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WAEMU at a Crossroads?

A Contribution to the Debate on the Perspective of its Monetary and Exchange Rate System

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Main messages

The monetary and exchange rate system of the West African Economic and Monetary Union (WAEMU) is characterised by a single currency, the West African CFA franc (XOF). Its anchor is a fixed exchange rate against the euro. France provides an unlimited and unconditional guarantee for this exchange rate regime.

Despite the reforms introduced in 2019, which suppressed French participation in the institutions of the Monetary Union and the obligation to deposit a portion of reserves with the French Treasury, and which opened the door to a change in the name of money, this system is still the subject of criticisms, sometimes economic, more often political and even emotional. .../...

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... /... *The economic criticisms have mainly targeted the fixed exchange rate against a strong currency (FRF and then euro) generating an over-evaluation with its supposed negative impact on the competitiveness and hence the growth of WAEMU countries. However, it is not possible to demonstrate a negative influence of the XOF on the economic performance of WAEMU member countries over the long term. These criticisms have also diminished in the last two decades, no doubt because of a higher growth in the WAEMU than in other comparable economies in Sub-Saharan Africa (i.e., non-oil economies) over the last ten years.*

But the criticisms are above all political. The colonial origins of the monetary and exchange rate system, which dates back to 1939, have a symbolic dimension that disqualifies it in the eyes of some sections of public opinion. Some aspects of this system are also still wrongly perceived as restricting the sovereignty of WAEMU member States. This is particularly true of the French guarantee and euro peg, whereas the restrictions stem directly from the choice of a fixed exchange rate (which constrains the monetary policy of the Union) and a monetary union (which is a transfer of sovereignty to the Union). Furthermore, changes in parity are the sole responsibility of the WAEMU authorities.

This rejection by part of public opinion tends to weaken, or even obscure, economic and institutional reflection on possible solutions should the countries concerned wish to change the current system. Given the internal coherence of this system, it is not certain some of its fundamental elements can survive without the others: an end to France's exchange rate guarantee would probably result in less credibility for the fixed exchange rate regime, and a change of exchange rate regime could jeopardize the very existence of the monetary union.

At the initiative of the WAEMU, an inclusive discussion within the Union on possible solutions for replacing the XOF would therefore be useful. It should enable a better assessment of the opportunities, risks and costs of these changes and of a transition period. It would also give France an opportunity to see whether and how it can support the development desired by the WAEMU countries. This document aims to facilitate and shed light on this reflection.

<u>The paper focuses first on an important element of uncertainty, which is the future geographical scope of monetary union</u>. It is important to bear this in mind, as it has major implications for the exchange rate regime. WAEMU is first and foremost a political project that was originally built on a monetary union. The principle of economic and monetary integration in West Africa enjoys strong (but fragile) public support, which could justify enlarging the Union. But the implementation of integration for the whole Western African remains laborious and highly hypothetical, as demonstrated by the still-postponed project of monetary union within ECOWAS.

The West African Monetary Union (WAMU) has been in operation for over 60 years. It has acted as a catalyst for institutional, economic and financial integration, which has strengthened slowly but surely over the last thirty years and has survived every crisis. In our view, this is an important asset for the countries that make it up, and a solid basis for possible geographical enlargement. This enlargement must, however, be weighed against the cost and risks in terms of deepening or even maintaining integration. It must also be based on prior macroeconomic convergence, which is demanding.

A potential enlargement of the WAEMU to other West African countries means that we need to think about the exchange rate regime. Indeed, some countries in the region, such as Ghana, have made known their intention to plead for a flexible exchange rate regime.[1]

In this case, could the enlarged Union continue to benefit from French guarantee? WAEMU member countries should consider what France's position would be in the event of enlargement, possibly without a fixed exchange rate. Enlargement, particularly if it involves large economies such as Ghana, would increase the risk incurred by France because of its guarantee. France would therefore have to decide for itself whether or not to continue providing this type of support to an area of greater size, should the Union so wish. France's position on this issue is currently unknown. It is important to remember that France must refer any substantial changes to the agreement to the European Union (EU). Consideration could also be given to whether France could support these changes by developing other support mechanisms.

<u>The note then discusses the development of the WAEMU in the event of a scenario without monetary cooperation with France.</u> The Union's member States might want it to continue the system, without France's support. The disappearance of France's guarantee, if desired by the member States, could lead to the choice of a new common exchange rate regime, an issue which is often overlooked. This is a difficult task, involving in-depth discussion between WAEMU members. It is not certain that they share the same visions and interests on what this new regime could be. The discussion would be both technical and political. In the first instance, it would concern whether or not to maintain a fixed parity of the Union's currency against a currency or a basket of currencies.

Maintaining a fixed exchange rate without a French (or an external) guarantee would undoubtedly be possible. Many countries in the world and in Africa have a fixed exchange rate (possibly adjustable) whose parity is supported by their own disciplines and rules. This «autonomous» fixed exchange rate regime would nevertheless require at the very least, a significant level of foreign exchange reserves (and probably the maintenance of their total mutualization) and a strengthening of common budgetary discipline. Their purpose would be to limit the probability of an exchange rate crisis and the occurrence of repeated devaluations.

For its part, the adoption a managed floating exchange rate regime, since it is difficult to imagine free floating, implies the implementation of an intervention policy by the central bank of the WAEMU (BCEAO) to regulate the exchange rate, which requires a high degree of solidarity. It also implies a gradual move towards inflation targeting, which would progressively replace the exchange rate as the anchor of currency stability.

In all cases, maintaining a monetary union requires greater solidarity and institutional integration, in particular the establishment of stability funds or mechanisms to prevent and mitigate liquidity crises in member States. It also implies budgetary discipline and strict respect for coherence between national budgetary discipline and common monetary policy. There would be many governance challenges to overcome, whatever exchange rate regime is ultimately chosen. They would include delicate balances to be defined between the largest WAEMU economies and the others.

[1] *In its latest ranking (AREAER, 2023), the IMF classifies Ghana's exchange rate regime as one with a de facto crawling peg to USD (crawling like arrangement).*

Unless all these questions are answered satisfactorily, the outcome could be the dissolution of the WAEMU and the adoption by some or all of its former members of national currencies. National currencies are possible and are even the rule in Africa, as in much of the world. However, such a development would be a step backwards in regional integration, with significant political and economic consequences. In particular, we could expect to see large and frequent devaluations, leading to high inflation and even hyperinflation in the most vulnerable countries as well as extensive dollarization of economies as it was the case in countries like DRC and Zimbabwe). This would also be the case in the event of a poorly managed change in the WAEMU's exchange rate regime, even if the union does not break up. These are obviously not inevitable consequences, but it would be difficult to avoid them without a significant tightening of macroeconomic policies, at least for a time, particularly in the most vulnerable countries.

<u>Finally, the note addresses the issue of transitions to a new monetary and exchange rate regime</u>. Whatever the desired point of arrival, and even if it is clearly defined by the WAEMU Member States, particular attention must be paid to the transition.

History shows that leaving or even changing a fixed exchange rate system entails risks that are all the more likely to materialize if they occur "on the fly". This is even truer in the case of the WAEMU, the oldest fixed exchange rate system in the world, which has only seen one change in parity. Conversely, these risks can be contained by a programmed transition with a clear commitment from governments and the BCEAO (i) to put in place the conditions necessary for introduction of inflation targeting (ii) to guarantee the stability of the currency during the transition period and (iii) if necessary, to guarantee a fair and realistic conversion rate between the new currency (or currencies) and the old one (XOF).

These subjects are discussed in detail in the following note.

Introduction

In recent years, public opinion in WAEMU has been increasingly critical of the monetary system based on the CFA franc[2] (XOF). Admittedly, the 2019 reform removed some of the most symbolically irritating features of the cooperation between France and the West African Monetary Union (WAMU)[3], such as the French presence on the governing monetary bodies and the obligation to deposit 50% of foreign exchange reserves with the French Treasury. It opened the door to a change of name for the currency, which has not yet materialized. This has not helped to put an end to the public debate. Beyond discussions on the economic performance of this exchange rate regime, political considerations have been added with increasing intensity.

Two events give a new colouring to the subject: in September 2023 the constitution of the new Sahel Economic Confederation or Alliance (AES) and in March 2024 the accession to the presidency of Senegal of a political movement, PASTEF, which has made the denunciation of the CFA franc (XOF) an important element of its electoral platform. These developments make major reforms to the common currency of the current eight member countries more likely. But what kind of reforms? While public opinion is rife with criticism, structured proposals for a new system are much rarer. The "day before" is much more talked about than the "day after".

