MASTER FILES
ROOM C-525 0421 LIMITED DISTRIBUTION ONLY

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Seminar 94/11

10:00 a.m., November 18, 1994

M. Camdessus, Chairman
A. D. Ouattara, Acting Chairman
S. Fischer, First Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
	M. Sirat
J. Bergo	
	V. J. Fernández
I. Clark	
B. S. Dlamini	D. Z. Guti
	J. Shields
	L. E. N. Fernando
J. E. Ismael	L. M. Cheong
	W. C. Keller, Temporary
	A. Chang Fong, Temporary
	J. Prader
	D. Daco, Temporary
Y.-M. T. Koissy	H. A. Barro Chambrier
G. Lanciotti	
	B. S. Newman
	S. Ishida, Temporary
	S. Rouai, Temporary
	A. G. Zoccali
	E. Wagenhoefer
A. S. Shaalan	Y. Y. Mohammed
	V. Y. Verjbitski, Temporary
E. L. Waterman	J.-H. Kang
	G. H. Huisman, Temporary
Zhang M.	Wei B.

J. W. Lang, Acting Secretary
T. Ranaweera, Assistant

Also Present

IBRD: J. F. Chevallier, Central Africa and Indian Ocean Regional Office; C. P. Humphreys, Southern African Regional Office; F. L. Laporte, Western Africa Regional Office. African Department: E. A. Calamitsis, Director; R. Abdoun, G. Belet, C. Brachet, J. A. Clément, I. A. H. Diogo, C. A. François, M. T. Hadjimichael, J. Harnack, E. C. Harris, J. Mueller, E. Sacerdoti, A. Tahari, R. H. van Til, R. C. Williams. External Relations Department: S. J. Anjaria, Director; P.-M. Falcone. Fiscal Affairs Department: X. Maret. IMF Institute: M. G. Fiator, D. E. Zamoratsi. Legal Department: J. M. Ogoola. Policy Development and Review Department: A. Basu, R. H. Nord, C. Puckahtikom, B. E. Rourke. Research Department: M. S. Khan, Deputy Director; F. Larsen, P. Wickham. Secretary's Department: J. M. Boughton, A. Mountford. Treasurer's Department: W. J. Byrne. Office of the Managing Director: S. Sugisaki, Special Advisor; G. R. Saunders, Personal Assistant. Advisors to Executive Directors: J. M. Abbott, S. K. Fayyad, T. K. Gaspard, R. Kannan, J. Leiva, J.-C. Obame, C. F. Pillath, B. A. Sarr. Assistants to Executive Directors: S. E. Al-Huseini, R. D. Bessone Basto, J. Dagustun, D. Desruelle, M. Dzervite, L. Fontaine, C. M. Gonzalez, O. A. Himani, P. J. Jilek, K. Kpetigo, N. L. Laframboise, T. Lwin, Ng C. S., M. W. Ryan, D. Saha, T. Sitorus, R. von Kleist, Zubir bin Abdullah.

1. CFA FRANC COUNTRIES - COMMON POLICY ISSUES

Executive Directors considered a staff paper on common policy issues of the CFA franc countries (EBS/94/151, 7/29/94).

The staff representative from the Policy Development and Review Department made the following statement:

> Prior to today's meeting, some Executive Directors expressed interest in receiving an overall view of the performance of the CFA franc countries in 1994, under the Fund-supported programs adopted following the January 1994 devaluation of the CFA franc. Accordingly, the staff would like to summarize the experience in program implementation so far as follows:
>
> First, the authorities throughout the zone have coped relatively well with the immediate aftermath of the devaluation and, in particular, they have been successful in keeping wage increases within the programmed limits. With the implementation of other complementary policies, the rate of inflation was quickly brought under control after the initial surge in prices. For the year as a whole, inflation should not exceed a range of 35-40 percent in most countries.
>
> Second, despite a wait-and-see attitude on the part of private investors, there are now signs of substantial economic recovery and growth in the tradable goods sector. The weighted average in real GDP is now estimated at 2 percent in 1994, compared with an average decline of 1.4 percent in 1991-93.
>
> Third, the external accounts of most countries have improved markedly as a result of a strengthening of trade balances, resumption of foreign assistance, repatriation of flight capital, and higher commodity prices in world markets.
>
> Finally, performance in the fiscal area has varied from country to country. The programs of the West African Monetary Union (WAMU) countries have been broadly on track, with the exception of Niger. In the Central African Monetary Area (CAMA) countries, except for Gabon, the programs have encountered problems, in particular in the mobilization of government revenue.
>
> On this basis, the midterm reviews under the programs have been completed for Burkina Faso, Côte d'Ivoire, Mali, and Gabon; and the review for Benin is to be concluded shortly. In addition, Senegal had its stand-by arrangement replaced by a three-year enhanced structural adjustment facility (ESAF) arrangement in August, while Togo had a three-year ESAF arrangement approved in September. The staff is working closely with those countries

where difficulties have been encountered to ensure the needed improvements in performance.

Mr. Koissy made the following statement:

The paper prepared by the staff provides an overall insight into the institutional arrangement of the CFA franc countries and their experience under the internal adjustment strategy pursued, until the realignment of the parity of the CFA franc against the French franc in January 1994, and the events that led to this historic decision. Although, it may be too early to draw broad conclusions on the measures introduced, the paper helps to draw attention to some of the risks that should be addressed to ensure continued success of the adjustment programs in the CFA franc countries. Today's discussions will be useful to my authorities, as they assess the result of their new adjustment strategy, and prepare for the challenges that still lie ahead.

At the outset, I would like to stress that my authorities fully endorse the staff's assessment that, notwithstanding the poor growth performance since 1985, the monetary arrangements of the CFA franc zone have, on balance, brought considerable benefits to members over the past four-and-a-half decades in terms of price stability, growth, and the regional solidarity. However, as indicated in the paper, for a variety of reasons, the CFA franc countries did not take full advantage of the monetary unions, while they were affected by some of the drawbacks. Consequently, in reviewing how to strengthen the monetary unions, these countries have reaffirmed their firm political commitment to broaden monetary cooperation and strengthen regional solidarity. It is in this context that they are accelerating the implementation of a number of reforms in the WAMU and the CAMA. These reforms encompass the financial sector, fiscal harmonization through convergence criteria related to the overall balance and composition of fiscal operations, foreign trade, and the harmonization of investment codes. Moreover, my authorities welcome a more active approach by the Fund in fostering greater integration among the economies of the two monetary unions at this critical stage of institution building.

So far, the measures introduced since January 1994 have been fairly successful in achieving the financial stabilization objectives. Tight financial policies and a prudent incomes policy have enabled inflation to be kept under control, and internal and external imbalances to be contained. However, progress has been slower than envisaged in reviving economic activities and in promoting employment, and the present situation points to the need for an acceleration of structural reforms to achieve the medium-term growth objectives. Thus, while it is true that the design of Fund-supported programs adopted by the individual countries, in the wake of the exchange rate realignment, appropriately took into account factors that have a bearing on the roles of national monetary and fiscal policies, there are union-wide issues that need to be addressed to help sustain the implementation of these programs over the medium term, thereby ensuring their overall success at the level of the zone. In this context, the following issues, although not exhaustive, need to be considered.

First, in view of the uniform size of the exchange rate adjustment in all the countries except the Comoros, and the fact that the analysis indicated an overvaluation in real terms in the range of 10 to 52 percent, it would be useful, as data become available, to evaluate some of the specific issues confronting the countries at the lower end of the range and the implications for program design in these countries. As indicated in the paper, for these countries, there is room for a differentiated wage policy and for other offsetting fiscal measures.

Second, if the recovery of economic activity and imports do not materialize quickly, the risks of revenue shortfalls will be heightened, notwithstanding the measures to strengthen tax and customs administration and reduce tax exemptions. Moreover, the ongoing trade reforms in the two unions involving harmonization and reduction of external tariffs, and the shift in the structure of imports will entail a net short term loss of tax revenue for a number of countries, particularly the landlocked ones. In view of these risks, it would have been useful to emphasize alternative revenue measures to be implemented quickly, should the revenue target not materialize, and envisage, at the outset, in all the programs, contingency and compensatory financing, including through the ESAF.

Third, on monetary policy, in view of the mobility of capital between the unions and France, there has been a tendency to maintain a positive differential in real interest rates with the French market to stem capital outflows. Notwithstanding the reforms under way to restructure the financial system in order to deepen financial intermediation, the imperfection and segmentation of markets, combined with this interest rate policy stance, limit the room for maneuver of individual countries in their efforts to bring down real interest rates. In addition, as union members do not pursue an independent monetary policy, the targets for net domestic and foreign assets will need to be coherent at the union level. The various operational implications for the design of the programs and for the monitoring of monetary aggregates merit further consideration.

Fourth, the larger debt burden brought about by the devaluation, as well as uncertainties in the availability of external financing, will subject the adjustment programs of these countries to even greater constraints. This has important implications for these countries, and points to the need to reassess, as soon as possible, the present debt restructuring arrangements to ensure that the medium-term growth and balance of payments objectives of the countries remain achievable. In this connection, an acceleration of the stock-of-debt approach should be envisaged to help these countries deal more effectively with their debt difficulties. Moreover, the share of the nonreschedulable debt, including debt due to multilateral institutions and pre-cutoff debts in total external debt of most CFA franc countries, has increased substantially. We hope that the upcoming paper on the multilateral debt problem will address these issues and propose possible solutions.

Fifth, the extent of the structural problems in the CFA franc countries has played an important role in the magnitude and duration of the recession in these countries. It is not surprising that the adjustment strategy followed by all countries after the devaluation involved correction of structural rigidities needed to enhance competitiveness, and improve supply response notably in trade, tariff, and producer prices. Overall, although the positive financial impact of the devaluation is expected to facilitate reforms in exporting sectors, progress will take a considerably longer time to achieve in the vast majority of public enterprises, owing to technical difficulties and complex restructuring programs. These delays are likely to have a further depressing effect on investment confidence and economic activity. Success in the implementation of structural reforms will be crucial in maintaining the level of competitiveness achieved through the exchange rate action, and in realizing sustained growth over the medium term. In this regard, close collaboration between the Fund and the Bank toward achieving the structural reform objectives will be critical.

Sixth, the importance of social safety net measures, to attenuate the adverse effects on the most vulnerable groups and help muster social consensus on the new adjustment strategy, cannot be overemphasized. However, now that the temporary freeze in the adjustment of prices has lapsed, most countries seem to be faced with technical and financial constraints in their efforts to identify and put in place more durable social safety net projects. This situation has been exacerbated by the severe unemployment generated by the retrenchment in the public sector, and likely delays in the private sector employment creation. It would be important that program reviews continue to address more thoroughly the worsening unemployment situation, and monitor progress made in the effective implementation of social safety net measures.

Seventh, with regard to the exchange system, my authorities have indicated on many occasions their determination to maintain the convertibility of the CFA Franc and an exchange system free of restrictions. They are fully aware of the added credibility that the acceptance of the obligations of Article VIII will lend to their action. However, before formalizing their acceptance, they would like to ascertain that their balance of payments position is sufficiently strong and that the underlying policies are adequate to sustain external shocks, without reverting to exchange restrictions. They have also indicated that conditions for rescinding the suspension of bank notes repurchase have not yet materialized, and that development in the economic and financial conditions in neighboring countries will have an important bearing on their decision.

In conclusion, I welcome the quick response of management and the staff to the request made by the Executive Board for an early assessment of developments in the CFA franc countries following the devaluation. Despite the risks and uncertainties created by the size of the devaluation, there are clear indications that progress is being made in the implementation of the adjustment programs. The success of these programs will be enhanced by maintaining close monitoring, and also by showing flexibility whenever needed. Moreover, the benefit of this exercise can be enhanced, if the paper can be updated regularly, in the context of out regional surveillance exercise.

Extending his remarks, Mr. Koissy said that he agreed with the view expressed by Mr. Clark and Mr. Kiekens in their preliminary statements that the CFA franc zone was far from being an optimal currency area, especially from a Canadian or European perspective. However, the factors that drew the CFA franc countries together and the overall positive results achieved needed to be recognized. There was an urgent need to strengthen the foundation of the monetary union, and improve some of the institutional arrangements.

Directors had emphasized that high priority should be given to reducing the fiscal deficit and implementing structural measures, notably civil service reform, Mr. Koissy commented. The available policy choices were highly sensitive, and would continue to be the authorities' greatest challenge, especially in view of the need to address administrative deficiencies.

At the time of a program review, it might be useful to give proper attention to finding ways to deal once and for all with the problem of domestic arrears, Mr. Koissy observed.

The resumption of the repurchase of CFA franc bank notes from neighboring nonmember countries would need to be examined in a broader context, because connected to it were the difficult problems of unfair competition to legitimate businesses, and illegal capital flight from the CFA franc zone, Mr. Koissy noted.

France had strongly supported the adjustment policies in the CFA franc zone countries, Mr. Koissy commented. French financial assistance and technical support had enabled the achievement of the financial objectives of individual country programs. The authorities appreciated that assistance, and had hoped that they could continue to count on such support, as well as enhanced assistance from other countries in the future.

