always implemented total freedom in capital movements; they never introduced any exchange restrictions or dual exchange rate systems, and their trade regimes are generally open and free, compared to other similar countries. These features, together with the fact that their currencies are fully backed by France's international reserves, have proved an important element of their integration in world financial institutions. My authorities are convinced that this strict adherence to the Fund's fundamental rules and presumptions would not have been possible without the monetary discipline which the arrangements incorporate--and its inevitable corollary, the stability of the exchange rate.

The efficiency of monetary policy has been improved, in recent years, through the implementation of several reforms. The measures undertaken in the WAMU in 1989 are well known, and I would briefly recall that they aim at a more market-oriented scheme in determining credit expansion. This reform is linked to the regional money market open to the commercial banks. In addition, on a national basis, comprehensive programs of rehabilitation of the financial intermediation system have been initiated with the assistance of various donors. Interest rates have been, for their part, aligned with those in France, with a differential that attracts savings.

On October 16, 1990, the Board of the BEAC also adopted a comprehensive set of measures to improve the monitoring of monetary policy. The privileged discount rate has been abolished, while the normal one has been increased from 10 percent to 11 percent. The conditions of the statutory advances to the Government have been reinforced, and the Governor of the BEAC has been empowered to modify rates, increasing the autonomy of the central bank. Moreover, as in the case of the WAMU, a Banking Commission has been set up on a regional basis to ensure the supervision and the control of the banks.

Despite these improvements, the monetary authorities have not been in the position to prevent serious and damaging deterioration in the quality of credit. Due to various pressures, mainly on state-owned development banks, monetary rules have not been sufficiently strong to arrest the deterioration in the quality of

portfolios held by these banks, and by extension, to the overall banking system. As stated by the staff, the pressures applied through the demand for central bank refinancing translated into the necessity to choose between commitment to financial stability and the responsibilities of the central banks as lenders of last resort. In the effort to preserve financial stability, a liquidity squeeze has developed in several countries.

This liquidity squeeze has been strongly reinforced by the slippages which have occurred, on a wide scale, in the conduct of fiscal policies.

Although individual countries have relinquished monetary sovereignty to a joint and commonly managed monetary institution, they have kept at the national level the control of fiscal policy. Except for the limits on monetary financing of deficits, there is no binding constraint on the operation of national budgets. Thus, those countries which have chosen to react to the deterioration in their terms of trade through fiscal expansion and compensation introduced an inconsistency in their policy mix which is at the root of their present difficulties.

We have to acknowledge, in that regard, that severe slippages occurred in the 1980s. Despite the deterioration in the terms of trade, most of the countries implemented overambitious investment programs with low rates of economic return. Large fiscal deficits appeared, first in the WAMU, and, after 1986, in the CAMA. The main feature has been the decline in the ratio of revenue to GDP linked to excessive trade and tax regulations. Moreover, delays in adjusting producer prices led to large deficits for official marketing agencies and stabilization boards. In parallel, the so-called informal sector increased rapidly in response to the diminution of profitability of the productive sector.

There are several channels through which overly permissive fiscal policies have contributed both to the financial fragility and depression in the real economy. First, by creating internal imbalances between demand and supply (and between savings and investment), fiscal deficits have translated themselves into foreign indebtedness. To an increasing and worrying extent, the balancing of national budgets has relied heavily on foreign assistance. In fact, the level of foreign debt has increased dramatically in the area, from 64 percent to 81 percent of GDP between 1982 and 1989. Second, to the extent that they could not be financed by foreign sources, the deficits had to be covered through internal means. In the absence of any accommodation by monetary authorities, this led to the progressive accumulation of internal arrears, which have all but crippled the financial and banking systems in some countries of the area.

These arrears, which, in fact, can be seen as a form of compulsory lending from the private to the public sector, have also contributed to the crowding out of private investment and consumption and thus have a direct impact on the rhythm and modalities of growth. For instance, the absence of a secure and properly functioning banking system has constituted a powerful incentive to the emergence and development of the informal sector. Thus the elimination of these arrears and the consolidation of the capital base of the main banks appear as a prerequisite to overall adjustment of the many economies and a priority for the period to come.

More generally, financial reform constitutes the main objectives pursued by our authorities in the immediate future. Our authorities are now working in four main directions: improving and rationalizing the tax structure; rebuilding an efficient and sound banking system; enhancing private savings; and reducing arrears.

On the fiscal side, lessons have been drawn principally from a seminar which was held in Ouagadougou in February 1990 under the aegis of the WAMU and with the participation of both the Fund and the Bank. This will lead to three main areas of reform. The first is broadening the tax base through harmonization of taxes on domestic transactions and reaching the informal sector by extending business operating fees (patente) at the level of each individualized activity, shop, or enterprise. The second is improving tax administration; the main objective is to increase coordination between the administrations in charge of determining the base for domestic taxes and those in charge of collection. In the customs area, a simplified framework called SYDONIA, elaborated in collaboration with the French customs, has been extended to all the countries pertaining to the franc zone. The third is reforms of the tariff structure by, in particular, the adoption of a common policy on tax exemptions, the diminution of quantitative restrictions and their replacement for certain commodities by higher duties and taxes, and the compression of the rates structure up through the maximum rates and a wider application of minimum rates.

At the center of the reform process is the rehabilitation of the banking system. The World Bank and various donors are fully part of the process in several countries. Of the main features that underline banking system reforms in every country, the first is to maintain only banks that, after restructuring, could become profitable, solvent, and liquid. In several countries like Senegal, Cameroon, Benin, and Equatorial Guinea, this process is well advanced, with a drastic reduction in the number of financial institutions.

The second reform is to reduce government interference in the Bank's management through privatization and by limiting the government's share capital to a maximum of 25 percent. Under this process, recapitalization of the solvent banks has been carried out with assistance from both donors and private partners. It is worth noting in this regard that global financing plans have been designed with projected annual government contributions compatible with the government budget. In parallel, specific operations have been undertaken aiming at redeploying the people involved in the restructuring.

I would like to stress that, in order to maintain the BIAO network, agreement has been reached for the present system to be restructured with the participation of an African-based international bank. Finally, after the liquidation of inefficient government banks and the privatization of others, the restructured banking system will consist of commercial banks. Thus, the promotion of grass roots institutions has been fostered in parallel for institutions that would operate on a cooperative or mutualist basis.

Third, and in addition, a working group on savings was created in April 1990, taking into consideration the fact that it should be an essential objective in order to reinforce the ongoing restructuring of the banking systems as well as foster adjustment policies. Among the different measures envisaged to further mobilize savings are new instruments of collection with fiscal incentives and the development of mutualism to extend the system to the informal sector. The working group will give its conclusions for operational actions during the first six months of 1991.

Fourth, the reorientation of financial reforms is focused on the systematic elimination of arrears under the different ongoing Fund-supported adjustment programs. The design of each individual program includes specific measures to move rapidly toward equilibrium in public finances and to substantially reduce payments arrears. This has been accomplished through the rationalization of the functioning of the different agricultural subsectors, or "filières," and the marketing boards and stabilization funds. Moreover, internal reorganization and financial restructuring of parastatals have been implemented. Finally, expenditure control and monitoring have been reinforced to avoid further accumulation, in particular, from extrabudgetary operations. Under these conditions, domestic arrears have been reduced from CFAF 202 billion to CFAF 136 billion between 1988 and 1989 within the WAMU.

Let me now turn to the very important issue of competitiveness. As the staff itself recognizes, any assessment or

measurement of competitiveness is highly tentative. The study provides us with impressive figures, which I certainly shall not challenge, but which need to be put into perspective and thus cannot be taken as absolute indicators.

First, the measurement of competitiveness is highly sensitive to the starting point. If we take the beginning of the previous decade, rather than 1985 as did the staff, the overall picture is rather different. It is our assessment that the real effective exchange rate of CFA countries is about at the same level today as in 1980 (not taking into account the very recent depreciation of the dollar). Such a long-term perspective is especially warranted as, contrary to previous decades, the dollar has undergone wide and impressive real swings, which should be taken into account in the analysis. Failure to do so would in fact implicitly be equivalent to recommending a pegging of primary exporters' currencies to the dollar, which I would very much hesitate to do.

A second consideration is that when we look at consumer prices, the competitiveness of CFA countries has been and is still very strong indeed. Third, the situation of the tradable goods sector has been considerably improved by the producer price adjustments which have occurred in the past 15 months, especially in Côte d'Ivoire. We were encouraged by the statement made by the staff, at the occasion of reviews of this country, that the prices are now fully in line with requirements of international competition.

Thus, the competitiveness issue is much more a question of internal adjustment of relative prices, and internal transfer of resources between the tradable and nontradable sectors. This is, obviously, closely linked to the question of fiscal adjustment and the rationalization of the public sector. This is why, as I stated earlier, fiscal and public sector consolidation lies at the root of the question of competitiveness.

What should be, in this perspective, the mechanism of adjustment? In a very balanced manner, the staff states that, should internal adjustment be insufficient, alternative strategies would have to be considered, which is a nice allusion to an exchange rate realignment. I would like to state that my authorities' strong opposition to that measure does not rest on any ideological or dogmatic approach. I can assure the Board that the question has been thoroughly and extensively reviewed, and that, together, with our African partners, we have looked at all the evidence and arguments available. This has led to the generally agreed (between us) and today strongly implemented strategy of internal adjustment with exchange rate stability.

Let me stress briefly the reason why this choice has been made: in considering the question of adjustment, our authorities had to balance the obvious benefits of exchange rate stability against the very dubious results of an alternative strategy.

I need not recall in detail the benefits of exchange rate stability, which I have had many occasions to stress in this Board. By providing a nominal anchor for expectations, exchange rate stability ensures the credibility of the overall anti-inflation strategy; it enables lower interest rates to occur and ensures financial stability. This is especially necessary, since the adjustment process triggers social and political pressures which would, in the absence of the fixed nominal anchor, very likely derail the whole course of economic policy.

In this regard, the advantages of any exchange rate adjustment are very dubious. It seems to me that three questions would have to be answered before such an alternative were considered. First, to what extent would a nominal adjustment translate into a real exchange rate depreciation? Whatever the results of econometric models, we have very strong doubts in this regard. Looking in particular, at the experience of other countries on the same continent, we find that exchange rate depreciation has triggered a spiraling inflation process and that any real benefits have been small and essentially temporary. Neither we nor our African partners think that, by some hidden virtue, labor and goods markets would behave differently in CFA countries. The experience clearly shows that the real exchange rate is definitely an endogenous variable, over which monetary authorities might have very little control.

Second, supposing that some real exchange adjustment were achieved, to what extent would it lead to a reduction in the external imbalances? This is the very well-known issue of elasticity. I will not elaborate on this any further. Suffice it to say that, as far as primary commodity exporters in Africa are concerned, there are very strong presumptions that both on the export and import sides the reaction of trade flows to real exchange rate changes would be very dim and take a long time to appear. So, any positive effect of a real depreciation would have to be felt through an increase in profitability of the tradables sector, supposedly leading to an increase in potential and effective output in the long run.

This leads me to the third and, in my view, most crucial issue regarding exchange rate adjustment: to what extent would it trigger, in the long run, a sufficient supply response to enable stronger growth and diversification? This is an issue which we have been considering at length and discussing thoroughly with the

staff. The results are somehow frustrating: it has been impossible to establish a clear correlation between exchange rate adjustment and export diversification in the long run. Some countries, especially in Asia, have succeeded in building up and broadening a strong industrial base through real exchange rate depreciation. Others have failed. Another group has met with great diversification success without any significant exchange rate adjustment in the long run. So there seems to be a presumption that the conditions of internal adjustment are much more important in this regard than any external monetary correction.

Furthermore, there are several indications that real exchange rate depreciation could have a negative and contractionary effect on aggregate supply in the long run. First, it would increase the debt overhang both on the external and internal sector; it is generally assumed today that, even in the case of extensive and concessional rescheduling, the amount of public external and internal debt can act, within some limits, as a strong impediment to investment and growth. We have no doubt that this is the case in some countries of the franc zone and that their situation would be heavily aggravated, in this regard, if their foreign debt were to reappreciate.

