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OPINION | COMMENTARY

Farewell to the CFA Franc: Macron and Ouattara End a Colonial Relic

The eco, West Africa's new money, would be sounder if accompanied by a currency board.

By Steve H. Hanke

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French President Emmanuel Macron and Ivoirian President Alassane Ouattara in Bouake, Ivory Coast, Dec. 22. PHOTO: LUDOVIC MARIN/AGENCE FRANCE-PRESSE/GETTY IMAGES

French President Emmanuel Macron and Alassane Ouattara, president of the Ivory Coast, have delivered the coup de grâce to a colonial relic: the CFA franc. Created in 1945, the CFA franc is the only colonial currency arrangement still in existence. Fourteen African countries constitute the CFA franc zone. These countries in West and Central Africa are split into two separate economic and monetary unions in which the CFA franc is the coin of the realm. But the two presidents announced Dec. 21 that when the new year is rung in, the currency will disappear in the eight countries of the West African zone—home to 130 million people—and be replaced by a new one, the eco.

While other colonial moneys met their demise long ago, the CFA franc has survived and thrived. It is convertible across the countries that are members of the CFA franc monetary zone, with no capital controls existing among members. Paris still plays a pivotal role in setting the zone's policies. France guarantees the convertibility of the CFA franc at a fixed rate to the euro and influences decisions in the zone with an "operations account" at the French Treasury. Paris has subsidized the system, but also imposes discipline by controlling member states' access to credit at the French Treasury.

The CFA franc system has worked well compared with central banking practiced in other African countries. Fiscal deficits and sovereign debt levels are lower, reflecting the discipline that the fixed exchange rate imposes on member countries. Inflation and unemployment rates have been lower in CFA countries than in other African economies.

So why did the CFA franc become a hot potato for Mr. Macron? As in the past, colonial politics have entered the arena. This past summer, for example, Luigi Di Maio, Italy's foreign affairs minister and leader of the antiestablishment 5 Star Movement, took direct aim at Mr. Macron. Mr. Di Maio attacked France's foreign policy for, among other things, using the CFA franc to exploit its former colonies. In those former colonies, some activists and leaders agree with Mr. Di Maio's assessment.

To lower the temperature, Mr. Macron decided to remove the West African CFA franc from the marquee and replace it on Jan. 1 with the eco. In addition to the currency's name change, France will close the CFA franc's "operating account" at the French Treasury. The requirement that the Central Bank of West African States deposit 50% of its foreign reserves at the Banque de France will also be eliminated and French representation on the West African central bank's board will be terminated. But Paris will continue to guarantee convertibility of the new eco with the euro at a fixed rate.

These changes are mostly cosmetic. The introduction of the eco is mainly a strategic move by Messrs. Macron and Ouattara. For some two decades, the Economic Community of West African States has debated and planned a new currency, to be called the eco, for use in a large interstate union. This union would have a natural center of gravity in Nigeria, the region's largest economy and most populous country. The new, primarily Francophone eco throws a wrench in the works of the original Nigeria-centric eco monetary union.

Now that one version of the eco is moving forward, what should be the next move of the countries it covers? The best option would be to transform the eco zone into a superior currency-board system. A currency board would issue notes and coins convertible on demand into a foreign anchor currency, the euro, at a fixed rate of exchange. The board would hold anchor-currency reserves equal to 100% of its monetary liabilities, and it would generate profits from the difference between the interest it earns on its reserve assets and the expense of maintaining its liabilities.

By design, the currency board would have no discretionary monetary powers and could not issue money on its own credit. It would have only an exchange-rate policy: The exchange rate would be fixed. The sole function of the currency board would be to exchange the ecos it issues for euros. Consequently, the quantity of ecos in circulation would be determined entirely by demand. The eco would be a clone of its anchor—the euro.

Currency boards have existed in some 70 countries. No currency board has failed to maintain its currency's convertibility at a fixed rate to its anchor currency. This illustrious record includes many currency boards in Africa, notably those in former British colonies.

Despite their exemplary record, currency boards were replaced with central banks throughout most states over the past century. There were three main reasons for the shift. First, influential economists praised central banking's flexibility and capacity for fine-tuning. Second, newly independent states were trying to cut their ties to former imperial powers. Third, administrators were anxious to obtain new clients and "jobs for the boys" at the International Monetary Fund and the World Bank, and they lent their weight and money to the establishment of new central banks. In the end, the Bank of England was the only major institutional voice to speak up for currency boards.

A new currency board in West Africa would allow the eight countries in the eco zone to issue the soundest currency in Africa. They would benefit from the hard budget constraint and fiscal discipline the system would impose. And if that wasn't enough, a currency board would generate a profit and allow the member states to become totally independent of Paris in the currency sphere.

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