On the Way to a Single Currency for ECOWAS Countries?

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THE ECOWAS COUNTRIES are on the way to establishing a single currency by 2020. Nigeria is poised to play a major role in this process. While the plan apparently has unanimous support, "the devil is in the details."

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GRAIN DE SEL: *What is your analysis of the currencies now in use in West Africa?*

GILLES DUFRÉNOT: The "currency map" of West Africa comprises several different exchange regimes. There is a monetary union, made up of the eight countries of the franc zone, whose currency is tied to the euro; and a set of non-convertible national currencies whose exchange rates in relation to the dollar or the euro are fixed administratively to a greater or lesser degree. The fact that different exchange regimes coexist in a small area does not favour trade between countries due to the high transaction costs involved (for example, fees for currency conversion and the insurance costs incurred by importers and exporters to cover exchange risks). Furthermore, for currencies not pegged to an international currency, the problems linked to the credibility of their exchange policies and the uncertainties linked to volatile exchange rates discourage stable foreign capital and investment over the medium and long term.

GDS: *What are the arguments in favour of a single currency for the countries in the Economic Community of West African States (ECOWAS)? Are there difficulties and stumbling blocks to be overcome?*

GD: The idea of introducing a single currency within ECOWAS is based on several historical observations. First, monetary unions tend to foster regional trade as long as they attain a critical mass. Second, regional trade is what drives economic growth, rather than transactions in the context of North/South specialisation. The reason for this is that regional trade most often involves the exchange of similar products, avoiding the pitfall of national industries evicted by imports. Lastly, following on the trade Triad,[1] the global economy is likely to take shape around currency poles in coming years. It will be important for African countries to have their own poles, alongside

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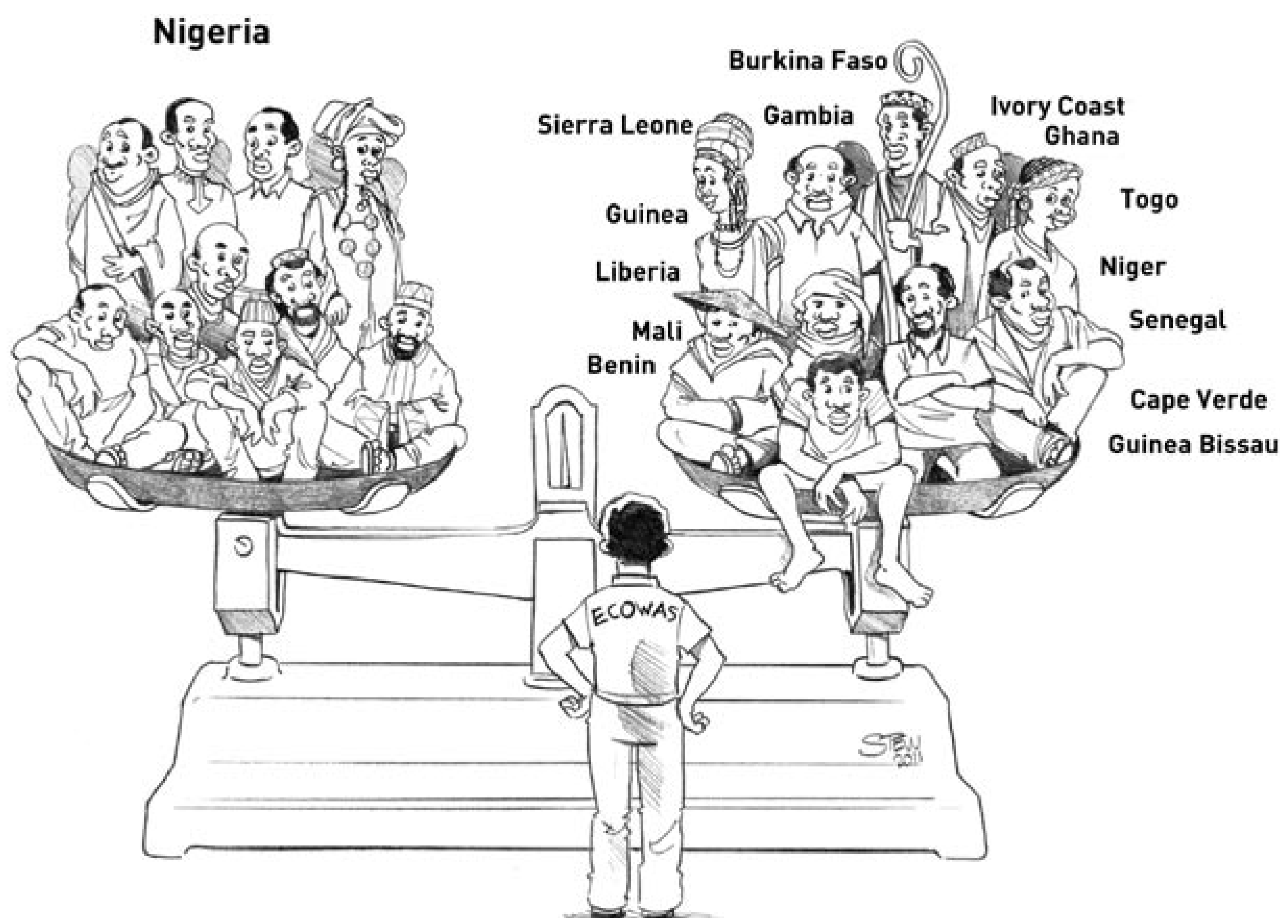
1. The Triad refers to the three trade zones, i.e. North America, Europe and Asia.