Second, any monetary correction would increase the cost of imported capital goods and, thus, the relative price of investment, thus acting as a further disincentive for an increase in the potential output. Third, nominal depreciation would reduce the real value of bank credits, both outstanding and new, and thus exert a very strong contractionary impact on business investment.

All these negative effects are very likely to occur; as shown by recent research in the World Bank, there might be in the long run a strong negative impact of real exchange rate depreciation on potential output. The essence of the problem seems to lie in the following fact: factors which are used in the tradable and non-tradable sectors are not easy substitutes. In the presence of market rigidities, relative internal price changes would not result in huge transfers of resources. So, improving the functioning of markets and the process of internal allocation seems a prerequisite to the resumption of investment and growth. This makes, in our view, the strongest possible case for internal, rather than external, adjustment, however long, painful, and difficult this process might be.

In conclusion, I would like to stress that the French Government is committed more than ever before to strengthening and expanding its cooperation, on an equal and mutually beneficial manner, with its African partners through the franc zone. We

strongly believe this is the best institutional and monetary cooperation that could be imagined between ourselves and our partners. That does not mean everything is perfect. There is a lot of room for improvement, especially in reinforcing regional cooperation and ensuring better mutual market access for goods and production factors. Greater regional economic integration remains a main objective; as Mr. Santos rightly pointed out in his statement, this would enhance the real flexibility of our economies, thus getting the zone closer to the ideal scheme of the so-called optimum currency area. As our own experience in Europe shows, this is a long-term endeavor but not an impossible one.

In this perspective, my authorities have absolutely no doubt that the franc zone will benefit from the current movement toward greater European integration. It is worth noting, in that regard, that this will leave the fundamental mechanisms of the zone absolutely untouched. We are committed to strongly working toward the expansion of financial cooperation between African and European countries, as well as to granting better and increased access for African products on our markets. We strongly think that monetary and exchange rate stability will enable those countries to fully take advantage of those wide-ranging and increasing opportunities.

Mrs. Hansen made the following statement:

We welcome this opportunity to discuss the arrangements of the CFA franc zone. We found the paper before us interesting in a number of respects, but it also seemed to sidestep a number of important issues concerning the CFA franc arrangements. In this connection, we agree with Mr. Peretz that it is unfortunate that the CFA franc paper could not be considered at the same time as the two other upcoming papers on exchange rate matters, which shed some additional light on issues of relevance to the CFA franc zone.

The paper before us indicates that a principal positive result of the CFA arrangements is that inflation rates in the CFA countries have generally corresponded very closely to the inflation rate in France, which, especially since the mid-1980s, has been quite moderate. The CFA arrangements have also limited the amount of central bank credit extended to individual central governments. They have not, however, prevented countries from running large central government budget deficits, financed by external borrowing and/or large domestic payment arrears to public sector enterprises. Nor have they prevented domestic banks from building up large portfolios of bad loans to public sector enterprises. This is not to say that domestic economic policies would necessarily have been any better under some other exchange rate

system, but merely to point out that the policy discipline, which is said to be one of the central tenets of the CFA zone, has, in large part, been lacking.

The paper makes clear that an important problem has been the lack of supervision over the individual national banking systems by the two central banks. It is unfortunate that the Fund itself may have inadvertently contributed to this problem by confining the framework of its annual consultations to policies within the control of the individual national authorities. We agree with Mr. Peretz that the interests of both the Fund and member countries would be better served if the policies of the zone were given greater attention in future Fund documents.

As noted in the paper, the parity of the CFA franc vis-à-vis the French franc has remained unchanged at CFAF 50 = Fl since 1948. Even if one accepts that a fixed exchange rate pegged to the French franc, or by now to the deutsche mark, along with a number of European currencies, is the best system for these countries, an obvious question to ask is whether the parity established over 40 years ago is still appropriate from the standpoint of external competitiveness. This is a difficult question to answer, particularly since the paper only considers developments since 1980.

The paper's conclusion places considerable weight on the fact that member countries have maintained a stable real effective exchange rate. However, as noted on page 25 of the paper, the real effective exchange rate is not a reliable indicator of the appropriateness of the nominal exchange rate level, as it does not take account of terms of trade developments or the buildup of external debt. To these two items, one might add that it does not take account of increases in real wages. These factors are fundamental in assessing whether the nominal exchange rate approximates the long-term equilibrium exchange rates, consistent with satisfactory growth in these developing economies. Indeed, the paper goes on to acknowledge that following a substantial deterioration in the terms of trade there is a need for a marked improvement in competitiveness. In addition, with the buildup in external debt, the paper notes a need for changes in the structure of output, which I take to mean export diversification, if foreign debts are to be serviced. After conceding that stability of the real effective exchange rate may not even be desirable against the background of a deteriorating economic environment, it is curious that the paper's conclusion draws such attention to the "success" of CFA zone countries in maintaining stable real effective exchange rates.

It is disappointing that, having mentioned the need for improved competitiveness and export diversification, the paper does not pursue these points in greater depth. A reading of recent Article IV consultation papers would suggest that there has not been much export diversification in these countries over the last 20 years, except for oil, which, at least for a time, has kept several countries of the zone afloat. In this regard, it would have been interesting to see a table showing changes in the export structure of CFA zone countries compared to those of other developing countries outside the zone.

The paper does cite some interesting data (page 26) comparing manufacturing wage costs and output costs in Côte d'Ivoire and Cameroon with those of various comparator developing countries. From this partial data, there seems to be a correlation between the lower wage costs in such countries as Malaysia, Mauritius, and Morocco and these latter countries' relative success in diversifying exports. A more systematic look at such data would have been helpful.

It is clear from the paper that greater internal adjustment is needed in a number of areas--to reduce public sector imbalances, resolve the problems in domestic banking systems, and reduce nominal prices and costs so as to improve external competitiveness. It is encouraging that a number of countries in the zone, and, indeed, the two central banks themselves, have adopted stronger policies in recent years. However, we would not go so far, nor do I believe would the Fund's Article IV papers go so far, as to make the sweeping statement on page 35 that "...sound macroeconomic and structural adjustment policies are being pursued."

We do agree, however, "that there is no substitute in the current circumstances of the CFA zone countries for the implementation of strong budgetary, monetary and structural measures...." Indeed, if countries choose to maintain the existing parity, these are the sole means of reducing external imbalances and promoting growth. However, given this fact, one must ask how much adjustment is required and whether it is realistic to expect this amount of adjustment to be achieved through domestic policies alone. Unfortunately, the paper does not address these issues. One may only conclude that in view of the substantial deterioration in the terms of trade, the massive buildup of external debt, and the very high wage and cost structure in most of these countries, a very sizable degree of adjustment appears to be required to improve external competitiveness.

Whether domestic policies alone can bring about marked improvements in competitiveness depends upon there being considerable downward flexibility in real wages, a condition which to date seems lacking in a number of the major countries such as Cameroon, Côte d'Ivoire, and Gabon. Other structural changes in the economy could also help improve competitiveness, though here it must be noted that competitors outside the zone are pursuing much the same kinds of structural change, with the result that the gap in competitiveness may be all the more difficult to close through structural policy changes.

In conclusion, let me reiterate that we strongly support the CFA zone countries' efforts to improve their macroeconomic and structural policies. Indeed, the experience of the zone seems to indicate that policy discipline must come from within and cannot be successfully imposed from without, even under a fixed exchange rate system. This fact is also borne out by the experience of various Asian countries which have pursued generally sound domestic economic policies and achieved remarkable rates of export growth and GDP growth under flexible exchange rate systems.

While we do not dispute the countries' rights to choose whichever exchange system they consider best suited to their economic policy objectives and country circumstances, we do believe it is important that they be willing and able to pursue policies which are consistent with the arrangements they have chosen. In this connection, it is not clear from the analysis in the paper that a number of the countries of the zone can achieve the needed improvements in external competitiveness to service their debts, raise growth, and improve living standards, without a combination of stronger policies and an adjustment in the level of their nominal exchange rate.

Mr. Fuleihan made the following statement:

The staff paper touches upon several important issues, albeit in a highly nuanced fashion. Nonetheless, the paper provides some useful insight into the functioning of the CFA arrangements. Before delving into the economic implications of membership in a currency union, it is important to examine whether the conditions for a successful currency union among the CFA franc zone countries exist.

The literature on optimal currency areas indicates that one or more of the following conditions are necessary for a successful monetary union: a high degree of intraregional trade; similar economic structures; a high degree of factor mobility; or a desire for a common level of inflation among union members.

As the staff paper indicates, intraregional trade among the CFA franc zone members is limited. Nonetheless, I am not certain that this is an essential condition for currency union membership, since membership itself may foster greater intraregional trade, provided that barriers to trade in goods and factors of production among union members are removed. Clearly, a common regional currency would remove investor exchange rate risk and foster greater capital and goods flows across countries. Unfortunately, however, factor mobility among union members remains limited. This reduces the potential for increased intraregional trade and severely constrains the union's ability to weather different relative price shocks across countries.

Consequently, the importance of currency union membership among the CFA franc zone countries must lie in their desire for a common level of inflation. However, the main impetus for membership is not a desired common level of inflation among members, but rather a common inflation level of each member with France. Therefore, it appears that the major benefits from membership are derived from the exchange rate peg to the French franc and the convertibility of the exchange rate rather than from a common regional currency.

The staff paper makes a strong and, in my view, convincing case for the usefulness of the exchange rate as a nominal anchor to the economy. Indeed, the CFA franc zone monetary arrangements have served the membership well in terms of a low level of inflation and continued convertibility. Clearly, the relative independence of the two central banks has played a crucial role in enhancing credibility and containing monetary financing of fiscal deficits. In this respect, the paper entitled "Analytical Issues Relating to Fund Advice on Exchange Rate Policy" provides persuasive arguments in support of adopting stable exchange rate policies in small open economies. In my view, the jury is no longer out regarding the adoption of a real effective exchange rate peg. Indeed, the staff's strong case against such a policy, given its potential to unleash a wage-price spiral when inflation is high, has put this debate to rest. Nonetheless, I remain convinced of the need for discrete adjustments in exchange rates when permanent exogenous shocks have fundamentally distorted the equilibrium level of the exchange rate.

In this context, it is crucial to note that the adoption of a fixed exchange rate precludes the use of the exchange rate as an adjustment tool, thereby imposing a heavy burden on fiscal and wage policies to preserve the competitiveness of the economy. It goes without saying that the exchange rate can serve as a nominal anchor only if sufficiently tight financial policies are implemented. Therefore, it is unfortunate that the CFA franc countries

have been unable to restrain fiscal policy, thereby resulting in a deterioration of the external position and an unsustainable accumulation of foreign debt, as well as the emergence of payments arrears.

More significantly, since the establishment of the currency union and the peg to the French franc, the economies of the union members have been subjected to permanent exogenous shocks which have altered the equilibrium exchange rate. Hence, when the use of exchange rate is precluded, then an overcorrection in fiscal policy coupled with downward flexibility in wages is essential. These expenditure-reducing policies will be particularly painful, since they are not coupled with the dampening effects of expenditure-switching that result from an exchange rate adjustment. Moreover, the vulnerability of these economies to secular terms of trade shocks may partly stem from an overvaluation of the exchange rate. Indeed, the ability of an economy to diversify away from a few primary commodity exports is dependent on appropriate domestic relative prices.

It is often argued that a fixed exchange rate system would, in itself, impose the necessary discipline on policymakers. While I am generally sympathetic to this line of reasoning, one must be realistic in terms of an economy's ability to withstand draconian fiscal corrections for a prolonged period of time. Naturally, this is usually coupled with a call for comprehensive structural adjustment to ensure wage and price flexibility. However, one must also recall that it took some fully developed economies a whole decade to implement appropriate structural reforms and to impose the necessary financial discipline. It is therefore obvious that in the case of the CFA franc zone countries a one-time exchange rate correction could be very useful.

