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The Integration of Economic Monetary Policy Systems of West African States

Positive or Negative Implications

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Abstract

A motion has been moved by the Economic Commission for West African States (ECOWAS) for the unitization of all monetary policy systems in the West African hemisphere. Its ultimate aim being the introduction of a united currency system to be used by all West African countries. Some critics argue that independent monetary and exchange rate policies have been relatively ineffective in influencing domestic economic activities, while others state that a monetary union among West African states would be costly taking into consideration the magnitude of accompanying shocks to each domestic economic system.

What is the way forward? Do we lend an ear to the proposal adopted by the ECOWAS Convergence Council that establishes the modalities for the realization of a united or single currency objective under the ECOWAS Monetary Cooperation Programme (EMCP); or do we keep in place a separate or divided

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system of monetary policy operation?
This article intends to review the pros and cons attached to this major issue by reviewing, in general, the individual monetary policy systems currently in operation by these West African countries and envisaging what a united monetary policy system could achieve (in the long run); its advantages, as well as disadvantages.

JEL classification numbers: E42, E52.
Keywords: ECOWAS, monetary policy system, currency system, EMCP.

1 Introduction

According to an article released by The African Manager on Wednesday the 12th of September, 2012, titled “ECOWAS single currency for launch 2020”, “The long-held dream of a single currency for the 15 members of the Economic Community of West African States (ECOWAS) is set to become a reality in 2020, according to a comprehensive strategy for achieving the single currency, obtained by PANA.
Under the Roadmap for the ECOWAS Single Currency Programme, which was approved and adopted by the Convergence Council of Ministers and Governors of the West African Monetary Zone (WAMZ), the ECOWAS Monetary Union should be launched in 2020 with the establishment of the ECOWAS Central Bank and introduction of the common currency. Also, the WAMZ monetary union would be launched "on or before" 2015 with the establishment of its Central Bank and introduction of its common currency, ECO, for the five countries in the Zone”.
These are indications, which show that the ECOWAS is going ahead and maintaining its stand on the single or united currency strategy.
But, the issue is, could this be said to be a wrong move on the part of ECOWAS, and what implications could this have on the monetary policy of these African States.

2 History and Background Information

ECOWAS was founded on the 28th May 1975 by the Treaty of Lagos as a Regional Economic Community with a vision to create a single regional economic space in West Africa through integration and collective self-reliance. It was meant to be an economic space with a single market and single currency capable of generating accelerated socio-economic development and competing more meaningfully in the global market of large trading blocs and uneven patterns of trade. ECOWAS members include Benin, Burkina Faso, Cape Verde, Cote

D'Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo (Figures 1 and 2).

