

## Monetary Integration and the Poverty Reduction Debate in the CFA Zone<sup>1</sup>

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### Abstract:

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The overarching hypothesis in this paper is that monetary integration contributes to poverty reduction. I take a supportive view toward the argument that in the CFA zone, countries have performed better than their non CFA zone counterparts in terms of macroeconomic indicators, poverty eradication and income distribution. I therefore, attempt to offer a unique opportunity to investigate monetary integration and poverty reduction in the CFA zone.

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**Key words:** Monetary integration, macroeconomics, poverty, Africa, CFA zone.

### Introduction

Much research has been undertaken on the role of monetary integration to increase economic growth<sup>2</sup>, but little is known about monetary integration contribution to poverty eradication. While recent theories and evidence indicate that monetary integration plays an important role in forcing macroeconomic discipline<sup>3</sup>, evaluating the role of monetary integration in countries where poverty is widespread is a very hard and complex task. Due to the fact that, the causes and characteristics of poverty differ from country to country, I endeavour to carry out a comprehensive examination of the constraints and opportunities for poverty reduction in countries of the CFA zone<sup>4</sup>. This will require understanding of the distributional effect of monetary policies, the nature, intensity, and spread of poverty. This paper will therefore look at the link between monetary integration and poverty reduction.

One of the critical challenges facing CFA zone countries is how to enhance their economic competitiveness and increase their share in the global trade in order to achieve their poverty reduction targets. Among the various strategies adopted to surmount this challenge, CFA zone countries have consolidated their monetary integration. However, the latter countries are not the only group adopting this strategy. Many countries of the world have grouped together to form, expand or strengthen various monetary integration arrangements in the last decade. In addition, the efficacy of monetary integration arrangements is revamping integration of developing countries in the global economy and subsequently their impact in reducing poverty have become important subjects of analysis in the last decade. Many recognise that monetary integration forms an important part of the strategy for developing countries to achieve a 'smooth and gradual' integration into the world economy (Kennes 1997). An ensuing analytical question is whether and how monetary integration reduces poverty.

Data used in this paper therefore provides a unique opportunity to investigate monetary integration and poverty reduction in the CFA zone. My analysis suggests that integrated monetary policies have direct impact on the income of the poor. Further I found that monetary integration reduces poverty in the CFA zone.

The rest of this paper is structured as follows: Section one presents the literature survey on the definition of monetary integration. Section two analyses, the basis of macroeconomic performance, poverty lines and the distribution of income in the CFA and Non CFA zones countries and section three concludes.

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<sup>2</sup> See Claveranne, B. (2005) and Azam, J. P. (2004) for research in this area.

<sup>3</sup> See Fielding, D (2002) for further research in this area.

<sup>4</sup> The zone includes 14 member states in Africa and, in Europe, France. It therefore comprises both south-south coordination (SSC) between its member states, and north-south coordination (NSC) with France i.e. Europe.

## 1. Literature Review

### *Monetary Integration and Poverty Reduction in the CFA Zone*

The term monetary integration may describe institutional or legal monetary link between states Coden (1972). Member states in a monetary integration are subject to common monetary and fiscal policies. However, the definition of a monetary integration will be related to its degree of integration. The rationale for any monetary integration is provided by the general framework of the theory of optimum currency areas. Mundell was among the first economic theorists who first cited labour mobility as the most important determinant of optimum currency area. It facilitates adjustment between regions and prevents economic slowdown because it implies employment equalisation over areas which, in its absence, would be characterised by extreme high and low employment. When the currencies of small countries are pegged, Mundell argues that:

If you throw the devaluation instrument away, you want to have some protection in case your country gets into unemployment or excessive internal debt problems. If there is a shift of demand from your own country onto goods of the metropolitan centre, that will cause unemployment at home. If it can be mitigated by the labour flow to the metropolitan centre, the problem will be less acute”

(Mundell 1961: 366-367)

Allen (1976) defined monetary integration further by asserting that a monetary integration should include the following characteristics:

- A single money, or several currencies fully convertible at immutably fixed exchange rates.
- An arrangement whereby monetary policy is determined by all parties concerned, allowing no national autonomy in monetary policy. For example, as financial integration increases, inter-regional interest rate movements must become closer.
- No national autonomy is also allowed in a single external exchange rate policy.