Moving beyond the particular level of the CFA franc, the crucial issue of the structural differences among union members is not adequately addressed in the paper. A casual look at the differences in the current account deficits, fiscal deficits, real GDP growth, and the production base of union members is sufficient to raise doubts regarding a common exchange rate level for all members of the union. More significantly, as indicated in the staff paper, union members have been confronted with different exogenous shocks necessitating different responses. Clearly, the fundamental equilibrium exchange rates differ across countries. It is therefore surprising that the paper does not address this issue.

Hence, given that the main benefit accruing to zone members from the currency union stems from the credibility of the exchange rate policy and the convertibility of the currency rather than

from a common regional currency, it may be helpful to envisage different arrangements which preserve these benefits and avoid some of the costs discussed above. Indeed, one could imagine a structure similar to the ERM, whereby different countries would peg their exchange rates to the French franc at different levels within a certain flexible band. Such an arrangement would preserve convertibility and credibility while allowing for cross-country differences in economic structures and exogenous shocks. Moreover, such a system could permit adjustments in the individual rates in response to fundamental and permanent relative price shocks.

In conclusion, the staff paper provides helpful background information to the diverse and intricate issues involved in the CFA franc zone arrangements. However, the paper only begins to allude to the basic issues at stake in the concluding section. Consequently, one is left with the impression that the conclusion of the paper is an introduction to another. While I sympathize with the staff's reluctance to propose major changes in the zone arrangements, such issues should have been discussed more directly, especially since this is purely a seminar discussion.

Ms. Powell made the following statement:

After the lengthy delays, I am pleased that we finally have the opportunity to address this very important topic.

As my constituency contains a relatively successful example of a currency area, I am sensitive to the possible advantages of such arrangements. Indeed, the CFA franc arrangements would appear to have been successful in attaining one of its central objectives--the achievement of relative price stability--while the staff provides some indication that economic performance was also enhanced in other areas.

However, it would be difficult to conclude that economic performance under the arrangement was fully satisfactory. In particular, and somewhat paradoxically, despite the relatively low rates of inflation achieved, the domestic payments systems of the member countries seem to have suffered from severe distortions and liquidity crises. Perhaps most importantly, it is obvious that fiscal discipline was not achieved. Thus, while the experience of the CFA franc arrangement does point out possible benefits from such currency zones, it also clearly illustrates the fact that such arrangements can neither substitute for, nor guarantee, sound domestic policies.

I would like now to comment in more detail on the arrangement, in the context of its three main features: (i) the agreement to a common peg to the French franc; (ii) the agreement to a common currency area; and (iii) the agreement to restrict central bank financing of government expenditure.

An important aspect of the arrangement has been the peg of the CFA franc to the French franc. The durability of this element is surprising, given, as the staff note, a number of characteristics of the zone's members make them relatively poor candidates for a pegged exchange rate regime. These include their relatively narrow export base, and rigid domestic price and cost structures, which, given a fixed exchange rate, tend to increase the vulnerability to real shocks.

Indeed, the relative stability of the real effective exchange rate during the 1980s, calculated on a consumer price index basis, seems more symptomatic of this rigidity and, therefore, vulnerability, than a sign of the arrangement's success. A successful adjustment to the severe deterioration of the terms of trade suffered over this period would more likely have included a relative decline in domestic costs and prices. The resultant real depreciation could have contributed to a re-establishment of external balance, as well as to a smaller loss in real output growth.

The second feature of the arrangement is that it represents a currency union. The durability of this feature is also surprising, since intrazone trade and, therefore, the obvious advantages of a currency union, would tend to be relatively small. Moreover, a common exchange rate would tend to limit the scope for adjustment to country specific shocks, which appear to dominate. As a result of relatively inflexible domestic cost and price structures and limited factor mobility, real shocks could have serious output consequences. Indeed, one is struck by the asymmetric impact of the recent oil price increase, which represents a substantial terms of trade improvement for the oil exporting CAMA countries, while the oil importing WAMA countries have suffered a deterioration.

The third feature of the CFA zone is the limits that are placed on central bank financing of fiscal deficits as a means of encouraging fiscal discipline. In view of the excessive fiscal deficits of the member countries, it is difficult to conclude that the arrangement was successful in enhancing fiscal discipline. According to the staff, this can be partly explained by the fiscal authorities' access to external borrowing through part of the period, and to other forms of domestic financing, including a buildup of arrears. Moreover, the treatment of crop financing,

the financing of public enterprises, and the onlending of Fund loans, appear to have been important defects of the system. We also wonder whether the constraint over central bank financing--which is limited to no more than 20 percent of fiscal revenue--was sufficiently tight, given that it was rarely a binding constraint.

Finally, we wonder what the impact of the arrangement was on the incentive for members to make necessary fiscal adjustments. For example, in response to a deterioration of the terms of trade, a tightening of fiscal policy would be advised, so as to reduce aggregate demand and encourage a realignment in relative prices. However, it would seem that the adoption of restrictive fiscal policies was often made more difficult by the fact that fiscal revenues were also extremely vulnerable to external shocks, given the reliance on trade taxes.

We wonder whether a more flexible exchange rate policy could have enhanced the ability of members to make necessary fiscal adjustments. For example, if an exchange rate depreciation were adopted in response to a fall in export prices, by limiting the decline in the domestic currency value of exports, the impact on trade taxes could be alleviated. In this manner, fiscal adjustment could be facilitated. This assumes, however, that the overall impact of a depreciation on the fiscal balance would be positive and that policies to limit second round effects from higher import prices would be followed.

I would now like to make a few comments in a forward-looking context. As I said at the outset, for many small countries, currency arrangements similar to that adopted by the CFA zone may be more appropriate than freely floating exchange systems. However, they cannot be expected to guarantee disciplined financial policies. Nor can they generally be expected to be fully successful unless monetary and fiscal policies are disciplined. In this context, we welcome the serious efforts being made by many members of the arrangement to trim their fiscal deficits, adopt more flexible pricing policies, and improve the functioning of domestic financial markets. Nonetheless, as the staff notes, if these efforts were to prove unsuccessful, alternate adjustment measures should be considered.

Clearly, one possible measure to consider would be a realignment of the value of the CFA franc. In our view, the diversity of the economic situations of member countries might make this an extremely difficult strategy to adopt. As a result of this diversity, any benefit of a depreciation to one region, would likely come at the cost of another. A salient example is suggested by the recent increase in oil prices. While an appreciation might be suggested for the oil exporters of the

arrangement, this would impose a significant burden on the oil importers. Thus, in our view, the success of a policy of periodic exchange rate adjustments depends on an effective means of redistributing any gains and losses from such adjustments.

An alternative, therefore, could be to consider pegging to a basket. As Mr. Landau noted, a substantial share of the zone's exports are priced in dollars on international markets, where the zone is generally a price taker. As a result, variations in the dollar/franc exchange rate translate into a terms of trade shock. For example, with a depreciation of the U.S. dollar in terms of the franc, the domestic currency price of exports falls relative to the domestic currency price of imports from France and other EMS countries. Thus, by pegging to the franc, the zone becomes vulnerable to both real and nominal shocks. This might suggest that a peg to a basket, which would include the U.S. dollar, could provide better insulation from external shocks, without weakening the discipline of the arrangement. Could the staff comment?

Mr. de Groote made the following statement:

Before beginning my discussion of the analytical and operational aspects of the arrangements, let me express my surprise that the concerned central banks and Executive Directors' offices have not provided any advance documentation to support or guide our discussion. Since the multidimensional nature of the issue requires us to adopt a perspective which goes beyond the theoretical level, the opportunity to consider a variety of views presented beforehand would have greatly aided our understanding.

Where there is considerable mobility of production factors, where the adjustments for accommodating developments which affect costs are flexible and prompt, and where product diversification is broad enough to provide a shield against exogenous shocks, the advantages of participation in a common monetary union consist principally of cost savings arising from economies of scale. Other advantages could emerge from specific features of the union, such as exchange rate stability, or the credit facilities that the union might grant to its members. I make a distinction between these two kinds of advantages, because exchange rate and credit arrangements are not necessarily of the essence of a union.

In a Ricardian analysis, where the mobility of production factors is perfect, differentials in the prices of the same goods in different locations arise solely from proximity to the markets and the costs of transportation. If we disregard some discrepancies in the treatment of negative externalities, especially environmental threats of brief duration, the emergence of a

division of labor is a matter of resources and markets. A common measure for the division of labor within a single system is the level of intraregional trade. Where intraregional trade is high and there is no urgent need for foreign exchange earnings to bring the state of technological advancement up to world standards, a low degree of division of labor can be the major factor perturbing domestic relative prices in the medium term. Under these conditions, monetary unions and common currency zones present real advantages to their participants. Investment decisions can be made easier and take less time to bear fruit, since the risks are hedged. Resource allocation can be improved by the wider range of opportunities, while the exchange rate can play the role of a common buffer against short-term external terms of trade shocks.

In the CFA franc zone, however, we find none of the above conditions which might define a second-best Pareto optimality. First, the mobility of labor is restricted not only within the CFA region and between the region and France, but even within individual countries, due to segmentation of their labor markets. Second, production is everywhere concentrated in primary goods; diversification is almost nonexistent. Third, although credit is rationed through the central banks, the interest rates vary from country to country. Fourth, the market distortions arising from the prevalence of price controls and subsidies in many of the participating countries still represent a major obstacle to more efficient resource allocation. Fifth, though I regret having to point this out in the case of members that are beneficiaries of Fund programs, it is a fact that adequate data do not exist on which we might base an objective comparison of trade restrictions. We are thus forced to fall back on common sense judgment, which suggests strongly that trade restrictions in the region remain rather stringent. If for all these reasons it seems difficult to justify the existence of the CFA zone on purely analytical grounds, its usefulness is clearly demonstrated by the advantages resulting from a system of stable internal rates, combined with a high degree of access to convertibility through the CFA franc's convertibility into the French franc. The latter practical advantage could go far to overcome the absence of clear analytical advantages on other counts. This advantage might be even greater, as I will explain later, if the CFA zone system were one of stable and adjustable exchange rates instead of stable and immutable exchange rates.

Beyond such theoretical observations, there is much cause for concern to be found in the operational features of the CFA arrangements. Credit allocation based on administrative fiat rather than market-based need, coupled with inadequate banking supervision, has brought the financial sectors of many of these countries to the verge of collapse. The growth during the period

1981-89 of cross-border nonbank deposits by nonresident depositors, expressed as a percentage of domestic bank deposits, gives some evidence of emerging financial disintermediation and loss of confidence in the banking system. Also, even though the lack of an institutional framework may sometimes require the use of direct controls in the conduct of monetary policy aimed at stabilization, the large share of parastatals in many of these economies may conceal the real dimensions of credit expansion. We have often seen in developing countries with heavily protected parastatal sectors that a credit crunch may show its largest effects in the accumulation of arrears from the government to the parastatals, and the accumulation of cross-sector debt between state enterprises. Could the staff help us here with some notion of the extent of cross-sector parastatal debt in the CFA zone countries, and on the impact of such debt on monetary policy? I would also like to know the staff's views on the feasibility of moving to a market-based banking system without losing the essential qualities of the zone arrangements.

I turn now to economic performance. Since the science of economics, unlike the art of medicine, has managed to get this far without resorting to the use of control groups, I will gladly use Table 4 of the staff paper as a proxy. Since 1985, the only indicator for superior performance in the other, i.e., non-CFA zone sub-Saharan economies, has been economic growth; it can be argued that restrictions on credit expansion in the zone countries is one cause of lower growth. However, the many cases in which World Bank projects have stalled or failed for lack of domestic counterpart financing compel me to believe that inappropriate fiscal policy priorities are a more important cause of lower growth in the CFA zone, a point also made by Mr. Peretz and Mr. Landau. The crucial element in the comparison between the CFA zone and other sub-Saharan countries is that although from 1985 to 1989 the sub-Saharan countries outside the zone made real effective exchange rate depreciations which were substantial compared with those made by the zone group, the export performance of the non-zone countries showed little improvement, while their debt ratios somewhat worsened. Similarly, on the inflation front, striking differences can be seen; given the prevalence of price controls and subsidies in both groups of countries, any clear judgment about the reasons will have to await the staff's comparison of the effects of these distorting factors in the two groups. Pending further analysis of the issue, it seems justifiable to conclude that adherence to a system of stable rates has yielded positive results in terms of inflation control and debt management, while it was moderately favorable in terms of export growth and least favorable in terms of GDP growth. Could the adoption of a system of stable but adjustable rates have led to better results overall? The experience of the EMS seems to give interesting

indications in this regard; but again, we are comparing here two subgroups in sub-Saharan Africa, where priorities are very different from what they are in Western Europe. The comparison is additionally complicated by the circumstance that one group has fixed but immutable exchange rates, while the other has floating rates.