international currency poles (the dollar, the euro and the yen). The timetable for implementing a single currency in ECOWAS is outlined as follows. First, the countries that are not members of the franc zone will set up their own monetary zone called the West African Monetary Zone (WAMZ) in 2014, adopting a common currency, the West African Currency Unit. These countries are Gambia, Ghana, Guinea, Nigeria and Sierra Leone. Next, starting in 2020, the WAMZ and WAEMU will merge their two currency zones to create a single monetary zone throughout ECOWAS, adopting a new currency. Cape Verde and Liberia should also join this zone. The Cape Verde escudo is pegged to the euro, and the governor of the Central Bank of Liberia has officially requested that Liberia join the WAEMU.

There are not any barriers *per se* but, as we all know, the devil is in the details. First, a monetary union has better chances for survival when the member countries have similar economic structures, when their economic policies are coordinated, and when each country agrees to refrain from adopting policies that would be harmful to other members. An institutional framework that favours this must therefore be set up. The countries outside the franc zone have adopted economic policy convergence criteria. However, it is more difficult to attain the convergence of living standards within a union composed mostly of poor countries that do not have the equivalent of the "structural funds"[2] that Europe had. Second, it is not enough to have a single currency. The exchange regime is a fundamental issue, because decisions have to be made about what is best for the countries in their relationships with the rest of the world. The future single ECOWAS currency could be allowed to float against international currencies, or it could be pegged to them at a fixed exchange rate, or it could even fluctuate in relation to a bundle of selected currencies. Choosing an exchange regime is difficult because to do so one must take all aspects of economic and social "well-being" into account: debt levels, impact on trade, inflation, growth, etc.

GDS: *What specific role would Nigeria play in setting up this currency? Could the idea of a commodity-currency emerge?*

GD: Nigeria is the only ECOWAS country that has the capacity to support the single currency, given its economic and financial weight in the zone and its central bank's experience managing an independent currency. Another aspect is that, given agriculture's significance for the zone's economic growth, the choice of an exchange regime is not a trivial matter. For example, currency devaluation can improve the terms of trade for export markets, but at the same time raise production costs if most production inputs are imported. In the eyes of the Nigerians, the single currency should serve to protect the zone's agricultural and industrial potential; consequently, the exchange policy and trade policy will have to be linked when it comes to agriculture. The single currency should help limit the risk of Dutch disease,[3] the impact of international exchange rate variations, and the instability of agricultural income due to widely fluctuating domestic prices. Nigeria has extensive experience in these areas, and this should benefit the zone. In this context, the notion of a commodity-currency is making headway. Just as there once was a gold standard, the exchange rate for the future single currency could be set, not in relation to an international currency, but in relation to the prices for the main commodities exported by ECOWAS countries. For example, if the world cotton price falls the currency could be devalued automatically, and the zone's export revenue—in national currency—would not be affected (unlike what happens today). Obviously, the countries would have to agree on which agricultural products should to serve as the reference for the commodity standard.

Naturally, there are alternatives to adopting a commodity-currency. One can also imagine a currency whose the exchange rate would be set in relation to a bundle of currencies, or an international currency. These options have the advantage of enhancing the credibility of the future central bank (credibility is important to investors who lend capital, and to funding agencies, insofar as it eliminates exchange risk). The drawback, however, is that in terms of competitiveness the single currency would be entirely exposed to international currency fluctuations. ■

2. Readers should recall that structural funds are used to help future member countries' economies catch up before entering an economic zone so that their living standards converge with those of existing member countries.

3. Dutch disease is an economic phenomenon in which abundant resources linked to high export revenue drive out the sectors of activity in the economy that are not specialised in export commodities.