Toward this end, national authorities must relinquish individual control over their international reserves and invest such control in a union authority (Allen 1976: 4). Therefore, the authors mentioned above emphasize the need for institutional safeguards to guarantee the existence of a single monetary policy.

The CFA zone encompasses elements of monetary integration described above. In Central and West Africa for example, the franc zone includes 13 member countries: Benin, Burkina Faso, Cameroon, Central Africa Republic, Chad, Congo, Côte D'Ivoire, Equatorial Guinea, Gabon, Mali, Niger, Senegal and Togo. The Franc zone owes its origins to the administration of French colonies before and immediately after World War II. In 1945, the *Franc des Colonies Françaises d'Afrique* or CFA franc was created and was to be issued by the *Caisse Centrale de la France d'Outre Mer*, which had been established during the war to provide a substitute for French bank notes issued under the occupation. Until 1962, the abbreviation “Franc CFA” stood for *Franc des colonies françaises de l'Afrique*. Today, this label is interpreted as *Franc de la Communauté Financière Africaine* in West Africa and is legal tender in Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo. In Central Africa the same label is interpreted as *Franc de la Coopération Financière en Afrique Centrale* and is legal tender in Cameroon, Central African Republic, Chad, Republic of the Congo (Brazzaville), Equatorial Guinea and Gabon. Both currencies follow almost identical monetary arrangements<sup>5</sup>:

- Convertibility into French franc i.e. Euro at a fixed parity. The exchange rate between the French and CFA francs is fixed at 100 FCFA = 1 FF. Changes in this parity required the unanimous consent of all zone members, including France.
- Guarantee of convertibility by France through the establishment of an operation account for each colonial central bank with the French Treasury.
- Free capital mobility throughout the zone.
- Pooling of most foreign exchange reserves at the French Treasury.

The introduction of the Euro left the monetary arrangement in the CFA zone un-touched, except for the fact that its currency is now pegged to the Euro. France, when becoming part of the Euro area, did so with the understanding that decisions regarding new members or changes in the exchange rate of the CFA system would be communicated in advance to European institutions.

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<sup>5</sup> For more information on the origins of the CFA zone, please see Claveranne (2005)

Interest rate structure and levels are determined by the BEAC (*Banque des Etats de l'Afrique Centrale*) in Central Africa and the BCEAO (*Banque Centrale des Etats de l'Afrique de l'Ouest*) in West Africa which set artificial discount rates identical for all member countries. Each country's National Credit Council sets the margin to be added to the BEAC or the BCEAO determined discount rates, so that ultimate borrowing and lending rates may differ between countries of the zone.

In addition to monetary integration, countries in the CFA zone also aimed to advance economic integration by founding, in Central Africa, the CEMAC (Communauté Économique et Monétaire de l'Afrique Centrale), and in West Africa, the UEMOA (Union Economique et Monétaire Ouest Africaine) in West Africa and the Communauté Économique et Monétaire de l'Afrique Centrale () in Central Africa. In the next section I assert that low inflation rates generated by the monetary and economic integrations have contributed to poverty reduction in the CFA zone. This assertion is supported by Fielding (2004) who argued that:

Households in a subset of the countries (in the CFA zone) especially poor household, bear the brunt of the price volatility... The policy instruments at its (CFA zone) disposal are potentially valuable set of tools to combat the price uncertainty that arises from exogenous shocks and increases the vulnerability of the poor.

(Fielding 2004: 592)

Shorthand and Stasavage (2004: 534) provided evidence that the CFA zone central banks take into account inflation rates and the output gap positions when making interest rate decisions. The regional integration also has effect on the price of goods produced and consumed by the poor. There is also a wider regional trade gain which benefits the poor.