I share many of the staff's views on the exchange rate and external viability. I found particularly convincing Mr. Peretz's defense of the advantages of a system of stable and adjustable rates. I have heard more and better sermons on the merits of virtue from young preachers than from their seasoned seniors. In any case, the declining competitiveness of many of the zone's exported commodities, the prospect that export market diversification will become necessary with the imminent completion of France's integration into the EC, and recent developments in the EMS may well call for further discussion in the course of which we shall surely have to allow some breathing space for the zone countries to correct their fiscal imbalances and eliminate existing rigidities. On the possible role of the exchange rate, it will be interesting in the course of our further study of the zone to learn the staff's views about the introduction of flexibility in the otherwise commendable system of stable rates that seems to have served the zone members so well up to now. On this point I was particularly interested by Mr. Santos's statement that a rate adjustment will be envisaged whenever necessary, since I was inclined to think that such a need was already evident. Mr. Landau has recapitulated the arguments against adjusting the exchange rate; I found him a shade less convincing than usual on two points. First, while it is obvious that an exchange rate correction can only have a durable effect if the rate remains adjusted, in real terms, long enough to allow for a reallocation of resources between internal and external absorption, I would have thought that the CFA zone is in a particularly privileged position to avoid offsetting price increases because of the effectiveness of credit policy, the low rate of inflation, and the recent favorable turn of fiscal policies. In other words, there are few cases in which the conditions for an adjustment in real terms seem so likely to be fulfilled. Second, while I enjoyed Mr. Landau's reference to the Lerner-Robinson elasticity formula, I fail to see why one should be pessimistic about the possibility of eliciting a strong internal supply response if the rate can be adjusted in real terms; such a response is quite likely in this case, because it coincides with improved profitability for enterprises and, thus, with improved conditions for growth. It would also help improve the position of the public finances and aid in the rehabilitation of state economic enterprises, which are most timely objectives given today's circumstances.

All in all, our recommendations to zone members can be similar to those we address to other members in the region: fiscal correction through revenue enhancement, expenditure discipline, the abandonment of price controls and subsidies, the liberalization of internal and external trade, privatization, and the creation of market-oriented institutions. Today's choices for the zone countries resemble those which I expect will be recommended more and more often when the former centrally planned economies seek Fund assistance: priority has to be given to streamlining an administratively controlled financial system in order to encourage the private sector when the markets are not strong enough to send clear signals. Solutions to such dilemmas must involve a large share of value judgments on questions ranging from the social structure of the country to the practical resilience of its economy; such questions are, of course, country specific. We will not lack opportunities to discuss these issues over and over again when the members of the zone submit to the Board proposals for the Fund's support.

Mr. Thorláksson made the following statement:

I very much welcome this discussion on the CFA franc zone as a prelude to the more general discussion on the nature of the Fund's advice to member countries on exchange rate policy. I hope these two discussions together will result in time savings for the Board when it reviews the exchange rate policies of various member countries.

The existence of monetary unions, like the CFA franc zone, adds interest and challenge to the Fund's surveillance task. Usually, exchange rate policy is assessed in the light of a country's balance of payments situation and the prevailing economic conditions, making a judgment on the effectiveness of its policy relatively straightforward. However, when a monetary union comes into the picture, these assessments are much more difficult, as the existence of a fixed exchange rate regime puts restrictions on other economic policy options. In addition, the initial choice of exchange rate arrangement obviously has temporary or cumulative consequences for the economies in general but particularly for their external positions.

The main objective of a monetary union is, of course, to improve economic conditions for the union's members by reducing, to the extent possible, for its members the adverse effects of fluctuations in exchange rates. At the same time, such an arrangement is intended to bring about domestic price and wage discipline in the economy. However, although monetary unions may provide discipline in monetary policies, they are no substitute

for appropriate economic policy adjustments and should not be regarded as such either.

The linkage of the CFA zone countries to the French franc has historical reasons. I will not go into detail on the significant positive and negative consequences for the countries concerned, as the staff paper depicts these clearly. Nevertheless, one can draw the rather definite conclusion that economic policies have not been sufficiently consistent. During the 1980s, fiscal policies have not been restrictive enough or consistent with the requirements of the fixed exchange rate regime. In particular, these economies have not been able to adjust to comparatively low rates of inflation, as fiscal policy has been too expansive and wages, as well as producer prices, have not always been appropriately responsive. The mounting domestic and external debts now necessitate an enormous adjustment of economic policies.

The question to be asked against this background of inadequate policy consistency over the last decade, is whether it is advisable for the CFA countries to continue with this exchange rate arrangement. The costs and advantages of the current system must, of course, be assessed in relation to alternative exchange rates regimes. In this context, I think it is necessary to distinguish between, on the one hand, the monetary arrangement itself, and, on the other, the exchange rate parities involved.

On the first point, that is the arrangement itself, a stable or fixed exchange rate system should lessen the uncertainties for the economic agents, as opposed to a floating system. Stable parities should provide discipline for future policy adjustment. Over time, exchange rate and price stability should promote confidence conducive to increased trade and investment. A common monetary arrangement is also more efficient and transparent than one under which, in practice, 13 different currencies are used. Moreover, the technical aspects of the arrangement, such as the pooling of reserves and overdraft facilities in France, add flexibility to this fixed regime. If we focus on the medium term in our policy considerations of the advantages of a stable regime, rather than certain short-term benefits that a more flexible arrangement can provide, we have concluded, on the systemic issue at hand, that a continuation of the CFA franc zone is in the best interests of the countries concerned.

On the second point, that is the parities involved, the task is to identify parities that will facilitate a sufficient tightening of fiscal policies in these countries. In this context, one might maintain that a devaluation of the CFA currencies would distribute the burden of adjustment and thereby make the implementation of other necessary policy changes more feasible.

To conclude, the Nordic countries believe that the CFA franc zone countries face two stages of economic adjustment. The first stage should be a transitional period, during which all policy elements, including the common exchange rate parities, have to be corrected with allowance for the possible differentiation between the two groups of countries. In light of the imbalances that emerged during the 1980s, and even after a necessary strengthening of fiscal policy, we think that it is no longer a question of whether exchange rate adjustments are required, but rather how large they should be. The length of the transitional phase and the amount of flexibility of exchange rates during the transitional period, depend on circumstances and the consistency of economic policies--that means the extent to which they, particularly fiscal policy, depart from the policies pursued until now.

The second stage should then be the stabilization of prices, wages, expectations, etc. through a nominal anchor. However, we believe that the type of exchange rate arrangement chosen in the linkage to the French franc is secondary to the consistent application of economic policies, which, without doubt, is the most important underlying factor for stable exchange rates. Nonetheless, the chosen exchange rate arrangement can importantly contribute to the credibility of these policies.

Mr. Landau said that the essence of his position was that the second stage, which Mr. Thorláksson had described, might not be possible once the first stage had been reached. In other words, stabilizing inflationary expectations after an adjustment of the exchange rate was much more difficult than in the period before such an adjustment.

Mr. Yoshikuni made the following statement:

The staff paper provides a good basis for our discussion today. I am particularly impressed by the staff's ambitious and successful attempt to analyze the dynamic adjustment process to external developments under the CFA franc exchange arrangements. Also, I found the statements by Mr. Santos and Mr. Landau very interesting and helpful; they provide candid views of the member countries of the CFA franc zone. I recall that this study was originally called for in order to assess the implication of the exchange arrangement for the adjustment performance of the zone countries, as well as to consider how these countries can best pursue their adjustment objectives. Furthermore, it should be stressed that the Board has expressed its concern about the fragile external position of these countries and their growth performance, while we have generally welcomed their price stability.

This being said, let me first touch upon a few issues about the monetary effects of the CFA franc arrangement. The two central banks give priority to maintaining their net foreign reserve position to ensure continued convertibility of the CFA franc at the fixed rate. This policy objective requires a prudent monetary policy, including prevention of the central government's deficit being financed by the central bank. As a result, the zone countries have achieved a commendable price performance and their real effective exchange rates have generally been stable by international standards.

However, while price stability is an essential element for sustainable growth, their performance in output growth as well as in the external sector has been rather disappointing. In recent years, the most important factor for the stagnation of the zone countries is the sharp deterioration in the terms of trade. In my view, the negative effects of the external shocks are amplified by rigidities in wages and underdevelopment of the nontraditional sectors. Growth prospects are further hampered by the delay in fiscal adjustment, which resulted in the accumulation of domestic payments arrears.

In considering these complicated matters, I think that the problems of the monetary arrangement and the problems of each member's policy responses should not be mixed in principle. That being said, if the zone countries cannot adjust their policies to meet their domestic and external objectives, the effectiveness of the monetary arrangement itself will be questioned.

Thus, from the viewpoint of the zone countries' growth profile and their external performance, I would like to raise two issues, namely, credit allocation and the level of the exchange rate.

While the staff paper summarizes the recent reform efforts in credit policy, the absence of effective market-oriented instruments seems to have led to discretional credit allocation in favor of the traditional sectors. Crop financing has allowed preferential lending rates and eventually unlimited access to rediscounting, and has therefore limited credit to the private nontraditional sector. In this respect, the more problematic factor may be the public enterprises' deficit financing. Inefficiency of the public sector was translated into domestic arrears, under the overall credit ceilings and limited availability of the external finances in recent years, thus resulting in deterioration of the soundness of the banking system. It should be pointed out that the deficit of the public enterprises is also reflected in the government's deficit to some extent, and it skewed credit available to the private sector. While the member countries' fiscal

balance must be strengthened, a more market-oriented credit policy should be established in order to promote development of the non-traditional private sector.

The second question about the monetary arrangement is the level of the pegged exchange rate. While the staff paper does not seem to address this question in depth, I am not sure whether the fixed rate, which was not changed for more than 40 years, has appropriately been reflecting the fundamentals of the zone countries' economies, in view of their prolonged external deficits. While I am not in a position to encourage competitive devaluation, prolonged recourse to the exceptional external financing throughout the 1980s, and slow development of the import-substitution sector may give rise to doubt about the adequacy of the relative price level under the fixed exchange rate scheme.

On the other hand, the stability of the real effective exchange rate pursued by the monetary arrangement does not provide by itself a safeguard against deterioration in the terms of trade and other exogenous shocks. The arrangement can absorb the shock only if countries do not face external shocks simultaneously. However, even in this case, each country has to reduce its production costs to secure competitiveness. In the absence of the exchange rate adjustment, reduction in cost through structural adjustments takes considerable time and tends to prolong external imbalances. In addition, without the recourse to monetary financing, the severe adjustment has to take place under unfavorable economic circumstances.

As to the policy response to the external shock, namely, a deterioration in the terms of trade, I fully agree with the staff that expeditious correction in fiscal imbalances and elimination of rigidities in wages and prices are essential. It is heartening to note that some small member countries are making vigorous efforts in wage adjustment under the Fund programs. However, fiscal and incomes controls in the two core countries in each bloc are encountering difficulties, and their overall adjustment is slow. With regard to the policy recommendation, I have little to add to what has been elaborated in the staff paper. In particular, given the fixed exchange rate, it is essential to pass through the international price signal to the producer prices in a timely manner. At the same time, I attach particular importance to flexibility in setting individual public salaries, in addition to reducing the total wage bill. It is our common experience that public salaries have a significant influence on private wages. In addition, greater labor mobility across borders and between rural and urban areas would contribute to smoothing an adjustment of incomes in the face of an external shock.