Figure 1: Map of Africa depicting the ECOWAS Countries

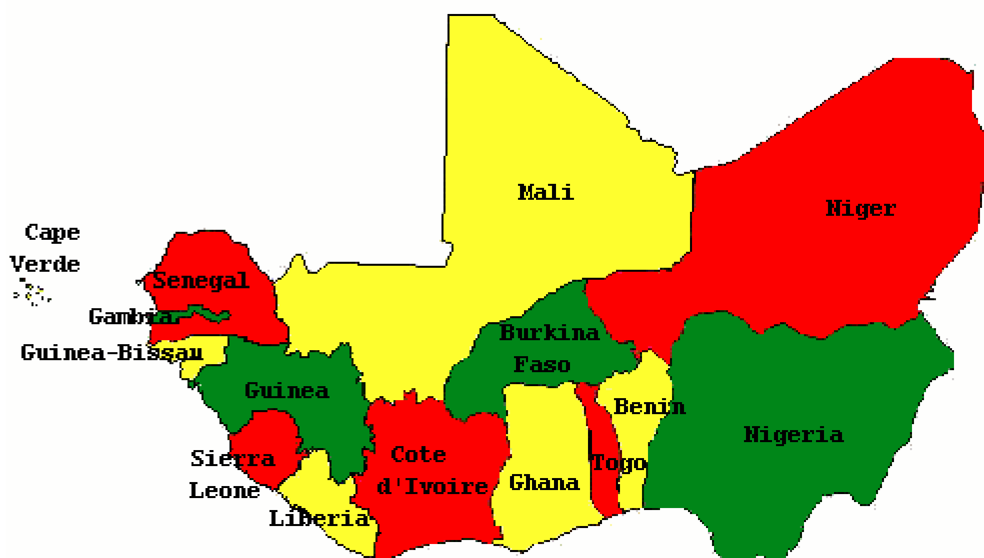

Figure 2: Map of the ECOWAS region with their Names and Locations depicted

The ECO, is the name of the currency for the ECOWAS second monetary zone, the West African Monetary Zone (WAMZ) comprising The Gambia, Ghana, Guinea, Nigeria and Sierra Leone (the first having been that constituted by the West African Economic and Monetary Union, or WAEMU). This complements the CFA zone made up of eight francophone States and Guinea Bissau. Both zones are part of the ECOWAS monetary integration programme.
The Surveillance Mechanism, a system adopted by ECOWAS Heads of State and

Government in December 2001, is intended to serve as the regional instrument for monitoring the harmonization of macro-economic and financial policies of Member States and is a crucial move towards achieving the monetary integration objectives especially a common currency by 2020. In this regard, efforts are being intensified towards creating a monetary zone using a single currency managed by a common Central Bank within the framework of the ECOWAS Monetary Cooperation Programme.

The ECOWAS Convergence Council, comprising Ministers of Finance and the Governors of Central Banks of Member States, approved in 2009 a revised road map for the realization of a single currency for West Africa by 2020. The approval followed the adoption of the report of the inter-institutional working group on the ECOWAS single currency that articulates a clear, concise and comprehensive strategy for realizing a single currency for the region.

The map outlines activities to be undertaken ahead of the new date including the review and harmonization of the convergence criteria, the harmonization of statistics, domestic policies and the legal, accounting and statistical frameworks of public finance.

Between 2009 and the first quarter of 2013, the map envisages the harmonization of the regulatory and supervisory framework for banking and other financial institutions, the establishment of a payment system infrastructure for cross border transactions, the completion of the payment system infrastructure in Guinea, The Gambia and Sierra Leone and the completion of the ongoing integration of the financial markets of the region.

3 Current Economic Projections for the Monetary Policies of the WAMZ States

3.1 The Gambia

As at end-December 2011, the gross international reserves of the Central Bank of The Gambia was US$182.50 million, equivalent to 5.1 months of import cover.

Total assets increased to D18.7 billion (64.0 percent of GDP), or 5.3 percent from 2010. Gross loans and advances, accounting for 29.2 percent of total assets rose modestly to D5.45 billion (18.7 percent of GDP), or 3.1 percent. The non-performing loans ratio decreased to 12.9 percent, lower than the 14.5 percent in 2010.

Inflation Outlook: The decline in headline inflation is consistent with the deceleration in money supply and the stability of the Dalasi. Inflation is expected to remain in single digit in 2012 predicated on prudent implementation of monetary and fiscal policies as well as the easing of global food prices.

Taking the above factors into consideration, including the inflation outlook and the lack of demand pressures from the slowing of the domestic economy, the MPC

has decided to reduce the policy rate by 1.0 percentage point to 13 percent. The expectation is that other interest rates, particularly lending rates, would be reduced.

Table 1: Macro-economic Indicators for the Gambia

Factors	2010	2011	2012	2013
Real GDP growth	6.3	5.5	5.6	5.6
Real GDP per capita growth	3.6	2.7	2.9	2.9
CPI inflation	3.9	4.7	4.8	5
Budget balance % GDP	-5.4	-4.2	-3.8	-2.8
Current account % GDP	-17	-17.5	-16.9	-16.4

3.2 The Ghana

The weakening of the local currency started in the last quarter of 2011 and was driven by several factors including the growing demand for foreign exchange to support increased economic activity due to the expansion of the economy. A second, more structural factor is the changing nature of the trade pattern which is gradually shifting towards Asia, especially China, for which transactions are mostly conducted on cash basis. The persistent depreciation of the cedi can have far reaching consequences on the inflation profile. A third factor relates to external sector conditions, such as the euro zone crisis which have also instigated investor portfolio outflows from the bond market in the latter part of 2011. There are also the speculative activities by foreign exchange traders trying to profit from the depreciation of the currency while other market participants seek to hedge against further depreciation thereby exacerbating the situation.