Mr. Clark made the following statement:

> Consistent with this chair's interest in focusing more attention on regional surveillance and regional economic issues, I welcome the opportunity to discuss the policy issues of the CFA franc countries. This exercise is particularly important, in view of the Fund's role in the massive economic adjustment currently under way in the region. The program design and subsequent developments in the zone must be closely monitored to ensure that the opportunities arising out of the historical 1994 devaluation are not lost.
>
> With the Fund's assistance, the CFA franc zone members manipulated a key economic price--the exchange rate--to effect a substantial change in relative prices. If managed properly, this should raise the zone's external competitiveness, and lead to sustained economic growth and financial viability. In this context, I would like to make two general points about the paper: the first concerns the content and focus of the report; the second concerns the nature of the CFA franc currency union, and the elements necessary to ensure its success in promoting the prosperity of all of its members.
>
> The main objective of reviewing policy issues is to determine how program design could be improved. As the staff paper was prepared in July, it could not assess the economic performance of CFA franc countries. However, now that we have sufficient information to make a preliminary assessment, I would submit that the original purpose of this paper has been overtaken by events. Directors exercised their views on program design on an individual country basis repeatedly this year, and are doing so again in the context of mid-term reviews. Consequently, it would appear somewhat academic to review the original program design again, without looking at recent economic performance.
>
> For instance, we understand that preliminary results in the CFA franc countries are generally favorable; namely, prices have stabilized since the initial big jump, exports have picked up, capital has begun to flow back, and reserves have risen considerably. On the other hand, there appear to be weaknesses in some areas; tax revenues have fallen far short of expectations in some cases, structural reforms have been slow to materialize, and there is confusion about the best allocation of scarce government

expenditures. An analysis of these issues and the general themes raised repeatedly by Directors at individual country program reviews would add considerable value to the seminar.

I would like to commend the staff for its excellent job of laying out the historical setting, surveying the common targets and features of Fund programs, and providing an aggregate medium-term outlook for the region as a whole. In this regard, the paper serves as a good basis for a thorough review of the programs and performance of the CFA franc zone countries which could be held at some point in the future. Such a review is particularly important in view of the role of the Fund in the decision by the region to devalue, and the subsequent adjustment process. Keeping in mind the priorities of the work program and the need for the Executive Board to maximize its time, I would suggest that this review take place in the first or second quarter of 1995.

On the substance of the study, I have a general comment to make on the currency union in general. At the outset, empirical and theoretical evidence would suggest that the economies of the CFA franc zone are not well suited to a common currency area. Members have the most to gain from a currency union when they have some or all of the following characteristics: a high level of factor mobility, flexibility in the cost of factors of production, economies which are open inside the region but relatively closed to outsiders, high product and sector diversification, and symmetry of external shocks. Comparing these features with those of CFA franc countries leaves something to be desired.

Conversely, there are other reasons related to political economy and monetary management which argue in favor of preserving the union. As outlined in the staff paper, these include greater financial discipline, lower transaction costs, lower currency risk, economies of scale, better control of government recourse to central bank credit, and most important, the need to strengthen monetary cooperation and regional economic integration. While an orthodox currency union would ensure integration a priori, it would appear that the CFA franc zone members would like to use monetary and currency union as a structural anchor that can draw their real economies together.

In view of the choice of CFA franc zone members to maintain the common currency, the overriding priority of economic planning should therefore be convergence of both macroeconomic and structural fundamentals, in order to achieve the characteristics necessary to ensure the success of the union. Otherwise, the different levels of economic development and resources between members will ultimately lead to greater strains on the union, and intensified wealth disparities between members.

The key areas for convergence, some of which are already under way, include trade and tax harmonization, the operational procedures and strategic objectives for monetary policy, macroeconomic fundamentals, statistics and indicators, exchange and payments regimes (Article VIII), and the many areas in need of a regulatory and legal framework. Although the staff has outlined these items clearly, they should be pursued with greater urgency in view of the weak technical foundation underlying the union.

Mr. Shaalan made the following statement:

In the past, many speakers at the Board have rightly characterized the devaluation of the CFA franc as a necessary shock, as well as an opportunity to introduce an overdue macroeconomic adjustment program. This opportunity is now further enhanced, after a long period of continuous deterioration, by a favorable turnaround in the region's overall terms of trade, and by the promise of substantial debt relief and concessional financing. The CFA franc countries should take advantage of this unique convergence of positive opportunities, and continue to implement the new adjustment strategy in full. I believe that the main policy elements of this strategy are appropriate, and would like to restrict my comments to the following.

First, on the primacy of the fiscal objective. The key objective of the new adjustment strategy is the improvement of the fiscal situation. This is all the more important, because the exchange rate peg effectively leaves little room for an independent monetary policy. In this regard, it is very important to avoid monetary tightening as an offsetting measure for an eventual fiscal relaxation, and thus become less focused toward the fiscal objective. When this policy mix, of monetary tightening following fiscal relaxation, was implemented in the last few years, it resulted in the emergence of domestic and foreign arrears, and the general weakening of the financial condition of domestic enterprises. Reducing fiscal deficits should remain the primary, not a second best, objective of the CFA franc countries' adjustment strategy.

Second, on the composition of the fiscal measures. If anything, the adjustment experience of 1986-93 revealed the institutional constraints facing fiscal consolidation efforts, which led adjustment measures to shift to cuts in public investments and essential services, thus jeopardizing social stability and future growth. I therefore welcome the staff's emphasis on the need to reduce the high wage bill in the public sector, and the setting up of expenditure norms to avoid the transfer of the burden of adjustment on the productive element of public expenditure. The reduction of the wage bill, and associated civil service reform measures, are obviously key elements of the programs in place.

Third, on the perennial issue of the feasibility of strong programs in the time frame envisaged for them. As has been repeated on previous occasions by many of us, these programs are overall ambitious, seeking to achieve, as early as in 1996, substantial reductions in the fiscal deficit and inflation, and a substantial increase in investment ratios. This anticipated strong performance, especially if it is to be sustained, may require that adverse external shocks, especially changes in terms of trade, be minimal, and that administrative and other institutional constraints be largely remedied. These preconditions are either outside the policy reach of authorities, or would usually take time to be effectively implemented.

Fourth, on structural reforms. On page 19 of the paper, the staff indicates that "...fiscal viability at the country level and an appropriate monetary policy at the union level would be sufficient to ensure external viability...." I agree with this assessment about the type of sufficient conditions for external viability, but would like to add that external viability without growth may be unstable over the medium to long term. An adequate fiscal policy is necessary, but not sufficient, for either growth or external viability beyond the short term. Fiscal adjustment measures must be accompanied, foremost by their twin structural measures of civil service and public enterprise reform, and by an extensive array of other structural reform measures, as detailed in the staff paper. A sustained progress on the structural front will perhaps be the authorities' greatest challenge.

Mr. Daco, speaking on behalf of Mr. Kiekens, made the following statement:

First, let me commend the staff on the document circulated in July that we are discussing today. The document, which combines the virtues of conciseness and precision, gives a candid analysis of the situation of the CFA franc zone, and the options and risks, which it entails for the adjustment process in the CFA franc countries. I agree with the staff concerning the need to preserve existing institutional arrangements, the limits of the internal adjustment strategy, and the content of the new, more comprehensive adjustment, and will center my comments on these three issues.

As regards the rationale for preserving the existing institutional arrangements, it is not always easy to assess the relative qualitative effects on budgetary discipline of economic unions, monetary unions, and currency unions. In addition, it is difficult to measure the quantitative effects of a monetary union, particularly the benefits in terms of economies of scale or reduction of inflationary expectations, and see whether these advantages can compensate for lost autonomy in price behavior or fiscal policy. And as the staff paper points out, political considerations accompanied by other indirect economic effects also play an important role. The choice these countries made to adjust their exchange rate in concert, even though they face very different situations, is proof of their political desire to maintain their solidarity.

The experience of the CFA franc countries provides an interesting contrast to the integration process taking place in Europe. In Europe, monetary union is to be the last stage of the integration, to be attempted only after progress with economic union has produced a certain degree of convergence of the economies. The CFA franc countries have done the reverse by first deciding to establish a monetary union, and only then to form an economic union. Without commenting on sequencing one way or the other, I am struck by the complementarity of economic and monetary integration. I would urge the authorities to strengthen the integration of the countries of the zone by removing trade barriers, impediments to factor mobility, and harmonizing their macroeconomic policies, in order to reap the benefits of an optimal currency zone.

On the limitations of the internal adjustment strategy, I agree that reducing the imbalances would have required substantial budget cuts and a very tight monetary stance. This would have caused a severe contraction in demand, and pushed the countries into a deflation with very dangerous social consequences. A more comprehensive strategy was therefore needed.

With respect to the comprehensive new adjustment strategy for the zone, I can only quote the Chairman's summing up of our recent world economic outlook discussion: "the beneficial effects on growth associated with the recent adjustment of the CFA franc will depend upon a steadfast implementation of the accompanying stabilization policies and structural reform in the countries concerned."

A tight fiscal policy, including public sector wage restraint as part of a civil service reform, will be the first condition for success. As the paper points out, strong fiscal adjustment is a way to give the nongovernment sectors more room to expand. At the same time, by increasing the resources available to the government for repaying its arrears to the private sector, and encouraging private capital inflows, it will give the private sector more resources to invest.

Fiscal policy within a currency union requires coordination to avoid possible spillover effects. However, I still have some questions about the surveillance process planned for both the WAMU and CAMA. Norms are being developed for the level and composition of the fiscal position, together with multilateral surveillance procedures to help countries converge to these norms. My first concern is with the scope of surveillance. Some of the variables under surveillance seem to be beyond the reach of the authorities. My second concern is with the severity of some of the targets. As an example of both concerns, the norm concerning investments financed by domestic resources is so high that only Senegal is likely to meet it. It seems to me that any targets set ought to be realistically achievable. Any other course is likely to discredit the whole surveillance process. That leads me to my second question: what happens if the norms or targets are not respected? In other words, what sanctions are attached to the surveillance procedure, and what instruments are available to the two unions to encourage or compel members to take corrective actions? The staff's comments on this issue will help us assess the seriousness of the surveillance process.

Moving economies onto a higher growth path requires fundamental structural changes that often do not immediately bear fruit. This is another reason for not postponing structural reforms. I would therefore urge the few CFA franc countries that have not yet reached agreement on a program with the Fund to do so. Wage restraint is necessary, but not sufficient alone. Stabilization has to be supported structurally by civil service reforms, price liberalization, labor market liberalization, and reform of the financial and public enterprises sectors. The staff correctly identifies the public enterprise sector as a major source of macroeconomic imbalances and impediments to growth. The reform of this sector is the major challenge presently facing the authorities, and is the area where they will be able to show their commitment to adjustment. Without structural reforms, there will be no supply response to the adjustment and no investment opportunities will be created. To allow private investment to take over and flourish, the state's role in the economy must be reduced. Moreover, the privatization process has to be accompanied by improved tax administration and collection.

The CFA franc is a nominally anchored currency. There is thus limited scope for the CFA franc zone to conduct a monetary policy independently of the anchor country: its inflation rate and interest rate cannot deviate much from those in France. Last March, the staff predicted that CFA zone prices, after a six-month transition period, would return to the low levels prevailing prior to the devaluation. Could the staff shed some light on recent price developments?

In the same vein, a Working Paper issued in August 1994 entitled "Linkages in Price Level and Inflation Rate between CFA Franc Zone Countries and France" examined the long-run convergence of the price levels of 11 CFA franc countries with those in France from 1979 to 1993. Its conclusion contradicts the commonly held view, shared by the staff in today's CFA franc paper, that in the long run, these price levels converge. I am inclined to think that the apparent inconsistency between the two arguments is probably due to the lack of high quality statistical data in the zone. I would nevertheless appreciate the staff's comments on this issue.

However, the same study did show that there was a structural change in the price level patterns of the CFA franc zone countries during the mid-1980s. Also, no convergence of price levels was apparent from 1979 to 1985, a period during which the performance of the zone was not criticized.

In addition to the risks cited in the report--the substantial and protracted deterioration of the CFA franc countries' terms of trade, and the depreciation of the dollar, I would like to suggest another. I wonder whether the exchange rate policies of the zone's neighboring countries did not have some influence. Both Ghana and Nigeria, for example, have devalued several times, which must have had some negative effect on the trade performance of the CFA franc zone countries. I also wonder whether the devaluation of the CFA franc would not trigger corrections of the exchange rates of neighboring countries.

During the discussion of Côte d'Ivoire's program, I was puzzled by the authorities' statement that concerns about illicit trade and capital flows had forced them to suspend the repurchase of CFA franc banknotes outside the zone. Their concerns were especially mystifying, because sizable returns of flight capital had taken place and illicit trade, if any, most probably is taking place in currencies other than the CFA franc. The present document explains that the CFA franc devaluation, trade reforms, and increased competitiveness have reduced the price distortions vis-à-vis neighboring countries. It also claims that the suspension of repurchases has reduced the use of the CFA franc in informal cross border trade. I wonder if increasing the CFA franc's convertibility would not give the markets, and investors, a strong signal that they can have confidence in the countries of the zone. Is there any better way of boosting their confidence than by increasing currency convertibility?

