INTERNATIONAL MONETARY FUND

Fund Surveillance Over Members of Currency Unions

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In consultation with other departments

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I. Introduction

1. **Effective Fund surveillance over the members of currency unions entails discussions at the regional level.** This requirement derives from the fact that currency union members have devolved responsibility for policy areas that are central to Fund surveillance, notably monetary and exchange rate policies, to regional institutions. Discussions have been held for some time with regional institutions in the euro area, the Central African Economic and Monetary Union (CEMAC),[1] the Eastern Caribbean Currency Union (ECCU),[2] and the West African Economic and Monetary Union (WAEMU).[3] However, only for the EU institutions responsible for euro area policies have these discussions been formalized as constituting an integral part of the Fund's surveillance on the individual members of the currency union.

2. **At the conclusion of the 2004 biennial surveillance review, Directors called for formalization of discussions with regional institutions in the remaining currency unions: CEMAC, ECCU and WAEMU.** [4] Specifically, "Directors agreed that it would be desirable to establish an appropriate framework for policy discussions with regional institutions in these three currency unions, which would recognize that these discussions form part of the Article IV consultations with concerned members. Such steps would

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[1] Cameroon, Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon.

[2] The ECCU comprises six Fund members—Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines—and two dependent territories of the United Kingdom (Anguilla and Montserrat).

[3] Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Togo and Senegal.

[4] *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Overview*, available at www.imf.org (August 24, 2004).

strengthen surveillance over monetary and exchange rate policies, trade policies, and financial sector regulation and supervision."[5]

3. **This paper proposes to formalize the modalities of discussions with the regional institutions of these currency unions in the context of the Article IV consultations with the members of these currency unions**. The proposal draws heavily on the experience with the modalities of regional surveillance of the euro area, while taking into account current practices and specific institutional arrangements in the CEMAC, ECCU and WAEMU. The appendix summarizes the key features of these three currency unions.

II. Current Practice

A. Euro Area

4. **The modalities of regional discussions in the context of Fund surveillance over euro-area members were formalized in 1998**.[6] Regular discussions with the EU institutions had been held for some years, and staff reports covering these discussions had been prepared and discussed by the Board since 1992. Formalization of these modalities was prompted by the implementation of the third stage of the EMU and the introduction of the euro on January 1, 1999. These arrangements have worked reasonably well in practice, and have allowed for an effective policy dialogue with EU institutions.[7]

5. **At the time, it was clarified that discussions at the regional level would form part of the Fund's Article IV consultations with individual euro-area member countries.**[8] Though these countries had devolved responsibility for certain policies to regional institutions, they remained individually responsible for discharging their obligations under Article IV of the Fund's Articles of Agreement.

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[5] *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision,* Public Information Notice on the Executive Board Discussion, August 24, 2004, available at www.imf.org.

[6] *Surveillance Over the Monetary and Exchange Rate Policies of the Members of the Euro Area,* SM/98/257, 11/25/98, and Decisions No. 11846-(98/125) and No. 12899-(02/119), available at www.imf.org.

[7] *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Overview,* August 24, 2004, available at www.imf.org, and Box 1 of *Euro Area Policies,* IMF Country Report No. 04/234, available at www.imf.org.

[8] *Surveillance Over the Monetary and Exchange Rate Policies of the Members of the Euro Area,* SM/98/257, Decision No. 11846-(98/125) available at www.imf.org.

6. **Present modalities of Fund surveillance with respect to euro-area members comprise:**

- Annual Article IV consultations with individual members.[9]

- Twice-yearly staff discussions with EU institutions responsible for common policies in the euro area. The discussions are held separately from the discussions with individual euro-area countries, but are considered an integral part of the Article IV consultation with each member.

- An annual staff report and a formal Board meeting on the first round of discussions, which are considered part of the Article IV consultations with individual members. This meeting is followed by a summing up, which is expected to be cross-referenced in the summings up of the Article IV consultations with the individual members.

