The Uncertain Future of the ECOWAS Common Curreny

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Since the early 2000s, there has been a push to a common currency in the fifteen-member Economic Community of West African States (ECOWAS). Following in the footsteps of ambitious projects throughout the developed world, including the euro, this project seeks to bring together the Francophone and Anglophone economies in West Africa and create a unified economic and monetary union with a common currency. This can help foster industrial development, facilitate both regional and global integration, support employment and reduce poverty. As with the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA), and the Southern African Development Community (SADC), the ECOWAS arrangement is also part of a growing continental trend towards fostering stronger regional unity.

Established with the Treaty of Lagos in 1975, the ECOWAS project has been a long and challenging journey. There have been a plethora of summits and several tangible accomplishments, including the development of core institutions, such as the ECOWAS Secretariat in Abuja, and the development of a harmonised framework with macroeconomic convergence criteria. On the political side, ECOWAS has worked to diffuse regional conflicts and to prevent violations of democratic principles in the zone. Moving from economic cooperation to broader political union, the idea has been to help foster economic development and regional integration in West Africa.

The ECOWAS project can be conceived of as part of a pan-African vision to bring the disparate economies closer together and reduce transactions costs between member nations. A key objective is to help create a unified economic space that capitalises on economies of scale and reduces the barriers for trade and regional integration. By reducing tariffs and non-tariff barriers, accelerating trade facilitation, and having a common currency, the regional authorities hope to reduce exchange rate risk and make it easier to trade across borders. Another objective is to improve the economic fortunes of the poorer countries, and thereby facilitate convergence with the leading economies. The ultimate ambition is to move from economic union to a fuller political union, modelled on the EU.

The initiative has been supported through ambitiously worded legislation that articulates the vision of the founders. According to the revised Treaty of ECOWAS of 1993,[1] one of the key goals of ECOWAS is 'the harmonization and coordination of national policies and the promotion of integration programs, projects and activities, particularly in food, agriculture and natural resources, industry, transport and communications, energy, trade, money and finance, taxation, economic reform policies, human resources, education, information, culture, science, technology, services, health, tourism, legal matters.' This is a broad remit that will require institutions and personnel. Other goals include the harmonisation of policies to protect the environment, the establishment of a common market, and the removal of obstacles to the free flow of goods, services and people between the respective countries.

Regional monetary integration, through the setting up of a regional Central Bank that governs the monetary policy of the zone, has been an essential part of the ECOWAS agenda. The Bank was envisioned to be based in Abuja and would be in a somewhat federal model overseeing the finances of its member states. Like the European Central Bank, the idea was to have a pooling of resources at the ECOWAS Central Bank in return for a single currency and monetary policy coordination and supervision. The Bank would retain some independence from the member states but be accountable to them. There would be a gradual implementation process to this common vision.

For a variety of reasons, the ambitions have not fully materialised. The ECOWAS single currency

project has been delayed repeatedly. It has now been pushed to 2027 given that member countries were not ready in 2020, partly due to Covid-19. In parallel, competing visions between the Francophone and Anglophone blocs have not helped forge a consensus. Partly due to external macroeconomic challenges and partly due to a lack of full convergence on perspectives, especially among the leaders of Nigeria, Côte d'Ivoire, Senegal and Ghana, the project has not yet become a reality. The Francophone countries remain pegged to the euro, while the Anglophone ones currently have flexible currency arrangements.

Theory

A common currency can be a positive force for economic development. Given Africa's fragmentation and proliferation of many landlocked countries with small domestic markets, there is a case for deeper market and regional integration. An ECOWAS common currency could foster regional economic integration, improve macroeconomic management, and lead to a more prosperous West Africa. One envisions unlimited travel within ECOWAS borders modelled on the Schengen arrangement in Europe.