Finally, in view of the importance of the subject, I would also support revisiting it in another Board seminar focused this time on economic developments since the devaluation.

Mr. Sirat, speaking on behalf of Mr. Autheman, made the following statement:

I welcome this paper on issues common to the CFA franc countries. I appreciate the staff's positive assessment that the CFA franc zone's institutional arrangements can preserve macroeconomic stability and foster regional integration. Like the staff, my authorities consider the CFA zone a vivid example of the benefits that can be reaped from external convertibility, and a nominal anchor policy.

In the aftermath of the devaluation, fighting inflationary pressures was the priority. The governments' ability to adhere firmly to wage restraints was, and remains, decisive, and I would find it difficult to follow Mr. Koissy's assumption that there could be room for a differentiated wage policy. I continue to share the Director of the African Department's conviction that wage restraint should be enforced everywhere. The increase in rural income has helped to reinforce this restraint, as well as our readiness to support exceptional and transitory measures to limit initial inflation.

The inflationary risk now appears reasonably modest. The institutional monetary arrangements of the CFA franc zone should now help bring inflation down to a sustained low level. These arrangements allow member countries to build on their past record of low inflation, in order to foster the credibility of the new parity. The independent regional central banks gave the appropriate up-front signal in adjusting immediately short-term interest rates. They were also right in lagging behind markets in reducing their intervention rates. Such behavior should contribute to a lasting abatement of inflationary expectations.

Another feature of the zone is the convertibility of the CFA franc. As in the past, it can provide an incentive for foreign investment, if fiscal policies remain sound. It is important that legal convertibility not be altered by practical limitations, as the exchange system is virtually free of restrictions on payments for current transactions. I encourage CFA franc countries to move in a concerted manner to Article VIII obligations.

I consider that the critical contribution of the Fund is to sustain fiscal discipline. The rule limiting government access to central bank borrowing cannot guarantee it; experience shows that this rule can be bypassed through recourse to nonbank borrowing, or through the accumulation of arrears. I agree with Mr. Shaalan that the restoration of fiscal balance is the centerpiece of Fund programs, as the soundness of monetary policy can be ensured ex ante.

CFA fiscal programs, assuming prudent wage policies, rest primarily on revenue performance, which appears to be uneven. The risk of revenue shortfall mentioned in the staff paper, associated with the uncertainty surrounding price elasticity of import demand and weak tax and customs administrations, calls for a close monitoring. A prudent sequencing in tariff and tax reforms is also warranted, because reforms designed to be revenue neutral often translate into revenue shortfalls, as we have noted in many Fund programs. Finally, further technical assistance from the Fund will be necessary to assist the CFA countries to broaden the tax base, and to address administrative deficiencies.

CFA franc countries' programs also depend critically on the availability of timely external financial assistance. The Fund's quick response permitted a rapid mobilization of World Bank support, and a rapid conclusion of debt-rescheduling agreements in the context of the Paris Club, in addition to substantial bilateral debt relief, notably from my own country. One cause of concern could be the limited number of donors. I hope that this debate will help convince potential new donors to support successful programs.

The response of the tradable sector to the change of relative prices is very encouraging, including the recovery of intra-zone trade. The return of sustained growth, the ultimate objective of the devaluation, implies further structural reforms in order to promote private sector development.

These negotiations are primarily the World Bank's responsibility, but a close collaboration between the Bank and the Fund through the policy framework paper process is needed. In particular, we look forward to the Fund staff's active involvement in a number of areas, notably trade and tariff reforms, and financial reforms.

As for the financial sector, should we be concerned by the lower than expected increase in the demand for credit? So far, my answer is no. I consider that this delay reflects the improved profitability of the tradable sector, and the sharp decline in domestic demand associated with wage restraint. But the recovery of growth, when capacity utilization would regain normal levels, will have to be accompanied by a recovery in credit to the private sector. Banks are constrained by the weak financial position of the private sector, which is a consequence of the high level of unsettled arrears and, to a lesser extent, of losses resulting from the change in parity. I consider that in the event of windfall receipts, or unexpected room for maneuver, the priority should be given to the settlement of the Government's arrears owing to the private sector vis-à-vis the resumption of public investment.

The Fund programs have been designed in a regional framework associated with unionwide monetary policy; enhanced regional integration, notably through trade and tariff reform; and increased emphasis on fiscal harmonization and surveillance. This regional aspect is at the core of the Fund and Bank support, following the devaluation of the CFA franc. This has important consequences for future work. First, in the design of future reforms, the Fund staff should include the regional dimension in their country-specific approach. For example, tax and tariff reforms should take into account the needs of landlocked countries. Second, the objective of Fund programs is a return to sustainable growth of the CFA franc countries as a whole--countries facing initial difficulties must be urged to resume adjustment. Third, the CFA franc countries cannot be considered independently from their immediate neighbors, in particular Nigeria. I believe that the Fund could be more active in assessing the reciprocal consequences of macroeconomic policies and measures undertaken by CFA franc countries and non-CFA franc countries, and exert more forcefully its surveillance role on exchange rate developments.

Finally, I would like to commend the staff of the African Department for the excellent quality of their intensive work.

Extending his remarks, Mr. Sirat said that Mr. Clark had enumerated the theoretical considerations that might go against, and the practical reasons in support of, the existence of the zone. He welcomed the fact that, on balance, Mr. Clark had agreed with the staff's assessment about the adequacy of the provisions of the existing monetary union.

Mr. Clark said that he had been struck by the theoretical and practical arguments in favor of a currency zone. The countries of the CFA franc zone had been going through severe adjustments over the preceding eight months, although the degree of overvaluation had differed substantially from country to country--from 10 percent to 50 percent. Most of the burden of adjustment under a fixed exchange rate system would fall on the price side, particularly on wages. In view of the leading role of public sector wages as a benchmark for wages across the board, the fact that all CFA zone countries had adopted roughly the same wage adjustment in the public sector--10 to 20 percent--regardless of the degree of overvaluation of their currencies was disappointing, as more of the burden of adjustment overall would therefore have to come from increases in unemployment, or increases in other prices. A rapid adjustment of the other factors would be necessary in order for the benefits of the common currency to be realized.

Mrs. Wagenhoefer made the following statement:

The common policy issues of the CFA franc can be looked at from two different angles, one more backward looking, the other forward looking.

Looking backward, we should assess the situation, ask what mistakes were made, and what the membership as a whole can learn from the CFA franc country experience. Looking to the future, we will have to ask ourselves whether the adjustment strategies devised by the authorities with help from the Fund are consistent and theoretically sound, and whether they address at least some of the mistakes that were made in the past.

Assessing the current situation, I cannot agree with the staff's final observations that "the monetary arrangements of the CFA franc zone have produced for its members considerable gains in terms of price stability, growth, and the development of a regional solidarity." Events of 30 or 40 years ago may be of interest to historians, but, in view of the profound changes the world economy has undergone in the last two decades, they are not really relevant for today's policy decisions. If we concentrate therefore on the last ten years, the picture is very grim, indeed. As the staff has rightly noted in the document, "the CFA franc countries are in the lowest range of social indicators...and their social indicators have deteriorated for several years." The staff rightly states that the CFA franc countries have shown an "exceptionally poor economic performance." We share this assessment, which comes as no surprise. We do not, however, share the staff's distribution of blame, which puts far too much emphasis on external developments, which could not be helped, or countered by the authorities. As I do not want to overextend my colleagues' patience, I will only comment on a few select issues.

The staff more or less neglects the period before 1985, concentrating on the decline of the terms of trade since 1985, especially because of the decline of the dollar against all major currencies, including the French franc, since that year. What the staff fails to mention is that the terms of trade improved dramatically during the late 1970s and the first half of the 1980s when the dollar rose sharply. During those years of high export earnings and loose monetary policy--the French inflation rate averaged more than 11 percent per year from 1980 to 1984--the countries of the CFA franc zone did not manage to substantially improve their fiscal balances. Unfortunately, pre-1985 data are not included in this staff document, but had to be looked up in the staff paper of 1990. The decline of the dollar from 1985 onwards was a normalization that should have been expected after the excessive appreciation until then. Unfortunately for the authorities, the sliding French franc anchor finally found stable ground in 1985--guided by the firm hand of our Managing Director--and thereby increased adjustment pressures. Through "critical weaknesses in the area of expenditure policy" (page 7), especially through wage pressures in the public sector and the state-owned monopolies in the non-traded-goods sector, mounting fiscal deficits were met through heavy recourse to "foreign borrowing and exceptional grants and through large accumulations of domestic and external payments arrears" (page 7). This in turn led to the vicious circle of exceptionally poor economic performance the staff has vividly described.

There are three important lessons that can be learned from this experience. First, a common currency area with negligible interregional trade--as low as 4 percent in total exports and 7 percent of total imports for the CAMA--leaves its members very vulnerable to exogenous shocks, especially if the anchor currency experiences large exchange rate shifts against the currency in which most exports are denominated. The remedy for this would be to increase interregional trade and factor mobility to at least approach the necessary economic conditions that constitute a successful currency area.

Second, tight monetary conditions and low inflation on their own do not guarantee successful economic development, as long as the two other pillars of adjustment, namely fiscal policy and structural policies, are lacking in strength. Many of the CFA franc countries demonstrate vividly how the combination of low inflation and severe structural rigidities--especially of wages--can lead to a buildup of extreme pressure and severe economic imbalances, which require draconian measures to correct. This is an especially useful lesson for all countries in transition, which are flirting with the idea of using an exchange rate peg as a nominal anchor. Halfhearted fiscal and structural policies combined with a strong nominal anchor will only lead to more painful adjustment later on.

Third, severe fiscal imbalances, especially if prolonged, can undermine even a highly credible nominal anchor that has held for more than forty years. This is one of the reasons why the European Union has set tight deficit targets as a precondition for reaching monetary union.

One highly interesting feature of the CFA franc monetary arrangements on which one could comment extensively is the "lifeboat solidarity"--sink or swim with the group--that forces members with vastly different economic fundamentals into the straightjacket of identical monetary measures. I will constrain myself to just one comment on these issues. We find it highly regrettable that the staff seems to recommend that those countries with relatively less external adjustment needs before the devaluation should adapt to this measure through higher inflation or higher wages. This is definitely the wrong policy prescription, and casts another shadow over the effectiveness of the Fund's surveillance activities over these countries.

Turning to the forward-looking part of my comments, I would like to concentrate on just one item, namely public deficits. We have just heard from the staff that it is really in this field that progress is unfortunately lacking this year. We have aired our concerns over the overly optimistic scenarios concerning domestic savings performance in many of the program discussions we have had in this Board since January of this year. The fiscal goals, as summed up in this staff document, are hardly able to dissipate our concerns. I will highlight only two specific issues, namely the concentration on so-called primary balances, and the so-called budgetary convergence indicators.

We have often warned against using the so-called primary balances as a measure of fiscal discipline. Excluding interest payments from deficit targets amounts to playing Ponzi, that is, paying interest on the already accumulated public debt by simply issuing new bonds. As we know, as soon as real interest rates are higher than real growth, this strategy leads to "exploding" deficits. This is especially the case if, as in the CFA franc countries, the already accumulated level of debt is very high. For the CFA franc countries as a group, the weighed average ratio of external debt to GDP has risen from 59 percent in 1986 to 99 percent in 1993. As the staff rightly notes, in this institutional setting, the distinction between domestic and foreign debt is less important. We, therefore, have to add considerable domestic debt to the already heavy burden of external debt. The severity of the debt problem is grossly understated by looking at the primary balances.

The idea of budgetary convergence indicators sounds fascinating at first sight. However, considering the rigidity of wages in the past, and the absence of major structural reforms, it is unclear how the wage bill is going to be constrained to 50 percent of fiscal revenue, if the revenue goals are not met. Even worse, if in some years the revenue performance is good, this will undoubtedly lead to upward wage pressures until the 50 percent margin is fully utilized, which in turn locks in high wages if revenues decline once more, for instance, through a deterioration of terms of trade or cyclical movements. This target will, in our view, reach the opposite goal of what is intended--racheting up real wages during times of revenue abundance, without supplying the tools to reduce wages in leaner times.

It is hard to stop once one has started looking at the problems connected to the CFA franc countries. The staff has clearly spelled out downside risks, which we feel are very real. As other colleagues will wish to comment, I shall stop at this point.

My final remark concerns the complete absence of possible alternative scenarios, which would circumvent many of the severe economic problems I have hinted at. The staff does once refer to the alternative of "13 separate national currencies." This is, however, not the most probable outcome of a demise of the CFA franc currency area. Much more probable would be that several countries would continue to peg to the French franc, others might adopt the dollar, and some might even be able to supply their own stable currency. For obvious reasons I shall not go into greater detail.

Mr. Sirat agreed with Mrs. Wagenhoefer that monetary arrangements should be assessed from a long-term, rather than a short-term perspective. From the perspective of the previous 10 to 15 years, there was a strong justification for the CFA franc zone. Mrs. Wagenhoefer's remarks would also make a convincing argument--with which he would agree--in favor of a more stable international monetary system under which variations in exchange rates between the U.S. dollar and other currencies would be limited. Vulnerability to external shocks was a general problem in Africa, and had not been unique to the CFA franc zone. The CFA arrangement gave greater credibility to the policies of member countries, and had helped them address external shocks.