The increased depreciation of the cedi and the sharp rise in the crude oil prices on the international markets has generally heightened inflation expectations. The extent to which retailers adjust their mark-ups in the face of anticipated rising cost pressures will be crucial in the coming months. In particular, manufacturing input prices are likely to rise on the back of these pressures. This is evidenced by the recent data from the Ghana Statistical Service which showed that the producer price index has risen significantly over the past six months, giving an indication of how consumer prices may evolve in the near future.

The path of inflation expectations is not clear given the mixed perceptions from businesses and consumers. While consumer’s inflation expectations were down, that for businesses heightened driven mainly by uncertainties in the foreign exchange rate market. If households’ and businesses’ medium-term inflation expectations are heavily influenced by recent trends, then continued increases in inflation expectations may cause agents to place weight on the assumption that inflation will be persistently high. If those expectations are factored into wages and prices, that would raise medium-term inflationary pressures. There has been

observed some slight upward movement in inflation and it remains uncertain at this stage how inflation expectations.

Table 2: Macroeconomic Indicators for Ghana

Factors	2010	2011	2012	2013
Real GDP growth	7.7	13.7	8.3	7.7
Real GDP per capita growth	5.4	11.3	6	5.4
CPI inflation	10.8	8.7	8.2	7.7
Budget balance % GDP	-5.9	-4.3	-1.8	-1.5
Current account % GDP	-8.2	-11.6	-8	-9

3.3 Guinea

Inflation remained very high in 2011 (21.2%) despite a strict budget policy and continuing efforts to curb credit. It should drop to 16.7% in 2012 and 10.1% in 2013.

Public finance management is based on the principle of a single account and cash-based budget execution. The budget deficit was fairly high (13.8% of GDP in 2011) even with a tight budget policy. This strictness significantly reduced current spending (to 17.7% of GDP), while total revenue increased slightly (to 16.9% of GDP) due to better tax collection. The budget deficit should continue to shrink in the short term, to 8.1% of GDP in 2012 and 6.6% in 2013.

To mop up excess liquidity and to slow growth of the money supply, the central bank (BCRG) in 2011 increased the required minimum reserve rate for banks and their intervention rate to 22%. The country's foreign exchange reserves were the equivalent of 5.4 months of imports.

Guinea has a young population like all African countries, with more than 74% of the population aged below 35. Unemployment is mainly urban and especially affects graduates and those between 20 and 29. In the capital, Conakry, and major towns, more than two-thirds of higher education graduates under 30 are unemployed. This is partly due to a lack of government jobs and few opportunities in the formal private sector and has been aggravated by political instability, slower economic growth and inadequate policies to help young people, among other factors.

Table 3: Macroeconomic Indicators for Guinea

Factors	2010	2011	2012	2013
Real GDP growth	1.9	4	5.1	5.5
Real GDP per capita growth	-0.3	1.7	2.6	2.9
CPI inflation	15.5	21.2	16.7	10.1

Budget balance % GDP	-13.9	-13.8	-8.1	-6.6
Current account % GDP	-6.5	-9.1	-6.1	-6.2

3.4 Sierra Leone

The MPC discussed global economic trends and their implications for economic growth prospects in Sierra Leone. The Committee noted that global economic trends point to recovery but at varying paces across different regions of the world. Whilst growth in the Euro zone is projected to slow markedly in 2012, growth in Sub-Saharan Africa (the region relatively less exposed to the global slowdown) is projected to pick up to 5,5 percent. The Committee noted that there are downside risks to the Balance of Payments of Sierra Leone, notwithstanding the benign outlook of prices of the country's main export commodities.

The Committee discussed developments in the real sector and noted that the Sierra Leone Business Confidence Survey report for Quarter 1 of 2012 showed improvement in business sentiments, with the index increasing by 1.9 points from Q4 2011 to 65.9 index points. The highest improvement was observed in the trade sector which recorded a 5-point increase during the period to 63.9 points. Recent stability of the value of the Leone (relative to major foreign currencies) and declining inflation are behind the observed strengthening of business sentiments.

The MPC also discussed recent developments in prices and noted that the national consumer price inflation has declined from 14.5 percent (year-on-year) in March 2012 to 13.9 percent in April 2012, supported mainly by relative stability in the value of the Leone and the Bank's tight monetary policy stance. While food inflation declined from 18.4 percent (year-on-year) in March 2012 to 17.7 percent in April 2012 (compared with 24.8 percent a year ago), non-food inflation weakened by half a percentage point in the month to 13.5 percent (having reached 16.1 percent a year ago).