- An informal oral report to the Board on the second round of discussions with EU institutions to provide adequate context for bilateral consultations that do not coincide broadly with the annual Board discussion on the currency union's policies.[10]

- To the extent possible, clustering of Article IV discussions with individual member countries around the discussions with regional institutions.

7. **Discussions with EU institutions cover monetary and exchange rate policies, as well as common policies in other areas.** The latter include financial sector regulation and supervision, trade and competition policies, as well as structural policies in other areas considered relevant for Fund surveillance. An assessment of the fiscal position of the euro area as a whole is also included, as a necessary input for assessing the coherence of macroeconomic policies.

B. CEMAC, ECCU, and WAEMU

8. **Staff has also been holding regular discussions with regional institutions responsible for common policies in the CEMAC, ECCU, and WAEMU:**

- Since 1998 and 1999, respectively, discussions with WAEMU and CEMAC regional institutions have taken place once a year.[11] The staff report is discussed in a formal Board meeting and a summing up is prepared.

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[9] Except for Luxembourg, which is on a 24-month consultation cycle.

[10] In November 2002, modalities for the second semiannual discussion with the EU institutions were changed. The staff report for this discussion, which used to be submitted to the Board for information, was replaced by an oral staff presentation to the Board SM/98/257, and Decision No. 12899-(02/119), available at www.imf.org.

- Since 2003, discussions with ECCU regional institutions have taken place twice a year.[12] Both sets of discussions are followed by a Board meeting, one of which is a formal discussion with a staff report and a summing up. The other Board meeting is informal; since 2004, it involves an oral presentation by staff, supported by tables and charts.

9. **As in the euro area, regional discussions in these three currency unions have focused on policies under the aegis of regional institutions, as well as other policies of regional importance.** Discussions have covered monetary and exchange rate policies, progress in macroeconomic convergence, common trade policy, banking supervision, and, in particular, the consistency of fiscal and structural policies with the existing exchange rate arrangements. Policy discussions are increasingly backed up by analytical work—selected issues papers were included in the documentation for the 2003 and 2004 consultations with the ECCU.

III. Proposed Modalities of Surveillance

10. **Formalization of discussions at the regional level in CEMAC, ECCU, and WAEMU are not envisaged to entail significant operational changes.** However, the formal recognition that these discussions form part of the Article IV consultations with individual members could help strengthen the effectiveness of surveillance over policy areas at the core of the Fund's mandate, and would ensure uniformity of treatment across the Fund membership.[13]

11. **Modalities for Fund surveillance over members of CEMAC, ECCU, and WAEMU would comprise the following:**

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[11] Informal discussions also take place at the occasion of the Fund's Spring and Annual Meetings.

[12] The regional dimension of the Article IV consultations with the member countries of the ECCU was introduced in 1999, with the circulation of two regional papers as background for the Article IV consultations with individual ECCU member countries. To supplement the discussions with the regional institutions, annual discussions with each of the ECCU's Fund members on regional issues were introduced in 2004.

[13] All obligations under the Articles of Agreement in general, and under Article IV in particular, will remain the responsibility of the member country, including the obligation to provide data for the effective conduct of surveillance. The member countries may, however, decide to discharge a part of their obligations by arranging for the institutions of the currency unions to provide the Fund with regional data.

- Article IV consultations with individual member countries. The frequency of these consultations would continue to be determined by country-specific circumstances.[14]

- Yearly staff discussions with regional institutions responsible for common policies in the currency unions. The discussions are held separately from the discussions with the individual member countries of the currency unions, but are considered an integral part of the Article IV process for each member.[15]

- An annual staff report on the discussions with the regional institutions followed by a Board discussion, which are both considered an integral part of the Article IV consultations with the individual member countries. The summing up of these discussions would be cross-referenced in the summings up of the Article IV consultations wih the individual members. These discussions would focus on policies under the aegis of the regional institutions and, as relevant, other policies of regional importance.[16]