I am somewhat concerned about the slowness of the external adjustment, although this is inevitable to some extent, as well as the uncertainties surrounding the trade environment for the zone countries. The latter includes relative appreciation of the CFA franc vis-à-vis neighboring countries' currencies, as well as the implications of the EC market unification. Price developments in the key export commodities are also uncertain. I am concerned whether the countries with no flexibility in their exchange rates can adapt to these external developments in a timely manner. While one of the merits of adhering to the established fixed rate may be to secure confidence in the international financial community, external payments arrears, successive rescheduling, and prolonged use of the Fund's resources may jeopardize those countries' credibility. In this respect, it is crucial whether the two core countries, Côte d'Ivoire and Cameroon, can succeed in their external adjustment efforts under the current circumstances.

In concluding, I wish to note that the CFA franc arrangements have served well in securing price stability among the zone countries. However, the existence of structural rigidities and the past expansionary fiscal stance have made external adjustment more difficult. On the other hand, questions may arise as to how to secure efficient credit allocation under the arrangement between and among the member countries. In addition, in view of the prolonged external imbalances, we may consider the adequacy of the current exchange rate level at some point.

The success of the CFA franc arrangements crucially depends on the depth and speed of the adjustments being currently undertaken, particularly by Côte d'Ivoire and Cameroon. In the event of unsuccessful developments, the effectiveness of the exchange arrangements may be questioned.

Mrs. Sirivedhin made the following statement:

The CFA franc arrangements have indeed served a useful purpose for franc zone countries. As the staff paper rightly points out, the exchange arrangements, in which France has played a strong supporting role, have provided members with external credibility, based on the French franc as a nominal anchor for members' macroeconomic policy. At the same time, the common currency and common central bank arrangements have supported a system of mutual coordination of, and surveillance over, monetary performance. Both these elements have contributed to a relatively favorable record of economic performance, particularly insofar as the inflation rate in the zone countries is concerned. The record in respect of GDP growth has been somewhat varied, being to a large extent subject to such exogenous factors as terms of trade

and weather conditions. Performance in mobilizing domestic savings has roughly followed growth performance. External performance has been even more mixed, varying in response to external factors and export competitiveness.

In fact, it is in regard to this last factor, competitiveness, that one weakness of the CFA franc system can be seen. True, the relatively stable real effective exchange rates have been helpful in keeping price and cost inflation closely aligned to that of France, and, therefore, lower than it might otherwise have been. Nonetheless, with fixed exchange rates, if competitiveness is to be maintained in an environment of currency depreciation by competitor countries, or deteriorating terms of trade, downward flexibility of prices and wages is necessary. This has not, unfortunately, been the case. Downward rigidity of prices and wages, together with deteriorating terms of trade and lower real effective exchange rates in export-competing countries, has drastically reduced the competitiveness of franc zone exports, thereby placing increasing pressure on external balances.

Another point worth noting is that despite strict rules over central bank lending to the government, large fiscal deficits were quite prevalent in the late 1970s and early 1980s, made possible through considerable foreign borrowing. The consequent debt-service obligations have in many cases created a burden that had to be dealt with through exceptional foreign financing.

Having said this, I note that, despite difficult circumstances in the late 1970s and 1980s, countries in the CFA franc zone have achieved the distinction of being able to maintain the convertibility of their currencies, while avoiding multiple currency practices and exchange restrictions, and maintaining an open trading system.

Turning now to the zone's policy options, none of the previous speakers have suggested the option of ending the common monetary arrangements as a viable alternative. As far as the currency peg is concerned, however, there seem to be differences of view. Three alternatives have been mentioned: first, maintain the present parity with the French franc; second, devalue against the French franc; or third, change to a basket peg.

The first alternative, maintaining the present French franc parity, has the advantage of preserving the credibility that has been accumulated over the years. The implication of this option, as correctly pointed out by the staff, is that for it to be sustainable, strong improvements must be made in reducing public sector imbalances. Meanwhile, downward flexibility in prices and wages must be achieved, and structural and regulatory reforms must

be made in order to improve competitiveness and provide incentives. The measures being pursued by the authorities should help improve the situation considerably. A danger, however, is that, with sufficiently strong measures, a contraction of the economy may result, possibly involving some costs in terms of employment and welfare.

Against this, it should be considered whether credibility would not be even better preserved if the zone were to opt for a more "realistic" exchange rate, taking into account the numerous exogenous developments that have transpired over the years, which do not appear to be reversible, and which had made the CFA franc somewhat appreciated in real terms. This is not to say that devaluation of the CFA franc would absolve the authorities of the need for fiscal and monetary retrenchment or structural adjustments. These would still be needed in any case, especially if credibility of the new exchange rate is to be achieved. However, it would help erase some of the losses in the competitiveness of exports, help considerably in restoring external balance, and would indeed be consistent with normal prescriptions for countries with overvalued currencies.

The third option, delinking the currency from the French franc and linking it to a currency basket, would make sense from the point of view of changed trade patterns. The bulk of trade of member countries is no longer with France but with many European countries, so a basket peg appears to be realistic. On the other hand, since European currencies, including the French franc, are in any case joined together in the ERM, a change to a European currency basket peg may not in practice result in a substantial difference from a single currency peg, depending on the initial point at which it was pegged. A basket that includes the U.S. dollar may be an option that would be viable considering that many commodity prices are denominated in U.S. dollars. Staff comments on these options would be welcome.

Mr. Posthumus made the following statement:

The Franc zone study, long awaited, gives much information about what is possibly the longest existing currency area in the world. But I would not be surprised if neither the supporters nor the opponents of such a currency area are convinced that they should change their opinion. A definitive judgment is perhaps not possible, but for the countries concerned there is much at stake. Many members of the area face huge problems, and the staff's concluding remarks indicate that if these problems cannot be solved, alternative adjustment measures would have to be considered, as the staff formulates it. The paper discusses the problems of

decreasing nominal incomes. In my view, however, the importance for smaller and not so small countries of a stable exchange rate (as Mr. Landau underlined) and of low inflation cannot easily be dismissed. One thing is clear: the competitive position of local producers has to be improved, and this may be difficult and costly. I note that Mr. Landau fully supports this approach.

The study indicates that a fixed exchange rate regime and a strict monetary policy are mutually supportive but are not sufficient to maintain macroeconomic balance. Fiscal policy, including foreign borrowing, must also be controlled. Clearly, the franc zone regime has had a number of loopholes, which, sooner or later, were used by the members of the system. The franc zone experience in this respect may be relevant in the context of EMU discussions. If, as Mr. Landau states, internal adjustment deserves a greater role than external adjustment, which seems to me to be right, then in creating the EMU this certainly has to be taken into account as well.

I would like to make a few comments on the study before us. On page 8, there is a somewhat surprising presentation, which links the CFA franc zone to the EMS countries. The CFA franc zone was historically not only a predecessor of the EMS, but during the major part of its existence there was no stable relation between the French franc and the other European currencies. The presentation is therefore misleading. In addition, the high aggregate weight of the European countries that are now members of the EMS in trade with African countries is also not limited to the CFA franc zone, but holds for most of the other African countries as well. Mr. Santos and Mr. Peretz have put the franc zone in its proper historical and international perspective.

The paper compares the development of the franc zone countries with a group of other sub-Saharan countries. In doing this, however, the study completely abstracts from the role of France in the franc zone and, in particular, the importance of the French contribution to it. This contribution has taken two forms. France has extended substantial development assistance to these countries, mainly in nondebt-creating forms. Page 32 compares average financial deficits of CFA countries with other sub-Saharan countries, by comparing the data after grants, but it gives no indication of the size of these grants. Furthermore, the costs which the French Treasury has incurred over the years were probably significant as well. It should be possible in a study like this to give full information on these cost aspects.

The staff paper mentions, a number of times, the precarious situation of the commercial banking system. A little more information would have helped. For example, how are interest rates

determined by the commercial banks? Are differentials, with respect to financial markets in France, a reason for capital flight? Are deposit rates so low--because of the requirement to lend to investors at preferential rates--that the public makes little use of the formal system for its savings? This hypothesis would be supported, at least in the BEAC region, by the data in Table XII on the ratios of bank deposits and M2 to GDP indicating rather low levels of financial intermediation.

An important question is not answered: why is the performance of the CFA countries in terms of growth and competitive position better in the period 1970-84 than in the period 1985-89, compared with that of the other sub-Saharan countries?

Finally, reading this paper and hearing the discussion, it is clear that it will not be easy for the Fund to find a way of discussing arrangements like the franc zone in a meaningful way. And we will face the same problem when we discuss EMS and EMU issues. One problem is that we do not have an authority with which to speak. Another is that the discussion cannot be too open and specific, to prevent unsubstantiated rumors about what the Fund thinks. Mr. Peretz has dealt with this aspect more specifically.

Mr. Goos made the following statement:

I am in broad agreement with the staff's analysis and recommendations and will therefore offer only a few observations.

I found it quite remarkable that the CFA franc arrangements--in clear defiance of the theory of the optimal currency areas--have weathered more than 40 years quite successfully and without falling apart. This begs the question whether the theory is able to fully capture the economics--and, I should perhaps add, the politics--of common exchange rate arrangements. In this context, it is interesting to recall that, at the inception of the EMS, the theory was also invoked by quite a number of observers who predicted an early collapse of the exchange rate arrangement.

Seen in this light, the experience of the CFA franc zone offers particularly interesting lessons of more general relevance. It clearly shows the substantial benefits that common monetary and exchange arrangements can generate in terms of price and macro stability if linked to a stable anchor. Perhaps even more important is the clear demonstration of fiscal discipline as a necessary ingredient for the success of the arrangements, suggesting that fiscal policy should also be subjected to explicit rules of the game. This conclusion from the CFA franc zone experience is

of course highly instructive in the context of the current discussion of the requirements of monetary union in Europe.

There are a number of observations in the paper which I found particularly heartening and which I hope will find their way into the staff's day-to-day business with program countries and into bilateral surveillance. Here I have in mind in particular the conclusion on page 7 that, in weighing the costs and benefits of a common external standard, the balance for small developing countries would tilt in favor of adhering to such a standard. Equally encouraging is the observation, on page 8, that exchange rate adjustment should be reserved only for cases in which deep and intransient real shocks hit an economy or currency area, because recurrent adjustments tend to undermine confidence in the currency and generate speculative capital outflows.

At the same time, I am concerned about some of the views expressed in the context of the discussion of the real effective exchange rate, notably that, irrespective of external competitiveness in a narrow sense, factors such as terms of trade changes and the debt-service burden would generally need to be taken into account in assessing the adequacy of the exchange rate. There are a number of arguments that call for caution here. First, using the exchange rate for purposes other than correcting problems of external competitiveness is tantamount to trying to resolve one's adjustment problems on the backs of others. By the same token, the Fund should not be seen as recommending competitive devaluations. Second, one can think of a number of terms of trade shocks that do not lend themselves to correction through exchange rate measures, such as the real increase in oil import costs. Third, in the small open economies under discussion, which are price takers, it is doubtful that exchange rate changes can affect relative prices of tradables and nontradables in a lasting fashion. Apart from producing inflation, currency devaluations, therefore, are likely to have only limited durable effects on real income. But perhaps we should leave these issues to the general discussion of exchange rate policy that is on the Board's agenda for later this year.

Turning now to the issue of what the CFA franc zone countries should do to restore domestic and external equilibrium and growth, I am in general agreement with the staff's reasoning. However, I would perhaps have some reservations against forcing labor mobility at the present juncture. The huge discrepancies in wage earnings within the CFA franc zone could induce substantial migration, thereby causing severe dislocations and frictions in both low- and high-wage economies.

The question whether the present approach to adjustment of the CFA franc countries is feasible, or needs to be supplemented by what the staff calls euphemistically "alternative measures," is extremely complex. What is clear, however, is that exchange rate action would be no substitute for the many painful reforms that need to be pursued in all circumstances, such as the rehabilitation of the banking system and of public enterprises. On the other hand, we feel that the adjustment and restructuring task could be facilitated, and the resumption of growth accelerated, if the ongoing efforts were supported by a devaluation of the franc.