It is all the important to look at the latter since the West African CFA franc (XOF) has served the WAEMU member countries rather well economically in the past decade. FERDI's research shows that, in terms of growth and over the long term (1964-2017), the franc zone monetary system has not been more unfavourable than that of other African countries with different exchange rate regimes[4]. In recent years, the XOF has protected WAEMU economies well against external and internal shocks, which has not been the case for its neighbors, such as Ghana, Nigeria and Guinea. Finally, the system has delivered monetary stability that has no equivalent in Sub-Saharan Africa. This advantage has been particularly remarkable in the event of political and security crises, as, due to the system, the currency is immune to them. This situation highlights the need, in any new monetary arrangement envisaged for the WAEMU, not only to respond to political and identity-related demands, but also to ensure economic benefits equivalent to or greater than the current system. It is also important that the transition between the current system and the possible new regime is controlled.

The exchange rate regime must also be assessed from the point of view of regional solidarity and cooperation between member countries. One of the reasons for the durability of the current monetary system is its overall coherence, underpinned by more than sixty years of practice. The

[2] Critics often ignore the fact that there are two FCFAs, one for the UEMOA (XOF), the other for the CEMAC (XAF), which are two completely separate currencies that are not freely convertible, although for historical reasons they have the same fixed parity against the euro.

[3] WAMU: West African Monetary Union, which preceded the creation of the WAEMU in 1994.

[4] Cf. Feindouno S., Guérineau S., Guillaumont P., Sylviane Guillaumont Jeanneney S., Plane P. (2020) *Zone franc, croissance économique et réduction de la pauvreté*, FERDI.
And also:
- IMF (2024) West African Economic and Monetary Union Staff report on common policies for member countries-press release; staff report; and statement by the executive director for the WAEMU, April.
- Feindouno S., Guérineau S., Guillaumont P., Guillaumont Jeanneney S., Plane P. (2022) "Monnaies nationales ou régionales et réduction de la pauvreté en Afrique", Revue d'économie du développement 2021/4 (vol. 29), De Boeck Supérieur, 128p.
- Fiseha H., Lars Christian. M. (2018). "Explaining the WAEMU Growth Spurt: The Role of Financial Deepening and Macro Policy", Policy Research Working Paper, No. 8675. © World Bank, Washington, DC. http://hdl.handle.net/10986/31077.
- Plane P. (2023) "La compétitivité hors prix de l'UEMOA : mesure et évaluation comparée", with the contributions by Alban A. E. Ahouré and Youssoufou Hamadou Daouda, FERDI Report, 252 p.

French guarantee made it possible to maintain a fixed exchange rate against a strong currency, with only one devaluation, an exceptional performance for a group of mainly Low-Income Countries (LICs). It has also led to monetary union between African countries, based on a simple rule (fixed peg to another currency). This union has also had positive consequences for the overall climate of political cooperation between member countries, which benefits go beyond economic union. These are sometimes underestimated.

It is therefore important to consider in advance what reforms might be made to the common currency of the WAEMU, with which all the member states have lived since independence, with the exception of Guinea Bissau (joined in 1996) and Mali for 22 years (1962 to 1984), and what form the monetary system might take, particularly in the event that the WAEMU states wish to put an end to monetary cooperation with France, in response to the political demands of a section of public opinion, as expressed in particular on social networks[5]. Clumsy and ill-conceived reforms could have considerable repercussions, not only economic but also political and humanitarian. They could also have a profound effect on relations between the current member states. This subject is largely underestimated and little debated.

The sole purpose of this note is therefore to explore the various conceivable options, and their conceivable consequences, in order to shed light on choices which, by their very nature, are at the heart of the sovereignty of African governments. It explores the two dimensions, relating on the one hand to the geographical and political perimeter of the Union (including the absence of monetary union) and on the other hand to the conceivable monetary and exchange rate systems. It may be surprising to begin by discussing the future geographical scope of WAEMU. But WAEMU is first and foremost a political project. Its spatial scope has direct potential implications for the nature of the regime and its relationship with France. These implications are a good starting point for this paper.

In all the scenarios to be discussed, a distinction must be made between the situation where monetary cooperation with France is maintained, with or without enlargement of the Union, that of total exchange rate and monetary autonomy for the Union, and that of its break-up. Finally, the note examines provisions designed to minimize the risks of transition from one regime to another, should changes be decided.

While this note presents an overview of the current situation and options, it will also present the authors' own views on these issues at each stage of the process.

[5] For example, the Pan-African Anti-CFA Front led by the Franco-Beninese activist Kemi Seba has been very active on social networks since 2017. In addition, demonstrations and rallies in Ouagadougou, Bamako, Niamey and Dakar have featured virulent slogans calling for the CFA (XOF) to be withdrawn. In intellectual circles, the many advocates of its withdrawal include philosophers and political scientists, as well as economists such as Kako Nubukpo, current Commissioner of WAEMU Commission and former Minister of the Economy in Togo. This rejection is also perceptible in Central Africa, in Cameroon and Gabon for example, but to a lesser extent. Criticism has finally found its way into Governments. For example, Mays Mouissi, the current Minister of Finance in Gabon also advocated to withdraw the FCFA (XAF) before being appointed.

1. The scope of the Union: three possibilities

The African member countries of the WAEMU face three categories of opportunities in terms of the geographical scope of their monetary union.

a) Geographical continuity of the current monetary arrangement

This first option assumes that the AES countries and Senegal continue to adhere to the current system, subject to possible reforms. These may be symbolic (the name of the currency, for example) or technical (a change of anchor, for example). These are discussed in the next section.

b) Enlargement

Cape Verde, Gambia, Ghana, Guinea and Sierra Leone have long been the countries targeted for WAEMU enlargement.

The arguments in favour of enlargement are economic, insofar as WAEMU is not only a monetary union but also a free trade zone with the perspective to become a fully fledged single market and an area of deep economic cooperation. The enlargement of the Union would have merits through its effects of scale. It would enable a better sub-regional economic balance with Nigeria.

The arguments are also political. The development of economic and monetary cooperation can have an impact on the quality of political cooperation in general, reduce the risk of conflict and create new channels of communication and solidarity between countries.

The negative arguments relate to the increased national risks of a balance of payments crisis, the additional complexity of governance and decision-making, and eventually the possible additional difficulty of deepening the Union. There is necessarily a trade-off between intensity of cooperation and geographical extension of the Union.

Whatever the merits and risks of an enlargement of the Union, if it were undertaken, it seems likely that the countries targeted would not join the Union as it stands as some have made known for many years. Major reforms would be needed to bring them on board.

These reforms undoubtedly relate to the governance of the Union: the WAEMU would be faced with the challenge of building a form of governance that would continue to have to deal with the same types of challenges as the European Monetary Union. However, whereas these challenges have so far been met by countries sharing the same monetary history and culture, the challenge would be to create a new common economic and monetary culture between countries with a history of monetary erosion and countries with a history of monetary stability. The accession of Guinea-Bissau is a useful precedent, but one that cannot be fully transposed in event of enlargement to larger economies. Initially, the sub-optimality of the Union would be reinforced.

These reforms would also affect relationship with France, for two sets of reasons.

Firstly, it is likely that the largest potential members will not wish to retain a fixed exchange rate system. This is the case of Ghana, which has made this known in 2019. It is certainly possible to maintain monetary cooperation between France and an enlarged WAEMU with a flexible exchange rate regime, to be defined. But this would mean negotiating with France to modify substantially the monetary agreements, and hence France would have to refer the matter to the EU.

Secondly, maintaining France's exchange rate guarantee on the XOF in the event of enlargement of the Union also requires verification of France's position, which is unknown at this stage. For France, enlargement of the Union would entail an increase in the risk implied by the exchange rate guarantee, due to the increase in the size of the African partner economies themselves, but also to the monetary history of the countries likely to join, which are vulnerable to balance of payments crises and which do not have the long experience of the WAEMU countries in managing this system. France itself should verify the compatibility of this increase in its guarantor risk with its own agreements with the European Union and request their validation. Decision 98/683/EC of 23 November 1998 on exchange rate matters relating to the two CFA franc and the Comorian franc provides for procedures for consulting the European institutions in the event of substantial amendments to existing monetary cooperation agreements. The main partners concerned are the European Central Bank (ECB), the Council (Economic and Financial Committee, EFC, and therefore the Member States) and the European Commission. Recital 11 of the decision states that "*the competent Community bodies should be able to give their opinion before any change is made to the* ***nature*** *or* ***scope of*** *the current agreements; this applies to changes concerning the parties to the agreement and the principle of free convertibility at a fixed parity between the euro and the CFA and Comorian francs, this convertibility being guaranteed by a budgetary commitment from the French Treasury*".