I also assert in the next section that the above integration also serves to increase the overall investment, savings and per capita income and thereby reducing poverty in the zone. Azam asserted that:

The crucial link is through the fact that formal sector workers, who are much more affluent than other category of workers, in most countries of the CFA Zone, are running business in the informal sector. They invest their savings in small firms, where they generally employ people from their social network.

(Azam 2004: 558)

The fact that six<sup>6</sup> out of thirteen CFA zone countries in Central and West Africa till date have reached the *completion point* indicates their commitment to reduce poverty. Claveranne (2005) asserted that meeting the *completion point*, the CFA zone countries confirm their ability to carry out a pro-poor economic policy<sup>7</sup>. It should be noted that to reach the completion point, the latter countries met a number of triggers involving macroeconomic stability and commitment to a poverty reduction strategy.

## 2. Macroeconomic Performance, Poverty And Income Distribution: CFA And Non CFA Zones

In subsections 2.1 and 2.2, I compare respectively macroeconomics and poverty indicators for Central and West African countries in the CFA zone with those of the Non CFA zone. Only selected countries where relevant data to my study could be found in the World Bank data base are considered in this section. It follows therefore that, in the CFA zone, seven countries have been selected: Benin, Burkina Faso, Cameroon, Central African Republic, Cote d'Ivoire, Niger and Senegal. In the Non CFA zone, four countries have been selected: Ghana, Nigeria, Sierra Leone and The Gambia. Macroeconomics indicators analysed in subsection 2.1 are Inflation, Gross Domestic Savings as a percentage of Gross Domestic Product (GDP) and Gross Domestic Income per capita. Poverty indicators analysed in subsection 2.2 are: Poverty Line, Poverty Headcount and the GINI Coefficient.

### 2.1 Macroeconomic Performance

#### *Inflation*

Figure 1 shows that, in terms of inflation, CFA zone countries demonstrate a superior performance compared to their Non CFA zone counterparts. Over the 1961-2000 periods they averaged an inflation rate of only 6% per year compared to the Non CFA zone states at 22% per year. Monetary integration in the CFA zone may have contributed to the latter performance. For example, Honohan (1992) established a long-term relationship between CFA inflation rates and the "core" inflation rate of France. Furthermore, the control over the rate of domestic credit expansion by the CFA two central banks appears to have played a major role to the current low rate of inflation.

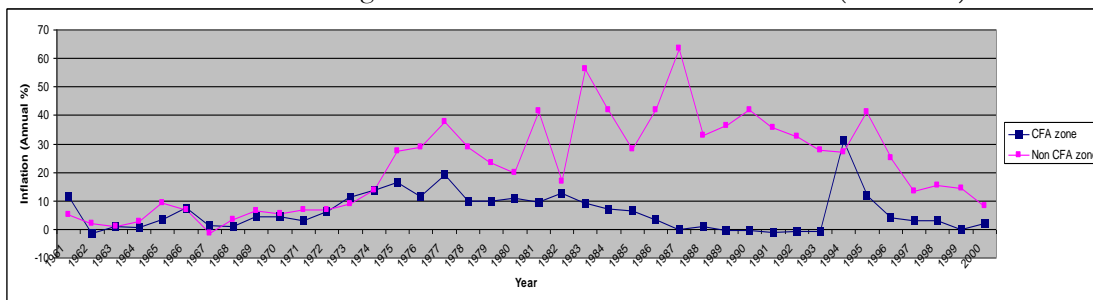
<sup>6</sup> The six countries to reach the completion point are: Burkina-Faso, Mali, Benin, Senegal, Niger and Cameroon.

<sup>7</sup> Claveranne, B. (2005: 206)

Fixed exchange rates have enabled CFA zone countries to maintain lower inflation than their neighbours. The openness of the CFA economies prevents strong linkages between fiscal financing through credit expansions and monetary growth. If there is too much credit expansion, it will simply leak out into imports or capital movements within the zone and France. If there is too little, it will be made up by capital inflows. One may deduce that the fiscal expansion has little impact on the stock of money, and hence inflation.