In emphasizing the strong need for concessions on the existing debt of the CFA franc countries and all other poor countries in general, Mrs. Wagenhoefer was right, Mr. Sirat continued. In that respect, it had been heartening to note creditors' support--including that of Germany--for generous concessional restructuring for CFA franc countries within the framework of the Paris Club. It appeared that Mrs. Wagenhoefer had been disappointed about the lack of growth and adjustment in Africa. The challenge now was to foster growth and stability in the CFA franc zone, of which a key element was the building up of sufficient external reserves in order to deal with external shocks. It was for that reason that he had supported a general SDR allocation.

Mrs. Cheong made the following statement:

The decision early this year by the CFA franc zone countries to adopt a more comprehensive adjustment strategy that incorporates a substantial realignment of the parity of the common currency should be commended. The statements by previous speakers have already addressed the theoretical soundness of the policies. Therefore, I shall confine my remarks to some practical issues, as several of the Southeast Asian countries have also undertaken similar massive adjustment measures, and our experience had taught us some useful lessons.

Devaluation is a brave step to take, especially of the magnitude implemented by the CFA franc countries. But as we know, its impact can be limited, especially when a country's exports are mainly primary commodities, and it remains extremely vulnerable to external shocks. Our experience has shown that the adjustment at the macro level can ensure successful long-term results, if accompanied by complementary micro policies for the external sector. In the CFA franc countries, export diversification, initially in resource-based industries, could further enhance the trade reform measures already being undertaken. This is timely, as the tradable sector is already recovering in 1994, as highlighted by the staff. Here, in view of the low savings/GDP ratio, specific measures could be designed to attract direct foreign investment in these countries. As noted in Mr. Clark's statement, capital has begun to flow to these countries, and it would be timely to work out an attractive investment package.

The stabilization program will not lead to sustainable growth without a strong commitment to fiscal reforms. It is disturbing to note that in trying to curb expenditure, the main area of spending cuts has largely been in development expenditure, including education. More disturbing, in some CFA franc countries, public sector wages continue to increase. I share Mr. Shaalan's emphasis on the need to reduce current expenditure, especially public sector wages, with a more moderate reduction in development expenditure. The program to downsize the public sector by 10 percent a year is admirable, but this is often difficult to implement until the private sector has expanded sufficiently to absorb the excess public sector personnel. In the initial stages of the reform exercise, we have found that cuts in civil service salaries are easier to implement as it is more equitable. In one of the Southeast Asian countries, there was a 10 percent cut in wages of the public sector, which was immediately followed by a consolidation and reduction of wages in the private sector; the public sector did not have an increase in nominal wages for the next ten years. In addition, it has been the experience of the East Asian economies that investment in education is one of the key foundations for promoting long-term growth. Cuts in development expenditure should not, therefore, affect such expenditure. Rather, it is development expenditure by public sector enterprises that should be contained, especially for projects with large import content.

Our experience has also shown that authorities must be willing to change the policy mix when it does not work, that is, a willingness to admit mistakes quickly and change course in midstream.

The scope of the structural adjustment that each country had agreed to undertake is wide-ranging and ambitious. Successful implementation would require total commitment and considerable time. The political will to stay on the path of reform is crucial, particularly in the immediate transitional period, when the social and political costs of adjustment would be very high. As this present adjustment effort has so far been blessed with the generous resources and support of a number of bilateral and multilateral agencies, including that of the Fund, it should be enough incentive to stay on this path. It may well be extremely difficult for the CFA franc countries to attract such goodwill again, if they ever stop short in this present adjustment effort or if the resources granted to them are used inefficiently.

Finally, I would agree with Mr. Koissy's statement that movement toward full convertibility of the CFA franc should await strengthening of the balance of payments position, and that current adjustment measures result in a more stable economic environment. However, it is notable that convertibility would be a major factor in attracting foreign investments. Perhaps there could be a mix of payments liberalization to attract foreign investment that still gives the CFA franc countries sufficient flexibility to prevent destabilizing capital flows.

In conclusion, I would like to wish the CFA franc countries every success in their adjustment efforts.

Mr. Keller made the following statement:

The staff has produced an interesting study, which gives valuable insight into its considerations of the design of Fund-supported programs, following the devaluation of the CFA franc ten months ago. Although it may still be rather early to fully evaluate the effects of this decisive step and subsequent adjustment measures, it would have been useful to have a more comprehensive analysis than the staff has given of the preliminary results of these policies, both as part of the Fund's intensified regional surveillance, and considering the Fund's important commitment in the zone. In addition, it might have been interesting to also get a more thorough assessment of the economic rationale for supporting the existing institutional arrangements of the CFA franc zone. We will articulate our remarks around these broad issues.

The Board has already reviewed a number of the more successful programs. In these countries, progress is encouraging on a number of fronts. We thank the staff for having summarily related the more successful, as well as the more worrisome, developments, so that I do not need to refer to the positive developments relating to wage restraint--in the public and private sectors--in order to keep inflation under control; to the pickup in commodity prices, which has created a favorable environment in exporting countries; to debt and debt-service relief; and even to capital inflows. In turn, more worrisome developments include overliquid banks, a delayed pickup in investment, and the sluggish resumption of private confidence in the formal economy--in particular in the financial sector. Here we would only wish to refer to the robustness of the informal private activity, which provides a living for many, and of the traditional social fabric, which functions largely as a social safety net.

There will be ample opportunity to review these developments, as well as the implementation of urgent structural measures in the context of individual countries.

However, we may have fewer occasions to review the less successful adjustment programs. Indeed, a summary overview of all 13 arrangements of the Fund with CFA franc countries suggests that roughly half of them are in serious difficulties or altogether off track. If the devaluation of the CFA franc was the right measure to take, adjustment failures in half the countries cannot be qualified as satisfactory success in adjustment. We would appreciate the staff's comments on the reasonable chance of bringing at least the less problematic programs back on track.

A second interesting finding is that the problematic programs are mostly stand-by arrangements. With one exception, stand-by arrangements were concluded with countries that were not ready for ESAF programs. Only one other stand-by arrangement was replaced by an ESAF arrangement. Although ESAF programs would certainly have been more appropriate in most of these cases, it is not clear whether these countries would have been in a better position to perform well under an ESAF program. However, a less precipitate program preparation, which would have allowed a number of countries time to get ready for a comprehensive program, might at least have improved the chances for eventually implementing it successfully, although drawings on the Fund would have been delayed. From this trade-off situation, between quick disbursement and solid program implementation, what policy conclusions does the staff draw?

A third observation is that the countries of the WAMU, on average, seem to perform quite differently from the countries of the CAMA. We will not discuss the differences in countries' adjustment needs or the many possible reasons for this development, but the emerging wedge between the two monetary unions may strain the CFA franc parity between the two unions, probably more so than differences between countries of the same union. It would be interesting to have the staff's or Mr. Koissy's views on these developments.

This brings us to the question relating to the support of the existing institutional arrangements in the CFA franc zone. We note the political determination of the countries concerned to preserve the zone because of its advantages. We assume that this will be the bottom line for their adjustment efforts.

However, the costs of a monetary union based on a fixed exchange rate regime, and the difficulties in smoothing developments between its members should not be underestimated. In such a regime, the required monetary discipline dampens economic fluctuations but, at the same time, shocks in the real economy, such as recurrent droughts and frequent terms of trade shocks, may exacerbate fluctuations. The scarcely diversified structure of production and exports of the CFA franc countries add to their vulnerability. Exogenous shocks are rarely symmetric as the intercountry correlation between shocks is less than perfect. Moreover, because intra-regional trade flows remain small, there is no transmission mechanism for a shock to spill over into the other countries of the zone. However, stagflation in half of the countries would bear costs for all. Thus, a country experiencing a shock, adverse or favorable, will see its economic activity constantly change relative to the other members of the zone, thus creating permanently changing adjustment needs. Shocks will also translate into higher budgetary and employment swings than if the country was free to resort to exchange rate policy. In order to reduce these effects somewhat, there is a need for an intensification of efforts toward greater regional economic integration, including goods, labor, and capital markets, for which the Fund could provide its assistance, in close cooperation with the Bank.

As fiscal policy is the main available instrument for adjustment, a heavy burden continues to lie on the budget, which is also most exposed politically. It is the very weakness of the financial policy that has caused in the first instance the need for the CFA franc devaluation. It is again this structural weakness, as well as the administrative ability--and in some cases a lack of political clout--to address it quickly, that is still at the root of problematic performance under the programs. There, governance, in particular the motivation of the civil servants and the citizens, is a basic problem.

In conclusion, if divergent and differentiating developments are not tackled structurally, it might indeed prove difficult, in the longer term, to preserve the zone as it exists. Formal convergence criteria are the way to harmonize developments, but observing them in all countries is the critical determinant of success in all monetary unions.

Mr. Shields said that the paper explained the background behind recent events, and in particular the arguments for and against currency union. He would also endorse the way that the paper had looked at the CFA franc region as a whole. It might be feasible to consider such a study in a wider perspective, by including other countries in the geographical region. In that manner, it would be possible to take note of the influence of other countries on the zone, and the zone on other countries in the region. In the currency union itself, the question of the exchange rates of neighboring countries would be important.

Some of the regional issues might be covered in individual country studies, Mr. Shields continued. However, a regional perspective was needed to analyze commodity trade and external shocks. There might be ways in which the region as a whole could undergo adjustment--not necessarily focusing on adjustment at the individual country level.

He would support the preparation of a follow-up paper analyzing the devaluation experience 18 months after the devaluation, Mr. Shields commented. It would then be possible to see how the devaluation had affected adjustment programs. Such a study should be focused on the region as a whole.

The staff paper highlighted the critical issues of the devaluation itself, the adjustment strategies that had been put in place, and the question--addressed by Mrs. Wagenhoefer--of whether the currency union had been feasible in the past, and whether it continued to be feasible under the present circumstances, Mr. Shields commented. The initial conditions of the CFA franc zone countries prior to the devaluation had been diverse. Therefore, the adjustment paths of its members could not be the same, particularly with respect to wage adjustments. It would be desirable to achieve adjustment through very low domestic inflation in countries with a relatively weak competitive position. Although low inflation would be preferable, there could be some diversity, depending on how countries carried out policies.

As Mrs. Wagenhoefer had pointed out, the CFA franc zone had not been an ideal currency area in the past, Mr. Shields observed. However, the zone had some obvious advantages in terms of external credibility and trade expansion, and therefore it could be considered a second-best approach.

The CFA franc zone had delayed essential external adjustment for a while, Mr. Shields commented. If individual economies had had more flexibility, they might have moved sooner and on different paths to achieve growth and adjustment. The rigidity of the system had been responsible for those delays.

The crucial question was the strategy to be followed in the future, Mr. Shields stated. The new reliance on structural and fiscal convergence to make an economic and monetary union work seemed promising. Although there could be concerns about the fixed exchange rate policy, if it were pursued with enough determination, it might succeed.

Perhaps the staff could explain how the fiscal targets operated, at what levels, and how they would be monitored in the region and in individual countries, Mr. Shields said. In that regard, the European experience was different; it was important to know whether a workable scheme could evolve in the CFA franc zone.

Most of the countries in the CFA franc zone were ready to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, Mr. Shields concluded. Perhaps the staff could say when those countries would do so.

Mr. Sirat said that, by design, the CFA franc zone had some elements of rigidity, which might not necessarily be bad, and the advantages of the zone should not be forgotten. The CFA zone had assured one region of Africa price, social and--therefore--political stability. The decision to devalue had been long delayed, because it had been a difficult decision for the countries and financial institutions concerned. The inflation record of the CFA franc zone could be compared favorably with that of other countries. At the recent Board discussion on conditionality (Seminar 94/9, 11/10/94), a majority of speakers had favored a nominal anchor policy as the best way to combat inflation in the medium term, although no consideration had been given to the best way to ensure sustainable long-term growth. He agreed with Mr. Shields that the next study of the CFA zone should form part of a review of a broader geographical region of Africa.

Mr. Shields said that there were two different questions: one relating to the use of the exchange rate as a nominal anchor for fighting inflation, and the other relating to a broader currency zone. He had focused attention on the latter issue to determine whether the rigidity of the pegged exchange rate was a specific factor that had delayed devaluation. West and Central Africa, not the whole of Africa, might be included in a broader study.

Mr. Al-Jasser made the following statement:

> The staff paper presents an interesting and useful background to today's discussion of the common policy issues facing the CFA franc zone countries. We have had several opportunities to discuss many of the challenges facing the zone members in the context of the discussions of the individual programs and subsequent reviews.
>
> Following these discussions, I believe that we can all agree that the devaluation was an important and necessary step to help these countries address the daunting challenges they faced. At the same time, we can also agree that the devaluation is no more than a short-run palliative whose effects will quickly dissipate unless the root causes of the problems facing these countries are immediately and credibly addressed.
>
> I appreciate the frank statement by Mr. Koissy, in particular, his view that "the CFA franc countries did not make the most out of the monetary unions in terms of the advantages

generally associated with such unions, while at the same time, they were affected by some of the drawbacks." I do not think that it is very helpful now to dwell on the raison d'être of the arrangement. Rather, the issue at this point is to ensure that the programs in place maximize the benefits while minimizing the costs of the currency arrangement.