It should be noted that it is also highly unlikely, given the state of political balances and sensitivities, that the European Union would want to take France's place in providing an exchange rate guarantee for the enlarged Union, should the African states concerned so wish.

The enlargement of WAEMU would therefore require a rethink of many of the Union's rules, and perhaps its relationship with France, whose position needs to be verified. Any changes in this relationship would undoubtedly lead, as we shall see below, to new transfers and sharing of sovereignty between member states. It is important to bear in mind the chain of causes and consequences in any debate on relations between the current WAEMU and its potential new member states, especially as their economies are larger.

c) Breaking up

This option has always been on the table. Several countries have left the WAMU or the franc zone over the years (Mauritania, Guinea and Madagascar, outside WAMU), or have returned to it after leaving (Mali). It is back in the limelight with the creation of the AES and the declarations of its leaders, even if they appear to be acting with great caution. As for the new Senegalese authorities, they do not seem to be considering this option for the time being, even though it was included in their electoral programme.

Many of the smaller African countries have their own currencies and are experiencing varying degrees of economic development. It is therefore conceivable that the Union could break up, with each currency's future fate depending on the quality of its own management. There are national BCEAO agencies in all member countries. In addition to the executives working at the head office in Dakar, they have staff who could, if necessary, form the future national central banks. This scenario will be discussed in section 4, as it nevertheless increases transition risks.

Within this scenario of breaking up, sub-scenarios can be distinguished.

The first is that of a complete dissolution. Given the size of its economy, only one currency, that of Ivory Coast, would have *de facto*[6] partially regional status. In theory, it could be envisaged that certain countries issuing national currencies could conclude a monetary cooperation agreement with France. This would require both France's consent and a request from the African side. France's position must be verified and should not be taken for granted. It will have to take into account the persistence of its image and political risks on the one hand and its risks as guarantor on the other. For countries operating in isolation on the foreign exchange and capital markets, the economic, financial and political consequences would be significant. The characteristics of this new situation will be discussed below.

A second scenario would be for the three members of the Alliance of Sahel States (AES) to leave the Union. A Union of just five countries - Ivory Coast, Benin, Togo, Senegal and Guinea-Bissau - would be possible. This Union could maintain monetary cooperation with France, which would obviously be acceptable to the latter given its small size and the quality of the economic and political dialogue with the member countries. It is likely that the currency of this restricted union would have a safe-haven value and would establish itself as a regional transaction currency following the example of the XOF.

We could imagine that the member countries of the Union, restricted to five or four countries (in the event that Senegal decides to leave the Union), seek to organize monetary cooperation with their neighbors, in particular Ghana and Guinea, which brings us back to the enlargement scenario, with a smaller base of historical member countries. This approach would entail the same conditions for political accession and economic success as the current WAEMU enlargement.

Finally, we might ask whether economic and trade cooperation between the WAEMU countries would survive the end of their monetary cooperation, because of the distortions of competition that exchange rate fluctuations would be likely to cause. Economists see this as a paradoxical historical development. Indeed, monetary cooperation between the member countries of the West African Monetary Union (WAMU) preceded the establishment in 1994 of economic and trade cooperation with the institution of the WAEMU, contrary to the timetable of the European Union. Admittedly, in the case of the latter, the single market has existed (in the presence of the United Kingdom) and still exists in part today without a single currency, but the final objective remains to make the euro the currency of entire European Union in order to avoid distortions of competition. Furthermore, if the new currencies were to be non-convertible between themselves, which is a probable hypothesis, the national exchange controls would complicate transactions within the economic Union.

Furthermore, it seems politically difficult to imagine that economic and trade cooperation would continue after the break-up of the monetary Union, particularly if it is accompanied by delicate discussions, as can be imagined (see below). This process would complicate and weaken economic

[6] *De facto*, i.e., in informal exchanges, as we can assume that these different currencies would be nonconvertible in general and also between them.

cooperation. It could therefore go so far as to potentially call economic union into question. It is conceivable that it would make more sense to continue strengthening economic and trade cooperation at ECOWAS level if the latter succeeded in bringing the AES states back into the fold, but, even in this case, it would be a setback. This would be a simplification of the West African regional organization, which would not prevent institutions such as the BOAD[7] from continuing to exist.

Indeed, the history of ECOWAS shows that this is at best a long-term perspective. ECOWAS would have to make significant progress in terms of organization and efficiency if it were to effectively replace the current economic and trade mechanism of WAEMU, which is more integrated formally but above all in practice. Nigeria's disproportionate size compared with the other countries and its chronic monetary instability make its transformation into a monetary union hypothetical.

It is therefore to be feared that the break-up of the monetary union, potentially associated with a high degree of instability in national currencies, could lead to a step backwards in terms of economic and commercial integration in Western Africa.

The authors' point of view

The monetary Union can perfectly well be maintained in its current form. In that case, however, it would seem desirable to strengthen it and introduce new reforms. This point will be developed further below.

Extending the WAEMU to new countries would increase its economic, commercial and monetary geographical scope, make it more attractive and give it greater weight in the eyes of the financial markets and regional and international institutions. As with the European Union, however, there are trade-offs between deepening and widening. The latter would require a rethink of the organization of the WAEMU, with all the political and technical issues that this entails, which are rarely mentioned. It could only happen at the end of a process of nominal convergence that could take several years, and by carefully settling for new members the question of the conversion rate of currencies (for real convergence) and the level of foreign exchange reserves at entry.

Could monetary cooperation with France continue in its current form if the Union is maintained or even enlarged? This will depend on demand and the choices made by member countries in terms of monetary and exchange rate policy, as well as France's assessment of the risk involved, which implies a political discussion on this subject between the countries concerned and France.

For our part, we believe that a break-up of the monetary union would be a far-reaching event that should be avoided. In saying this, we obviously recognize that these are absolutely sovereign decisions by the States concerned, which may be motivated by considerations far removed from the subjects of this note. The consequences of such a break-up would be both symbolic and economic or practical. On the one hand, WAEMU member countries would forgo the positive effects of regional integration on the growth of their economies, notably the scale effects (most member countries' economies are small).

On the other hand, it would put an end to the remarkable exception represented by the WAEMU (with the CEMAC) due to its age and its fourfold dimension: monetary, financial, commercial and economic. In addition, the break-up itself, if badly managed, would have major negative

[7] Banque Ouest Africaine de Développement, the Development Bank of the WAEMU

consequences for growth and poverty, as well as for security and political stability, as we explain in section 4.

The populations (with the exception of those of Guinea Bissau and Mali) have known no other configuration than monetary union, and until recently there were few opinions opposed to this union. In practical terms, there is a great deal of trade in goods, services and people between the member countries, although this is poorly measured by official statistics, as much of it is informal. Maintaining commercial, economic and financial cooperation is essential and would be less effective without a common currency.

We now outline the three sets of options available to WAEMU Member States in terms of their monetary and exchange rate systems. Each of these options has its own advantages and risks. As we have just seen, they are linked to the geographical and political perimeters on which decisions must also be taken.

2. Monetary cooperation with France, with the possibility of expansion to other countries

This scenario assumes that the WAEMU member states and France are prepared to maintain the core of monetary cooperation, which is the guarantee. In this case, changes to the system are possible and undoubtedly necessary. They concern the name of the currency, the management of the guarantee and possibly the link to the euro.

a) From a symbolic point of view, the WAEMU countries could agree on a new name of their currency

The principle of a new name (ECO) was already decided in 2019, but as part of a monetary union project at ECOWAS level. Since then, this project seems to have ground to a halt, even though some countries are expressing their attachment to this project launched in the last century. Changing the name of the currency is therefore at this stage the sole responsibility of the WAEMU authorities. They must navigate between two pitfalls: the change of name must reflect a real regional identity and all member states must be able to identify with it; it must not erode confidence in the currency's solidity. As the name ECO, which was chosen in 2019, has been preempted for the ECOWAS common currency project, it could be appropriate for the WAEMU member states to move towards another name for their common currency, thereby symbolically affirming a monetary sovereignty that already exists.

b) On the economic and financial front, within the Union's current perimeter, further thought could be given to the ways and means of dialogue between the WAEMU and France in the context of the guarantee.

The 2019 reform has removed foreign exchange reserve management constraints for WAEMU member states and France's presence in WAMU governance bodies. France is no longer a member of the BCEAO's Board of Directors, Monetary Policy Committee or of the Board of the Banking Supervisor. However, this reform has preserved the unconditional and unlimited nature of the guarantee.