I recognize, however, that this is easier said than done and gives rise to the intricate issue of how to determine the appropriate rate of devaluation. In view of the enormous discrepancies in external competitiveness and economic performance, this issue should ideally be assessed on the basis of bilateral surveillance. But this raises the question of whether the franc zone arrangements could be expected to survive such an exercise, which, if I am not wrong, would necessitate the introduction of national currencies in the member countries with differing exchange rates. On the other hand, it appears difficult to envisage a uniform rate of devaluation that would do justice to the diverse circumstances of individual members. A rate of devaluation that would be appropriate for, say, Côte d'Ivoire, would probably imply a substantial overshooting for other more stable economies in the arrangement, with adverse consequences for domestic and external stability. Similarly, too small a devaluation would probably make little difference to the situation in Côte d'Ivoire and could perhaps give rise to speculation on further devaluations. I have no answers to these difficult issues; maybe the staff would care to comment.

Mr. Peretz considered that the lesson to be learned from the CFA franc arrangements seemed to be that it was important to agree clearly that a no bailout condition would be enforced. Much of the difficulty in the CFA franc zone had occurred because lenders to the member countries seemed to believe that their loans would be underwritten in some way or another.

Mr. Goos remarked that the issue was whether markets would believe such a bailout claim. It was important for the markets to believe in the intentions of member countries that were serious in their attempts to forge a monetary and political union. The markets probably would not see great risks that individual member countries would not be bailed out by the essential institutions if they were to run into problems.

Mr. de Groote said that he did not share Mr. Goos's views on the difficulty Mr. Goos saw in adjusting the exchange rate in real terms. One might feel either that such an adjustment was never easy or possible--in

which event an adjustment should be ruled out--or that such an adjustment was particularly difficult in the CFA franc zone. The comments by Mr. Landau and Mr. Santos suggested that an adjustment in the real rate should be possible, as the member countries had recorded an exceptionally good performance on the inflation front and, on the whole, credit was well managed, although banking supervision could be improved. Hence, the conditions in the CFA franc zone were more favorable for an effective reduction of the exchange rate in real terms than the conditions in other currency areas.

If the argument was a general one, namely, that adjustments of the rate never had an effect, that was a completely different line of reasoning from the argument pertaining to an adjustment of the CFA franc in particular, Mr. de Groote continued. That general argument had been widely made in Belgium just before 1982. The adjustment of the exchange rate in Belgium--in keeping with the Fund's recommendation--had significantly helped to improve the country's situation.

In his statement Mr. Goos had commented on the impossibility of maintaining for a very long period, on the basis of the purchasing power parity theory, a permanent purchasing power difference between France and the other members of the CFA franc zone, Mr. de Groote noted. He doubted whether the merits of an adjustment of the rate implied that conclusion. No one had implied that there would be a permanent adjustment of the rate or a permanent advantage for members of the zone vis-à-vis France. The point was that an exchange rate adjustment should elicit supply effects inside the zone countries, and the effects would by definition imply a more favorable position for not only the countries' enterprises, but also their public finances and the situation of their parastatal enterprises. Hence, in the long run, an exchange rate adjustment would not represent a permanent "beggar thy neighbor" policy. In fact, it would be a form of complementarity, as it would lead to increased income in the countries of the zone, an increase in exports to France, and an increase in French exports to those countries. An exchange rate adjustment was not a zero-sum game; everyone had something to gain if adjustment succeeded. And the conditions in the CFA franc zone were optimal for the success of an adjustment, as Mr. Landau had noted.

Mr. Landau considered that Mr. de Groote had raised an important and interesting question. The skeptical attitude that was generally evident with respect to flexible exchange rates in general was traceable to the realization that the experience of the previous decade suggested that translating nominal adjustment into real adjustment was more difficult to accomplish than had been supposed.

The sub-Saharan African countries had tried an alternative strategy and clearly had not achieved real exchange rate adjustment over long periods, Mr. Landau continued. Therefore, in his view the members of the CFA franc zone were not more flexible or rigid than other African countries.

Inflation had accelerated in other African countries, where real exchange rate changes had proved very costly and very temporary.

The reason why CFA franc zone countries could afford exchange rate adjustment without running the risk of inflation was not because those countries had achieved monetary stability, Mr. Landau commented. Rather, those countries had maintained exchange rate stability, which had enabled them to maintain monetary discipline and control inflation. It was important to appreciate the direction of that causality.

A single discreet adjustment of the nominal exchange rate in the context of free capital movements and with no further expectation of adjustment had never been tried, either in Europe or in the CFA franc zone, Mr. Landau observed. No one knew to what extent expectations of further adjustment would build up immediately after the initial adjustment. It was for that reason that other options had to be tried in countries that already had a very fragile external and financial position.

Mr. de Groote commented that he had not had in mind the merits of perfect exchange rate stability versus full floating. Rather, he, like Mr. Peretz, had in mind a system of stable and adjustable rates, for which there were interesting precedents, such as France's arrangement with countries other than those in sub-Saharan Africa. The essence of the functioning of the EMS had been to permit changes in effective exchange rates, as had been the case, for example, in Italy and France in recent years, as well as Belgium in 1982, when there had been a major change in the effective exchange rate with the suspension of indexation. It was more appropriate to refer to well-managed exchange rates than to widely floating rates. The EMS was able over time to avoid frequent exchange rate changes; whenever changes were made, they were kept within a very limited range, because they became fully effective. Presumably such a system was conceived on the basis of the idea that the public would react favorably to the expectation of limited changes in the exchange rate. Apparently the United Kingdom had decided to join the EMS because the authorities wished to give the public in the United Kingdom the confidence that whenever a change occurred, it would not be followed soon by another change. A specific characteristic of the system of stable and adjustable rates was the confidence that a devaluation would not be followed by another devaluation for some time.

The Chairman commented that the experience described by Mr. de Groote was applicable to the Belgian franc in 1982; there had been a clear expectation that the devaluation at that time would not be followed soon by a further adjustment. In the early years of the EMS, several members of that group had had to make several realignments before credible stability had been attained.

Mr. de Groote commented that the Chairman seemed to agree with Mr. Landau that a system of fixed but immutable rates was preferable in order to avoid the danger of a system of widely fluctuating rates. Some

had argued that it was best to avoid a system of floating rates by never changing the rate in the zone. In his view, the aim should be to consider whether or not there could be a CFA franc system of stable but adjustable rates, not a system of fluctuating rates.

Mr. Posthumus noted that a system of stable but adjustable exchange rates no longer existed under the EMS; there was no longer discussion about adjustments to the rates in the system. The current EMS had evolved; it was not the product of a specific decision. The EMS partners had realized that they could not continue the original system of stable but adjustable rates. Hence, experience seemed to teach that over time a system of stable but adjustable rates could not be maintained.

Mr. Peretz commented that Mr. de Groote had usefully noted that there were many examples of countries that, under the ERM and the Bretton Woods system, had made step adjustments in their exchange rate and then re-established credibility. In his view, a system of fixed but adjustable rates had certain advantages: it brought home the discipline of the markets to governments in a way that currency unions did not. The comments thus far on exchange rate policy in general underscored his feeling that it would have been best to combine the present discussion on the CFA franc zone with the scheduled discussions on general exchange rate issues.

Mr. Landau said that he fully agreed with Mr. Posthumus. The system had evolved in such a way that prospects for further realignment were less likely than hitherto, mainly because of the capital mobility among the EMS countries that had been achieved. Under the Bretton Woods system, there had been fixed and adjustable rates but without full capital mobility--a point that should be kept in mind in assessing the performance of that system. The exchange rate realignment in the EMS since 1979 had not induced significant real exchange rate changes between European countries. In fact, real exchange rates had been very stable between European countries.

Mr. Yoshikuni commented that it was always important to consider whether a country's current exchange rate was appropriate in the context of the fundamental economic conditions and external viability of the country. In addition, there was an important difference between the EMS and CFA franc arrangements: the EMS was flexible in relation to other regions, while the CFA franc zone was not.

Mr. Santos commented that in his opening statement he had not mentioned the level of the real effective exchange rate, for several reasons. First, he agreed with Mr. Goos that it was a very complex issue. Second, his authorities had already chosen their main course of macroeconomic and structural policy adjustment and doubted whether an adjustment of the real effective exchange rate would be beneficial to their economies. Third, as Mr. Goos had emphasized, the members of the franc zone were producers of primary commodities and price takers in the external market, and they therefore understandably doubted the usefulness of a devaluation for the

current account. Finally, the authorities were not confident that a so-called one time only exchange rate adjustment would be seen as credible; investors were likely to believe that further adjustments would follow.

Mr. Ahmed made the following statement:

There are few cases of monetary arrangements in the developing world that can claim the same degree of success as the CFA franc arrangement. Member nations have enjoyed an excellent record on inflation, as well as the benefits of full convertibility. Furthermore, one cannot overemphasize the importance of the degree of stability that the current system provides for economic activity.

The system, as is apparent from the staff paper, has endured some serious strains in recent years. The fundamental problems facing the CFA economies, however, are not rooted in the nature of the monetary arrangements; although one must concede that the rigidity of the system may have exacerbated some of the problems by reducing the number of policy options available at the governments' disposal.

The staff paper clearly indicates that the problems facing the CFA franc countries are rooted in fiscal rather than monetary developments. The varying, and in some cases quite serious, fiscal imbalances, as well as the debt burdens of some of these economies, are the fundamental sources of economic strains facing the system. Furthermore, the analysis provided by the staff contains evidence of loss of competitiveness, particularly when compared with other neighboring countries.

The staff makes two main recommendations, both of which are necessary for the sustainability of the CFA arrangements. However, it is important to stress that, given the nature of the monetary arrangements, the coordination of fiscal policy within the zone is of equal importance. Hence, while it is essential to reduce the public sector imbalances and to take decisive action in increasing wage and price flexibility, it is not apparent how successful these policies will be in the absence of an effective mechanism for fiscal policy coordination or some effective mechanism for regional fiscal surveillance.

The staff paper refers to the fact that the majority of the CFA franc zone countries have implemented various financial and structural adjustment programs with Fund and Bank assistance. The strength and comprehensiveness of each program has varied between countries. It is important to note here that the burden of responsibility for the success of the franc zone arrangements lies with every country. Programs in every member country must be

coordinated with all others, otherwise slippages will have serious implications for the zone as a whole.

A prerequisite for the success of any monetary union is the unrestricted mobility of goods and factors of production within the zone. While it is true that the markets for the goods in which member countries have tended to specialize is small within the zone, it remains important for the authorities of member countries to undertake a cooperative effort in reducing the structural impediments to mobility on factors of production, including labor, as well as any impediments to the free movement of goods.

One must concede that there are considerable difficulties with implementing policies aimed at increasing wage and price flexibility. If these policies do not succeed, then a devaluation would be needed. However, a devaluation must be seen only as a last resort for a number of reasons. While a devaluation would provide the needed boost to competitiveness and help in the adjustment of domestic and external imbalances, it might well cause a backlash for several reasons. First, a devaluation would erode the confidence that has so far been enjoyed by the CFA franc. Such confidence might not be easy to restore. Second, the various countries have different degrees of misalignment, and, consequently, if a devaluation is to be pondered, it is not apparent that there exists an exchange rate level that will correct the imbalances in all the countries simultaneously. Such a devaluation will therefore only partially correct imbalances in each country. In such a case, the need for fiscal and other adjustments recommended by the staff might be even more urgent. On the other hand, if devaluation is a necessity, it might lead to a dissolution of the arrangement, as each country would require a different level of the exchange rate. In any event, as the fundamental problems challenging the CFA franc zone economies are structural in nature, it is not clear that any alteration of the monetary management would be anything more than a short-run palliative for problems that would continue to exist until they are directly addressed.

Mr. Chen made the following statement:

We welcome this seminar as the first chance in the 1990s to review the CFA franc arrangements. Many theoretical and operational issues and problems of the CFA franc arrangements were raised at the last review and, given its complicated and diverse--as well as historical--nature, heated discussions were perhaps unavoidable. And I should say that those issues and problems remain unsolved today and have remained in our thoughts.

Nevertheless, the paper before us for discussion seems to be concise and informative and will no doubt be useful material for our talks today.