The intellectual case goes to Robert Mundell's celebrated argument for currency unions. According to Mundell (1961), an optimal currency area works best in countries with similar economic structures, high capital and labour mobility, and a system to transfer fiscal risks across the countries in the currency union. The more the circumstances correlate with the Mundell reality, the more effective the currency union is. Given that currency unions have countries with different shocks affecting them, the fiscal transfer system is important to ensure that some countries are not left behind and are compensated for shocks. The compensation is important because when countries join currency unions, they lose sovereignty over monetary policy and also lose control over the exchange rate and interest rates, which are powerful tools of adjustment.

One challenge for ECOWAS monetary integration is the large heterogeneity of countries, especially in terms of size, production structures, and macroeconomic management. There are large countries, like Nigeria, which account for more than 65 per cent of ECOWAS GDP, and there are smaller Sahelian countries, such as Niger, Mali and Burkina Faso. The income per capita varies: Cape Verde ($3630), Côte d'Ivoire ($2290), Nigeria ($2030), Senegal ($1450), Gambia ($750), and Niger ($560). The size differentials between the countries, both in terms of GNI per capita, are quite noticeable. Moreover, there are more politically stable countries like Ghana and Senegal, and mineral-rich but fragile countries like Guinea, Liberia and Sierra Leone. On top of all this, there are differences in production structures, macroeconomic management, and development strategy, rendering the common currency project a risky undertaking.

The lack of synchronised shocks between countries, especially between oil exporters and oil importers, is particularly troubling. In order to facilitate integration and create a common macroeconomic foundation, the ECOWAS authorities developed several key convergence criteria (modelled on the Eurozone) stipulating that the fiscal deficit/GDP ratio should be less than 3 per cent, the annual average inflation rate less than 10 per cent, and the debt/GDP ratio less than 70 per cent. Country compliance for these criteria has been uneven and challenging.

The CFA franc Zone and its Discontents

One of the complex challenges of the ECOWAS region is to merge the Anglophone and Francophone countries of West Africa. The CFA zone, a legacy of French rule, encompasses fourteen low-income, mostly francophone countries in Central and West Africa, accounting for nearly a third of sub-Saharan African states. There is the West African Economic and Monetary Union (WAEMU) and the Central African Economic and Monetary Union (CEMAC), each with the same parity to the euro. The zone encompasses a wide range of countries, including the more prosperous coastal economies and the poorer Sahelian economies. There is also a complex political economy between African governments, France and the International Monetary Fund (IMF), with a strong focus on stability and low inflation, as opposed to a more growth-oriented perspective.

The system is based on several institutional arrangements. First, the countries of the franc zone were pegged to the French franc from 1945 to 1999, since when the CFA currency has been pegged to the euro. As such, the CFA zone is the oldest fixed exchange rate regime in the world and predates the euro. Second, there has been an Operations Account in the French Treasury whereby countries deposit 50 per cent of their reserves. Third, France guarantees the convertibility of the CFA franc at the fixed peg to the euro. Finally, there is free capital mobility between the zone and France. A set of fiscal rules prevent monetisation of deficits and excessive credit creation, although

in practice there have been some departures from these norms. The system has not varied significantly since its conception in the post-war world. The main change was a 50 per cent devaluation in 1994. Like the EU, the CFA has multiple convergence criteria linked to inflation, debt and interest rates that seek to lay a path for macroeconomic convergence in the zone.

In December 2019, President Macron of France and President Ouattara of Côte d'Ivoire announced a reform of the system, including the change in name from the CFA franc to the eco; the removal of French officials from the governing bodies of the Central Bank and other institutions, and the removal of the operations account and consequent restitution of African pooled reserves. The idea was to modernise the system, though there were many concerns that the reform did not go far enough. The fixed peg to the euro was left untouched and the French convertibility guarantee was not specified.

The exchange rate has been a topic of some debate, both among the academic community and among policymakers. On the one hand, the conventional view on the CFA franc is that of Gulde and Tsangarides (2008), which finds that the exchange rate system and the common monetary institutions have been credited with helping the CFA zone for many years to achieve lower inflation and more macroeconomic stability than other countries in sub-Saharan Africa, and that the system can be further reformed to make it more effective. The stable CFA franc also improves predictability for foreign investors by minimising exchange rate risk.