Logically, the cooperation agreement between the Governments of the WAEMU Member States and the Government of the French Republic, concluded on 21 December 2019, contains, like the previous agreement, provisions applicable in the event of reserves being exhausted and the guarantee being called upon. The agreement stipulates that in the event of a severe crisis (currency coverage ratio, i.e., the ratio between the average amount of the BCEAO's external assets and the average amount of its sight liabilities, of less than 20%), France may exceptionally appoint a representative to the BCEAO's Monetary Policy Committee[8], with voting rights, for the period required to manage the crisis. In addition, to prevent or manage a crisis, France may exceptionally ask to take part in the BCEAO’s Board meetings without voting rights and in the Banking Supervision body[9].

[8] Article 8 of Cooperation Agreement between the Governments of the Member States of the West African Monetary Union and the Government of the French Republique.

[9] Article 4 of Guarantee Agreement between the Banque centrale des Etats de l'Afrique de l'Ouest and the Republic of France.

No automatic monetary restriction is imposed, which would have been seen as a step backwards compared with the 1973 reform[10]. The 2019 reform leaves only one obligation. It consists of the "raking", i.e., the forced transfer to the BCEAO against currency issued by it of foreign currency balances held by any public or private body in WAEMU member states (article 5 of the Convention). This provision is a legacy of the past. In the unlikely event that it could be implemented and would be effective, it would even be more aggressive than monetary restriction measures.

It is likely that in such a case (depletion of reserves) the solution lies in an agreement between the IMF and all the WAEMU countries, with a collective objective of replenishing reserves. But negotiations with the IMF are often difficult and lengthy, and depend on each country's relations with the IMF. Neither France nor the WAEMU institutions have the power to impose an agreement with the IMF, even if, as was the case for the CEMAC in 2016 (Yaounde Summit), a collective reform process can be put in place on a voluntary basis and accompanied by an overall foreign exchange reserve target subscribed by the Central Bank. But even in this case, any agreement remains specific to each of the countries supported by the IMF and France.

It is problematic for the member States not to know to what extent France would be prepared to contribute financially to support the balance of payments and the level of the parity in a context of long-term deterioration of external accounts and without corrective measures. In any case, providing for corrective measures ex ante is an element of credibility for the monetary cooperation and the exchange rate system in general, even if it appears (wrongly !) to constrain monetary sovereignty. Indeed, as indicated above, it is in fact the dual choice a fixed exchange rate and a monetary union that constrains the room for manoeuvre in monetary matters and not the measures taken to ensure the credibility of these choices.

c) *In the event of a geographical shrinkage or, on the contrary, an enlargement of the Union, the options are not the same*

We have already pointed out that the withdrawal from the WAEMU of some of its members could have no impact on monetary cooperation agreements with France. On the other hand, the accession of new States to the WAEMU would raise the question of maintaining the French guarantee and the choice of the Union's exchange rate regime.

If the new WAEMU chose to move towards a floating exchange rate regime, would monetary cooperation with France (or with other partners) still be possible or desirable? At the very least, it would require a change in the way the agreements operate. The combination of a managed floating of the new WAEMU currency and a guarantee from France would mean that the exchange rate

[10] The new cooperation agreements signed between France and the BEAC States in 1972, the BCEAO States in 1973 and the Comoros in 1979 confirmed the basic principles of the Zone and at the same time reduced the weight of French representatives in the governance of the central banks. The number of French representatives on the Board of Directors of the BCEAO decreased from one-third to one-seventh; from that time, the Governors were all citizens of member states (in fact from Ivory Coast); and the headquarters of the Bank was transferred to Dakar. The formal obligations relating to operating accounts have been relaxed, as follows: if the ratio of the BCEAO's net foreign assets to its current liabilities falls below 20%, the central bank must raise its key interest rate and lower the refinancing ceilings for commercial banks. If the operating account goes into deficit, the restrictive policy must be tightened, without specifying the measures to be adopted. Finally, in the event of a debit on the operating account, there is an obligation to "sweep up" the currencies held by public and private bodies for the benefit of the Central Bank. Cf Patrick Guillaumont and Sylviane Guillaumont Jeanneney "La Zone franc en perspective" *Revue d'économie du développement,* n°2 June 2017, p. 10 and 11.

policy would have to choose between depreciating the currency and reducing reserves or, if necessary, drawing on the French Treasury's credit line. The French authorities could not remain indifferent to this choice. On the other hand, the governance of a discretionary common exchange rate policy would prove particularly difficult to put in place.

Another option would be to maintain a fixed anchor with the euro replaced by a basket of currencies. This option is often mentioned, as it would make it possible to mitigate external shocks linked to changes in the euro against other major invoicing currencies, in particular the US dollar. It would also have the symbolic advantage of an anchor different from the currency used by France. However, this change would not offer any decisive advantage over pegging to the euro, and in particular would not resolve the imbalances in the balance of payments in the event of a misalignment in parity. Moreover, this peg would be more difficult for the BCEAO to manage technically. The risk to France from the guarantee would also be slightly increased, which would mean first asking France whether it would accept the system.

On a political level, the transformation of the exchange rate regime in an enlarged WAEMU towards either a managed float or a peg to a basket of currencies could provide an opportunity to explore the international partners likely to support it. This could be the European Union, but also other bilateral donors. This would be all the more conceivable as the guarantee would be limited and the conditions for its implementation precise. This development would blur the neo-colonial dimension of the current monetary agreements. However, the likelihood of this scenario being implemented is low because, with the exception of Portugal, no bilateral donor has a balance of payments support instrument. The EU only has one for its members outside the Euro area but with different ways and means.

The authors' point of view

The current system is based on a monetary union with a fixed exchange rate. It implies (i) a transfer of monetary sovereignty from the States to Union and (ii) a strong limit to the room manoeuvre of the Union's monetary policy due to the choice of a fixed exchange rate, the credibility of which depends on economic discipline. It is sometimes blamed on the French guarantor, but this is wrong: any system aimed at stabilizing the currency would imply even greater macroeconomic discipline in the absence of monetary cooperation with France.

From our point of view, it is important to remember that the discipline implied by the fixed exchange rate system vis-à-vis the euro is associated with advantages that the member States should not give up without thought. While the criticisms of the current exchange rate regime are numerous and well known, the advantages of alternative systems are not obvious either, and their shortcomings are rarely pointed out by critics of fixed exchange rates.

The first question is the choice of euro as the anchor. Some suggest replacing it with a basket of currencies. This system was quite popular in the 1980s, but is tending to disappear[11]. It involves stabilizing the average exchange rate of the national currency against the currencies in the basket, in other words stabilizing what is known as a nominal effective exchange rate. The advantage of the system would be to mitigate the impact of variations in the euro against other currencies on the

[11] i.e., only eight developing countries out of 102 that have adopted a de jure or de facto fixed exchange rate, including only two countries with a conventional fixed exchange rate.

exchange rate of the WAEMU currency against these same currencies[12]. *But it would lead to a variability in all bilateral exchange rates. Whatever the currency in which exports, imports and financial transfers are invoiced, including the euro, operators would run an exchange rate risk. There is in fact a current exchange rate risk between the XOF and currencies other than the Euro. To this exchange rate risk would be added the new exchange rate risk with the Euro. We therefore do not believe that this reform would provide the Union with any convincing advantages.*

The member States of the WAEMU may wish to change their monetary relationship with France for absolutely legitimate political reasons. From the authors' point of view, however, the pegging of the WAEMU currency to the euro, in preference to another currency (the dollar, for example) or a basket of currencies, will continue to be economically justified as long as most of its international trade and financial flows continue to be with countries that have the euro as their currency or whose currency is itself pegged to the euro. This is still the case today for the Union as a whole.

However, the use of a basket of currencies is often justified by the fact that while the majority of WAEMU imports are denominated in euros, exports of primary products are denominated in dollars. This means that exporters of these goods are particularly exposed to exchange rate risk, but no doubt particularly able to bear it. On the other hand, all other things being equal, there is a negative relationship between the international dollar price of raw materials and the rate of the dollar against other currencies, the euro in particular, due to interplay of global supply and demand. This phenomenon tends to stabilize the euro value of these exports.

The second question is the choice of exchange rate regime: fixed or floating? Almost all African countries that have opted for a flexible exchange rate have seen their currencies depreciate significantly in recent years, with far-reaching economic and social repercussions. The fixed exchange rate regime of the WAEMU has thus been a significant advantage during the inflationary upsurge of recent years. On the other hand, there has been no comparative disadvantage to fixed exchange rates in terms of long-term growth in WAEMU or CEMAC countries. Indeed, since 1994 there was no significant and lasting misalignment of the XOF real effective exchange rate[13].