In discussing the appropriateness of the Bank's monetary policy stance in the light of these developments, the MPC noted that growth in monetary aggregates has been trending downwards, consistent with the Bank's tight stance on monetary policy to contain inflationary pressures and keep inflation at a sustainably low level. The Committee also noted the efforts being made by the fiscal authorities in public expenditure management in support of the Bank's monetary policy stance.

Table 4: Macroeconomic Indicators for Sierra-Leone

Factors	2010	2011	2012	2013
Real GDP growth	5	5.7	6.2	6.2
Real GDP per capita growth	2.8	3.5	4.1	4.1
CPI inflation	17.8	18.1	11.7	9.4

Budget balance % GDP	-6.4	-5.3	-4.5	-3.6
Current account % GDP	-18.3	-55.7	-9.9	-9.6

3.5 Nigeria

The results of the African Development Bank's 2011 Country Policy and Institutional Assessment show that Nigeria has undertaken important reforms particularly in public financial management to improve efficiency in resource allocation and project and programme implementation. Corruption, however, is widespread. The government has made concerted efforts to fight corruption, especially through the Economic and Financial Crimes Commission and Independent Corruption Practices and Other Related Offences Commission. The country has a good chance of achieving the Millennium Development Goals (MDGs) on universal primary education, promoting gender equality and women's empowerment, some aspects of environmental sustainability, and developing a global partnership for development. However, the goals on poverty reduction, child mortality, maternal health and disease will be difficult to reach.

Table 5: Macro-economic Indicators for Nigeria

Factors	2010	2011	2012	2013
Real GDP growth	7.8	6.7	6.9	6.6
Real GDP per capita growth	5.3	4.1	4.4	4.1
CPI inflation	13.7	10.2	10.1	8.4
Budget balance % GDP	-7.7	-0.2	0.3	0.2
Current account % GDP	6.2	11.6	10.8	9.8

4 Pros and Cons of Proposal Assessed

Macroeconomic instability has been a major problem under the programme with most countries having experienced high inflationary pressures and exchange rate fluctuations within the last decade. These problems have sometimes been ascribed to inappropriate domestic monetary policy formulation and implementation, although exogenous factors such as natural disasters and external shocks have contributed significantly.

The central banks are responsible for regulation of the monetary system to achieve price and exchange rate stability. Traditionally, they further state, the central banks in West Africa have executed this role through short-term liquidity management techniques based on monetary aggregate targeting. However, there are indications that some of the central banks have transited or are considering the possibility of transiting to inflation targeting owing to certain difficulties.

Within the framework of the monetary cooperation programme, they believe, it is necessary to strengthen monetary policy and minimize possible spillover effects arising from inappropriate policies, especially, as the economies become more integrated by taking stock of the monetary policies in West Africa thereby understanding the effectiveness and implications of various practices in relation to specific macroeconomic fundamentals in member countries.

In considering the possible net economic benefits of monetary union, similarity of production structures, factor mobility, flexibility of wages and prices, and symmetry of shocks hitting the economies all enhance the attractiveness of such a union. In fact, there are major differences among the West African economies. In particular, Nigeria, a major oil exporter, faces a very different pattern of terms of trade shocks than the other economies of the region. Moreover, existing internal trade among the region's countries is quite low, although there is undoubtedly considerable informal trade that is not recorded. Of course, one of the reasons for proceeding to monetary union quickly is to promote improvement in macroeconomic policies and to enhance prospects for other aspects of regional integration, including regional trade.

Other advantages include significant gains in Gross Domestic Product (GDP) growth through the following key channels: reduced transaction costs, expansion of foreign trade, a drop in real interest rate and the easing of the current account constraint. In addition, by joining monetary union, the countries would be less vulnerable to sudden reversals of capital flows, which make the implementation of independent monetary policy more costly and less successful than a more or less appropriate imported policy.