By contrast, in a seminal work, Devarajan and Rodrik (1991) found that fixed exchange rates have been a bad bargain for the CFA member countries and that under reasonable trade-offs between output and inflation, these countries would have been better off having the flexibility to adjust to external shocks. In a detailed book analysing colonial and recent history, the politics, and the economics of the CFA franc zone, Pigeaud and Sylla (2021) provide a comprehensive argument against the CFA franc and document the complex political economy between France and African elites. They stress the lack of sovereignty in the formulation of exchange rate and monetary policy in the CFA zone.

In a recent book on the CFA franc zone, I (Zafar 2021) argue that the CFA franc zone is falling behind in growth and development performance, that the CFA macroeconomic arrangement is outdated, and that the institutional and exchange rate architecture have to be modernised to help support post-Covid economic recovery. The analysis highlights four challenges: perpetually overvalued currency (more than 20 per cent in WAEMU and 30 per cent in CEMAC in 2020) hurting African exporters; inability to adjust to trade shocks without cutting investment or accumulating debt; a political economy favouring urban elites and penalising rural producers; and a credit rationing regime which does not allow sufficient financial intermediation to meet firms' credit needs. Moreover, in the CFA zone, the landlocked countries are not converging in incomes with the richer coastal countries. Dessus, Diaz Sanchez and Varoudakis (2013) note the pro-cyclicality of public expenditure, the negative effects of shocks on public investment, and the high asymmetry of shocks affecting WAEMU member countries. They suggest ambitious reform, including justification of exploring options for greater counter-cyclicality of rules-based fiscal frameworks and for risk-sharing.

ECOWAS Challenges

In parallel to reforms of the CFA, ECOWAS has been working on a single currency for member nations. The performance of the countries with respect to ECOWAS convergence criteria has been mixed, especially in relation to the fiscal deficit. In June 2021, the ECOWAS member states agreed on a new road map to launch the eco in 2027, and would develop a new convergence pact that would cover the period from 2022 to 2026. The aim is to boost trade and growth.

The ECOWAS project represents a noble pan-African aspiration, but it should be done in a manner that ensures that the right building blocks are there. In a recent book on the potential for an ECOWAS common currency, Eswar Prasad and Vera Songwe find that a single ECOWAS currency would be a major and ambitious undertaking, with many potential benefits but also many implementation challenges. If leaders commit to building resilient policy and institutional frameworks that can create positive benefit-risk trade-offs, it could boost the economic well-being and prosperity of ECOWAS countries (Songwe and Prasad 2021). Writing from the African Development Bank, Bakoup and Ndoye (2016) argue that for an ECOWAS single currency to deliver its full benefits strong leadership will be needed as well as ownership by the parties involved.

The ECOWAS common currency project is a laudable long-term initiative but should not be done in a rushed way, without the necessary building blocks. The main challenges are set out below.

Common leadership vision

It will be key for the Anglophone leaders (especially Nigeria and Ghana) and Francophone leaders (especially Senegal and Côte d'Ivoire) to have a joint vision on the common currency. At the moment, there has been a trust deficit between many of the countries. The decision of Macron and Ouattara to use the name of the eco for the reform of the CFA had an adverse reaction among the Anglophone bloc. After the December 2019 Macron–Ouattara announcement, in January 2020 the West African Monetary Zone (WAMZ) issued a communiqué in which representatives from Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone condemned WAEMU's unilateral decision to move forward without consulting the other Ecowas countries. There were clear geopolitical divisions between France and Côte d'Ivoire on the one hand and Nigeria and Ghana on the other. A common currency project will require stronger trust and joint articulation of the common vision. In ECOWAS, it will be important to replicate the expansive vision of the founders – General Yakubu Gowon, Nigeria's then-president, and Togo's former president Gnassingbé Eyadéma.

