

## **CFA Zone and African Competitiveness**

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The CFA Zone is a monetary zone found in West and Central Africa under French colonialism, caved out by France in 1948 with a specificity of one currency known as CFA (French Community in Africa) pegged to the French Franc and later on to the Euro. These countries are made up of eight west African countries under the regional grouping of West African Economic and Monetary Union (WAEMU) and six Central African Countries under the regional grouping of Central African Monetary and Economic Union (CEMAC). The CFA Zone and African Competitiveness is the outcome of the 1994 devaluation of the CFA Franc which in it self was aimed at opening the CFA to competitiveness. This was due to the prolong deterioration of the terms of trade of the countries of the CFA franc zone, a steep rise in the labour costs of those countries and a nominal appreciation of the French Franc against the US dollar, all of which resulted in an overvalued exchange rate.

According to Gustavo Ramirez and Charalambos G. Tsangarides in an IMF working paper in 'Competitiveness in the CFA Franc Zone':

*Competitiveness can be defined as the ability of a country to operate efficiently and productively in relation to other countries while keeping living standards for its citizens high. From a macroeconomic perspective, competitiveness can be viewed as the degree to which a nation can produce goods and services that meet the test of international markets while simultaneously expanding the real incomes of its people over the long term under free trade and fair market conditions. At the microeconomic level, competitiveness is the capacity to sell products profitably. To be competitive, a firm, and by extension, a country must be able to charge lower prices or offer products of better quality than its competitors.*

Also, according to Ramirez and Tsangarides findings on competitiveness in the CFA Franc Zone:

*...the evidence of evolution of competitiveness in the region suggest that there are some areas where competitiveness has improved (particularly export profitability and market share in CEMAC driven oil market development) but others where competitiveness has worsened (including, for both regions, real effective exchange rate appreciation and poor scores on cost of doing business and governance). Second, there are serious competitiveness gaps when CEMAC and WAEMU are compared with their peer groups of countries, particularly in the area of business environment, governance, and human capital. Finally, in order to overcome competitiveness challenges in the regions there is a need for structural reform policies in both regions to boost productivity, reduce excessive factor costs, diversify the base of production, and create the conditions to attract higher domestic and foreign private investment in all sectors of economic activity.*

Drawing from the above findings, one thing which comes out is the fact that competitiveness in the CFA Zone depends on "favourable environment and the government policy." The environment component includes measures of

costs, prices, exchange rates, wages and their impact on the ability of the country to export enough goods and services to pay for its import requirements and maintain full employment. The policy component includes factors that contribute to better business performance through innovation and productivity, such as the business environment, governance, and physical and human capital. The determinants of the environment, namely, prices and costs, macroeconomic performance, and productivity and labour markets are the conditions of competitiveness that good policies create. Similarly, policies are both responses to and results of the current environment.

Since the devaluation of Franc CFA in 1994, countries in both the CEMAC and WAEMU regions have experienced varied growths. Nevertheless, oil market developments including variations in world oil prices and country-specific positions in the life cycle of oil production have dominated the CEMAC economies.<sup>1</sup> Equally, since 1994, real GDP growth in the CEMAC averaged about 5 percent of GDP (with a drop in 1999 as oil prices plunged) while in the WAEMU, growth has been lower and more volatile, averaging about 4 percent. Relative to averages in Sub Saharan Africa (SSA), real per capita growth has been strong. Also, growth in the CEMAC has exceeded that of emerging Asia and for 2001 – 2006 doubles the SSA average. Real growth in per capita terms was not as favourable for either regions, with WAEMU growing at lower than SSA rates and CEMAC just about the SSA rates. Disparities between WAEMU and CEMAC result from higher population growth rates in WAEMU and higher growth in the CEMAC due to oil markets.<sup>2</sup>

Considering that competitiveness is also measured through the quality of life which include life expectancy, literacy, and income, the UN Human Development Index rank CEMAC and WAEMU below emerging Asia and Latin America and the CEMAC region performs only marginally above the SSA average. All WAEMU countries rank in the low human development part of the HDI and four WAEMU countries (Guinea-Bissau, Burkina Faso, Mali and Niger) rank among the five lowest in the index with visually no improvement since 2000. CEMAC countries perform only marginally better, with Chad and the Central African Republic (CRA) in the bottom seven of the index and the rest rated as in 'middle human development.' At about 50 years, life expectancy for both WAEMU and CEMAC ranks much below the averages for emerging Asia and Latin America. Finally, income inequalities are higher in CEMAC than in WAEMU, about the SSA average and emerging Asia and OECD<sup>3</sup>. Despite the recent increases in GDP growth rates in both regions, it has generally failed to translate into improvements in the quality of life indicators and sustainable improvements in living standards.

