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THE CHALLENGES OF MONETARY UNION: RISKS AND PITFALLS AND HOW TO RESPOND TO THEM *

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I. INTRODUCTION

The important question of the choice of monetary and exchange rate regimes has, to date, continued to dominate public discourse at world economic gatherings despite the long history of the debate over what regime is appropriate and the costs/benefits of a particular regime over the other. One option that has been advocated is for countries to give up their national currencies to join a monetary union. Since the work of Mundell (1961), the literature has emphasized conventional optimal currency area (OCA) criteria in shaping the decision to give up national currencies to join a monetary union (Mckinnon (1963) and Kenen (1969)). Indeed, a monetary union is generally seen as the last stage of an economic integration process, which more often than not, tends to be preceded by a customs union or a trade bloc. The European Monetary Union (EMU) offers the largest historical experiment in which countries gave up their sovereignty in monetary (and other) policy areas and has captured the imagination of policy makers and researchers alike. It has also elevated other issues, related to complementary areas of reforms and integration, to the forefront of theory and policy analysis. These issues appeared to have shaped the discussion about monetary union and, more generally, on optimal regime choice for countries in other regions of the world, including Africa.

Recently, six of the 15 member countries of the Economic Community of West African States (ECOWAS), namely, The Gambia, Ghana, Liberia, Nigeria and Sierra Leone, embarked on an ambitious project to set up a second monetary union and common currency

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in West Africa (popularly referred to as West African Second Monetary Zone (WAMZ)), to coexist with the 53-year-old, West African Economic and Monetary Union (WAEMU), which has eight members.[1] The six countries of WAMZ have pledged to adopt a common currency by January 2003 and to work toward merging with the UEMOA by January 2004.

The purpose of this paper is to x-ray the challenges of monetary union with a focus on the risks and pitfalls and how to respond to them, paying particular attention to their relevance to the proposed second monetary union in West Africa. To accomplish this task, the rest of the paper has been divided into four sections. In section II we formally define a monetary union and briefly review its main features/characteristics and the rationale for forming a monetary union. We then discuss the benefits and costs of monetary union, as has been espoused in the vast literature on economic and monetary integration in the world economy in section III. This leads us naturally to the main focus of the paper in section IV where we take up the issue of challenges of monetary union, highlighting the risks and pitfalls and how to respond to them, particularly in the context of the WAMZ. Some concluding remarks are offered in section V to end the paper.

II. WHAT IS MONETARY UNION (MU)? WHAT ARE ITS MAIN FEATURES OR CHARACTERISTICS AND THE RATIONALE FOR MU?

In attempting to define monetary union, it may be helpful to explain one or two concepts, which are commonly found in the literature on economic integration and/or monetary union. One such concept is monetary integration, an aspect of economic integration, which involves exchange rate unification and currency convertibility. Monetary integration is an all-embracing concept, which may consist of monetary union or a common currency area (Ojo, 2001). Different writers have defined monetary union variously. For example, Mankiw (2003) defined MU as a group of economies that have decided to share a common currency and thus a common monetary policy. He notes that:

[1] WAEMU membership comprises the CFA francs zone covering mainly the French speaking countries of West Africa, viz: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Senegal, Niger and Togo. These countries form the Union Economique et Monétaire Ouest Africaine (UEMOA).

> *"If you have ever driven the 3,000 miles from New York City to San Francisco, ...you never have to change your money from one form of currency to another. In all fifty U.S. states, local residents are happy to accept the U.S. dollar for the items you buy. Such a* ***monetary union*** *is the most extreme form of a fixed exchange rate. The exchange rate between New York dollars and San Francisco dollars is so irrevocably fixed that you may not even know that there is a difference between the two." p. 333.*

Burda and Wyplosz (2001) on their part defined MU as an agreement among sovereign countries to use a common currency. They observed that:

> *"A monetary union involves the irrevocable fixing of exchange rates and the abandonment of margins of fluctuation among a number of currencies. In fact it means that individual currencies are no longer distinguishable, a common currency may be substituted. The immediate implication is that individual central banks lose any remaining autonomy, although one central bank is needed to manage the common currency." p. 525.*

While the above definitions by Mankiw and Burda and Wyplosz consider a common currency as an important element of monetary union, Masson (1992) makes a distinction between MU and a common currency area. According to him, in a monetary union, there is a common monetary policy in an environment where capital controls have been freed and financial markets are not segmented. In such a union, it may not be necessary to have a single circulating currency. This implies that the currencies of the member countries may continue to be used in the union conditioned on the rigid fixing of the exchange rates among them. A common currency area, on the other hand, entails the existence of a single currency and, hence, the absence of an exchange rate mechanism within the area, except as it relates to converting the common currency into the currencies of non-members.