Political Economy of Nigeria

Since Nigeria is the dominant economy in ECOWAS with a population of more than 200 million and a GDP that is more than 65 per cent of ECOWAS GDP, it will be the most significant power in a future ECOWAS monetary union. Already, Nigeria shoulders the larger part of the ECOWAS budget. Given Nigeria's strong internal challenges – management of oil volatility, fiscal transfers in a federal model, Boko Haram terrorism, and North-South divide, it will be a challenge for Nigeria to fully manage the common currency without strong support from some of the other countries, especially Ghana and Côte d'Ivoire. Nigeria's top priority is its industrialisation strategy and development of competitive value chains. Moreover, Nigeria has a more protectionist economic management philosophy than some of its neighbours, and during a crisis the reaction has been to close the borders with WAEMU and other neighbouring countries. Nigeria is also committed to protectionism to ensure rice self-sufficiency, while WAEMU is a strong rice importer with low tariffs for imported goods. Nigeria is committed to exchange rate flexibility and has also managed higher inflation than many of the CFA countries. It also has a low debt to GDP ratio. Any successful project will necessitate a convergence of philosophies in the zone.

Competing Philosophies and Currency Arrangement

The CFA francophone countries are pegged to the euro and have a link to France, which acts as a guarantor. The Anglophone countries of the ECOWAS zone have more flexible currency arrangements, and the Cape Verde escudo is pegged to the euro. The CFA franc zone focuses on low inflation and exchange rate stability, while the other countries focus more on expansive fiscal policy and growth. The competing currencies and economic philosophies should be reconciled for the ECOWAS common currency to work. A peg to the naira would be hard to reconcile with the CFA countries' focus on exchange rate stability, while a peg to the euro would be very difficult for Ghana and Nigeria, given their preference for exchange rate flexibility. The CFA countries fear the instability of the Nigerian naira or Ghanaian cedi, while the Nigerians and Ghanaians are concerned about the cost and rigidity of the CFA euro peg. A basket arrangement will be necessary. An added complication is that the eco's euro convertibility is supposed to be ensured by the French Treasury, but at present, there is a considerable degree of ambiguity in what it guarantees.

Role of Ghana

Ghana will need to be actively involved as it seems the best country to provide a bridge between the Anglophone and the Francophone countries. It has a similar production structure as Côte d'Ivoire but a political system and Anglophone culture more in tune with Nigeria. It has insisted that it wants to adopt a flexible exchange rate regime and have a federal system for the ECOWAS Central Bank. It is also in favour of less restrictive convergence criteria (in terms of fiscal and inflation targets) than favoured by the WAEMU states. It can be a regional mediator but its role must be made clearer.

Institutional Framework

A robust institutional framework is central to effective monetary integration. As Songwe and Prasad (2021) argue, an institutional framework, including regional financial market development and a uniformity of regulations on current account and capital account transactions, will be necessary for success. The harmonisation of legislation, particularly in relation to banking and payments systems, will also be key. The ECOWAS monetary authorities will have to decide on a prudential supervision framework, corporate bond markets, and interest rate policy. The countries should also have a common perspective on fiscal federa-

lism – the powers transferred to the regional authorities and the power kept by the national governments. Since it will be difficult to develop a system of taxes and fiscal transfers, it may be important to set up some structural funds.

Asymmetric Shocks

Due to the different resource endowments of the zone, the countries face asymmetric shocks. The presence of oil exporters, especially Nigeria, and oil importers, as well as the reliance of several countries on extractives (Niger's uranium, Burkina Faso and Mali's gold, Guinea's iron ore) means a strong preponderance of countries facing terms of trade shocks. Ghana and Côte d'Ivoire are the two big cocoa exporters in the world economy, and the shocks they face may not be the same as the ones Nigeria faces. These divergent shocks have implications on the currency arrangement.

Visa and Labour Movement

It will be important for ECOWAS citizens to be able to travel visa-free in the zone. Currently, there appear to be administrative difficulties for citizens to move and establish residency. This would be an important enabler of a common currency arrangement.

Private Sector

Consultations with the private sector should predate any common currency agreement. The perceptions of the private sector regarding risks will have to be managed. Since the private sector will be a job creator, the simplification of administrative processes for setting up businesses are part and parcel of any reform.