Achieving this goal necessitates strong policy coordination. I will therefore focus my remarks on issues relating to the coordination process and the contribution of the Fund in this area:

First, as Table 3 indicates, the magnitude of the devaluation was such that it was not the optimal size for each individual country. This is to be expected, as the structural rigidities and the size of the imbalances varied across member countries. The size of devaluation, however, addressed the needs of the largest members of the zone. But this has no doubt created challenges for other members. Thus, stronger adjustment measures are required in those countries where the exchange rate may still be somewhat overvalued, but particular care must also be taken to control inflationary pressures in those countries for which the currency is now undervalued. The approach taken by the Fund in countries that might have considered a smaller devaluation offers a somewhat higher growth rate. But it is important that higher growth not delay the implementation of important structural reforms.

Second, the paper appropriately emphasizes the importance of fiscal convergence. Here, I welcome the steps taken to strengthen multilateral surveillance among zone members based on convergence criteria. Indeed, fiscal convergence among the zone members is a necessary condition for the long-term success of the currency arrangement, as well as the success of the adjustment efforts in each individual member country. The circumstances of each country differ, and the pace of fiscal consolidation that is feasible will understandably differ. Nevertheless, as Table 12 indicates, fiscal convergence may be proceeding at a pace that is slower than would be desirable. Therefore, I would appreciate some comments from the staff on the possibility of accelerating the pace of convergence.

Third, another priority should be ensuring the timely implementation of structural reforms, which are important to fiscal convergence, as well as to the long-run competitiveness of these economies. All possibilities for regionally coordinated structural reforms ought to be fully exploited.

Fourth, as the liberalization and integration of the financial markets within the zone proceed, and indirect instruments of monetary policy are introduced, the scope for policies that could influence monetary aggregates at the national level will no longer be available. This will create new operational challenges for the design and monitoring of Fund-supported programs. The implications of this development will need careful consideration. The situation is further complicated if a member of the zone does not have a Fund-supported program. I would, therefore, appreciate some further elaboration from the staff on possible alternative approaches.

Fifth, there can be no dispute that the CFA franc arrangement has bestowed upon its members a number of significant benefits, in particular in terms of credibility. It is vital that the credibility gains of the past not be undermined following the devaluation. In this regard, the restriction placed by the zone members on the repurchase of CFA franc notes outside the zone seems counterproductive. I understand that no restrictions are placed on transfers through the banking system. Nevertheless, the restriction has had an impact on border trade. I understand that the authorities view this restriction as an instrument for ensuring that all trade is conducted through legal channels. At the same time, however, the reduction and streamlining of the tariff structures, as well as the devaluation, have substantially reduced the incentives for smuggling. As it stands, the restriction seems to be of no benefit, while placing doubts on the authorities' commitment to convertibility. I would therefore urge the authorities to eliminate this restriction expeditiously. I also join Mr. Sirat and others in encouraging the zone members to accept the obligations of Article VIII.

Sixth, the behavior of the external debt of these countries on the secondary market varied considerably across these countries in the period after the devaluation. Arguably, the secondary market for the external debt of these countries is thin. Nevertheless, it can provide some useful information on market reaction to the programs in place. Here, I wonder if the staff has any information on recent developments in this area that they could share with us.

Seventh, it is clear from the paper that the relatively large size of some of the economies of the zone places a considerable burden and responsibility on the authorities of these countries. The programs in place in these larger economies are strong, but one can never exclude the possibility of adverse exogenous developments. In this regard, it is important that all programs in place include sufficient contingency measures to cope with the domestic as well as the external spillover effects that may emanate from developments in any one economy.

Finally, I share Mr. Koissy's view that it would be useful to have this paper updated as circumstances warrant. I would only add that I am aware of the staffing constraints, but am not asking for a full-fledged review. The aim should be to distill the findings of the reviews that are being done on each program, and try to see what lessons we can learn and share on these issues.

Mr. Dlamini made the following statement:

Unlike many other African countries, the CFA franc countries have benefitted from a stable currency that provided an anchor against inflation. They also experienced a higher growth rate, and had a better performance on average in the fiscal area for many years before 1985. The currency convertibility arrangement with France was an added advantage. Yet in many important respects, what one might have thought as a special case bears a close resemblance to the general African scene. This is demonstrated by the vulnerability of the individual countries to adverse exogenous shocks, in particular terms of trade losses, and specialization in competing primary products, reflecting the lack of a diversified productive base. The corollary is the low level of industrial activity, and the weak intra-union trade.

Thus, while the devaluation has been the focus of attention, the fact remains that economic reform in other areas was also much needed.

The disequilibria in the CFA franc countries that emerged in recent years were serious, and few would disagree that the situation warranted strong and immediate corrective action. There is no doubt that addressing the fiscal problem had to be one of the cornerstones of the adjustment effort. A fixed exchange rate--and this is not endemic to the arrangement in question in the CFA franc countries--requires a disciplined fiscal stance. This is more important in view of the limited degree of freedom associated with monetary policy. The programs supported by the Fund recognize this, and can be considered as being on the right track.

The problem came to a head with the protracted deterioration in the terms of trade, and the countries in the unions basically found themselves in the same boat as most others in sub-Saharan Africa. Their situation drives home, once again, the threat to economic and financial stability that the secular decline in the terms of trade poses for countries without diversified economies. This should be a major concern for the members of the currency unions, and should receive priority attention in the overall adjustment strategy, just as the need for the macroeconomic stabilization in the aftermath of the devaluation. As seems to be the usual case, progress in the direction of economic recovery is slower than envisaged, and I would think that progress toward diversification is even slower. I would emphasize that the long-term prospects for sustained growth and stability in the unions will depend critically on appropriately designed policies, programs, and projects that directly strengthen the micro foundation of the member countries.

The speed of fiscal consolidation has to be watched carefully. In fact, the assumption regarding the contribution of the government sector to domestic savings seems to be ambitious. The smooth convergence of fiscal deficits in the unions may not be easy to achieve. Such convergence, among other things, will be affected by the growth performance in individual countries. Tensions will arise if there is an uneven rebound in economic recovery, or if the growth momentum cannot be sustained in all countries. The experience of the European Union suggests that the road to convergence can be a rocky one. It is interesting in this regard that in the European case monetary union is expected to come after convergence criteria have been met; in the case of the CFA franc countries, monetary union preceded convergence. The question is, does this make the road toward stability more difficult?

Breaking the circle of poor economic performance in the member countries requires comprehensive reform. The lesson that has become evident is that the absence of inflation does not by itself create a virtuous circle; nor does it necessarily reflect a sound economy. Despite low inflation, the average growth rate during the period 1986-93 was virtually zero; the investment/GDP ratio declined; domestic savings/GDP ratio was down; the soundness of a number of financial institutions had come under question; and capital flight was becoming a growing problem. All of these issues must be addressed. Some have implications for the nature of fiscal adjustment. For instance, the situation where the brunt of fiscal adjustment fell on public investment should not be repeated. Also, donor support should focus more on such things as economic infrastructure, institution building, and economic restructuring, rather than on general budgetary support, which in the past has helped to sustain wages that were out of line with productivity. It should be noted that institutional development is crucial, in view of the importance of various monitoring arrangements that must be put in place and in light of the steps already taken to further integrate the economies of the unions.

It is important that the donor community support safety nets and social policies in these countries. Their standard of living has fallen sharply in recent years, and it is reported that they are in the lowest quintile of the human development index of the UNDP. A number of the programs did not have well-targeted safety nets at the time of inception. Political support for the adjustment effort which must be sustained over the longer term depends on the alleviation of the burden of adjustment on the most vulnerable groups.

Mr. Bergo made the following statement:

I welcome this discussion, and the insightful paper by the staff on the background for the CFA franc devaluation in January and the institutional framework in the area, although the original purpose of the paper may have been overtaken by events, as Mr. Clark observed. A paper like this would have been an excellent basis for an up-front discussion of the Fund's involvement in the reform in the CFA franc countries, but it is also easy to understand why that was not possible. Even if the Board at that time had to review programs on a country-by-country basis, the present paper demonstrates that they were part of an area-wide strategy. As Mr. Koissy and others have observed, a regular updating of the paper, as program experience accumulated, would be helpful in our regional surveillance exercise. Such surveillance should also include neighboring countries, as suggested by Mr. Shields.

The strategy adopted also appears to have worked reasonably well. Financial stabilization has largely been achieved. The progress in restoring growth and increasing employment has been slower than envisaged, but a turning point may have been reached. Perhaps the staff could comment on the extent to which the improved outlook is caused by the increase in important commodity prices. Nevertheless, rather disappointing growth is not uncommon in program countries, and this is a matter that the Board has intensively discussed recently. Even if growth may be restored in the CFA franc countries, this is all the more reason to continue to give weight to our efforts to improve program design.

I appreciated very much Mr. Koissy's well-reasoned statement, and found myself very much in agreement with Mr. Clark's observations, both with regard to the focus of the report and the currency union. In the light of the statements made by earlier speakers, I wish to add a few remarks on this latter point.

Many speakers have pointed out that, at the outset, the CFA franc countries do not meet the criteria for an optimal currency area, and Mr. Koissy highlighted the long agenda to be addressed at the union level to better match economic realities to the monetary framework. Mr. Daco contrasted the developments in the CFA franc area with the integration in Europe, and I agree with them on the complementarity of economic and monetary integration.

I have great understanding for the motives behind the strong wish to continue the union, and will not argue that it was a mistake to do so. I think the jury is still out on this. But it must have been a challenge, both for the authorities and the staff, to tailor appropriate country programs to the uniform devaluation undertaken--except for the Comoros--in countries where, according to Mr. Koissy, the initial overvaluation ranged between 10 and 52 percent. Like Mr. Sirat, I would maintain that wage restraint should be continued area-wide, but the differences in the initial situation of the countries must nevertheless be expected to turn up somewhere, it is to be hoped in more rapid growth and higher employment in some countries.

Perhaps the staff would like to explain how the initial disparities were taken into account in the programs, and how it assesses the progress so far with respect to economic convergence.

The Managing Director then assumed the chair.

Mr. Huisman made the following statement:

I initially shared Mr. Clark's comments about the focus and content of the paper, in particular that it appeared somewhat academic to review the original program design again without looking at recent performances. But after listening to Mrs. Wagenhoefer, it became clear that such backward looking does not need to be only academic. I share some of her views, but perhaps more in the way formulated by Mr. Shields. I also share the remark by Mr. Bergo that an earlier ex ante discussion based on a paper like this could have been useful. Yet, I want to be somewhat more forward looking, and address the consequences of recent experiences with CFA programs for Fund monitoring and design. I will also address some issues related to further integration toward a full monetary and economic union.

The recent Board reviews of the most successful CFA programs have made clear that the first results are promising indeed: stabilization has been moderate to very successful, and supply responses of tradables faster than many initially expected. At the same time, structural reforms have moved far more slowly. If such a pattern continues, there is a great risk that the opportunity for devaluation and stabilization efforts will be lost, that the vulnerability of the CFA economies to exogenous shocks will not be sufficiently reduced, and that we shall see a return to a cycle of stop-go Fund programs. This stresses the need for the Fund and the countries concerned to focus on two crucial cornerstones of adjustment programs.

First, whenever stabilization is more successful than expected, structural adjustments can, and should, be accelerated to take advantage of the momentum. As a minimum, at any time the temptation to slow down structural adjustment should be avoided in the case of better than expected stabilization. An important question for the staff is whether inadequate administrative capacities in the poorest CFA countries--Mali, Burkina Faso--could be an impediment to a desirable acceleration of structural reforms, and if so, what could be done to overcome this problem? Perhaps the World Bank could say something about this, and in particular its technical assistance in that regard.

Second, in view of the fact that the exposure to price shocks is likely to remain high in the years to come, it is essential to carefully monitor both the sustainability of the peg of the CFA franc to the French franc, and the adequacy of sectoral measures aimed at diversifying the CFA economies and reducing the production bias toward primary goods. With regard to the former, it would be interesting to hear from the staff whether there are any mechanisms in place for assessing the need for adjustments to bring exchange rates in line with fundamentals? In this light I support suggestions by Mr. Clark and others for continued surveillance of the zone as a whole.

As regards issues related to the path toward full monetary and economic union, a general remark concerning the content of the union may be useful. As others have noted, contrary to other regional unions such as the European Union, the potential for regional trade and economies of scale seems much more limited; there is much less prospect for a common market--a fundamental element in the gradual development of other unions. Although I understand the wish for further integration in the CFA zone, I would caution that in terms of growth, expectations should not be too high.

Like Mr. Shields, I am interested in learning more about the reasoning behind the choice of the criteria for fiscal harmonization. I support the use of criteria, especially as a means of avoiding situations in which excessive budget deficits would put too large a burden on the common monetary policy. But, whereas in the European context criteria are broadly formulated in terms of government deficits and government debt ratios, in the CFA zone rather detailed criteria are used for specific parts of government outlays. Could the staff explain whether these criteria play any role in program conditionality?