Ultimately, parameters other than currency, such as structural or fiscal policies, conflict situations and security, for example, explain the differences in long-term economic performance between African countries. There are, however, two important points. Firstly, the WAEMU and CEMAC exchange rate regime has positive long-term effects in terms of poverty reduction due to lower inflation[14]. *Secondly, by making the currency largely immune to serious national socio-political unrest, it mitigates its effects, particularly on the most vulnerable populations.*

Nevertheless, if the current system were to continue, we believe it would be necessary to rethink some of the ways in which the Monetary Union operates, whatever its geographical scope. No doubt for the very credibility of the guarantee, the African and French parties would do well to specify the way in which the return to a healthy exchange rate situation would be managed at the level of the Union, and in particular the conditions for collective recourse to the IMF. In this respect, the process launched in 2016 in Yaoundé for the CEMAC is worth considering. It is necessary to go beyond the governance provisions mentioned in the Agreement, which risk increasing perceptions of political

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[12] Another advantage is that in the case where the basket is implicit (not formally revealed) it margins for short-term flexibility.

[13] *See IMF calculations or those of FERDI: Feindouno S., Guérineau S., Guillaumont P., Sylviane Guillaumont Jeanneney S., Plane P. (2020)* Zone franc, croissance économique et réduction de la pauvreté*, FERDI. Opus cited, chapter 1. Naturally, the diagnosis is very sensitive to the evaluation and differs from one country another, which is inevitable whatever the exchange rate regime in a union bringing together countries with different inflation factors.*

[14] *Cf. Idem, chapter 3.*

dependence if they are implemented as currently planned. We also believe that it is in the political and economic interest of WAEMU not to allow itself to be drawn into a situation where these governance provisions should come into play. Finally, in the interests of the system's credibility and acceptability, it might be appropriate for the Union to make provision for corrective measures in the event of a foreign exchange crisis, independently of the Agreement.

It is also possible that the WAEMU will move towards a system of managed floating, mentioned above. In order to make managed floating and the guarantee compatible, the arbitration procedures between the implementation of the guarantee and the depreciation of the exchange rate should be specified. It is conceivable, for example, that a rule for the nominal effective exchange rate (possibly with a fluctuation band) could be defined in advance as a function of the real effective exchange rate, the calculation methods for which would be specified. But this type of rule is difficult to manage and is therefore less credible than a fixed exchange rate. The hypothesis of the disappearance of the guarantee is discussed in the next section. It should be noted here that the enlargement of the Union could also provide an opportunity for a new guarantee agreement. The international community is considering strengthening regional financial agreements to support the balance of payments, in addition to IMF interventions, which meet the same objectives as the French guarantee[15].

It would be paradoxical to disregard a system that has proved its effectiveness and whose absence of ex ante conditionality makes it a modern instrument of international cooperation, as demonstrated by Portugal's system for Cape Verde and Sao Tome and Principe, but with a limited credit line and coordination with Portugal on macroeconomic policy. Should we draw inspiration from these agreements?

The important point of the new agreement could be to consider that purpose of the guarantee is to cover a deficit in the Union's balance of payments insofar as it is due to causes external to the Union, such as an exogenous deterioration in the terms of trade or a break in international supply circuits due to war or a serious epidemic, rather than to the macroeconomic policy of the States. The diagnosis should be made ex ante *and* ex post *by a commission of experts chosen by mutual agreement. The disadvantage of this system would be to reduce the credibility of the guarantee (currently unconditional) and to encourage speculation in exchange rate depreciation and therefore capital flight. Another option would be to provide for automatic recourse to the IMF in the event of the guarantee being activated. Member States could benefit from this reform, which would remove the uncertainty over France's requirements in the event of recourse to the guarantee.*

In order to further reduce the risk of a politically sensitive implementation of the guarantee, we also recommend consolidating the Union by creating an internal stability mechanism, complementary to the monetary cooperation between France and the WAEMU. The member States of the WAEMU, with the help of external partners and France in particular, could, for example, create a budget stabilization fund. This option would obviously be valid in the context an enlarged union or, on the contrary, a smaller one.

The non-optimal nature of the Union (in the traditional sense) is due to the fact that the current States (and future States in the event of enlargement to include other West African States) are subject to asymmetric shocks. This impediment cannot be minimized. The countries of the Union,

[15] *In general, the value of guarantees as an instrument of development aid is widely emphasised, in particular to encourage the private sector to invest. The French guarantee, which ensures exchange rate stability, also encourages private sector involvement.*

which are major exporters of raw materials, do not export the same commodities and are subject to different price cycles. What's more, whether they are located in humid or arid tropical zones, they face equally different climatic shocks. Their level of development remains disparate, as does their ability to mobilize fiscal resources or domestic or international private savings. Finally, the socio-political situation of the WAEMU countries is complicated. It is weakened by security problems in the Sahel and a number of political tensions, which is another form of asymmetric shock. The result is that, despite France's guarantee and the strength of their solidarity, the WAEMU States are, among the Low-Income Countries (LICs), those that have most often defaulted on their domestic debt in local currency. For a long time, direct monetary financing of governments was limited. It is now prohibited and should remain so, both to maintain the coherence of the monetary union and the credibility of its currency. But they have also often defaulted on their external debt and benefited from debt restructuring and/or cancellation from the Paris Club.

These asymmetric shocks are hardly mitigated by private and even less by public financial flows within the region. Apart from fiduciary exchanges, the only (limited) channel for intra-regional risk sharing is the regional market in government securities. Although this market has grown significantly, it remains essentially domestic and almost exclusively bank-based. It is also essentially a primary market. As a result, it has reinforced the interdependence between banks and sovereigns in each country. The regional government securities market can also contract, or even close, for certain countries in the event of severe pressure on bank liquidity and/or an increase in risk premiums, as the current situation shows. Finally, the emergence of arrears on this market would entail a twofold risk: that of its being called into question or that a headlong rush to monetize public debt. This is why the BCEAO intervenes in two ways to mitigate this risk.

This risk is addressed: (i) through a temporary liquidity mechanism for countries experiencing payment difficulties in servicing their domestic debt; (ii) securities purchases, as demonstrated by the last purchase operations decided by the BCEAO in 2023 and 2024 against the cycle, as monetary policy was being tightened.

To complement the mechanisms implemented by the BCEAO and reduce their pro-cyclical impact, would therefore seem worthwhile for the WAEMU to draw inspiration from the European Stability Mechanism (ESM). The ESM was created in 2012 to provide financial assistance to member States that are experiencing or are at risk of experiencing serious financing problems. The purpose of the WAEMU stabilization mechanism (the SMWAEMU) would be threefold: to *enable risk sharing within the Economic and Monetary Union that does not rely exclusively on the currency; to limit the occurrence of defaults on debt, particularly on government securities; and to protect monetary policy from fiscal dominance and the subsequent risks of balance of payment crisis.*

The advantage of this solidarity mechanism would be that its capital could be built up both by contributions from member States and by contributions from donors, including but not limited to France. Financing the SMWAEMU could thus be extended to other partners, including the EU. The participation of external partners in this type of mechanism is easier to envisage, at least in the short term, than in guarantee mechanisms such as the Agreements, which do not fit into the toolbox of sovereign fund donors other than Portugal and France.

3. A fully independent monetary system for the WAEMU

Whether WAEMU remains in its current configuration, or even more so if its membership expands to include other states, member States may wish to see their monetary ties with France disappear.

In the long term, the relative growth of the Union's money supply and GDP compared with that of the French economy will make the transformation of this relationship inevitable. The relationship is only credible in its current form[16] if the economy and money supply of the WAEMU zone remain small relative to those of France, which is unlikely to be the case over a very long period. It is therefore useful and important to consider future of the WAEMU without an unlimited guarantee from the French treasury.

The essential question then is how to ensure the stability of the currency in the absence of the French guarantee? Without a guarantee, it is necessary either to allow some *flexibility in the exchange rate* or to provide *a mechanism for consolidating the* Union's *external reserves in case of a balance of payments crisis*.

There are several exchange rate flexibility schemes.

a) Free floating is not realistic

The first is free floating. This solution has the advantage of not requiring a policy decision on exchange rates. But a free float would add the risk of an endogenous monetary shock to the external shocks. This explains why this option has only exceptionally been adopted in developing countries (Somalia only in Sub Saharan Africa, but this reflects the absence of a State) or emerging countries (currently Chile and Mexico). In fact, its success requires two conditions. The first is a well-functioning and sufficiently deep interbank foreign exchange market (which requires free movement of capital), otherwise there is a risk of high exchange rate instability. The second is a monetary policy that is sufficiently credible to ensure a nominal anchor. Very few developing countries meet these two conditions, as the recent currency crisis in Ghana illustrates. Even countries that have succeeded in introducing inflation targeting, such as Kenya, continue to intervene on their foreign exchange market to offset the variability of the external anchor. On the other hand, the European Monetary Union has been able to opt for a free-floating euro, in absence of a federal government, because of its financial development including freedom of capital flows and the credibility of the ECB.