Following the environment and conditions for competitiveness, a number of issues come to play to permit a favourable environment for CFA

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<sup>1</sup> *Of all the CEMAC countries only the Central Africa Republic does not produce oil. Petroleum constitutes the bulk of the region's export receipts and the greater proportion of its budgetary revenue.*

<sup>2</sup> *Gustavo Ramirez and Charalambos G. Tsangarides, 'IMF Working Paper on Competitiveness in CFA Franc Zone,' 2007, p. 8.*

<sup>3</sup> Organization for Economic Cooperation and Development

competitiveness. These include: productivity and labour markets; cost and prices; and macroeconomic performance.

Productivity can be considered as a determinant of both economic growth and an indicator to competitiveness. Productivity is a measure relating to quantity and quality of output to the inputs required to produce it. This refers to labour productivity which can be measured by quantity of output per time spent or number of workers employed.

The real per capita GDP growth in WAEMU and CEMAC suggest that WAEMU productivity is the lowest among all developing country comparator groups including SSA, with the trends indicating a decline since 1995-2000. The CEMAC productivity is about the SSA level and has been improving since 2000.<sup>4</sup> According to Ramirez and Tsangarides, measured productivity compared with trading partners for both WAEMU and CEMAC has been declining. While high population growth rates exert a resource constraint, some labour market conditions, such as labour force participation, appear promising when contrasted with comparator groups.

As a result of the 1994 devaluation, the immediate incidence on prices and profitability helped to make the CEMAC and WAEMU countries more competitive. This was followed by a steady appreciation of the Real Effective Exchange Rate (REER) by about 32% through 2000 and by another 21% from January 2001 to December 2006. By 2006 CEMAC REER was at 86% of its pre-devaluation level. The WAEMU REER appreciated by 21% through December 2000 and by another 11% from January 2001 to December 2006. By December 2006 WAEMU REER was at 77% of its pre-devaluation level. This means that CFA countries exports are now less competitive compared to other SSA countries as a result of the CFA peg to the euro. On the other hand imports are cheaper especially oil products which are priced in dollars. However, despite increases in oil production and prices, oil revenue for CEMAC oil exporting countries is declining as the sharp appreciation of the CFA franc reduces its value in local currency terms.

Within the various regions, there are significant variations. Within WAEMU, Benin has witnessed the highest appreciation since the 1994 devaluation and Mali the lowest. By December 2006 Mali's REER stood at 66% while Benin's at 89%. In the CEMAC region at the end of 2006, Equatorial Guinea had the highest appreciation of 116% of the pre-devaluation and Gabon the lowest with 70%.<sup>5</sup>

As regards the Internal Real Exchange Rate (IRER), which is the appropriate measure of competitiveness for small economies where the cost of production is reflected in the price of non-tradable goods and the price of imports determined in world market, in CEMAC fluctuations in the IRER followed those of the CPI-based REER but with wider amplitude. For the WAEMU the IRER was in line with the CPI-based REER.

The labour cost based REERs have remained below the CPI-based REER in both CEMAC and WAEMU. CEMAC's labour-cost based REER depreciated much more than the CPI-based REER after the devaluation, and has

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<sup>4</sup> Ramirez and Tsangarides, 'IMF Working paper,' p.11

<sup>5</sup> Ibid, p. 13

remained lower at about 62% of its pre-devaluation level. The WAEMU labour-cost-based followed a similar pattern up to 2003 but since then has been appreciating faster than the CPI-based REER, suggesting that recently labour cost have been rising faster than prices. Further, for both regions, the stronger depreciation of the labour-cost based REER compared to the CPI-based REER suggest that there was a downward adjustment of nominal wages.<sup>6</sup>

As regards the Unified Regional Nominal Effective Exchange Rate, CEMAC now stands at about 60% of its pre-devaluation level at the end of 2006. In 2000 the URNEER reached its minimum at 50% of its 1993 level. The CEMAC Unified Regional Real Effective Exchange Rate (URREER) appreciated about 28% from 1994 to 2006 and is now at about 83% of its pre-devaluation level. Due to the peg of CFA to Euro, the URREER, relative to European Union is less volatile than total URREER. As concerns the WAEMU, the URNEER has appreciated by 30% since 1994 and is currently at 80% of its pre-devaluation level. By 2007, its URREER was about 72% of the pre-devaluation level. Unlike the URREER compared to the EU, the WAEMU URREER compared to trade partners in SSA is more volatile, and there were episodes of extreme depreciation in February 1995 and in January 1999.

Concerning the Equilibrium Real Exchange Rates, Abdih and Tsangarides estimate that while both the WAEMU and CEMAC real exchange rates were slightly more appreciated than their estimated long-run equilibrium levels at the end of 2005, the estimated misalignments were not statistically significant. This suggests that at the end of 2005, both the CEMAC and WAEMU real effective exchange rates were broadly in line with their long-run equilibrium values.