- A second round of staff discussions and an informal report to the Board, if needed, to provide adequate context for bilateral consultations with the currency union member countries that do not coincide broadly with the annual Board discussion on the currency unions' policies.[17]

- To the extent possible, clustering of the Board discussions for the Article IV with individual member countries around the regional Board discussions. While this

[14] All ECCU member countries are currently on an annual consultation cycle, with the exception of Dominica, where a Fund-supported program is in place. In CEMAC and WAEMU, a number of countries (Benin, Burkina Faso, Cameroon, the Republic of Congo, Côte d'Ivoire, Gabon, Mali, Niger, and Senegal) are currently subject to the rules on consultation cycles in program countries; the remainder are on annual cycles.

[15] These modalities would, however, not preclude the staff from engaging in additional discussions on issues of regional importance with the national authorities. Currently, in the case of the ECCU an annual discussion on regional issues takes place with national authorities because the highest decision-making body of the two key regional institutions—the OECS and the ECCB—is comprised of the Prime Ministers or the Finance Ministers of the member countries.

[16] The appendix discusses in more detail the policy responsibilities of the various regional institutions.

[17] The format of the informal report would be decided on a case-by-case basis, but it would be expected to consist of an oral presentation supported by tables and charts, following current practice for the euro area and the ECCU.

synchronization is more difficult in the case of program countries, a clustering of regional discussions with at least the largest members of the currency union may be feasible. Such clustering would help ensure better integration of the issues discussed at the regional level in the consultations with individual member countries.

12. Given that the proposed modalities of surveillance in the CEMAC, ECCU, and WAEMU closely resemble the current practice, the resource implications of the formalization of surveillance are expected to be negligible.

13. The following three decisions apply these modalities to the member countries in the three currency unions. The texts of the decisions are essentially similar; the editorial differences in the ECCU decision reflect the fact that some members of the ECCU are dependent territories of a Fund member.

CEMAC, ECCU, AND WAEMU: KEY CHARACTERISTICS

This appendix reviews the key features of the three currency areas for which surveillance modalities are being formalized. In particular, two features are worth noting:

- **All three currency unions are part of a broader economic integration process.** While the Central African Economic and Monetary Union (CEMAC) and West African Economic and Monetary Union (WAEMU) are themselves economic unions, the member countries of the Eastern Caribbean Currency Union (ECCU) are also members of the Organization of Eastern Caribbean States (OECS). Other aspects of economic integration are, however, less advanced than in the European Union and policy coordination is still incomplete.

- **Each of the currency unions maintains a pegged exchange rate.** In the ECCU, the regional central bank operates a quasi-currency board to the U.S. dollar; in the CEMAC and WEAMU the exchange rate is pegged to the euro and its convertibility is guaranteed by the French Treasury.

Reflecting similarities in their institutional set-up, the CEMAC and WAEMU are reviewed together, followed by the ECCU. The description covers: (i) the historical background; (ii) the key institutions; (iii) the policy responsibilities; (iv) policy convergence; and (v) data provision.[18]

A. CEMAC and WAEMU

Historical background

Established in 1999 and 1994, respectively, the CEMAC and WAEMU are two closely linked currency unions. Together they form the CFA franc zone, a currency area established at the end of the Second World War (Box 1). Created in the aftermath of the devaluation of the CFA franc, both CEMAC and WAEMU expanded policy cooperation among their respective member countries beyond the already well established monetary cooperation and customs union; both economic unions have been making progress in harmonizing trade policy, legal and regulatory systems, and in providing convergence of fiscal and other policies in support of the common monetary policies. The two currency unions comprise 14 members: 8 in WAEMU (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Togo and Senegal), and 6 in CEMAC (Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon).

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[18] Regarding data provision, the IMF Balance of Payments Committee has established a Currency Union Technical Group (CUTEG) that includes representatives from CEMAC, WAEMU, and ECCU. Its objective is to prepare an appendix for the next revision of the Balance of Payments Manual. This appendix will include conceptual and methodological guidance on issues related to the compilation of balance of payments and international investment statistics in currency unions and other regional economic and monetary arrangements.