The second option is an exchange rate managed through intervention in the foreign exchange market (known as a managed floating), as adopted in a number of emerging and developing economies. According to IMF statistics, however, the choice of a managed floating is a minority one, with 35 countries opting for it, compared with 40 that have adopted a system of official fixed exchange rates (end of 2022). However, there are also those countries that tightly control their exchange rates through massive and frequent foreign exchange interventions, classified as

[16] A change in this proportion would naturally lead to a change in this guarantee, by limiting the amount and/or strengthening the conditionality. It should be noted an important part of the credibility of this Agreement, but also of the exchange rate system, lies in the credibility of the corrective measures that would be put in place in the event of an exchange rate crisis.

"stabilized regimes" (assimilated *de facto* by the IMF to fixed exchange rates) or crawling pegs. As a result, almost all emerging or developing countries manage their exchange rates.[17]

b) The issue of managed floating in a monetary union

In the WAEMU, nominal anchor has so far been based almost exclusively on exchange rate fixity. It is likely that until a monetary policy with a credible inflation target is put in place and tested, a degree of exchange rate stability and therefore an active exchange rate management policy will be necessary. The governments of the WAEMU member States currently have jurisdiction over exchange rate decisions. They would therefore need to define new collective decision-making procedures for an exchange rate management policy including interventions. Another option would be to set up a federal government to define the desired trajectory and the means of achieving it. This is unlikely to happen in the short term in the WAEMU. The final option would be to entrust the day-to-day management of the exchange rate to the BCEAO, in accordance with the directives of the Monetary Policy Committee. After the abandonment of monetary policy, this would constitute a new transfer of sovereignty to the Union level. It implies a high degree of cohesion. It should be noted that existing monetary unions have solved this problem either by fixing the exchange rate (ECCU[18], CEMAC and WAEMU) or by free floating it (in the case of the European Monetary Union).

c) Giving more flexibility to the fixed exchange rate regime

If the choice were a fixed exchange rate, there are two possible ways of making the current system less rigid. *Firstly*, the unanimity rule to change the parity could be abandoned. This would involve amending the WAEMU Treaty. Article 15 of the 2007 Treaty stipulates that decisions of the Council of Ministers, which is responsible for exchange rate policy, must be taken unanimously. One could imagine a simple majority (one State, one vote) or a qualified majority (with, for example, a percentage of votes required of 2/3 or 3/4) or a majority weighted by the size of the populations or the GDP[19]. However, abandoning the unanimity rule could be seen by some countries as a loss of sovereignty. A qualified or weighted majority is less flexible and undoubtedly less effective than a simple majority, but it would not imply a permanent transfer of sovereignty for Ivory Coast if it retained a blocking minority. *Secondly*, a *crawling pe*g could be devised, indexed to various indicators (price trends, balance of payments with trigger thresholds). Twenty-eight developing countries have currently adopted a crawling peg (*de jure* or *de facto*) at least temporarily[20]. It has the disadvantage of being technically complex and difficult to manage in operational terms, which limits its credibility.

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[17] IMF *Annual Report on Exchange Arrangements and Exchange Restrictions 2023* (Statistics at the end of 2022.) regimes other than controlled floating are dollarisation (14), currency boards (12 countries), conventional fixed exchange rates (40), stabilisation systems or *de facto* fixed systems (23), official or *de facto* sliding parities *(28),* other managed exchange rate systems *(11)* and free floating (*31).*

[18] Caribbean Monetary Union. The fixed exchange rate is based on the currency board mechanism.

[19] Weighting by GDP would be unfair, as small countries are more affected by devaluation than large ones, and would run counter to solidarity between States with different economic dimensions within the Union.

[20] *See previous note.*

The authors' point of view

If the Member States of the Union wished to cease monetary cooperation with France, they could choose for one of two solutions, a fixed exchange rate or a controlled float.

The first, maintaining a fixed exchange rate regime, would be reassuring for the populations of the Union and would allow continuity with the current system. We believe that this should be debated in detail between member States. But we recognize that it is difficult in the context of enlargement.

We also believe that France withdrawal implies changing the mechanisms for deciding on changes to the parity. It also seems to us that the credibility of the fixed exchange rate regime should be ensured at the very least by rules and mechanisms enabling (i) a higher level of foreign exchange reserves than at present to cope with major exogenous shocks, without devaluation[21] and (ii) ex ante corrective measures in the event of a foreign exchange reserve crisis.

Shocks to the balance of payments only justify an adjustment to the rate if they appear to be lasting or relatively permanent, given the social consequences of a nominal depreciation. But not resorting to devaluation in the event of a temporary balance of crisis implies the existence of large foreign exchange reserves and strong solidarity between the countries of the Union to share out fairly the effort involved in defending parity.

To help boost foreign exchange reserves in the long term, one avenue which could be explored is the creation or extension sovereign wealth funds by each country. These funds would be placed in the form of term deposits in XOF and remunerated at the BCEAO. This mechanism makes it possible to comply with the rule of centralizing external assets at the BCEAO and to strengthen foreign exchange reserves against these deposits. The effectiveness of this mechanism in strengthening precautionary reserves depends from the governance of these funds. The more restrictive the rules for government contributions (for example, automatically linked to levels of oil and gas revenue), the more effective the mechanism will be in increasing the level of foreign exchange reserves at cruising speed. The more restrictive the withdrawal rules, the more effective the mechanism will be in slowing the erosion of foreign exchange reserves. The degree of constraint, and therefore of relinquishment of sovereignty, is the result of a trade-off with intra-zone solidarity and the stability of the Union and its exchange rate regime.

Pooling reserves at the Union level requires an extremely high level of solidarity. Solidarity is already high within the WAEMU due to the total pooling of foreign exchange reserves. The pooling of reserves, which is a rare commodity in all WAEMU countries, is facilitated by the existence of a clear rule (a fixed exchange rate), common foreign exchange controls and the French guarantee. Indeed, with the French guarantee, each member State will always have access to foreign currency, within the limits of the Union foreign exchange controls. In a different environment, the pooling of reserves is likely to be less consensual. The centralization could be circumvented, as it has been the case sometime in the past. This could destabilize the Union. Setting up a solidarity fund with clear financing rules would be one way of mitigating this risk, but it would also imply a very high level of solidarity, which would be even more visible.

[21] *It should be noted that the ECCU relies on a currency board mechanism to guarantee the fixed parity of its currency against the USD.*

The second solution is to adopt a floating but managed exchange rate regime. This would be accompanied by gradual introduction of an inflation-targeted monetary policy. The creation of a solidarity savings fund, essential in the case of a fixed exchange rate, could also prove very useful. Active exchange rate policy should be managed independently at federal level. In this case, we would recommend giving the full responsibility to the BCEAO.

On the other hand, we would advise against the third solution, that of a free floating: the WAEMU does not appear to have the necessary conditions for the successful management of this type of exchange rate regime. An uncontrollable cycle of depreciation and high inflation would most probably be the consequence of such an approach. No country with a limited level of economic and financial development is currently using it[22]*.*

In the two cases we have just mentioned (fixed exchange rates or managed floating rates), the request by the member states to do away with the French Treasury guarantee would imply a significant strengthening of institutional integration and therefore a strong level of political solidarity to preserve the WAEMU. In addition, putting in place the conditions for success would require time and preparation. It should be remembered, for example, that the BCEAO has no experience of managing a foreign exchange market.

Thus, in order to maintain confidence in the currency and avoid destabilizing capital outflows, the BCEAO's statutes, which will have to be amended, should continue to guarantee the central bank's independence, prohibit direct loans to governments and no doubt introduce stricter rules on the purchase of government securities.

Given the removal of the guarantee as a safeguard for exchange rate stability, the member States of the Union should maintain greater common discipline in the repatriation of currencies and their centralization at the BCEAO. The powers of the BCEAO should be strengthened to ensure this discipline. In all cases, the evolution of the exchange rate system must lead, at least during a transitional phase, to a higher level of protection by foreign exchange reserves. The fact that some WAEMU countries have also become, or are about to become, oil and gas producers and exporters also implies greater variability in foreign exchange inflows and outflows, and therefore a higher foreign exchange reserve target[23]*.*

The evolution of the system would highlight a well-known problem in the Euro area: the coexistence of a monetary union and national budgets. More than in the Euro area, budgetary rules are necessary but not sufficient to ensure a soft coexistence.