Considering the fact that there is no reliable data on total production costs in both regions and no first hand data on the wage rate including the private sector, an index of the civil servant wages is the most favourable for nominal wage index. The nominal wages tend to have grown slower than other domestic prices in most countries in both regions. By the end of 2006, CEMAC countries showed a similar decline in the real wage index except Equatorial Guinea (where government expenditures increased sharply with oil revenues) and Gabon. In WAEMU real wages in 2006 were lower than in 1993 in Burkina Faso, Cote D'Ivoire, and Togo but through 2003 had risen in Benin, Mali and Senegal. The decline in real wages was most noticeable at the time of the devaluation, because exchange rate pass-through to wages is weaker than pass-through to other prices. In summary, the various real exchange rate measures point to an appreciation of the CFA franc in both WAEMU and CEMAC, suggesting a loss of competitiveness.

The third variable of Macroeconomic performance in CFA competitiveness measures the evolution of export flows and market shares, as well as foreign direct investment (FDI) flows. FDI flows also reflect the attractiveness of a country's investment climate and tend to be correlated with increases in exports. Since 2001, CEMAC shares of the export market to the world have been increasing, to Africa declining, and Europe roughly constant. Intra-

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<sup>6</sup> *Ibid*, p. 15

CEMAC trade has been virtually flat at about 1% since 2000. Over the same period, WAEMU market shares to the world appear to be increasing, and for Africa and the EU decreasing, but intra-WAEMU exports have been expanding and are much higher than the intra-CEMAC exports. For the CEMAC region, export performance has been dominated by the oil sector, as is evident by the increase of both the share and volume of oil exports. Since 1997 there has been a decline of non-oil exports to GDP, though they began to pick up in 2005. In comparison to export shares of other groups, CEMAC average exports-to-GDP in 2001 to 2006 are higher than in Latin America, SSA, and almost at the level of emerging Asia. At about 31% WAEMU's average export shares are below SSA generally but compare favourably to the other comparator groups.<sup>7</sup>

While FDI in both WAEMU and CEMAC is low in dollar terms, it has been significant as a share of GDP. FDI in CEMAC has been steadily increasing, surpassing other SSA countries since 2001, primarily due to oil-related investments. It amounted to about 40% of the region's GDP in 2005. In WAEMU FDI has been flat at about 15% of regional GDP since about 2000. Generally, FDI has been increasing in CEMAC and compares favourably with the rest of SSA, but has stagnated for WAEMU.

Through a survey-based indicators of the business environment by Ramirez and Tsangarides, in both WAEMU and CEMAC, the cost of starting a business are higher than in SSA generally and any other comparator group. The minimum capital required to start a business in a WAEMU country is 2.5 times higher on average than in SSA and registering property is about 30% costlier in both WAEMU and CEMAC. Labour regulations in WAEMU and CEMAC are 20-30% more rigid than in SSA. For investors, disclosure of ownership and financial information is not as satisfactory in the CEMAC as in SSA, though about the same for WAEMU and it is more difficult and costly to enforce contracts. Closing a business in CEMAC is about twice as costly and time consuming than in SSA, and the recovery rate is extremely low (10 cents on the dollar compared to 18 for SSA). In the WAEMU, time to close a business is longer but the cost is lower than the SSA average, and the recovery rate is about 23 cents, above both the CEMAC and SSA averages. Starting a business in SSA generally is four to five times more than in a median developing country, and the costs in CEMAC or WAEMU are six times higher. Although CEMAC and WAEMU countries face high hiring costs, they are only 50% above the median developing country.

Almost 60% of profits are taken in taxes in CEMAC, and about 48% in WAEMU, which is at the SSA median and not far from the median developing country (46%). As for the external sector, in 2006 the WAEMU region is again very close to the SSA average, but in CEMAC the total number of days needed to export and import was about 10 more for the median country compared to WAEMU and SSA. The median developing country can place its merchandise in just 26 days, in WAEMU a country needs 32 days, and in CEMAC 44 days. Imports reach their destination in the median developing country in 34 days, but the process takes 48 days in WAEMU and 56 days in CEMAC.