According to Mr. Clark, the overriding priority of economic planning in the context of further integration is the convergence of both macroeconomic and structural fundamentals. I find the latter somewhat difficult to understand, because it could imply that given the fixed exchange rate no instruments are left for countries to react to country-specific real shocks.

Finally, an issue in the monetary sphere that this chair has raised during the discussion on Côte d'Ivoire concerns the fact that some countries in the CFA zone no longer maintain any restrictions on the making of payments and transfers for current international transactions, and thus are in principle in a position to accept the obligations of Article VIII. Nevertheless, they prefer that such steps be taken in conjunction with their partners in the monetary union. Although I can understand the wish for a joint move, I have two remarks. First, it is difficult to understand why, in a monetary union with one monetary policy, differences exist with regard to such restrictions. Second, I would very much hope that movement to Article VIII status for some members of the CFA zone is not blocked by the slowest adjuster of the club, a risk that could appear, if, as Mr. Koissy has said, one waits until the balance of payments positions are sufficiently strong for every country in the zone. Perhaps the staff can comment on this, taking into account the apparent different developments in this field within the two CFA franc monetary unions.

Mr. Lanciotti made the following statement:

Let me start by thanking the staff for this thorough and comprehensive paper. The analysis of the common issues of the CFA franc countries allows a better understanding of the implications of policies undertaken than if we were to study those same measures in each country separately, where the specificities of each single case might distract us from the relevant factors.

Following a period of high growth and low inflation--as compared with the average for sub-saharan Africa--the CFA franc zone countries started, in 1985, to experience a deterioration of the terms of trade and a nominal effective appreciation of the CFA franc. Even though the governments' response was an internal adjustment strategy aimed at decreasing the fiscal deficit by reducing domestic costs and restructuring the public sector, there were limits to what could be achieved with internal adjustment. Efforts to bring wages and domestic prices in line with world prices proved unsuccessful, and the loss of competitiveness caused a reduction of exports and the slowdown of economic activity, with severe consequences for the budget deficit and accumulation of arrears. Reflecting the economic stagnation, enterprises' financial situation deteriorated, and the rise in nonperforming loans put the liquidity and solvency of the banking system at risk.

The difficult economic situation experienced by the CFA franc zone from 1985 to 1993 led to the conclusion that the overvaluation of the currency, resulting from the peg to the French franc, was no longer sustainable, and that a devaluation was necessary in order to restore export competitiveness and economic growth.

One question immediately arises from this situation. As the poor economic performance can be to a great extent attributed to the impossibility of using the exchange rate as an instrument of external adjustment, are there any advantages that can justify the current monetary arrangement, characterized by pegging the currencies of the CFA franc countries to the French franc? The fact that the devaluation--which, by using the exchange rate as an instrument for adjustment, can also be seen as a temporary interruption of this arrangement--is expected to restore conditions for growth and financial stability might lead us to give a negative answer to this question. However, before I continue to elaborate on this issue, I would like to say that, in my opinion, the answer is in the affirmative.

When discussing whether or not a zone should adopt a single currency--or different currencies with fixed parity--it is common to analyze whether it can be considered an "optimum currency area." Several papers have been written on this issue--see for example; Boughton, James M., "The CFA Franc Zone: Currency Union and Monetary Standard," IMF Working Paper WP/91/133, December 1991 --concluding that the CFA franc zone should not be considered as such. The evidence presented in the staff report--little intraregional trade; different productive bases; limited factor mobility, and price flexibility; and different responses to external shocks such as changes in the terms of trade--leads to the same conclusion.

However, when we consider the role of the French franc in the monetary arrangement, the criteria of the "optimum currency area" are no longer as important. The fact that the pegging of their currencies to the French franc provided CFA countries with price stability and financial credibility and that, until 1985, this was achieved without undermining economic growth would probably be enough to justify the present monetary arrangement. In addition, the pooling of reserves in the operational accounts at the French Treasury and the overdraft facility provide a convertibility to the currency that could not be obtained otherwise. Moreover, the argument of limited interregional trade no longer applies if we consider France as part of the region. Finally, as most of the trade of the CFA countries is with Western Europe, and as the French franc is relatively stable with respect to other European Monetary System currencies, the current monetary arrangement with the French franc as an anchor for the exchange rate, substantially reduces the exchange risk among the main trading partners of the CFA franc countries.

Two issues are of particular importance concerning the devaluation: its level and the adjustment strategy to be pursued thereafter. As the real effective appreciation was different among countries, it was not possible to establish a devaluation rate that would exactly offset the loss in competitiveness in every country, unless different rates were implemented among countries. Needless to say, this option was not suitable as it had implied the breakdown of the exchange rate arrangement. Moreover, the magnitude of the devaluation had to be large enough to avoid frequent changes in the exchange rate parity that would undermine the credibility of the policy commitment. Therefore, I agree with the decision to devalue taking into account the countries that had the most overvalued exchange rate as a benchmark, namely, Côte d'Ivoire, Congo, and Cameroon, which meant a rate of 50 percent. Undertaking a smaller devaluation tailored to the needs of the countries, with a relatively less overvalued exchange rate, and implementing tighter financial policies in the other countries, was infeasible, because a tighter fiscal policy in those countries would have raised doubts about the credibility of the policy itself.

When discussing the policy implications of the devaluation, one factor deserves special attention: inflationary pressures following the devaluation should not be allowed to compromise the competitiveness obtained so far. As the fixed exchange rate vis-à-vis the French franc leaves limited room for the zone's interest rate to be substantially different from that in France, monetary policy has to rely on controlling the net domestic assets of the common central bank as its main instrument. The existing ceiling for government borrowing from the central bank--equivalent to 20 percent of government revenues in the previous year--is likely to prevent the inflation rates at the country level from deviating substantially from the targets, provided that tight income policies are followed. Recent data in this area have shown that, after an initial jump, the price level has stabilized in most countries.

The above-mentioned ceiling for government borrowing, which prevents the expansion of monetary aggregates, introduces, however, a different constraint on the budget: a fiscal expansion beyond that limit would have adverse consequences on government debt and, in particular, its external component. I welcome the fact that, according to the staff report, almost every country has decided to pursue adjustment programs aimed at containing fiscal deficits and improving external viability. However, there are risks concerning the achievement of the program objectives for the budget deficit. Even though the improvement of the economic situation is likely to be positively reflected in the budget, the immediate effect of the devaluation on government revenues is subject to some uncertainty.

Although the devaluation might cause a contraction of imports, their price increase in national currency makes it difficult to predict the changes in the amount of import tax collections. The reduction of import tariffs, which would have a positive impact on the import level but a negative effect on tax revenue, leads to the same uncertainty. The net outcome will depend on the degree of liberalization and on several factors affecting the elasticity of demand and import substitution. In addition, in order to eliminate barriers to trade and increase economic integration, CFA franc countries have decided to harmonize taxes within the area. This measure will have different impacts among countries and will, for some of them, constitute an extra burden on the budget. All these factors that could contribute to additional constraints on the budget might cause, particularly in those countries where the exchange rate was more overvalued, the delay of public investment in several important areas needed to provide the necessary infrastructure for development and growth. There is already evidence of this happening in some countries, and I completely agree with Mr. Shaalan that, in order to achieve a sustained external viability, fiscal policy must be complemented with the structural reforms.

There are several reasons to continue the process toward regional economic integration. Because the monetary arrangement eliminates the exchange risk among the countries in the zone, it is important that other barriers do not prevent the achievement of the gains from trade. The decision to reduce tariffs, eliminate other restrictions, harmonize taxes, and introduce a common external tariff are most welcome. In addition, in view of the loss of monetary autonomy, policy coordination among zone countries is required in order to prevent substantial inflation differentials relative to France leading to losses of competitiveness, with serious effects on economic activity.

In almost every country of the CFA franc zone, reforms are presently being made under a Fund adjustment program. Even though I generally agree with the policies being followed, substantial efforts are still needed to achieve an economic framework compatible with the development of private sector and foreign investment. The devaluation of the CFA franc provides these African countries with the opportunity to pursue the structural adjustment needed in order to restore conditions for growth, while preserving financial stability. It is, therefore, important to avoid shortcomings in the fiscal area preventing the necessary adjustment.

Mr. Ishida made the following statement:

At the outset, I would like to express my appreciation to the staff for the comprehensive paper that they prepared for today's seminar. I am in broad agreement with their views on the outline of the programs followed by a number of countries after the devaluation of the CFA franc last January. As we have discussed since last March the details of the fiscal, monetary, and structural policies of each country's program, I will focus on the present monetary arrangements of the CFA franc countries.

Our consideration of this issue should begin with an adequate awareness of the implications of the serious economic deterioration over the past seven years. The staff had repeatedly pointed out that the deterioration of the economy could not be adequately corrected by means of internal adjustment policies alone, and that a devaluation of the CFA franc was required to restore the economy. Although there was no strong objection around the table to such a measure, two questions remain. The first concerns why the devaluation could not have been made sooner, and the second concerns whether there is an institutional problem with the monetary arrangement itself.

A number of Directors have expressed their views on the second question. One view emphasized the strong effect of the current arrangement on keeping inflation low, and I believe there is general agreement on this effect. However, I would like to consider some possible cases.

First, the staff stated that the main factors behind the deterioration of the economy were the large decline in the terms of trade, and the nominal appreciation of the CFA franc. They also pointed out that the countries of the CFA franc zone are highly vulnerable to adverse external shocks, in particular to declines in the terms of trade, because of the relatively nondiversified structure of production. Terms of trade shock is one of the major risks.

I therefore fully agree with the staff's emphasis that it is imperative to accelerate structural reform in order to make production more efficient and diversified. Nonetheless, as the pace of structural reform such as diversification of production is generally quite slow, it would be difficult to deny the possibility that the terms of trade might become worse before sufficient progress in diversification could be achieved. In view of the rigid monetary management, I question how such external shocks could be absorbed in the short run.

Second, as the staff stated, the larger coastal economies of the CFA franc zones, such as Cameroon and Côte d'Ivoire, are locomotives of growth and prosperity in the zone. Economic power varies considerably among the countries of the zone; for example, Cameroon's per capita GNP is more than four times that of Chad, and Côte d'Ivoire's per capita GNP is more than three times that of Niger. If labor and capital were mobilized freely in the zone, and as a result income levels among the countries were equalized substantially, the present monetary arrangement would be the best, without question. Nonetheless, in order to mobilize labor and capital freely, it is necessary to abolish a number of structural obstacles, which would require considerable time. I wonder whether it might not be worthwhile to look at the possible advantages of different monetary systems.

Third, although I fully agree with the staff's view that there is a risk of wage increase, and that wage containment is crucial, self-restraint on the part of trade unions cannot be the ultimate solution to restraining wages. Rather, the ultimate success of wage control depends critically on how effectively market forces work, and such forces are created only upon the completion of privatization, the abolition of a number of administrative regulations, and the breaking down of monopolies. Needless to say, considerable time is usually required to complete such structural reforms, and it could be argued that, in the medium term, a country might fail to restrain wage increases, and as a result rapidly lose its international competitiveness under the present exchange rate system.

In conclusion, I have no difficulties with the general view that a rigid monetary arrangement like that of the CFA franc zone has the significant advantage of keeping inflation sustainably low. However, it would be useful for the staff to analyze the demerits and costs of maintaining the current arrangement, when a number of structural rigidities remain and fundamental reform is required, and to compare the costs and benefits of the present system, and possible alternative systems.

Lastly, I fully share Mrs. Wagenhoefer's view that it is not reasonable to overemphasize just the good memories of pre-1985.

Mr. Wei made the following statement:

At the outset, let me join the previous speakers in welcoming the discussion of the policy issues in relation to the CFA franc countries, in the wake of the franc's 50 percent devaluation last January for all the member countries in the WAMU and CAMA, except for Comoros, for which the devaluation was 33 percent. I would also like to commend the staff for their comprehensive and insightful analysis of the issues, as well as for giving us thorough historical information which is most useful. Generally, I share the staff's views as presented in the paper, and thus I will limit my remarks to a few points.

Like some other Directors, I fully share the staff's conclusion on the rationale for preserving the existing institutional arrangements for the CFA franc. "The fixed peg to the French franc and the financial discipline derived from the monetary arrangements have produced a long history of low inflation in the CFA franc countries with, until recent years, orderly domestic and external financial conditions." It is our view that the alignment of the parity of the CFA franc against the French franc has contributed to the economic stability in that region over the past several decades, in view of the fact that on average the economies of the CFA franc countries have performed better than most of the sub-Saharan countries. Of course, every exchange rate regime has its own advantages and disadvantages. We believe that the disadvantages, or shortcomings, for the two monetary unions could be overcome. Therefore, the regime which is chosen by the authorities could be further improved, and continue to play a promoting role in the economic developments for those countries. The authorities' strong commitment to preserve the two monetary unions, and their political resolve to strengthen monetary cooperation and move on to regional economic integration is indeed welcome. The Fund should provide more policy advice, as well as technical assistance, to contribute to this process.