I wish to make several comments. First, the one point that is clear when looking at the operations of the CFA franc arrangements over the past four decades is that monetary unions could ensure a degree of price stability over the long run, and the monetary discipline enforced by the arrangements is really the cornerstone of the institutional arrangements. But, given the underdevelopment and imperfections of the various market mechanisms and the lack of sufficient conditions for an optimal currency area, the objectives of monetary policy can only be pursued by major administrative measures. An example of this is the direct credit policy and statutory limits on the different types of credit. Although the internal and external values of the CFA franc have remained relatively stable, serious financial rigidities, characterized by infrequent adjustments in interest rates, the superstability of the exchange rate, and rationing of domestic credit, have all been factors in eroding the soundness of the financial environment and in constituting a threat to the efforts made by the monetary union. In these circumstances, therefore, we wonder whether the price stability achieved by the special arrangements should be the only criterion by which to measure the effectiveness of CFA franc arrangements.

My second point is that monetary union arrangements can only ensure monetary discipline and cannot guarantee the fiscal discipline of member countries. As a result, unrestricted fiscal autonomy could induce individual member countries to resort to deficit financing for whatever reason. With restricted monetary financing, countries would naturally turn to external financing. On the one hand, this would dilute the dividends and benefits brought about by price stability and monetary zones--which may be conducive to growth--and, on the other, the external financial position of many economies could be rendered extremely weak and the countries could become severely indebted. Moreover, external debt financing is also a limited and unstable source of financing, especially since the onset of the present debt troubles. In a word, the deterioration of government expenditure in the franc zone would make it less likely to be an optimal monetary union.

Again, we wish to stress that monetary discipline by itself is not enough for the franc zone countries to really maintain sustainable growth. If the current institutional arrangements are to be maintained at the wish of the member countries, for whatever reasons, a mechanism needs to be set up that can enforce simultaneously fiscal discipline that is consistent with monetary discipline and which is effective in restraining the deficit

financing that may be resorted to by some of the individual countries. This will require further sacrifice--that is, giving up some autonomy in fiscal policy--as a necessary step toward broad-based political integration. And this could well be the condition needed in order to fully realize the benefits of monetary unions and to strengthen prospects for future reform.

Third, the recent deterioration in external debt highlights the fact that, in addition to the internal mechanisms of the monetary unions which tend to incur foreign debt and payments arrears, much of the blame can be placed on the central banks' lack of necessary supervision. Given the CFA arrangements, these countries may not have the incentive to supervise and manage foreign debt in terms of institutional arrangements. The central banks, therefore, cannot evade their responsibilities. Another source of concern is weak banking supervision, which has frequently led to bad and doubtful loans. Financial stability is not limited to price stability alone. If crises in banking and debt happened simultaneously, the CFA franc zone would be in serious jeopardy.

Fourth, over the past few years, there has been an obvious increase in trading between the monetary union members and Europe. This trend in diversified trade with EC countries may be attributed to the development of the EMS and to economic development in Europe as a whole, which has increasingly stabilized exchange rates for the franc zone trade with Europe. Eventually, we should probably ask ourselves whether a fixed trade-weighted basket peg might be advisable at the appropriate time, if it is not deemed to be necessary at the moment. That choice may still be open for the medium term, and it certainly is one way to reform the CFA franc arrangements.

My final point concerns the options available to the member countries of the CFA franc zone to achieve external viability and maintain or restore the momentum of growth over the medium term. We believe that there are ways to help even in the face of present obstacles, such as the continuous decline in export commodity prices, rising interest rates, trade protection, and deterioration in the terms of trade. In this regard, other countries should provide support and improve the external environment for the CFA franc countries as a way to bolster their efforts at making necessary economic adjustments.

We are pleased to learn from the staff paper that the CFA franc member countries have implemented a series of adjustment measures, including structural reforms. We commend this action. However, they should not be considered a substitute for comprehensive reform of the arrangements themselves. The growth

performance and financial position of the member countries at the time of this review have been growing worse when compared with the last review, which indicates the gravity of the situation. Strengthening the international competitiveness of the zone's export sector may be one type of policy objective. But because there are limitations to reducing costs, especially labor costs, which have held constant for some time, we believe that some form of depreciation or realignment will probably be one of the paths pursued in the near future. Besides, the development of financial markets and institutions may be realized with appropriate banking supervision and liberalization in these areas, which would improve the operational aspects of monetary discipline. There are obviously several pragmatic choices that could be made, as long as there are no restrictions on the CFA countries to maintain a fixed parity, like the one after 1948, which would not be understood by outsiders.

Overall, the CFA franc arrangements are perhaps now at a crossroads, given the tremendous changes over the past decade in the world economy as well as in relations between the CFA zone and the outside world. One practical problem is whether current arrangements still reflect the realistic economic and trade ties of the CFA franc member countries with France and the rest of the world. If the system is so inflexible that it hampers growth, then people will lose confidence in it.

We trust that the next review will take place sooner than the time period between this and the last review. And we hope that, by the next review, at least some of the problems facing the CFA zone will have been solved and the monetary unions will be strong enough to provide the benefits of both price stability and economic growth.

Mr. Evans made the following statement:

This paper raises some very important policy issues for the countries in the CFA zone and, perhaps more importantly, for the Fund itself in terms of its understanding of exchange rate issues and its general policy advice on exchange rate matters. So I assume that we will return to this matter when we have had our general discussion on exchange rate matters and that if we are going to address policy matters, we will do that after we have had our general discussion.

With that in mind, and because I have very little that is new to add to what has already been said, I will concentrate on just one point. It really is quite extraordinary that a group of more than a dozen countries could, for a period of 40 years, maintain

a fixed exchange rate between themselves and a major industrial country, particularly when one thinks of what that period of 40 years was and what has happened to exchange rates generally. That major country itself has changed its own exchange rate arrangements on more than one occasion and has been in and out of the ERM. So, the performance is quite extraordinary. It certainly has not been possible to have this arrangement anywhere else.

There seems to be no general agreement as to whether the economic performance of these countries has been any better or worse because of those arrangements. But there is certainly no suggestion that the performance of the countries has been worse than that of African countries or comparable countries generally. When one puts those two things together, it would seem to me that the conclusion that stands out--that should be undeniable--is that exchange rates do not matter.

We should think hard about this conclusion. Several speakers have stopped short of that conclusion, but some--Mrs. Hansen was one--have made the point, with which I think all of us would agree, that what matters most is the stance of domestic policies; regardless of what exchange rate arrangements one has, domestic policies will be of utmost importance in determining performance. The experience of the CFA franc zone countries seems to me to warrant the stronger conclusion that exchange rates do not matter, because their performance has not been worse than that of other countries.

Most of us, I think, would have difficulty extending that conclusion generally, and even the strongest proponents of the ERM have never suggested that exchange rates should remain fixed for 40 years or even for a much shorter period; hence, I wonder whether we are not addressing here the trivial case that we have addressed more than once of why it is that over that same period of 40 years Texas has managed to maintain a fixed exchange rate with New York State.

That leads to the question whether the CFA area is really very close to being a federation of states. It appears to be a strong political union, with an important common monetary policy and important fiscal transfers from France, all of which make the zone a very special case--perhaps a trivial case in terms of drawing any conclusions that would extend beyond the zone. I would certainly like to come back to this question when we have our general discussion on exchange rate matters. For the moment, I certainly think that it would be wise not to draw policy conclusions from the CFA franc zone experience; there is nothing that I can see that would suggest any change in the CFA arrangements,

given their comparative success, or even to any change now in the relationship between the CFA franc/French franc rate, because if it has lasted for 40 years, it can last a little longer.

Mrs. Hansen noted that Texas could maintain a fixed exchange rate relationship with New York State because there was considerable labor mobility within the United States. Such mobility was not evident in the CFA franc zone.

Mr. Evans commented that the question of labor and capital mobility had been addressed by the Board on earlier occasions. The fixed exchange rate in the CFA franc zone had held for 40 years, and it would be helpful to look at why that had been possible, and particularly to see whether or not the zone was a special case like a federation, such as the United States.

Mr. Landau commented that Mr. Evans's point was well taken; there was capital mobility in the CFA franc zone, and the question was whether labor mobility was necessary for a currency area to operate successfully. Mr. Evans had correctly stressed the commonality of purpose among the zone member countries; that point was important to bear in mind when considering any possible changes in the zone arrangements.

Mr. Monyake recalled that his chair had been among those that had requested the staff paper on the CFA franc arrangements. Countries in his constituency had found that devaluation was a major--but also the most troublesome--element of their adjustment programs. His authorities had wondered whether there was not some other measure that could perform the same--or nearly the same--function. Unfortunately, the discussion thus far had not pointed to any good substitutes for devaluation. However, it was clear that the CFA franc zone countries had managed to avoid resorting to devaluation, and the zone arrangements had instilled in the members a sense of fiscal discipline. Some information and analysis in addition to those in the present staff paper would be helpful in determining how the experience of the CFA franc zone members could help other countries in the same areas that, while facing the same problems as the CFA franc zone countries, also had to adjust their exchange rates substantially and frequently.

The CFA franc arrangements were unique, Mr. Monyake remarked. The CFA franc had remained at the same fixed parity with the French franc for over four decades, with France being a full cooperative partner. That common fixed peg obviously restricted domestic control over the use of the exchange rate as a policy instrument in the adjustment process. It also imposed monetary discipline, which was in line with the credo of the Fund. Such discipline had been relatively successful in containing the rate of inflation in the member countries compared with other countries in the region. However, the adjustment question that countries in the arrangement must address was not very different from that confronting other sub-Saharan countries. Monetary policy actions did not protect the members from the

vagaries of the external environment. Ten of the 13 franc zone countries were currently implementing a Fund-supported program--representing 35 percent of the sub-Saharan countries with a Fund-supported program.

Exchange rate management was usually a major feature of Fund-supported programs, Mr. Monyake continued, and an important question was whether a flexible exchange rate system would necessarily quicken the pace of adjustment. It could be argued that it would have done little to cushion the countries concerned from the shocks experienced in the 1980s. It was in that light that he agreed with the staff that there was no simple answer to the question of how effective the franc zone arrangements had been in promoting appropriate macroeconomic policies.

The fact that the economies in the franc zone were experiencing severe difficulties did not in itself diminish the credibility of the monetary arrangements, Mr. Monyake said. The evidence showed that the arrangements had been relatively successful in containing inflation and in maintaining exchange rate stability. The relationship between financial stability and economic growth was not firmly established, lending credence to the notion that, while such stability was an important goal of economic policy, it should not be an end in itself.

The CFA franc arrangements could benefit from some improvements with regard to both credit control and the management of fiscal policy in individual countries, the latter being an important element to relieve pressure on the collective external position, Mr. Monyake considered. The adjustment problem for the franc zone countries was no different from that of other sub-Saharan countries, and the magnitude of the external shock--the large deterioration in the terms of trade--was a major reason for the difficult process of recovery. Finally, as with other countries in the region, the debt burden of franc zone countries must be addressed forthrightly, and capital inflows were needed to support structural reforms.

The staff representative from the African Department remarked that Charts 1 and 5 summarized much of the background information on which the staff had based its presentation. Chart 1 showed the substantial size of the terms of trade loss experienced by the CFA countries since 1985; the loss of 50 percent for a relatively large group of countries was perhaps unique in the experience of developing countries. Any group of countries hit by such a tremendous shock would necessarily have great difficulty in adjusting. Therefore, any discussion of exchange arrangements in the zone must reflect the extreme difficulties that those countries had been facing and continued to face.

Chart 5 provided information on the response to the terms of trade shock, the staff representative continued. Many Directors had commented on the total government deficit shown in the chart, correctly noting that the deficit had gotten out of hand, and that the consistency--required by definition in a monetary union with a fixed exchange rate--between fiscal

and monetary policies had not been maintained. The same chart, however, also showed the very limited extent of domestic financing, which was essentially monetary financing; in that connection, the performance was clearly very impressive: countries that had suffered substantial terms of trade losses had been able to avoid monetary financing.

One of the central issues was the trade-off between nominal income flexibility and exchange rate flexibility, the staff representative noted. In that connection, an important question was whether it was realistic to expect the CFA franc zone countries to be able to adjust at the ongoing exchange rate. The staff's position on that matter, as reflected in a number of programs submitted to the Board, was that the adjustment could and should be made.