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<sup>7</sup> *Ibid.*p. 20

In governance, poor and weak institutions can undermine competitiveness by imposing significant direct and indirect cost on business environment and the cost of doing business. The World Bank's Worldwide Governance Indicators (WGI) covers six dimensions of governance in 213 countries for 1996-2006. The indicators are constructed by aggregating surveys and the dimensions covered are voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. Both WAEMU and CEMAC countries tend to rank below average on important dimensions of governance compared to other countries at a similar level. However there has been improvement in recent years and Senegal is cited in the 2006 WGI report as one of the six African countries that have made progress in improving governance and curbing corruption.<sup>8</sup>

CEMAC countries perform worst on the government effectiveness and control of corruption components, with on average less than 13 countries ranking below them. In terms of other components CEMAC countries rank between the 14<sup>th</sup> and 30<sup>th</sup> percentiles, with relatively higher ranking on political stability. WAEMU countries on average rank better than the CEMAC countries as about 30% of the countries surveyed ranked worse than the WAEMU average. Never the less there are substantial variations in WAEMU, as Benin, Senegal, Mali, and Burkina Faso are performing relatively better, and Cote D'Ivoire and Guinea Bissau relatively worse. Cote D'Ivoire and Guinea Bissau are doing badly particularly in political stability (Cote D'Ivoire at 1<sup>st</sup> percentile); rule of law (Cote D'Ivoire at the 4<sup>th</sup> percentile); control of corruption (Cote D'Ivoire at the 6<sup>th</sup> percentile); and government effectiveness (Guinea Bissau at the 4<sup>th</sup> percentile). Summarily, countries in the two regions tend to rank below average on important dimensions of governance, such as government effectiveness, regulatory quality, the rule of law, and control of corruption, compared to other countries at a similar level of development.

Over the years it has been obvious that technology and capital, both physical and human, are policy inputs that raise productivity and competitiveness. So far, infrastructure and technology indicators show improvements over SSA. Both WAEMU and CEMAC physical infrastructure as measured by the percentage of paved roads improved in 2000-2005 compared to 1990-1995. Never the less infrastructure development is generally poor in the CEMAC, though in the WAEMU it is 50 % higher than the SSA average and compares favourably with Latin America (27%) and the general Low and Middle Income (LMI) country average (30%). Using mobile phone subscriptions and internet usage as a proxy for technology suggest that CEMAC performs above both the WAEMU and SSA averages.

At about 50 years, life expectancy in WAEMU is higher than in CEMAC, which is marginally better than in SSA, but more worryingly, in both CEMAC and SSA life expectancies declined in 2000-2005 compared to 1990-1995. The 2000-2005 WAEMU and CEMAC rates are strikingly lower than for other developing country groups, such as Latin America (72 years), East Asia and

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<sup>8</sup> The other five mentioned in WGI are Botswana, Ghana, Sierra Leone, Mozambique, and Liberia

Pacific (70 years), and South Asia (63 years). Infant mortality rates have improved in WAEMU to about SSA rates (102 per 1000) but marginally worsen in CEMAC in 2000-2005. The rates are much higher than for Latin America (27), East Asia and Pacific (29) and South Asia (66). The education and health expenditures-to-GDP ratio is below SSA levels for both WAEMU and CEMAC. At about 4 to 5 % of GDP for health and 2.5 to 3% for education in 2000-2005, these will not be sufficient for these countries to attain the Millennium Development Goals; though primary education completion rates have improved for both WAEMU (35%) and CEMAC (521%). Finally, HIV prevalence in 2000-2005 was below SSA levels in both WAEMU (2% of the population) and CEMAC (6%). Never the less these rates are much higher than any other developing country group considered. The LMI country average was 1.2% and East Asia and Pacific average was 0.2%. Generally, while selected physical capital indicators point to improvement, particularly for the CEMAC, the two regions are seriously deficient according to human capital indicators.

### **Conclusion**

In conclusion, improvements in GDP growth rates have for the most part failed to translate into improvements in quality of life indicators. Also, export patterns and market shares in the CEMAC and WAEMU regions show some improvements in competitiveness. In spite of the real appreciation, the terms of trade and export profitability in CEMAC have recently improved, although the improvements have failed to translate into increased market shares. This is partly because the real appreciation was driven mostly by nominal exchanges and has failed to translate into price and wage increases. Generally, the overall terms of trade and profitability improvements have been driven by oil price and volume increases; for non oil exports terms of trade have been declining since 1990s. On the contrary, export profitability in the WAEMU region has remained roughly constant since 1994. The policy indicator of competitiveness suggest structural rigidities in business climate and governance, as well as significant challenges in improving human and physical capital in comparison to other peer groups WAEMU and CEMAC face significant challenges. Building competitiveness in order to raise growth and improve the quality of life needs to be a major objective of WAEMU and CEMAC.

Following Ramirez and Tsangarides recommendation which are also applicable here, priorities in both the WAEMU and CEMAC regions should include: structural reforms to boost labour productivity, reduce excessive factor costs, and diversify the base of production and exports of the economies; reduction of factor costs by improve access to new technologies; regional integration programs, notably in road infrastructure, telecommunications and energy, and other areas facilitating interregional trade; and creating the right condition for an increase in domestic and foreign private investment in all sectors of the economic (especially in the non-oil sector for CEMAC), beginning with reforming the legal and regulatory system, governance, and the business environment