In view of the limited room for an independent monetary policy owing to the nature of the monetary unions, it cannot be overemphasized that fiscal policy will play a central role in achieving the macroeconomic objectives. In this respect, I share Mr. Koissy's concerns on the risks of revenue shortfalls, which the authorities will be facing if the recovery of economic activity and imports does not materialize quickly. In fact, weak or even declining economic growth since the mid-1980s has been a serious problem for many of the CFA franc countries. On the one hand, more emphasis should be given to revenue-increasing measures, while on the other, the international community must increase its concessional financial assistance to these countries as well as the other African countries with heavy debt burdens. Otherwise, the authorities' adjustment efforts will be impossible to sustain. I am worried that the external debt, as a percent of GDP, for these countries will be projected to increase from about 85 percent in 1990-93 to 127 percent in 1994-96. Could the staff comment on this? We note that the World Bank has provided about $1.2 billion quick-disbursing support for CFA franc countries, which is indeed welcome. I am wondering how much of the financial assistance from other sources has been channeled to these countries by the combined support of the Fund and the Bank.

Briefly, on the development strategy for these countries, an export-oriented development strategy is becoming more and more popular. However, the reality is that a substantial part of the imports of these countries is, on many occasions, not for industrial products but consumption goods, which, as high technology is not involved, could be produced by these countries if more attention were given to their production. If the import-substitution development strategy is to be encouraged more appropriately, many resources could be used for productive purposes. Also, intra-zone trade, which is currently very small, would be expanded.

Finally, I am pleased to learn from the staff's opening statement that the overall program performance of CFA franc countries in the aftermath of the devaluation is encouraging. However, much remains to be done. Program monitoring should be strengthened. I share the view that the study of CFA franc countries policy issues could be updated in the context of our regional surveillance exercise.

Mr. Newman, introducing his statement, said that, although the CFA franc countries could choose any monetary arrangement allowed under the Articles of the Fund, the authorities should pursue policies that were consistent with the Fund's overall stabilization and adjustment approach. As Mrs. Wagenhoefer had pointed out, the constraints facing the CFA franc zone countries were severe, in view of the fact that the countries were attempting to pursue both a fixed exchange rate and a monetary union. Mr. Sirat had considered an exchange rate anchor as a desirable way to prevent bad policies; others had believed that an exchange rate anchor undermined the freedom to respond to external shocks. As many countries would be susceptible to external shocks, owing, inter alia, to bad policies, it was incumbent on the Fund to develop programs to handle those problems.

Mr. Newman made the following statement:

The long-delayed devaluation in January 1994 provided an opportunity for the CFA franc countries to reverse the consequences of the "lost decade" of 1985-94. The Fund is heavily involved in this process, but must avoid the mistakes of the past as it develops, negotiates, and implements programs. In particular, programs will need to take into account the rather narrow range of adjustment tools available to CFA franc countries owing to the monetary union. This is important in order to deal with the shocks that will inevitably occur in the future at less cost to growth and development than has occurred in the past.

As the staff's review of the experience of the region over the past decade makes clear, the CFA franc arrangements impose rigorous economic policy constraints on the authorities. With the exchange rate fixed, adjustment to external shocks must be achieved solely through changes in domestic incomes, prices, and wages. Moreover, the scope for a national monetary policy is constrained by the requirements of the anchor with the franc, as well as the needs of the union, thus precluding changes in nominal price levels and interest rates for adjustment purposes. Finally, fiscal policy is largely subordinated to the requirements of monetary policy.

These realities in large measure dictate the fundamental content of Fund-supported economic adjustment programs. The staff paper describes clearly the kinds of policies that the CFA franc countries must pursue in order to sustain the monetary arrangements they have chosen to adopt. The remedies outlined in the paper and prescribed in the programs are generally sensible: repair the fiscal balance sheet; shift the composition of spending away from the wage bill and transfers to poorly run state enterprises to human and infrastructural capital; embark on a number of structural reforms to free up labor and capital and engender a supply response. These prescriptions can be bitter medicine, which is not always taken. The expedience of second-best measures becomes attractive. However, constrained policy options make second-best policies more expensive.

What is needed is an assessment of performance and lessons learned. Such an assessment would evaluate progress with an eye towards the broad macroeconomic goals of enhancing savings and investment and establishing sustainable growth. The following issues would appear appropriate for such an assessment.

On the issue of government expenditures, I would strongly support Mr. Shaalan's emphasis on the need to constrain current consumption spending, especially the public sector wage bill and subsidies. I recognize that the staff appreciates the importance of curbing the wage bill and the associated need for civil service reforms. However, I get the impression that we easily acquiesce to excessive expenditures in this area, in light of the political pressures facing the authorities, provided alternative actions are taken to achieve the deficit-reduction objectives of the program. As often happens, the cuts are made in public investments and essential services, or social welfare, where the political resistance may be more diffuse. We need to take a much tougher line, in cooperation with the World Bank and donors, on the need for effective public sector downsizing in order to enhance the scope for a decline in the wage bill.

On the revenue side, the devaluation and favorable terms of trade changes have resulted in windfall profits in the tradable goods sector, particularly for cash crops that the authorities, with Fund support, have sought to tap through export taxes and other measures. The staff recognizes that such policies are second-best solutions that hamper allocative efficiency, but view them as necessary evils in order to smooth out incomes among the trade and nontrade sectors, as well as to increase public savings and investment. It is not clear, however, that interposing the government in the disposition of the increased income will result in a better distribution of income or greater savings and investment than would be achieved by relying on private market forces. Moreover, the convenience of the second-best reduces the urgency of first-best solutions both in terms of the broad goal of expanding the tax base to reduce its reliance on a narrow and volatile base, and providing a more equitable income distribution.

Fostering a dynamic private sector is the best means of creating a more agile and diversified economy. Again, flexibility is the key in view of the adjustment restraints imposed by the currency union. Action to reduce the government's call on savings must be complemented by a range of structural measures encompassing labor market flexibility, trade and price liberalization, regulatory streamlining, and privatization. There must be greater pass-through of world price developments to producers and fewer government middlemen. Financial sector intermediation must be enhanced and driven by market-driven opportunities, not government interference.

Lurking below the surface of so many of these policy concerns is the issue of good governance. The topic is sensitive and needs to be treated carefully. It is increasingly unavoidable, however, in instances where uncollected or diverted revenues and misappropriation of funds contribute substantially to fiscal shortfalls. Similarly, where government elites are perceived as ever on the alert for a newly developed business success to be tapped for funds, investment capital will remain on the sidelines.

Let me turn for a moment to the issue of CFA franc countries' efforts to forge an economic and monetary union. As has been observed by other speakers, the CFA franc zone does not have most of the characteristics required for an optional currency area. There is little intra-regional trade, factor mobility and wage/price flexibility are limited, and the scope for asymmetric external shocks is quite high. In view of the already severe constraints on adjustment policies, a successful effort to achieve full union will necessitate enormous structural changes and large resource transfers. Mr. Clark makes the point that monetary union appears to be a vehicle for anchoring structural changes rather than a product of those changes. In view of the experience of the European Community and the length of time that it will take for the much more advanced industrial countries to achieve a union, I would expect that a full union in Africa will be well beyond our lifetimes, and that the path will be an extremely difficult one.

In conclusion, I would like to join other Directors in urging another Board seminar on the experience of the CFA franc countries in implementing Fund-supported programs. I recognize that the Board will have an opportunity to review each of the programs on a regular basis. However, many of the issues are cross-country in nature and provide valuable lessons for both the CFA franc area as well as other regions implementing similar monetary arrangements.

Mr. Verjbitski made the following statement:

I would like to compliment the staff for the quality of the paper, and register my agreement with its appraisal of the problems and risks facing the CFA franc zone countries. In a currency zone with capital mobility, the room for an independent monetary policy is limited. Therefore, it is quite appropriate to discuss the economic adjustment effort in the WAMU and the CAMA not only on a country-by-country basis, but also on a regional level. The Fund played a major role in bringing about the historic decision of these countries to realign the CFA franc exchange rate in January 1994, and it would be prudent for the Executive Board to continue to keep the developments in the region under a close review. In this regard, I endorse Mr. Clark's suggestion to hold another Board discussion of the program performance of the CFA franc countries next year. Perhaps scheduling it for the second quarter makes more sense, if we are to look at the end-1994 economic indicators.

As many of the comments I intended to make have already been made by the previous speakers, I can limit myself to emphasizing three points.

First, most of the CFA franc countries have recently put together ambitious medium-term programs of adjustment, with a strong emphasis on fiscal adjustment, structural reforms, and private sector development. Such an approach is fully warranted for the obvious reason that currency devaluation alone will not produce sustainable economic growth. I share Mr. Shaalan's view that redressing fiscal imbalances must remain a matter of priority for these countries. Structural reforms of the public sector should not be delayed. In order to ensure a quick supply-side response in the economy to the current terms of trade improvement, the authorities' efforts to rein in public sector demand need to be parallel with measures aimed at encouraging financial intermediation and private investment activity.

Second, I share Mr. Clark's view that the economies of the CFA franc zone do not quite fit the theoretical framework for a currency union in general. Indeed, as Mr. Newman indicated, much remains to be done by the authorities of these countries in order to translate their regional solidarity into a full-fledged economic and monetary union. The staff are certainly right in advocating Maastricht-type fiscal convergence among the member countries in the two monetary unions, in particular with respect to keeping the level of public debt within sustainable limits. It should become a necessary complement to the common monetary policy. Trade and tax harmonization as well as cooperation in the areas of macroeconomic management, customs, and statistics are also needed to accomplish this task. The acceptance by all CFA franc zone countries of Article VIII obligations could be a step in the right direction. Nevertheless, before formalizing this acceptance, the authorities must have a clearer outlook for their balance of payments position. The Fund's technical assistance in this and other areas should be forthcoming.

Third, I find Mr. Dlamini's general observation on the need for a disciplined fiscal policy for maintaining a fixed exchange rate regime very relevant to the broader consideration by the Board of the advantages and disadvantages of floating versus fixed exchange rates for adjusting economies. Incidentally, in a recent Working Paper on this issue prepared by the staff, it was argued that, under a floating exchange rate system, governments inevitably pay an up-front price for incorrect policy measures, in the form of currency depreciation, whereas under a fixed exchange rate system, the costs of policy slippages are spread over the years ahead. I wonder if the staff could elaborate on this issue, in the light of Mr. Keller's comment that a number of programs in the CFA franc countries recently went off track.

Mr. Fernández made the following statement:

I will benefit from the seminar format of our meeting to express my personal and provocative comments. These comments are more focused on the essence of the institutional arrangement than on the recent economic developments of the area.

I agree with those who believe that preserving the institutional arrangement is a good thing from the political point of view; I am not so sure it is a good thing from the economic one.

My view is that more timely adjustments in the exchange rate between the CFA franc and the French franc would be desirable in the future. A target zone system could fit better in this situation of so many different economic structures.

When exchange rates are fixed, fiscal and structural policies are the only instruments at hand for the authorities; if these policies are not managed properly, interest rates will go up and growth will suffer. Therefore, it is very important that countries put their houses in order through the policy tools that remain mainly a national responsibility, thereby avoiding relying too much on the supposedly disciplinary effect of the exchange rate anchor.

In my opinion, to have a centrally managed budget is not just a matter of solidarity, but of efficiency and consistency, with the sustainability of the monetary union. This central budget would have the aim of offsetting specific country shocks, both internal and external, affecting economies of very different economic structures. This centrally managed budget could be partially endowed with official international resources.

In the absence of this fiscal instrument, price adjustment would be more likely to be required. Alternatively, exchange rate controls ought to persist to sustain artificial levels of exchange rates when policies are uncoordinated. A country should reconsider a strong currency in a situation where the competitors can freely adjust their exchange rates. In this regard, it may sound paradoxical to say that the French franc is too strict a monetary anchor for the needs of the CFA zone. I wonder to what extent French monetary policy takes into account the needs and the situation of the CFA countries.

I believe that more frequent relative price adjustments will be required in the future, primarily wage differentiation and interest and exchange rates adjustments needed to match different paths of fiscal and structural policies.

Finally, let me reiterate that I appreciate the need to maintain a common institutional arrangement for the CFA countries, but of a slightly different nature.

Mr. Newman wondered whether French monetary policy affected the CFA franc zone in a significant way. In view of the close relationship of German and French policies, German monetary policy might be an important factor as well.

The Chairman observed that, as the dollar was the anchor for many currencies in the world, consideration could also be given to the overall influence of monetary policy in the United States on other countries, including those in the CFA franc zone.

Mr. Clark, responding to Mr. Huisman, said that convergence of macroeconomic and structural policies--not identical policies--should be the goal of CFA franc zone countries. Individual countries should design policy measures to promote the operation of market forces, factor mobility, tax harmonization, a broadly similar regulatory environment across countries, and balanced fiscal positions, which could mean different individual program decisions in each country. The promotion of price flexibility, particularly with respect to wages, should not imply uniform wage measures in all countries; in fact, convergence required significantly different actions on the part of individual countries, in light of their starting positions.