The above performance supports the analysis on poverty carried out in the next subsection. High inflation in the Non CFA zone could be detrimental in two ways. First, inflation may not affect individuals below the poverty line due to their negligible average cash holdings. But it may wipe out the savings of the middle class and increase the number of poor. In this sense it widens inequality of income as indicated in Table 2 and increases poverty as shown in Figure 4 and in Table 1 in the next section. Second, if nominal wages increase less than the price of goods consumed by wage earners, worker's real income will decline. This may also increase the number of poor.

Figure 1: Inflation – Consumer Price Index (Annual %)



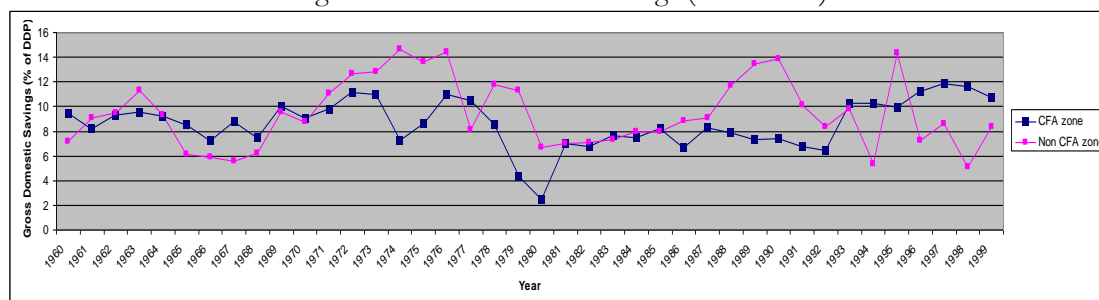
Source: 2002 World Bank - World Development Indicators CD-ROM and the 2006 World Bank - World Development Indicators website

*Gross Domestic savings (%GDP)*

Although the CFA regime appeared to offer its participants a higher Gross Domestic Savings ratio in the 1960s at the range of 9% per year compared to 8% to their corresponding Non CFA counterparts, Figure 2 indicates that in the 1980s and the mid-1990s, the Gross Domestic Savings of the groups reveal similar fluctuations. However, since the mid-1990s till now, CFA zone countries have outperformed the Non CFA zone countries in terms of Gross Domestic Savings.

The issue of savings is very closely related to the question of investment in the poor and by the poor. Without an enlarged pool of domestic savings, it is difficult to sustain higher rates of domestic investment which therefore contribute to a sustainable economic development - unless there is increased reliance on foreign capital. Conventional development economists have often assumed that the most effective way to boost savings is to channel income to those who are relatively rich, since they have higher marginal propensities to save than low-income groups. But the savings rates of the poor often tend to be higher than is generally assumed, and moreover, a more equal distribution of assets that provides the poor with greater access to assets can have substantial positive effects on their savings rates. Higher savings rates are usually tied to greater investment opportunities, and such opportunities most commonly arise from the possession of assets that can be built up over time. Those without assets and little prospect of obtaining them understandably have a dampened incentive to save. High savings in the CFA zone countries may be reflected in the Gross National Income good performance as illustrated in the next subsection.

Figure 2: Gross Domestic Savings (% of GDP)

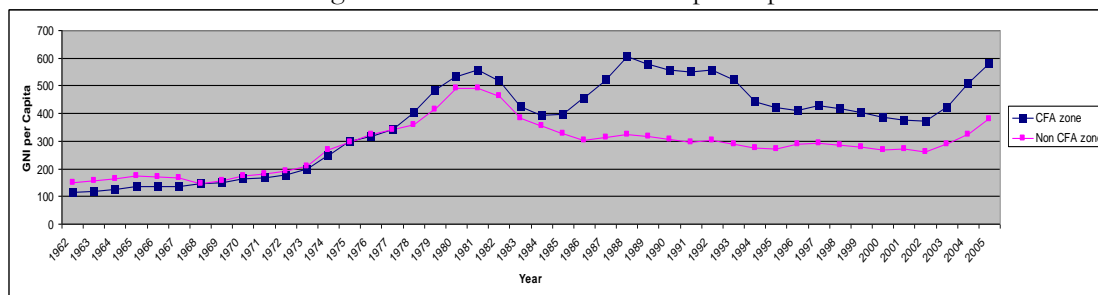


Source: 2002 World Bank - World Development Indicators CD-ROM and the 2006 World Bank - World Development Indicators website

