

CENTRAL BANK  
OF WEST AFRICAN STATES  
(BCEAO)

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**BCEAO / UNIVERSITIES/ RESEARCH CENTRES**

**3<sup>RD</sup> SYMPOSIUM**

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***THEME : Financial Stability and Macroeconomic Management  
in the West African Monetary Union (WAMU)***

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**INTRODUCTORY NOTE**

(Dakar, 11-12 July 2005, BCEAO – Head Office)

## **I - CONTEXT AND RATIONALE**

The world economy in this last decade was affected by successive financial crises which hit both developed and developing countries. This financial instability has caused significant economic and social consequences evidenced by a drop in real activity, corporate bankruptcies, a rise in unemployment and increased poverty. In this respect, the examples of countries like Mexico (1994-1995), South East Asia (1997-1998), Russia (1998), Brazil (1999) and Argentina (2001) should be mentioned. Thus, there is no need to stress the importance of financial stability, both at the national and international levels, in a context marked by economic interdependence and increased financial liberalization. The smooth running of economy depends on the existence of adequate financial infrastructure likely to favor an optimal distribution of resources.

WAMU member countries are not an exception to the rule. In fact, financial stability is a major challenge for development financing. The creation of a regional stock market, combined with a growing real estate market, an expanding microfinance sector and the establishment of a modern payment system require an in-depth monitoring.

Financial stability, which is today as important as monetary stability, is necessary to promote sound economic growth. With market globalization, central banks have to monitor financial stability, even if their ultimate objective is to maintain price stability.

In this respect, it should be mentioned that as part of the reflection on the issue, the BCEAO has initiated a programme for the Review of financial stability in WAMU aimed at consolidating and promoting financial stability. Hence the need to discuss the topic "Financial stability and growth in WAMU" at the BCEAO/Universities/Research Centres Symposium which will be organized in July 2005; the aim of this meeting being to provide a forum where the BCEAO and researchers will exchange views on this concept.

## **II - OBJECTIVES**

The symposium will provide to participants a forum to exchange views on the financial stability concept and its importance in economic policy in general and

monetary policy in particular. It will help identify financial stability challenges and make a review of the discussions on its link with development issues.

The conclusions of the research conducted by the BCEAO, sub-regional universities and foreign institutions (universities, research centres, international financial institutions, etc) on the theme of the symposium will be presented at the meeting. These conclusions should help better capture the importance of financial stability in the distribution of resources dedicated to growth promotion and identify the ways to achieve and maintain it.

### **III – CONTENT**

The theme of the symposium will be discussed during four sessions including an introductory session and a closing panel.

#### ***Introductory session : Financial stability in developing countries : definitions and characteristics.***

Financial stability, which is a quite new concept, illustrates the financial system's efficiency and solidity. It is difficult to give a definition of this concept because it is not a quantified objective. According to PATAT (2000), the concept has a multidimensional scope which could be described as a situation where the financial system's various system, and in particular their reciprocal relations, function smoothly without any brutal disturbances.

Financial stability can also be defined as a situation where the financial sector functions without discontinuity, thus allowing for an efficient distribution of resources, and has the capacity to resist to possible shocks in an adequate and durable manner.

These various definitions must be adapted to WAMU member countries and to developing countries in general, to take into account their financial system's specificities (narrow banking and financial markets, oligopoly, market dualism, etc). Owing to their financial systems structural features, African countries are exposed to exogenous shocks and face quite important risks. Thus, these fragile systems are regularly hit by crises; which make analysts believe that a systemic risk of general insolvency exists in Africa.

***Sub-theme 1 : Financial stability, a mission for the central bank ?***

The conduct of monetary policy and ensuring the viability of payment systems are key elements of a central bank's mission. The success of banking regulation and control depends to a large extent on the banking sector and global financial stability.

In fact, financial instability reflects a situation of volatility, either of financial assets prices, or of the loans issued by intermediaries. This volatility may lead to high nominal and real costs. Therefore, the central bank must protect banks and credit institutions against bankruptcy , in particular large sized institutions, whose failure can expose the whole system to insolvency risk.

Financial stability is neither an intermediary objective, nor a final objective for central banks, but systemic financial instability may annihilate their achievements on the front of price stability. While there seems to be a certain complementarity between price stability and financial stability, it is clear that the achievement of the first does not necessarily mean the achievement of the second.

But, as a result of central bank's systematic intervention to curb the adverse effects of banking or financial crises, it is to be feared that market actors would not fully assume their responsibilities and take disproportionate risks, as they feel protected by the safety net provided by the central bank. Therefore, the central bank should set out the conditions under which it may intervene to solve financial and banking crises.

The papers dealing with this sub-theme will be focused on the following topics :

*Paper 1 : The lender-of-last-resort function : historical background and lessons for the BCEAO ;*

*Paper 2: Optimality of the too-big-to-fail doctrine in WAMU*

*Paper 3: Should there be a single financial authority to ensure financial stability ?*

*Paper 4 : What macro and microeconomic indicators for assessing the solidity of a monetary union's financial system ?*

***Sub-theme 2 : Financial stability and WAMU member States economic performances***

Economic activity in developing countries in general, and in WAMU member countries in particular requires the mobilization of domestic resources for financing private investment. This supposes the existence of a globally efficient and solid financial system. On the other hand, financial instability and its consequences, i.e. monetary and banking crises, may affect real economy through investment and reduce durably economic growth.

The recent banking and monetary crises which caused a significant drop in foreign exchange reserves and an increase in interest rates have weakened global demand and supply, notably by increasing investment cost, and foreign debt servicing. This situation was then followed by corporate bankruptcies, job losses, and consequently, a slackening of economic activity and even recession

Analysis of recent financial crises transmission mechanism show that they begin in the banking sector, spread to the financial system's other segments (banks, insurance companies, microfinance institutions, etc) before affecting real activity. In the early stage, the financial sector suffers from huge job losses and the value of households assets drop sharply, which increases poverty and amplifies the social consequences of the crisis.

Hence the need to assess the importance of the link between financial stability and economic activity and to identify the various mechanisms through which financial crises can affect the real sector.

In this respect, the following papers will be presented :

*Paper 1 : Financial crises transmission mechanism in a fixed exchange rate regime : lessons for WAMU*

*Paper 2 : Credit risk analysis in the franc zone member countries*

*Paper 3 : What are the real costs of banking crises in Africa : what lessons for WAMU member countries ?*

*Paper 4 : Assessing the solidity of WAMU's insurance sector*

*Paper 5 : Assessing the viability of WAMU's microfinance sector*

***PANEL : What macroeconomic environment for a solid financial system in WAMU ?***

One key element for financial solidity is the establishment of a sound macroeconomic framework. In this context, it is important to specify the features of an adequate macroeconomic framework for developing countries such as WAEMU member States, likely to attract international investors and promote strong and sustainable growth. Panelists will be invited to give their opinion on the characteristics of this macroeconomic framework and on the appropriate fiscal and monetary policies for its building and consolidation.

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