In the WAEMU, these problems can only be solved by the States themselves. Should monetary instruments then be put in place, as in the Euro area, to ensure a minimum level of cohesion in the monetary union and thus (whatever the cost) its long-term survival?[24] *Given the pressure on public*

[22] It should be remembered that *only Mexico, Chile and... Somalia are currently using a pure float among developing countries.*

[23] *With a risk of Dutch disease leading to overvaluation or undervaluation of the real exchange rate whatever the exchange rate regime (fixed or floating).*

[24] *Faced with an existential risk during the sovereign debt crisis in the eurozone, the ECB has over time put in place various instruments to offset risk of fragmentation or even explosion in the zone (SMP, OMT, TPI), which reduce spreads sovereign debt within the zone through targeted purchases of securities by the ECB.*

spending in countries where needs are immense and macroeconomic governance is still open to improvement, it is difficult to imagine this happening, unless it is within the strict framework of a programme with the IMF. But in that case, it would be another transfer of sovereignty...

In terms of governance, the introduction of a majority decision-making system for the change in parity is of great importance. It will raise the question of the weight of Ivory Coast. Given that this country accounts for nearly half the zone's economy, can it accept having a say in only one eighth of the decisions? And conversely, is a de facto veto (based on a weighting of votes by population or GDP) or a de jure veto acceptable to the other members of the Union?

In all cases (fixed or floating), a solidarity mechanism, such as the one we have outlined, would be a useful addition to the solidity of the Union. Indeed, even in the case of a healthy situation for the Union as a whole, with a sufficient level of foreign exchange reserves, some States may find themselves in a situation of shortage of liquidity in local currency (and therefore simultaneously of access to foreign currency).

We can therefore see that remaining in the Union in the absence of France's exchange rate guarantee, and even more so in the case a move to a managed float, implies a very important set of decisions on governance of the Union which, to our knowledge, has not yet been the subject of any real discussion between the member States. This discussion must be anticipated, as it will necessarily take a significant amount of time.

The mechanisms chosen must be clear and convincing. They must make it clear that the Union has the institutional capacity to defend the monetary objectives it chooses, and is prepared to release the financial resources needed to respect the necessary macroeconomic disciplines. If this is not the case, the immediate sanction will be the loss of value of the currency, and its consequence, high inflation, a phenomenon to which the Union has not been exposed since independence (with the exception of a short period following the devaluation of 1994), or even hyperinflation and dollarization of the economy. The political and social consequences could be far-reaching.

WAEMU is a rare and important common asset for the member countries, with political, economic and social benefits extending far beyond the currency. Its continuation would be desirable, even if cooperation with France and the associated exchange rate system came to an end. However, in our view, abandoning a fixed exchange rate rule without precaution could pose an existential risk to the monetary Union, and indeed to the economic Union, as it exists today. This risk seems to have been insufficiently analyzed, discussed and taken into account in the debates on the WAEMU exchange rate regime.

4. The break-up of WAEMU

If the WAEMU were to break up, there would be two possible options: either the adoption of national currencies, which was mooted during the election campaign by the current Senegalese authorities, or the creation of a new Union with a common currency, as envisaged by the Alliance of Sahel States (AES).

The creation a national currency, or even the creation a common currency for a smaller number of member States, gives greater freedom to issue money, directly to the Government if the Central Bank does not have independent status. This makes it possible to finance a budget deficit and automatically avoids domestic government payment arrears. But the consequence of monetary expansion is, even more rapidly and surely in less financialized economies, (i) a deficit in the current and overall balance of payments and therefore pressure on foreign exchange reserves, (ii) higher inflation and (iii) a depreciation of the exchange rate aggravating inflationary pressures, whatever the exchange rate regime chosen. Distrust in the currency would lead to massive capital outflows that exchange controls would be hard pressed to prevent. In the event of a fixed official rate or a controlled floating rate designed to avoid sharp depreciation, a parallel or informal currency market will necessarily develop at a much lower rate. In the event of the break-up of the Union, we can expect a strong dollarization similar to that experienced by many economies, particularly in Africa, over the last few decades (DRC, Zimbabwe...), with a predominance of the euro and the dollar in fiduciary payments, or of the XOF if the latter were to survive in part of the former WAEMU[25]... However, in dollarized economies, the monetary authorities lose a very large part of their power to influence the economy, and therefore the countries lose their monetary sovereignty.

It is likely that national economic conditions would then vary greatly depending on the quality of monetary and exchange rate choices and the institutions of each country. Nevertheless, in our view, there is little reason to believe that the countries concerned would experience a different economic and social path in the medium and long terms from that of other sub-Saharan African countries. For some, this could be marked by good economic performance, but it would undoubtedly be characterized by significantly higher levels of inflation, which can only be avoided by very rigorous macroeconomic management.

This prediction is borne out by the economic history of Africa over the last few decades. In the sub-Saharan region, recent developments in Ghana, Nigeria and Guinea, for example, demonstrate the relevance of this prediction. If we look at the ECOWAS countries, we see that, according to IMF estimates for 2024, inflation rates are much higher everywhere than in the WAEMU or Cape Verde, the latter benefiting from monetary cooperation with Portugal of the same type as countries benefiting from a monetary cooperation agreement with France.

[25] *If, for example, the Sahelian countries were to leave the WAEMU, it is unlikely that residents of these countries would relinquish their XOF balances, which transfers from emigrant workers should help to replenish*.

Table 1. Inflation rate (annual average)
and real gross domestic product growth rate in 2024 (%)

	Inflation rates	Growth rates		Rates inflation	Rate of growth
WAEMU	3,4	6,6	Liberia	6,3	5 ,3
Cape Verde	2,0	4,7	Nigeria	26,3	3,3
Gambia	15,1	6,2	Sierra Leone	39,1	4,0
Ghana	22,3	2,8	CEMAC	4,5	3,4
Guinea	11,0	4,1	South Africa Sahara	15,3	3,8

Source: IMF World Economic Outlook, AFR Regional Outlook, October 2024.

The authors' point of view

The break-up of the WAMU into as many different currencies as there are former member countries may be the result of a choice by member States or the result of the failure of a monetary union, for lack of a sufficient level of solidarity and discipline in the event of the disappearance of the French guarantee. To date, no estimate of the costs of this potential break-up seems to have been made.

We have emphasized the risks of high inflation that the break-up of the Union would entail. High inflation is not generally conducive to growth: it blurs the relative prices of goods and services, making it difficult for companies to forecast returns on both production and investment. It also makes economic growth less inclusive, being particularly unfavourable to the poor. The poor cannot protect their cash balances, their only form of savings, and often their income, from currency depreciation, unless widespread dollarization gives them access to foreign currencies. But this access to foreign currencies is often reserved for the well-off.

As we have already pointed out, the populations of the WAEMU have benefited from a situation of relative monetary stability since its inception. A sudden break with this model could lead to social and political unrest that cannot be ignored. Added to this upheaval would be a regression in sub-regional economic and financial integration, with major consequences for economic activity, even if at this stage it is difficult to assess them.

Finally, with disappearance of the monetary union and the external guarantee of the currency, it is likely that the monetary immunization against serious national socio-political and/or security problems mentioned above will also disappear. In the event of a crisis, the depreciation or even disappearance of the national currency would add to the suffering of the population, as numerous examples on the continent have shown.

These developments are not inevitable. Stable and credible national currencies can emerge from the break-up. But the conditions for the success are well known: an appropriate institutional set-up, with a high degree of independence for the central bank, an exchange rate policy that is consistent over time, a sufficient level of foreign exchange reserves and rigorous macroeconomic policies. These are not just preconditions, but measures that must be proven to be sustainable.

On the other hand, some former WAEMU countries may wish to pursue bilateral monetary cooperation with France. All the parameters would then have to be renegotiated. We might question the political sustainability of such agreements, if they go beyond supporting a transition period, but this is a political domestic issue for concerned African countries. France's position on such an issue is also clearly unknown.

5. What are the transitional arrangements for moving from one system to another to avoid chaos?

Whatever the scenario of profound change envisaged, whether maintaining the Union without monetary cooperation with France or breaking up the Union, the introduction of these new regimes requires preparatory work, the importance of which is largely concealed or underestimated. These go well beyond the choice of the nature of a possible new exchange rate regime.

Let's consider first the case of a Union without the French guarantee, then the case of a dissolution of Union.

A monetary union while abandoning the guarantee will involve choosing a new exchange rate regime, negotiating a new form of governance and defining the objectives of monetary policy and the instruments to be used. These negotiations are both highly technical and highly political. It will have to involve the BCEAO, the finance ministries and the heads of State and Government simultaneously.

So, what should be the time frame for the end of the French guarantee? One option is to move very quickly with the assistance of the IMF, while another is to maintain the guarantee for several years in order to prepare the Union for the new situation and avoid speculation.