*Gross National Income per Capita (GNI)*

Figure 3 reveals that the Non CFA zone had a low edge over CFA zone countries in the periods 1960-1976 in terms of GNI per capita. By contrast, from 1978 till now, GNI has been higher in the CFA zone countries than that of the Non CFA zone countries. Low inflation and high domestic savings may have contributed to this outstanding CFA zone performance. It is widely held that a high GNI per capita is a strong representation of the country's ability to curb poverty (*ceteris paribus*). Dollar and Kraay (2002) have recently defended the view that growth is highly beneficial to poverty reduction. However, Killick and White (1999) have argued that growth alone will not be sufficient to reduce poverty, particularly in Africa, while White and Anderson (2000) have suggested that a strategy that combines growth and a better income distribution can have a better result in terms of poverty reduction. Indeed, the next subsection provides evidence of a better performance of income distributed in the CFA zone countries than that of the Non CFA zone.

Figure 3: Gross National Income per Capita



Source: 2002 World Bank - World Development Indicators CD-ROM and the 2006 World Bank - World Development Indicators website

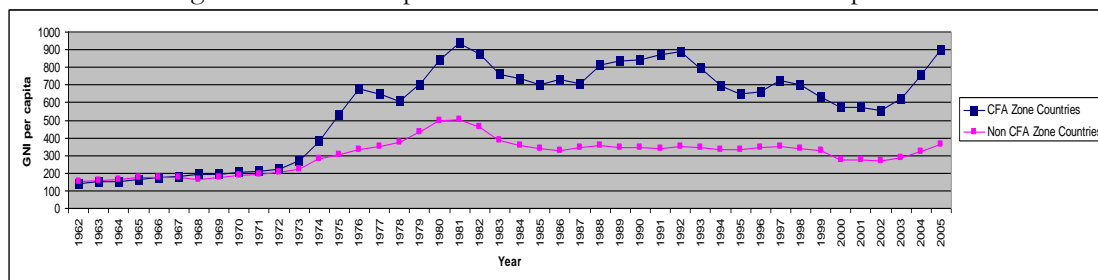
### 2.2 Share of Income and Poverty

Poverty is associated with the distribution of income. Thus, when considering poverty among households, it is necessary to put this in the more general context of the spread of incomes. Before dealing with the distribution of incomes, it is first necessary to set out the basis on which poverty lines might be established.

#### Poverty Line

For the purpose of comparing the share of income between CFA zone countries and their non CFA zone counterparts, we set as indicator of monetary poverty, the national per capita income of the poorest 20% of the population as calculated by Dollar and Kraay (2002). According to our criterion, Figure 1 shows that CFA zone countries have performed better than their non CFA zone counterparts in terms of the poverty reduction line since the 1970s till now. Low inflation, higher Gross Domestic Savings and higher GNI outlined earlier may have contributed to the poverty line performance in the CFA zone.

Figure 1: Income Expectation of the Poorest 20% of the Population.



Source: 2002 World Bank - World Development Indicators CD-ROM and the 2006 World Bank - World Development Indicators website

#### Poverty Headcount

The World Bank, being the sole producer of the world poverty headcount, observed that out of 6 billion people 1.2 billion live on less than \$1 a day<sup>8</sup>. On the basis of the World Bank headcount, Table 1 indicates that the number of people living on less than \$1 a day is lower in the CFA zone countries than in Non CFA zone Sub-Saharan African countries. The CFA zone states account for 31% of their total population, compared to 49% for the Non CFA states. In the CFA states the lowest poverty headcount is found in Cote d'Ivoire with 16% followed by Cameroon and Senegal with 17% each. Central Africa and Niger account for the highest poverty headcount in the CFA zone respectively for 67% and 41%.