Mr. Al-Jasser recalled that, before the CFA franc devaluation in January 1994, some Directors had expected that a change in the exchange rate policy could perform miracles, and that a devaluation would be a panacea. It was important to take advantage of the devaluation to address the serious structural problems of the CFA franc zone and to design programs to overcome them. At the same time, it needed to be borne in mind that program design would have to evolve over time, because of the many complex problems those countries faced. Being aware of the evolutionary process was therefore important to improve policy design, and part of that process should be a regular upgrading of the staff papers on the CFA franc zone that had been prepared.

The staff representative from the Policy Development and Review Department said that, in view of the situation in the CFA franc zone countries and their historical development before the devaluation, it had been expected that the countries would respond rationally to terms of trade variations--saving when there was a windfall gain, and spending when there was a sharp terms of trade loss. However, that had not been the observed historical experience.

Directors had stressed the diversity of the countries in the Central African Monetary Area and the West African Monetary Union, including the predominance of oil and minerals in some countries, and agricultural commodities in others, the staff representative continued. The two zones had experienced different external shocks. In general, if the fiscal response had been appropriate--if public sector wages had not been allowed to rise in favorable times and fall in unfavorable times--the outcomes would have been different. Furthermore, the large increases in public enterprise outlays and public investment had made the internal adjustment more difficult. Under such circumstances, even if a flexible exchange rate system had been in force, the outcome would not have been different. Before fixing the nominal exchange rate in the chaotic policy environment, many Directors would have advocated fiscal restraint and aggregate demand management, in order to add momentum to the fight against inflation.

How to maximize gains after taking into account the costs of a 100 percent devaluation had been the real issue, the staff representative remarked. There had also been concerns about the comprehensiveness of the accompanying structural packages to attain the goals set by each country. In general, all programs had been well supported by accompanying measures, and contained the elements that removed inherent rigidities. The new programs aimed at progressively reducing fiscal and enterprise deficits, seeking wage discipline, and eliminating distortionary and unproductive trade and domestic taxes. Past experience had shown that there had been policy slippages in some of those areas, but further progress had been preserved as a core element of the strategy.

Several factors supported the new, more comprehensive adjustment programs, the staff representative commented. International financing had been available to develop the production base and to smooth out the countries' fiscal and public sector adjustment efforts, and resources at the common central bank had been available to smooth out temporary variations in the zone's short-term credit arrangements.

In the new environment, in order to achieve better wage discipline in the public sector, efficiency considerations needed to play a role in determining wages, the staff representative observed. Public sector retrenchment had been necessary, but also adequate remuneration for those who remained in service. Greater flexibility in the labor laws for the private sector and the rest of the nongovernment sector was required to discipline wages.

If wage flexibility were achieved, and foreign assistance could be obtained to improve human resources and transport infrastructure, trade expansion could take place in the manner described by Mrs. Cheong, the staff representative commented. There might be scope for increased trade in a variety of manufactured products, and a shift away from agriculture to processing in early stages of manufacturing. Through the horizontal and vertical integration of manufacturing activities that could take place as a result of the expansion of trade, the CFA zone economies could gradually broaden their economic structures. The implicit discipline of the present currency arrangement could propel them in the direction of industrialization, as had happened in Asia and Latin America. If the right policies were followed, the outcome in Africa could be similar.

Several key elements would need to be taken into account in the formulation of regional monetary and credit programs, the staff representative commented. Analyzing the balance sheet of a central bank from that perspective, it was clear that the demand for currency and deposits would differ from country to country, depending on growth and differences in inflation rates. Furthermore, each country's balance of payments, and its contributions to the net foreign assets of the central bank, could also differ. Once those two variables were determined for each country, the net domestic assets of the central bank could be determined as a residual.

However, it would be difficult to differentiate net foreign assets ceilings by country, if financial markets were fully integrated, when securities were freely tradable across borders and financial assets held by private sector enterprises and households became fungible, the staff representative from the Policy Development and Review Department explained. In the present situation, net foreign assets could be differentiated by country only at the national central bank level. Also, the net domestic assets of the central bank at each national level could differ, and it might still be possible to maintain ceilings on total banking system credit by country.

Mr. Keller said that, although the structural policy packages were strong enough to remove the existing rigidities, almost half the programs in the CFA franc zone countries had been off track. How countries had implemented the core elements of the programs was not clear. The Fund needed to bring back on track, at least, the less problematic programs. A serious problem for both the Fund and the countries concerned was that most of the countries had negotiated stand-by arrangements with the Fund, because they were not ready for a more appropriate arrangement under the enhanced structural adjustment facility.

The staff representative from the Policy Development and Review Department replied that, if a country went off track, the Fund recommended further corrective action up front, and accelerated implementation of any measures that had not been implemented. The Fund urged the authorities to strengthen performance in the fiscal and monetary spheres. Within a three-month period, or as soon as there was convincing evidence of the implementation of a critical mass of prior actions, the Fund would be able to revise the adjustment framework for the country concerned. In the case of slippages in implementation, the Fund would consider that the country was still coping with the stabilization phase, and would insist on the implementation of the most essential elements of structural reform, including in the area of public enterprise restructuring.

The staff representative from the African Department said that the diversity in wage policies among CFA franc zone countries could be attributable to the different degrees of overvaluation in individual countries, which had made possible some flexibility in wage adjustments. For example, in Cameroon and Congo no increase in wages had occurred, and in Côte d'Ivoire, an increase of only 6 percent had been given. In countries with a relatively lower degree of overvaluation--like Benin and Mali--the public sector wage bill had increased relatively faster. Nevertheless, a global norm--and a range--had been useful, as it had facilitated the implementation of cautious wage policies in individual countries.

Multilateral surveillance of fiscal policies was a key element in the successful implementation and sustainability of programs of the CFA zone countries, the staff representative observed. Past experience had shown that it was not enough to have a common monetary policy and a common central bank. It had been essential to have also a vehicle to ensure fiscal convergence. The staff had collaborated with the two central banks in order to establish a satisfactory framework for implementing the surveillance policy.

In the case of the WAMU, a relatively limited number of simple and practical performance criteria, confined to areas under the authorities' control--such as the wage bill, domestic arrears, and the share of investment financed with their own resources--had been adopted, the staff representative from the African Department explained. Although the WAMU authorities had not adopted sophisticated or comprehensive concepts of the fiscal balance, the system could develop in that direction. In the CAMA region, where the circumstances of the countries differed significantly, more general criteria had been defined to move toward fiscal and external sustainability. In the long run, the system of multilateral surveillance of fiscal policies would exert a degree of moral suasion on individual CFA countries, which might be as effective as the Fund's. The CFA countries had not yet adopted a system of sanctions to deal with members who failed to meet established criteria, but in the long run, such a system would be developed to replace the active suasion exercised by Fund-supported programs.

Mr. Koissy made the following concluding remarks:

I would like to thank Directors for the interest they have shown in today's seminar. I very much appreciate their analysis and recommendations, which are valuable to my authorities. My authorities were expecting much from today's discussions, and I can assure you that your comments will enable them to improve the implementation of their adjustment programs.

I have noted carefully the points that have been raised today. Directors have emphasized the need to sustain a strong fiscal discipline, supported by the appropriate structural reforms; improve interregional trade and factor mobility; and diversify exports.

Several Directors have also drawn attention to the important issue of external debt, and of the constraint it places on the authorities' efforts to develop their economies. This is a major concern of all my CFA franc zone countries. The servicing of the debt is consuming a large amount of scarce resources, and it is the hope of my authorities that a more satisfactory solution to the debt problem will be found soon.

I must also add that the CFA franc zone authorities have shown strong courage and determination to implement the adjustment programs, which have had a severe negative impact on the population. While the assistance that they have received up to now has been helpful, there is no doubt that much more is needed. We are hopeful that other donors and creditors will join in the efforts to improve the growth prospects of these countries.

On the existence of the CFA franc zone on which some doubts have been expressed, I think it would have been better to ask what would have happened if the zone did not exist. There is no doubt that the situation would have been much worse. While there are obviously some drawbacks, the economic and financial stability that the zone has provided cannot be denied.

Finally, I will agree with Mr. Al-Jasser that, at this point, we should not concentrate on the raison d'être of the union, but rather try to maximize the benefits and minimize the drawbacks. This is indeed, as Mr. Bergo pointed out, a challenge to the countries concerned, and everything should be done to reach this goal.

Let me once more note the usefulness of this exercise, and assure Directors that their comments will be transmitted to my franc zone authorities.

The Chairman made the following concluding remarks:

Executive Directors welcomed the opportunity to discuss the common issues of program design and policy coordination facing the CFA franc countries and several aspects of common currency arrangements in general, including their long-term implications. They noted that the January 1994 devaluation of the CFA franc and the comprehensive adjustment programs launched by those countries had provided a historic opportunity for them to achieve sustainable economic growth, as well as steady progress toward fiscal and external viability and further regional economic integration. They were encouraged by the early evidence in a number of CFA franc countries of a resurgence of economic growth and export activities, the decline in inflation after the initial surge following the devaluation, the return of flight capital, and the strong improvement in the net foreign asset positions of the two central banks. The CFA franc countries would need to implement vigorously all the essential elements of their comprehensive adjustment strategy, with emphasis on both financial stabilization and structural reforms, in order to derive the maximum benefits of broad-based regional economic recovery and integration. Moreover, in program design for the individual countries, account would have to be taken of their different starting points. Almost all Directors said that, in pursuing adjustment policies, the authorities should have in mind the paramount concern of maximizing the upside and minimizing the downside risks of membership in a currency zone.

The reduction of government fiscal deficits and imbalances in the public enterprise sector was considered a key instrument for establishing an environment conducive to private sector growth, achieving progress in the reform of the financial sector, and attaining internal and external financial viability. In the tax area, the CFA franc countries needed to simplify, rationalize, and lower the burden of foreign trade taxation, while strengthening efforts to reduce exemptions, increase tax collections, and fight corruption. It would be important to shift progressively away from export taxes to alternative forms of direct taxation and, more generally, toward increased reliance on domestic direct and indirect taxes. To facilitate that shift, early actions should be taken to improve tax administration and to preserve the revenue base. Technical assistance from the Fund would help assist these countries in broadening their tax base. In the public expenditure area, the authorities of the CFA franc countries needed to adhere to strict wage restraint, shift expenditure priorities to urgent social and investment objectives, and maintain a rigorous and transparent system of expenditure control. In that context, they would have to press ahead forcefully with civil service reforms. Several Directors noted that the World Bank had an essential role to play in assisting the authorities of the CFA franc countries with periodic reviews of public expenditure and public investment.

In the financial sector, decisive steps would have to be taken to address the problems of financially distressed banks, and to develop the regional money and interbank markets, as well as a broad-based market for government securities. Those steps were needed to move toward a market determination of interest rates, develop the tools of indirect monetary control, and respond effectively to surges in bank liquidity.

Directors noted that past experience had shown that tight financial policies alone were not sufficient, but had to be complemented by far-reaching structural reforms to ensure a durable recovery and diversification of the economies, and they emphasized the role of the World Bank in assisting the countries with the design and implementation of those reforms. It was important to proceed soon and forcefully with the restructuring or privatization of public enterprises and eliminating monopolies. The problems in that area should not be allowed to slow the process of fiscal adjustment, to pose risks for the banking system, or to impede the expansion of private sector activity. It was also noted that the ability to adjust to external shocks would be enhanced by greater flexibility in wages and in hiring practices. Directors recognized that there were social costs connected with labor retrenchment in public enterprises and the civil service, which would need to be accompanied by severance payments and training schemes. For the banking system, the risk of reverting to state-directed interventions and subsidized lending operations had to be avoided, while the strengthened procedures for bank supervision would need to be adhered to strictly.

The attention being given to accelerating the process of economic and monetary integration in the CFA franc countries was welcomed, as this would help them reap more fully the benefits of the existing monetary unions. The potential for intra-zone trade was expected to be enhanced by a further liberalization of economic activity in each member country, as well as by the stepped-up efforts in both unions to establish a common external tariff, remove intra-zone trade barriers, and harmonize domestic tax systems within a framework of multilateral trade liberalization. In that context, Directors welcomed the steps taken to adopt a system of multilateral surveillance, based on convergence criteria aimed at ensuring the sustainability of each member government's fiscal and external position. They stressed that in the framework of regional policy coordination, the authorities of both monetary unions would need to strengthen their ongoing efforts to improve the macroeconomic database, with a view to facilitating multilateral surveillance and a timely response to changes in the economic environment.

Directors noted with satisfaction that the CFA franc countries continued to maintain exchange systems free of restrictions on payments and transfers for current international transactions, and several Directors therefore urged those countries to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement as soon as possible. They also urged those countries to terminate the suspension of the repurchase of CFA franc bank notes.

Directors encouraged the staff to continue to review developments and prospects in the CFA franc countries on a regular basis, particularly in the context of Fund-supported programs. Moreover, a brief overall assessment of the experience of those countries in 1994 would be conducted as more evidence became available, with a view to drawing lessons for program design. The design of Fund-supported programs would need to evolve in line with the changing and more complex environment, and to take increasingly into account the regional dimension, including the situation of countries that were not members of the CFA franc zone.

LEO VAN HOUTVEN
Secretary