Institutions

- The **Conference of Heads of States** and the **Conference of Heads of States and Governments** are the supreme policy-making institutions of the CEMAC and WAEMU**,** respectively. They are charged with the broad policy orientation of the unions.

- The **Councils of Ministers**[19] are in charge of the implementation of the decisions taken by these institutions. They are also responsible for the conduct of the regional surveillance, and to ensure that each member's policies are consistent with the objectives of the community.

- The **Executive Secretariat of CEMAC** and the **Commission of WAEMU** oversee the observance of the provisions of the treaties, and the implementation of the decisions taken.

- The **two central banks—Bank of Central African States** (**BEAC)** and **Central Bank of West African States** (**BCEAO)** for CEMAC and WAEMU, respectively**—**are responsible for monetary operations in the respective currency unions. The Governors are appointed by the Councils of Ministers; the Executive Board members are appointed by member countries (according to the country's size in BEAC, and two members per country in BCEAO). National Credit Commissions oversee monetary policy in the member countries.

- The **Regional Banking Commissions—*Commission Bancaire de l'Afrique Centrale* (COBAC) and *Commission Bancaire*** for CEMAC and WAEMU, respectively—are in charge of regulating and supervising credit institutions.

Policy responsibilities

Subject to the strictures of the CFA franc arrangement, **monetary policy is conducted by the regional central banks** (see Box 1 for more details). Monetary policy instruments available comprise charges on credit to banks (refinancing or discount windows), reserve requirements, and open market operations (in the case of the WAEMU). In the CEMAC, central bank credit to member governments is subject to a cumulative limit of 20 percent of budgetary revenue in the previous year.[20]

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[19] In the CEMAC, the Ministerial Committee of the Central African Monetary Union is in charge of issues pertaining to the Central African Monetary Union (CAMU).

[20] Central bank advances to member governments are no longer permitted in the WAEMU.

Fiscal policy is the prerogative of individual member countries. Nonetheless, in light of the crucial importance of fiscal discipline for the sustainability of the peg, fiscal policy is subject to regional surveillance (see below).

Box 1. The CFA Franc Arrangement [1]

Together, the CEMAC and WAEMU constitute the CFA franc zone.[2] Whereas there are two formally distinct currencies in both zones (the West African CFA franc in WAEMU, and the Central African CFA franc in CEMAC), the arrangement between both central banks and the French Treasury is almost identical (France is represented on the executive boards of the two regional central banks).

The CFA franc zone functions according to the following rules: (a) fixed parity against the euro, adjustable if required by economic reasons after consultation with the French government and the unanimous decision of all member countries; (b) convertibility of the CFA franc at the rate of €1 = CFAF655.957; (c) guarantee of full convertibility through the establishment by each central bank of an operations account with the French Treasury with market-related yields of charges; (d) free capital mobility between the two regions and France; and (e) the pooling of foreign exchange reserves in each monetary area.

The operating rules of the zone require that each central bank: (a) maintain at least 65 percent of their foreign assets in the operations account; (b) provide for exchange cover of at least 20 percent of their sight deposits; and (c) impose a cap on accumulated credit extended to each member country of 20 percent of the previous year's public sector revenue.

Aside from the 1994 devaluation, the parity between the CFAF and the French franc/euro has remained unchanged. The move to the EMU third stage and the creation of the euro did not have major implications for the zone, apart from the replacement of the peg to the French franc by the euro and the need to inform the ECOFIN about any change in partity.[3] As the agreement between the French Treasury and the CFA zone members is of a budgetary nature, it does not oblige the ECB to support the peg (EU council decision of November 23, 1998).

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[1] This box draws on Michael T. Hadjimichael and Michel Galy, *The CFA Franc Zone and the EMU,* IMF Working Paper, WP/97/156, 11/97 available at www.imf.org.