<sup>8</sup> World Bank 2001

Table 1 also shows that the lowest poverty headcount in Non CFA zone is found in The Gambia with 27% followed by Ghana with 41% while Nigeria and Sierra Leon account for the highest poverty headcount respectively with 71% and 57%.

### *The Gini Coefficient*

Poverty measures depend on the average level of income in a country and the distribution of income. Based on these two elements, poverty measures therefore focus on the situation of those individuals or households at the bottom of the distribution. Inequality is a broader concept than poverty in that it is defined over the entire population, not only below a certain poverty line. The inequality measure utilised in this paper is the *Gini coefficient of inequality*. The 'Gini' is based on the income levels of individuals. Assume there are 'm' distinct income groups, each income group is denoted by 'j' but there are 'm' such groups. Within each income group 'j' there is a number of individuals earning that income level. The total number of people 'n' is equal to

$$\sum_{j=1}^m n_j \quad (1)$$

The average/mean of any income (y) distribution is denoted by  $\mu$

This average is simply the total income of all individuals divided by the number of individuals. Hence,

$$\mu = \frac{1}{n} \sum_{j=1}^m n_j y_j \quad (2)$$

The Gini index determines the differences in income between each pair of incomes. These differences are then summed together with absolute values being used so that information is not lost through values being both positive and negative. We take the difference between income of individual 'j' and individual 'k', so that

$$(y_j - y_k) = \text{income difference} \quad (3)$$

We could estimate one of the differences and multiply by a factor of  $2^9$  because we take the absolute values of the income differences. The Gini coefficient is then represented by,

$$G = \frac{1}{2n^2\mu} \left( \sum_{j=1}^m \sum_{k=1}^m n_j n_k |y_j - y_k| \right) \quad (4)$$

There are 2 summations because firstly, we sum over all the ks holding each j constant, and then we do the same for the js, summing over all the js holding each k constant. Essentially, we are summing every single income differential in the sample. So everything inside the brackets represents the sum of the income differentials for the whole sample. This large number is then divided by  $2n^2\mu$ . The '2' comes from counting income differentials twice when summing over 'ks' and then 'js'. The n-squared and the mean income terms are included so as to normalize the Gini coefficient.

The above equations indicate that the Gini coefficient is good at picking up increasing or decreasing income inequality. For example, Table 2 shows that income is more unequally distributed in Non CFA countries than in CFA countries. The latter groups studied have a Gini coefficient of 49.3% and 44.26% respectively. The income gap between rich and poor is more widened in the Non CFA states than in their CFA counterparts. For example, the states of Sierra Leone and The Gambia show the highest poverty gaps in the Non CFA zone respectively with 62% and 50% while the states of Central African Republic and Cote d'Ivoire had the highest poverty gaps in CFA zone countries respectively with 61.33% and 48.39%.

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<sup>9</sup> This is purely for practical reasons

The percentage of people living in poverty may be reduced in the CFA zone in accordance with the world poverty headcount, while the same indicator shows that the level of poverty in Non CFA zone countries is not encouraging. The data provides support for the assertion that inequalities often widen despite the benefits of strong and sustained economic growth. In terms of poverty reduction, we could recommend that contrary to Masson and Pattillo (2002), the monetary integration project in the Economic Community of West African States (ECOWAS) should be encouraged. This would be a large value added to the process of regional cooperation and integration in West Africa. Other countries in Sub-Saharan Africa should follow suit. This conclusion is supported by Clement et al (1996) who argued that:

The two sub regions (Central Africa and West Africa) need to intensify the momentum of regional integration and economic cooperation. This would help avoid inconsistent policies. It would also facilitate the emergence of large economic areas that offer broader markets and opportunities for economic of scale, and encourage factor mobility. The development of the regional instrument to foster economic convergence therefore should be actively encouraged.