The Path Ahead

The ECOWAS single currency project is a great initiative but it should be properly prepared, taking into account macroeconomics, politics and institution-building. There appear to be several options:

Option 1: The Macron–Ouattara Option

The CFA countries remain pegged to the euro. The BCEAO and the French Treasury continue to maintain a strong link despite the abolition of BCEAO's operation account. The Francophone countries and Anglophone countries continue to pursue macroeconomic convergence in the future with no clear timeline.

Option 2: The Dominique Strauss-Kahn Option

As suggested by the former head of the IMF, this option requires that the WAEMU gradually expand to include ECOWAS economies, especially Ghana, since the latter is the second largest economy in ECOWAS. The question of the parity would remain a subject of debate as there is uncertainty around Ghana and the French guarantee.

Option 3: The Zafar Option

As proposed by Zafar (2021), this option means that the CFA countries abandon the euro peg for a tripartite peg (euro-dollar-renmimbi) that matches their growing and changing trade flows. This arrangement is then used to bring in countries other than Nigeria, such as Guinea and Ghana, who could accept a basket peg. During a longer-term stage after more than a decade, once the main institutions and arrangements are set up, the countries move towards a more managed float, with Nigeria as the regional leader. This option also proposes modernising the ambiguous French guarantee with a defined swap line with the ECB.

Option 4: The ECOWAS Option

This option means a full anchoring of all economies to either the Nigerian naira or a basket peg by 2027. The option assumes that all the preparatory work, including the building of political consensus, can be done in a few years.

Option 5: The Radical Option

After many delays and years of mistrust, the countries abandon any hope of a regional ECOWAS currency. They continue trade integration while at the same time, they pursue national currency goals. Each country decides on its own what currency it wants. WAEMU countries decide on a case-by-case basis whether they want to exit the CFA union and set up their own currencies based on their economic circumstance. A similar decision-making process is done for the other ECOWAS countries. Efforts are made to foster regional integration without a regional single currency.

Conclusion

This article argues that the third option is both politically feasible and technically plausible. The eco could become a more flexible exchange rate pegged to a basket and governed by inflation targeting. By balancing stability with flexibility, this option could provide a longer-term solution to the aspirations of West African monetary integration.

In a world of Covid, climate change, terms of trade shocks, political uncertainties and demographic pressures, it will be important for the ECOWAS authorities to find the optimal solution to their economic challenges as they forge ahead on their ambitious common currency project. The ideal fiscal and monetary policy framework will have to be developed to address the concerns of the member countries. Geopolitical considerations and rivalries will have to be addressed. The ultimate solution should be regional and not cater to external actors. Only then can West Africa emerge as a truly common economic space that could unleash the potential of the region.

Note

1. https://parl.ecowas.int/wp-content/uploads/2020/08/EN-Revised-treaty.pdf

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FORTHCOMING / À PARAÎTRE

La République de Guinée est devenue indépendante le 2 octobre 1958. En matière de politique étrangère, l'on constate des continuités à travers tous les régimes en ce qui concerne certains fondements. Mais si la première République (1958-1984) a mis l'accent sur les considérations d'ordre idéologique, les régimes successifs depuis 1984 se sont concentrés plutôt sur les aspects économiques. Cet ouvrage présente les contextes géopolitiques de la diplomatie guinéenne depuis l'indépendance et porte un regard critique sur les moyens humains et les infrastructures à l'aide desquels elle s'est déployée. Il analyse la nature et les facteurs explicatifs des relations bilatérales entre la Guinée et certains des pays avec lesquels elle a entretenu des relations particulières. Il s'intéresse aussi aux actions multilatérales du pays dans les cadres notamment de la CEDEAO, de l'OUA/UA et de l'ONU. Le dernier chapitre porte un regard prospectif sur l'avenir de la diplomatie guinéenne à l'ère du numérique. Il s'appuie sur un solide rappel des théories de relations internationales dans la première partie, et une riche littérature en français et en anglais, y compris des documents officiels sur les différents aspects du livre. Il a bénéficié de beaucoup d'entretiens avec de nombreux diplomates guinéens.

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