In coming to a position on that issue one must take a number of factors into consideration, the staff representative went on. The first such factor was the set of objectives being pursued by the authorities. Certainly, economic growth was one major objective; but it was by no means the only objective of those countries. On the contrary, the very fact of their membership in a union indicated that they highly valued a number of other objectives, including the convertibility of the currency, price stability, and solidarity among the member countries. Their set of targets was not limited to stabilization of output; it was a complex of targets. In addressing a number of those targets, the stability of the exchange rate played a direct and positive role.

A second consideration that was important to the authorities in addressing the issue of a trade-off between nominal income flexibility and exchange rate flexibility was the process of income determination, the staff representative went on. The degree of flexibility in income formation could be influenced by the course of exchange rate policy. An exchange rate policy that would in effect take the easy way out, as Mr. Peretz had put it, i.e., a devaluation to validate the distribution of excessive wage increases, could backfire and result in a higher than otherwise degree of nominal income rigidity. One of the arguments of the authorities of the zone countries was that, by sticking to a policy of very clearly adhering to a fixed exchange rate, they would eventually promote a more flexible system of income determination. Indeed, that had, to some extent, already started to happen, and it was a very important accomplishment in respect of producer prices. It had not yet been done in respect of civil service wage determination, but that was still a possibility.

A third point to bear in mind in considering the trade-off was the point made by Mr. Santos: a narrow and specific sense of relative cost comparisons was not the only requirement for sustained growth, the staff representative remarked. There was a broader sense of competitiveness, which included the appropriate functioning of the economy. The authorities of the member countries were very sensitive to the need to reform the banking systems and to the contribution that well-functioning and liquid

banking systems could make in a broad sense to the competitiveness of the economies. The authorities were also sensitive to the contribution of trade liberalization to economic performance. In the regulation of domestic trade, a number of recent measures had been in the right direction, reducing the weight of government in the economies. Those structural adjustment measures provided the authorities with a rather diversified set of instruments; they were not limited to action that would bear only directly on costs.

Another important question, as Mr. Evans had noted, was how the exchange rate of so many countries could remain fixed for such a long time, the staff representative remarked. The fact that the system had worked so long suggested that the system had sufficient flexibility to last. The experience of the 35 years to 1985 provided a kind of credibility for the system, and at present the authorities were trying to confirm that flexibility in the face of the very strong terms of trade shock of recent years.

The level of grants received by the CFA countries was on the order of 3 1/2 percent of their GDP, which was about the average for sub-Saharan Africa, the staff representative said. The French Treasury did not over time make a net contribution to the operations account, as Mr. Landau had noted. That account, however, served a critically important function: its mere existence provided credibility to the exchange system, and flexibility in its management, even when it was in the black. The operations account was not an instrument for the transfer of resources, and the comparative performance of the CFA zone did not seem to be related specifically to the level of transfers. It was, of course, much more difficult to assess the role that other, more material contributions by France--technical assistance and trade openness--might have played.

There had been regional cooperation between the Fund and the central banks of the zone countries in the past; the intensity of the cooperation had varied over time, the staff representative remarked. There had been very intense cooperation between the Fund and the central bank of Western African states in the early 1970s, when the Fund was instrumental in changing the instruments of monetary policy in that region. Over the past two years there had been a very intensive series of contacts between Fund staff and the two central banks on improving the design of the instruments of monetary policy. Those contacts were continuing, and the staff intended to maintain them on a more or less regular basis.

It had been suggested by Mr. Fuleihan that the staff should have paid more attention to the differences among the CFA franc zone member countries, the staff representative recalled. The competitive position of the various members of each union varied, with some countries having experienced more adverse terms of trade developments than others, as well as less favorable real exchange rate movements. As a result, one could conclude that the disequilibrium in exchange rates might be slightly different as between the member countries. The member countries themselves did not attach great

value to that information, which was in their view overridden by the principle of solidarity within the zone, whereby the relatively more fortunate, faster growing countries shared their windfall gains or other success with the smaller countries in good times, and the process was partly reversed in more difficult times. That practice was seen as a contribution to the overall stability of all the member countries.

The problem of domestic arrears had been raised by one speaker, the staff representative recalled. The difficulties facing the parastatal enterprises had less to do with the need to reduce arrears than with the need to return to profitable operating conditions. The arrears problem had more to do with the banking systems. The cost of restructuring the banking systems in the two largest countries, Cameroon and Côte d'Ivoire, was substantial--of the order of 20 percent of GDP. That cost, however, needed to be financed only partly with new resources from outside those countries; in effect, to a large degree, it had already been borne by the economies of those countries, and its settlement was a matter of consolidating existing claims and liabilities.

The prospects for moving to a more flexible determination of interest rates in the two monetary areas were reasonably good, the staff representative from the African Department continued. Over the past year there had been considerable progress in simplifying the existing structure of interest rates first in the Western Africa area and most recently in the Central Africa monetary area. Under the present system, interest rates were relatively straightforward, although they were still determined administratively. The next stage was to move to a system that would steer away from bank-by-bank credit controls and toward regulation of credit expansion based on interventions of the central bank in a money market. There was no guarantee that that stage would be reached quickly, but it was in prospect, and within a year the prospects should be clearer.

The staff representative from the Research Department said that he wished to comment on the question of the peg to the French franc versus a peg to a basket of currencies. It had been correctly suggested that some of the costs of pegging to the French franc included having the countries in the zone absorb shocks to French prices and to the exchange rate between the French franc and other currencies. One of the other arguments that had been advanced was that somehow a basket peg would have some influence on the CFA countries' terms of trade. The staff doubted whether that would happen. It was unlikely that, except in the very short term, prices in dollars would be constant; rather, they would not change when exchange rates between the other major currencies changed. The staff paper had outlined some of the problems associated with a single currency peg versus a basket peg. In particular, swings in effective exchange rates had been one of the costs that must be considered. Those considerations might, in the view of some, outweigh considerations relating to convertibility. The basket peg itself would be to a number of currencies, rather than to a single currency; for that reason, there would be no actual financial asset that would parallel

the behavior of the basket peg. There were additional confidence factors that might argue for retaining the peg to the French franc at the present stage. There would be a problem in relying on a basket peg for adjusting the level of the exchange rate, because ex ante it was very difficult to tell how in that respect a particular basket peg would perform over time.

Another staff representative from the Research Department commented that it was clear, as many Directors had observed, that it was difficult to justify the franc zone on the basis of optimum currency area theory, as labor and capital mobility and open trade were not particularly important factors in the zone. Therefore, the main issue was the extent to which the zone arrangements had been successful in imposing monetary discipline. In that connection, of course, the evidence was clear. It had been suggested that perhaps the same discipline could have been imposed by bilateral fixed relationships of the exchange rate of those countries *vis-à-vis* France and other major countries. Achieving discipline under that system would be much more difficult, because an important element in a currency area was the maintenance of a single central bank, which required giving up autonomy in the area of monetary policy. With bilateral fixed exchange rates, each country would have its own central bank, and it would inevitably be more difficult for the central banks to resist pressures to finance deficits.

To the extent that problems had arisen in the CFA franc zone, they were traceable to the substantial deterioration in the terms of trade and the financing of fiscal deficits through external debt, the staff representative continued. Some speakers had asked whether it would have been more effective to have considered alternative exchange rate regimes, and in that connection the real issue was how the zone countries would behave under alternative regimes. If one assumed that fiscal discipline would have been stronger under a fixed but adjustable peg, then, of course, the conclusion would be self-evident. On the other hand, if the flexibility to adjust the exchange rate and periodically resort to a certain amount of inflationary financing would relax fiscal discipline, the results could have been even worse.

It had been suggested by Mr. Evans that exchange rates did not matter, the staff representative from the Research Department recalled. In his view, exchange rates were not a substitute for appropriate financial policies, but it might be going too far to say that exchange rates did not matter.

Mr. Evans said that his point concerning exchange rates seemed obvious on the basis of the unique set of data provided in the staff paper. The staff could usefully test that proposition statistically.

The staff representative from the Research Department replied that it would be very difficult to conduct the statistical test that Mr. Evans had suggested, because, in order to look at the exchange rate alone, many other

factors would have to be held constant. There was no comprehensive model of the zone countries that could be used to test Mr. Evans's hypothesis conclusively.

The Chairman made the following concluding remarks:

I found this debate very interesting. Directors noted some of the unique features of the CFA franc zone arrangements, such as the long traditions of strong political solidarity among the members of this group. Directors also noted that in several fields the arrangements have worked remarkably well, despite the different economic structures of the members, the limited intra-regional trade, the limited mobility of the factors in these countries, and their very different abilities to weather external shocks.

However, the common priority attached to maintaining low rates of inflation and the arrangements for common monetary and exchange rate policies could not prevent a lack of discipline in other macroeconomic policies. The concluding section of the staff paper usefully summarizes the problems that have emerged--very substantial terms of trade shocks, fiscal imbalances, domestic arrears, erosion of the revenue base, weakening of financial systems, excessive cost levels, and structural constraints. It was interesting to hear the comments of Mr. Santos and Mr. Landau on the response of the authorities to these shocks within a system in which a stable exchange rate has offered a central anchor. The authorities in these countries have applied a strategy of domestic adjustment together with structural change and cost containment.

In arguing against a one time only depreciation, Mr. Landau stressed the questions of achieving a real depreciation and the elasticity of the supply response. Mr. Posthumus emphasized the importance of the political commitment of partners as well as the importance of the Fund's large transfers of resources for development and balance of payments financing, and Mr. Evans took this point even further.

But several other speakers were not fully convinced by these points. Mr. de Groote outlined why in his view the use of the exchange rate could be effective in the circumstances of the zone. A number of speakers stressed that exchange rate stability should not be confused with immovability of the rate, and everyone seemed to agree that the members of the franc zone did not approach the exchange rate issue in a dogmatic fashion; rather, it is a matter of choosing preferred solutions from a limited set of options.

The case for pegging these currencies to a broader basket has also drawn some support, although the staff has noted the

difficulties involved with that option. Everyone agreed that, whether or not the exchange rate is used, there is an urgent need for strong fiscal policies, structural reforms, and containment of costs. The impressive fixity of the exchange rate underscores that need.

Everyone also agreed that the zone needs time to continue to develop appropriate adjustment programs. But several speakers believed that the internal imbalances were too large to correct without using the exchange rate unless the members of the group were willing to incur costs in the fields of growth and export diversification. At the same time, all speakers agreed on the importance of the argument that, in this particular case, using the exchange rate would run the risk of taking the members of the zone into unchartered waters, of creating expectations of further depreciation, and of encouraging capital flight.

Obviously, there are differences of views on the role of the exchange rate, and these differences have not been resolved at this stage. However, the high quality of the debate has clarified questions that are central to the Fund's interest and to the well-being of its members, particularly the countries in the CFA franc zone.

I think that we need to reflect further on these matters. The staff should intensify its research on issues of exchange rate policy, and it should analyze more fully in its papers on CFA countries the implications of their present preferred adjustment strategy.

To conclude, this has been a very useful debate; we have clarified many of the issues. The preparation of this paper triggered very thoughtful analysis in the two groups of countries in the CFA franc zone and in France. The recent decisions taken by several countries in the two groups of countries have been helped by the perspective that was achieved in the preparation for this debate. As a witness of this work and exchange of views over the past few months, I would conclude that this experience makes a good case for regional surveillance. I noted Mrs. Hansen's point that analysis short of this regional approach might have occasionally led us to miss important points. I feel encouraged by the debate today to suggest that we should review more frequently the situation of this zone and have periodic updates of this study. I think that we have everything to gain from that effort, because it is our job, and these countries will be helped by adding this regional approach from time to time to individual country analysis.

Mr. Posthumus said that he hoped that the next staff paper on the CFA franc arrangements would be more open than the present paper, especially by addressing the various policy issues that had been raised during the present discussion. Of course, some caution was called for in undertaking a debate on such a matter, but less caution on the occasion of the next discussion would be useful.

The Executive Directors concluded their discussion of the CFA franc zone arrangements.

LEO VAN HOUTVEN
Secretary