(Clement et al 1996: 28)

Fielding (2002) also supported integrations by arguing that CFA zone has three main advantages comparing to their Non CFA zone counterparts: greater financial openness, an absence of exchange rationing and more stable prices<sup>10</sup>. He went further to argue that:

For a wide variety of measures the exchange rate peg delivers more integration than a flexible exchange rate. The differences are statistically significant and economically substantial. In the case of trade integration there is also evidence that a common currency – as opposed to a simple exchange rate peg – makes a difference. In this case, the size of the difference depends on geographical factors reflecting international transportation costs. The extra trade that a common currency delivers is greater among countries that face lower costs.

(Fielding 2003: 15)

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<sup>10</sup> Fielding, D. (2002: 158)

Table 1: Poverty Headcount in Non CFA and CFA Zone Countries (% of population)

	Benin	Burkina Faso	Cameroon	Central African Republic	Cote d'Ivoire	Ghana	Niger	Nigeria	Senegal	Sierra Leone	Gambia, The	Total Average
Non CFA Zone						41		71		57	27	49
CFA Zone	31	29	17	67	16		41		17			31

Source: World Bank's *PovcalNet* data tool, see <http://iresearch.worldbank.org/povcalnet>

Table 2: Gini Coefficient in Non CFA and CFA Zone Countries (in percentage)

	Benin	Burkina Faso	Cameroon	Central African Republic	Cote d'Ivoire	Ghana	Niger	Nigeria	Senegal	Sierra Leone	Gambia, The	Total Average
Non CFA Zone						40.75		43.6		62.87	50	49.3
CFA Zone	38.62	39.6	44.56	61.33	48.39		36.10		41.25			44.26

Source: World Bank's *PovcalNet* data tool, see <http://iresearch.worldbank.org/povcalnet>

#### 4. Conclusion

While monetary integration arrangements have existed in many parts of the world for a long time, their efficacy in changing the nature of the integration in African economies and subsequently, their impact in reducing poverty has become an important subject of analysis and policy in the last decade. In most parts of Africa, a new wave of regionalisation is taking place. Whereas some monetary arrangements are expanding, and others are being strengthened, new ones such as that of the ECOWAS are also being formed. In this paper, I attempted to offer a unique opportunity to investigate monetary integration and poverty reduction in the CFA zone. I have followed past practice in focusing primarily on the macroeconomic performance and on the international poverty line that accords with poverty lines typical of the poorest countries. For this purpose I started by analysing the level of inflation, the Gross Domestic Savings and the GNI per capita. I carried out my investigation on poverty by using a poverty line of the poorest 20 % and the number of people living on less than \$1 a day in the CFA zone countries and in Non CFA zone in Central and West Africa. The inequality measure utilised in this paper was the *Gini coefficient of inequality*. In conclusion, we can say that:

- In terms of inflation, CFA zone countries demonstrated a superior performance compared to their Non CFA zone counterparts.
- Since the mid-1990s till now, CFA zone countries have outperformed Non CFA zone countries in terms of Gross Domestic Savings.
- The Non CFA zone had a low edge over CFA zone countries in the 1960-1976 periods in terms of GNI per capita. By contrast, from 1978 till now, GNI has been higher in the CFA zone countries than that of the Non CFA zone countries.



- CFA zone countries have performed better than their Non CFA zone counterparts in terms of the poverty reduction line since the 1970s till now.
- The number of people living on less than \$1 a day is lower in the CFA zone countries than in Non CFA zone Sub-Saharan African countries.
- Income is more unequally distributed in Non CFA countries than in CFA countries.

Furthermore, monetary integration can affect poverty in a variety of ways: low inflation rates which will have effect on the price of goods produced and consumed by the poor, wider regional trade gains which benefits the poor, the increase in the overall investment, savings and per capita income. These effects will depend on the depth of the integration process and on the complementary condition that countries put in place. However, the latter positive effects are likely to remain limited in regions with non-members of a monetary integration. This means that expectations with respect to poverty reduction in non-monetary integrated countries may be tempered. This notwithstanding, money creation constraints, for example, is the reasons behind CFA zone countries extreme reliability on fiscal policies rather than monetary policies to solve government expenditure problems. Thus while I remain cautious in encouraging monetary integration in other parts of Africa, my results indicate that countries in the CFA zone have come furthest on the way to poverty eradication.

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