If the choice is made to keep a fixed exchange rate regime, it is possible that a devaluation will have to be considered from the outset when the new system is announced. Whatever current adequacy of the WAEMU real effective exchange rate, a change of regime would lead to cautious behaviour on the part of economic operators, which would present a risk for the level of parity. The choice a new parity level may then be imperative, which implies a discussion between States, which currently have competence in this area.

The dissolution of the monetary Union will need to negotiate the ways and means. This will involve the distribution of the BCEAO common assets and liabilities, a highly political issue, particularly as the different countries have contributed very differently to the Union's foreign exchange reserves. Provision will have to be made for the dissolution of the BCEAO and the dismissal of its staff, some of whom may be re-employed in the new national monetary institutions. A decision will have to be taken on the fate of the currency in circulation and its conversion into the various national currencies. The treatment of intra-WAEMU international claims will be a key element, and one that will undoubtedly be very delicate to solve. The dissolution of the monetary Union will also require a decision on the future of economic and trade cooperation, a complex issue. Finally, a decision will have to be taken on the fate of the BOAD, whose capital is majority-owned by the BCEAO and which will have to work with several currencies.

All this takes time to negotiate and implement, so that the process is carried out in the best interests of the States concerned. It is illusory that this process can be secret; on the contrary, it is the transparency of the process that will make it possible to limit uncertainties and hence speculation. It is indeed in the interests of economic operators to protect themselves against any slippage, especially if they fear that the end of monetary cooperation with France and the modification or disappearance of the monetary Union will result in a depreciation of the exchange rate and a surge in inflation.

The authors' point of view

Putting an end to France's exchange rate guarantee, whether by preserving the Union or by moving towards national currencies, requires major decisions on the part of the member States, which are often underestimated and, it seems, even less studied and prepared. The two types of transition obviously pose different problems and risks

In our opinion, if the countries concerned wished to move towards major reforms that would put an end to monetary cooperation with France, it would seem preferable (i) that their foreign exchange reserve situation be sufficiently comfortable (ii) that they give themselves a period that is both sufficiently long to conduct their negotiations and take decisions and not too long so that economic uncertainty does not lead to excessive consequences for the economies. It would seem advisable for the point of arrival and the timetable to be announced as early as possible and in the best case at the beginning of the process to reduce uncertainty, and in good collaboration with France for the end date of the guarantee.

A key point for confidence is the amount of foreign exchange reserves at the start of the process. This should necessarily be higher than the standards currently required by the IMF (four to six months of imports depending on the exchange rate regime). New rules to ensure that reserves are maintained at a high level should be introduced, ideally during the transition period. Whatever exchange rate regime is chosen, reserves will remain a key point of credibility for the new currencies.

A basic precaution on the part of economic operators will be to keep as many foreign currency assets as possible outside the Union throughout the period of debate and operational transition. This will have a negative impact on the level of reserves. Tighter exchange controls (including on current account transactions) would therefore appear to be necessary during the transition period. Negative expectations on the part of economic operators are inevitable. But exchange controls, if they are effective, will have significant negative effects (reduction in foreign trade, reduction or sudden stop of foreign direct investment and loans to the region) and will inevitably generate a parallel market with significant discount. It should therefore be maintained for as short a time as possible, especially as its effectiveness will undoubtedly be limited and decline over time.

If the Union were to break up, institutional issues would be easier to manage, as each country would be able to take its own decisions without any collective negotiation, although the dissolution of the BCEAO and the sharing of common assets and liabilities would require common decisions. The countries concerned will also have to negotiate the rates and terms of conversion of debts and claims as well as other financial assets.

At the same time, the risks of a chaotic transition when national currencies are created are the greatest. To avoid a situation with formidable social consequences, the choice of statutes for the new national central banks, ensuring their independence, will be essential. The choice of a conversion parity with the old common currency will also be a key point. Maintaining this parity for a sufficiently long period will also be an important confidence-building factor in speeding up the conversion process. As in the case of remaining in the Union, this will require a sufficient level of reserves, but also no doubt an initial undervaluation of the national currency, which will vary from country to country.

Insofar as the break-up of the monetary union would result in the alteration, or even the disappearance, of the WAEMU institutional framework, the foundations of an economic union should be rapidly negotiated and, for the time being at least, the current rules, particularly with *regard to trade and financial cooperation continue to apply. The member States will then be able to decide whether to maintain this trade cooperation or deepen the customs union at the ECOWAS level, or even at continental level (the Continental African Free Trade Area or CAFTA). Perhaps other parts of this institutional framework could be preserved (the banking Union?). As we have already mentioned, the break-up of the monetary Union will undoubtedly generate tensions (particularly, but not only, over the sharing of foreign exchange reserves and the conversion of inter-state claims). The ability to solve these conflicts quickly and on common ground is obviously a key factor in preserving the economic Union.*

Conclusion

If the WAEMU member States were to decide to end monetary cooperation with France, they would have to make important choices. It would be preferable for these choices to be thoroughly matured and to give rise to an informed, high-quality and quiet discussion and negotiation between them, which would also lay the foundations for the necessary transition from one regime to another.

Even if these choices fall solely within the sovereignty of the WAEMU countries, these decisions also involve France. Until now, France, through its President, has indicated that it would support the decisions of its African partners. But the political situation in France is changing and could change further.

The authors' point of view

Member States may still wish to maintain monetary cooperation with France.

However, in our view, solidarity between member States and with France is more in tune with the times than its origins suggest. It is akin to one of those regional financial agreements that the international financial community is trying to multiply to form a solid layer in the international financial safety net, making it possible to prevent currency and balance of payment crises. It remains a rare example of a concrete North-South link and a bridge between peoples.

In order to consolidate the existing system, however, we believe it would be useful to carry out a minimum of reforms. The aim would be to ensure greater ownership by concerned African countries, starting with the name of the currency, but also to strengthen the credibility of the guarantee by specifying the ways and means of solving the balance of payments crisis. The concerned African states may also be led to imagine new forms of cooperation between the WAEMU and France.

If monetary cooperation with France were no longer desired by the concerned African states, it would, on the other hand, be desirable to maintain a West African Economic and Monetary Union. This implies that its members should invest in a major dialogue between themselves, enabling them to take decisions that will have a major impact on their future and leading to a quantum leap in institutional integration.

If discussions between member States fail, the absence of agreement on new ground rules would lead to the dissolution of the Union. If this were to happen, it would be a major blow on the aspiration for regional integration, even if elements of economic integration could be preserved. The blow would be symbolic, economic and financial. It could have negative social consequences for the peoples of the region, particularly in the most fragile states. ECOWAS would have to bear alone the ambition of West African regional economic integration. While the merits of this organization are well known and appreciated, so too are its challenges and shortcomings, particularly in terms of economic and financial integration. At the time of writing, the actual withdrawal from ECOWAS of the three member countries of the brand-new AES is a particularly significant sign of this. Reinforcing the progress integration at the continental level (FTAA) would also be a productive path, but one that is likely to have a significant implementation and impact only in the long term.

In the event of disagreement among WAEMU member States on the governance and the principles of the Union, it would ultimately be better to have a diversity of national currencies, with or without states having signed monetary cooperation agreements with France, rather than a fragile, unconvincing regional monetary union that is bound to generate conflict between its members, and whose fate will in any case be its eventual dissolution.

Conversely, if WAEMU were to consolidate its stability and prosperity, with or without monetary cooperation with France, it could expand to include its neighbors and constitute a solid pole within ECOWAS, balancing Nigeria in and partnership and giving a new dimension and importance to Western Africa. This is a complex and demanding process, as it involves transformations in the institutional functioning of the Union, additional transfers or partial relinquishment of sovereignty, and a great deal of discipline so that the WAEMU retains its credibility. These negotiations between member countries should be conducted over a period, neither too short nor too long. It would contribute to the new impetus for economic integration on the continent.

It would be a pity if France were to remain absent from this debate. Of course, it is imperative for France to respect absolutely the sovereign choices of its partners, for whose benefit the WAEMU is being built. But it is not precluded, in friendship and in the interests of a partnership with a prosperous and stable Western Africa, from accompanying these choices by working towards constructive solutions, trying to preserve and support a fully sovereign regional Union, provided that it is politically viable and economically successful. Whatever the institutional relations between the Union and France, it is in France's political and economic interest for a stable and viable economic and monetary Union to contribute to the development of Western Africa.

"Sur quoi la fondera-t-il l'économie du monde qu'il veut gouverner ? Sera-ce sur le caprice de chaque particulier ? Quelle confusion ! Sera-ce sur la justice ? Il l'ignore."

Pascal

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