[2] Comoros has also been a member of the CFA franc zone since 1979

[3] ECOFIN's consent is needed for any change to the extent or nature of the arrangements.

Banking supervision is conducted by the regional Banking Commissions, which are headed by the Governors of the regional central banks. Prior agreement of the Executive Secretariat of the Banking Commissions is required for the licensing of any credit institution by national authorities. The Banking Commissions have only limited effective authority to impose sanctions on banks, without the consent of the Minister of Finance in the affected country.

- **The trade policy position of the member countries is coordinated by the Executive Secretariat and Commission in CEMAC and WAEMU, respectively.** Progress has been made in formulating a common regional trade policy and in establishing regional free trade areas, consistent with the provisions of their respective treaties. Both the CEMAC and WAEMU have common external tariffs.

Other structural policies are—like fiscal policy—the prerogative of the national authorities. Besides some progress achieved in trade policy, there have been initiatives to establish a common legal and regulatory environment conducive to private sector development. These initiatives cover business laws, investment charters, and competition policy.

Policy convergence

Partly in response to the establishment of the euro area, **both the CEMAC and WAEMU have established frameworks for regional surveillance with a view to achieving the gradual convergence of macroeconomic policies and performance among their member countries:**

- In 1999, the Council of Ministers of **CEMAC** adopted a regional plan to promote macroeconomic convergence. The convergence criteria were: (i) a primary fiscal surplus;[21] (ii) a ceiling on the public debt-to-GDP ratio of 70 percent; (iii) inflation less than 3 percent; and (iv) no increase in domestic or external government arrears. With the assistance of BEAC, the Committee on Multilateral Surveillance conducts quarterly regional surveillance exercises. The introduction of the convergence objectives has only had limited success as 4 out of 6 countries are in violation of at least one of the criteria.[22]

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[21] In order to take into account the impact of oil price volatility, the fiscal balance criterion is complemented by a "structural fiscal balance", which is defined as the primary balance based on the five-year average of oil revenue.

[22] Within the context of multilateral surveillance in the CEMAC, the evolution of a broader set of indicators is also monitored, including the reserve cover, the revenue-to-GDP ratio, the ratio of the public sector wage bill to revenue, the current account deficit as a share of GDP and the ratio of external debt service to exports.

- In the same year, a Convergence, Stability, Growth, and Solidarity Pact was introduced as an addendum to the **WAEMU** Treaty. The convergence criteria established had been divided into two groups: primary criteria and secondary criteria. The primary criteria are: (i) a fiscal surplus; (ii) a ceiling on the public sector debt-to-GDP ratio of 70 percent; (iii) an average annual inflation rate of at most 3 percent; and (iv) the nonaccumulation of domestic and external payment arrears. A set of secondary criteria span the civil service wage bill, public investment, the tax ratios, and the current account.[23] The original target date for meeting the convergence criteria was 2002. Since by end-2002 many member countries were in non-compliance, the transition period was extended to end-2005.

Data provision

With the exception of Equatorial Guinea, **all CFA zone member countries participate in the IMF General Data Dissemination System (GDDS).** AFRISTAT was created in 1993 to advise the national statistical institutes of member states. The IMF's regional technical assistance center in West Africa (AFRITAC-West) has contributed to improving macroeconomic statistics in WAEMU countries. Despite these efforts, the development of a regional database continues to face obstacles, including harmonization and reconciliation of national statistics.

B. ECCU

Historical background

The ECCU was established by the member countries of the Organization of Eastern Caribbean States (OECS) in 1983, and its members are also members of the OECS.[24] Its historical roots are the following: in 1965, the British Caribbean Currency Board (BCCB) was replaced by the Eastern Caribbean Currency Authority (ECCA) and, in 1976, the peg was shifted from the British pound to the US dollar. The eight member countries and territories of the ECCU are Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, which are independent states, and Anguilla and Montserrat, which are territories of the United Kingdom.[25] The six independent OECS states and Montserrat are also members of the Caribbean Common Market, CARICOM, established in 1973.

