V Conclusions

Economic performance in the WAEMU has improved considerably since the devaluation of the CFA franc in 1994. The growth of output has increased rapidly and now exceeds population growth by a substantial margin, exports and investment have recovered strongly, and budgetary and external imbalances have narrowed. Moreover, after a brief surge in the aftermath of the devaluation, inflation has returned to low levels. However, while the ratio of investment to GDP has risen since 1994, it remains low by the standards of other developing countries and even in comparison with other countries of sub-Saharan Africa, thus raising some questions about the sustainability of strong growth.

The fixed exchange rate regime adopted by WAEMU countries has been operating without interruption since 1948, except for the single change in the exchange rate peg in January 1994. This degree of stability testifies to the prudence of the BCEAO's monetary policy during this period and to the ability of governments to pursue supportive fiscal policies. At the same time, the subordination of monetary policy to the objective of defending the fixed exchange rate and the level of international reserves has not been costless in terms of growth and employment. The overdue exchange rate realignment of 1994 has demonstrated the capacity of WAEMU countries to implement in a coordinated fashion a comprehensive set of measures geared toward reestablishing competitiveness and restoring confidence in their economies. At present, the IMF staff, on the basis of an examination of a number of exchange rate indicators and the behavior of the external current account, considers the competitive position of the WAEMU to be broadly adequate. In the future, the evolution of these indicators will need to be kept under close review.

The monetary policy pursued by the BCEAO has made an important contribution to macroeconomic stability in the region. A number of steps would help these countries improve efficiency in the financial sector in the future. The central bank should improve the functioning of the regional interbank market to allow banks to channel their excess reserves to less liquid banks elsewhere in the WAEMU, thus contributing to the elimination of distortions and inefficiencies. The monetary authorities should also enhance competition between financial institutions. Lack of competition at present, particularly in view of the limited number of banks operating in the fragmented domestic markets, unduly raises lending rates and lowers the remuneration of deposits. The authorities should allow banks to open branches throughout the WAEMU and encourage them to compete for deposits and loans, which would improve the efficiency of the banking system and raise both private saving and investment. However, even if competition is improved, the supply of bank credit is likely to remain unduly constrained as long as the problems associated with loan recovery are not seriously addressed. Therefore, the IMF staff welcomes the efforts of the national authorities to improve the legal and judiciary environment. The entry into effect of the first Uniform Acts of OHADA will also contribute to this objective.

Another major preoccupation of the authorities is the need to further improve the soundness of the banking system. While they have made progress in the last few years, doubts remain about the financial situation of a number of institutions in need of restructuring. In particular, the rehabilitation plans for such banks should aim at a complete restoration of their equity base. In that context, the authorities should move to raise capital adequacy ratios to international standards.

The IMF staff believes that the success of WAEMU's common trade policy hinges on its ability to liberalize the region's trade regime. The common external tariff, to be phased in by January 1, 2000, represents an opportunity to achieve this goal. It should help raise productivity and incomes and improve the region's integration into the world economy by simplifying the present structure of import duties, lowering average tariff rates, and eliminating tariff peaks. However, it will be important for the WAEMU countries to avoid protectionist considerations in the final determination of the product classification scheme that they work out. Moreover, the application of any surtax should be severely limited in terms of level, coverage, and duration, and "statistical taxes" should be lowered in all countries as quickly as possible to the target level of 1 percent.

In the long run, the economic benefits resulting from the reallocation of resources and the improvement in competition made possible by the common external tariff should more than compensate for the losses that will unavoidably affect some producers in the region. In the near term, the reduction in average duties will have an adverse effect on government revenue in some countries. Although the decline in revenue should be compensated for through the reduction or elimination of exemptions on import duties and through other taxes, a transitional net revenue loss may well remain in a few countries. The resulting decline in government saving, if investment is to be protected, could lead to a transitory balance of payments gap. In those cases, and in the context of a strong program that includes strengthening the tax and customs administration, the possibility of additional, temporary financial support from the IMF and the World Bank will have to be considered.

A major challenge for the WAEMU will be to increase private investment, both domestic and foreign. The adoption of a common investment code should provide an opportunity to reduce or eliminate the tax incentives granted to domestic and foreign investors under existing regimes. In particular, the streamlining and harmonization of tax regimes under way in the WAEMU should allow governments to eliminate existing fiscal exemptions and preferences, which introduce serious distortions and deprive national treasuries of potentially large sources of revenue. A specific feature of the investment codes of WAEMU member countries is that they grant incentives in terms of value-added tax and tariff reductions, as well as corporate income tax incentives. The reduction or elimination in exemptions—under the value-added tax, in particular—would in many instances go a long way toward offsetting the revenue shortfalls resulting from lower tariffs. This reduction should go hand in hand with ambitious efforts to streamline the regulatory environment in which most enterprises function. In this respect, the harmonization of business laws represents a major achievement. The countries should take the next step of overhauling the functioning of the judicial system, which in many instances is an important source of significant delays and unreliable rulings.