From a monetary policy standpoint, real convergence required by introduction of the ECO can be best analyzed within the Optimal Currency Area (OCA) theory framework. OCA theory identifies certain criteria that a region should fulfill for it to be economically optimal to let go of the adjustment tool of a national currency. These criteria include whether the countries have similar production and trade patterns, whether economic supply and demand shocks are likely to be asymmetric across the countries and whether economic cycles are symmetric across borders. According to the OCA theory, pioneered by Mundell (1961), McKinnon (1963) and Kenen (1969), an independent monetary policy and the exchange rate instrument are necessary stabilization tools for alleviating the impact of asymmetric shocks for a region. The five major OCA criteria are openness, trade integration, cyclical harmonization and structural similarities of the economies; and the flexibility of labour and goods markets.

It must be noted though, that monetary unification requires an irrevocable locking of nominal exchange rates and the establishment of a common central bank. Monetary policy is to be determined centrally. In a monetary union, there is no option for adjusting the exchange rate parities to misalignment caused by differential inflation rates or supply or demand shocks hitting the region in an asymmetric manner. Also under monetary unification, the national governments have to be ready to delegate monetary policy entirely to the politically

independent supranational and central monetary authority. Monetary unification hence implies independence of the monetary policy from the influence of national fiscal authorities.

However, one of the main criticisms to the convergence criteria set is based on the so-called "one size fits all" nature of the policy. The interest rate decided by the West African Central Bank applies to all the countries in the WAMZ. There is a risk that an interest rate that may be appropriate for the area as whole may be inappropriate for some individual member countries. Those member countries with overheating economies and high inflation will have low real rates of interest when they need high real interests, while economies with high levels of unemployment and low inflation will have high real interest rates. If all the economies were operating at a similar point in the economic cycle, having the same interest rate would not be a problem. In practice however, there are still significant differences in the WAMZ economies. Concern has also been expressed that the constraints of a fixed exchange rate system would force countries with higher inflation rates to turn to overly restrictive policies in order to ward off excessive losses of reserves.

Moreover, there is also a tendency for a reduction in independence of macro-economic policy by the individual member states. In addition to no longer being able to operate its own interest rate, the individual countries would lose the independent exchange rate policy or monetary policy for their countries. Countries would no longer be able to increase the money supply in order to spur output and employment. Countries would no longer be able to pursue independent inflationary policies in order to collect seigniorage to cover governments' deficits and would have constraints imposed on its use of fiscal policy. WAMZ member countries' choice of government policy measures will be constrained by their membership of the single currency. Monetary policy will be in the hands of the West African Central Bank.

Concern has also been raised regarding foreign direct investment (FDI) flows. Not all countries in the sub-region have experienced an increase in FDI flows. While the monetary union might bring more FDI, the benefits are not always evenly distributed. They are generally likely to be concentrated in countries with large domestic markets that are used as platforms to "export" to other member states. In this circumstance, some countries might even experience disinvestments in their territories.

It is a strong indication that the risk of asymmetric shocks may be much more pronounced than usually expected. Under these conditions, much more effort and flexibility will be needed to adjust economic structures. Care must be taken in analyzing the differences between countries and in drawing general conclusions from this about the integration process.

5 Conclusion

Based on this bit of news and all others afore-written it is clear that the major decision is to go ahead with the plan of monetary policy unitization and a common currency.

The International Monetary Fund, the European Union, the Economic Community of Africa, the European Central Bank and the Bank of England are all in support of this proposal.

As to whether or not this proposal is to the best interests of the Western Africa hemisphere remains to be seen. Based on the Macro-economic Indicators of each country comprising the WAMZ states, it seems that each country, though possessing its pitfalls and problems, also has its potential to succeed in the future through its independent monetary policy systems currently in operation. Each country has taken systems to tighten its monetary aggregate demand and is now recording lesser inflation rates and even lesser for the future. This taken into consideration and also considering the fact that an independent monetary system allows each country to deal with its own problems is a major attribute to consider. It must also be mentioned here that giving one body control over the financial affairs of several countries amounts to what today can be described as modern day colonialism (in a financial sense of course), as all the power will be ascribed to one body or organization, who would have control over all the financial affairs of these states. In this day and age, this cannot be seen in a positive light.

The author believes that before this proposal is put in place, further research has to be conducted and physical material reviewed as to whether this plan of action is one to be undertaken. For, to deny any form of body, institution or organization, living or otherwise, of its independence is to subject it to some form of servitude, which in this day and age must never be condoned.

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