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[23] The four secondary criteria are: (i) a civil service wage bill of no more than 35 percent of tax revenue, (ii) a floor on the size of locally financed public investment at 20 percent of tax revenue, (iii) a tax-to-GDP ratio of at least 17 percent, and (iv) a ratio of the external current account-to-GDP ratio (excluding grants) of no more than 5 percent.

[24] The British Virgin Islands are an associate member of the OECS, but not of the ECCU.

[25] Barbados was an original member of the BCCB but left the arrangement in 1972 when it established its own central bank.

Institutions

- The **Authority of Heads of Government** of the member States of the OECS is the supreme policy-making institution of the organization.
- The **Central Secretariat** of the OECS is the principal institution responsible for the general administration of the Organization.
- The **East Caribbean Central Bank (ECCB)** was established in 1983. The Monetary Council, which meets three times a year, is the highest decision-making authority and is responsible for providing guidance to management. Each member government appoints one member of the Council. The Board of Governors—the executive body of the bank—comprises eight Directors, plus the Governor and the Deputy Governor, who are appointed by the Monetary Council.

Policy responsibilities

The ECCB is responsible for maintaining the U.S. dollar peg through a quasi-currency board arrangement. It issues the common currency, the Eastern Caribbean dollar, which has been pegged to the U.S. dollar since 1976 at EC$2.70=US$1. The ECCB Act places a floor on external reserves at 60 percent of the demand liabilities (reserve money) of the ECCB, resulting in an implicit ceiling on domestic assets of 40 percent of reserve money. The ECCB has maintained a reserve cover of more than 95 percent. Policy instruments at the disposal of the ECCB comprise discount and rediscount rates, reserve requirements, differential rates and ceilings for various types of transactions, and credit to members in accordance with specific rules.

Responsibility for regulating and supervising banks and systemic nonbank financial institutions in the ECCU is shared between the ECCB and the Ministry of Finance of each member country. The 1983 ECCB Agreement Act and the 1993 Uniform Banking Act established the ECCB's regulatory and supervisory jurisdiction over commercial banks and other licensed financial institutions, including offshore banks affiliated with local banks.

Fiscal policy is the prerogative of individual governments but subject to regional surveillance (see below section on policy coordination).

Trade policy positions of the member countries are coordinated by the CARICOM Secretariat.[26] A common external tariff has been adopted—though it is not fully implemented by all countries—and the Conference of Heads of Government of CARICOM decided in 1989 to create the Caribbean Single Market and Economy (CSME), which is scheduled to come into force in 2005.

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[26] In addition to the members of ECCU, 8 Caribbean countries are members of CARICOM: The Bahamas, Barbados, Belize, Guyana, Haiti, Jamaica, Suriname, Trinidad and Tobago. Anguilla, which is a member of the ECCU, is only an associate member of CARICOM.

While the OECS treaty provides for cooperation in areas other than monetary and exchange rate policy and trade, progress in other structural policy areas has been limited.

Policy coordination

In 1998, the Monetary Council of the ECCB adopted a set of fiscal benchmarks to support the quasi-currency board arrangement, to be achieved by 2007: (i) a surplus on the government current balance of 4-6 percent of GDP; (ii) an overall government budget deficit of no more than 3 percent of GDP; (iii) a total central government debt outstanding of no more than 60 percent of GDP; and (iv) debt service payments of no more than 15 percent of current revenue.

In practice, **fiscal policy coordination in the ECCU remains weak.** While the benchmarks were agreed by the ECCB's Monetary Council, which is comprised of the finance ministers of member states, the benchmarks have not been integrated into the national budgets or laws

Data provision

All ECCU member countries participate in the GDDS. The regional technical assistance center (CARTAC) has been providing technical assistance in national accounts, CPI, and balance of payments statistics. Weaknesses in the regional data remain with regard to the coverage, quality, and timeliness of trade, labor market, balance of payments, fiscal, debt, and price data.