This distinction may be regarded merely as an academic exercise as the two terms have come to be used interchangeably in practice. Indeed, a monetary union refers usually to a union using the same currency, and a true currency union to a union that irrevocably fixes exchange rates among members but allows for different currencies within the union. Compared to a currency union, a monetary union may be preferable because it does not face a potential credibility problem as to whether currencies are fixed irrevocably or adjustments will eventually be made.

In the light of the above, we can see that in its current form, MU incorporates the features/characteristics of monetary union and a true currency union, as follows:

- a voluntary coming together of independent nations at a highest political level to agree to an economic integration process that incorporates monetary integration as an integral part of the process;
- abolition of member countries' individual currencies and the establishment of a single currency that will be used throughout the union;
- the adoption of a common monetary policy throughout the member countries of the union and, hence, the existence of a single central bank to manage the single currency; and
- the irrevocable fixing of exchange rates where individual currencies are not abandoned.

What is the attraction or rationale for MU? The answer to this question is particularly important in the context of developing countries with diverse economic structures. Some economists have argued that a currency or monetary union promotes trade because it eliminates exchange rate volatility (Mundell, 1997). However, firm empirical evidence to show that exchange rate volatility has a significant negative effect on trade flows has been hard to find (Gagnon, 1992). Thus, the decision to form a monetary or currency union is often dominated more by political reasons than anything else.

The traditional theory on optimum currency areas (OCA) spells out criteria for creating a monetary union, which include the following: the degree of factor mobility, of trade integration, and the similarity of regional production patterns. The renewed interest in monetary union may not be unconnected with the increasing closer integration among regional economies around the world, which calls for greater monetary coordination, against the background of the globalization of the world economy, disappearance of fixed exchange rate regimes and capital account liberalization. Indeed, capital account liberalization when combined with the attachment of some countries to exchange rate stability makes it attractive to move from a soft peg to a hard peg, hence the renewed appeal to monetary unions. Europe has adopted this scheme. Previously, monetary unions had been established in French-speaking Africa and in the Caribbean Islands. The thinking is that this is where the world's future lies.

The Maastricht Treaty (1992) spelt out the following criteria for membership of EU countries in the Economic and Monetary Union (EMU), which started in January 1999:

- long-term interest rate not in excess of 2 percent above the average of the three countries with the lowest inflation rates;
- inflation rate not higher than 1.5 percent above the average of the three countries with the lowest inflation rates;
- no devaluation of its currency in the two years preceding the entrance into the union;
- government deficits and debts not exceeding 3 percent and 60 percent of the GDP, respectively.

Proponents of monetary union believe that only a single currency and its environment of stability will provide the citizens with the following advantages:

- a more efficient single market, once the single currency is in place;
- the stimulation of growth and employment;
- elimination of the additional costs connected with the existence of several currencies;
- an increase in international stability;
- enhanced joint monetary sovereignty for the member states.

In examining the rationale for MU among developing countries, Ojo (2001) notes that it is difficult to conclude that most developing countries meet the necessary conditions to run an effective monetary or economic union. This view was predicated on the political problems confronting these countries especially in sub-Saharan Africa, which he noted might completely erode the positive economic factors that may support viable economic integration efforts. This, notwithstanding, he advanced a number of compelling arguments for developing countries to continue with the integration efforts.

First, MU in developing countries could engender or accelerate the process of macroeconomic stability by strengthening national programmes of macroeconomic management. Thus, a collective strategy could contribute to the strengthening of efforts at achieving sustained macroeconomic stability, which would enhance monetary, price and exchange rate stability, engender strict budgetary discipline and better growth performance.

Second, monetary and economic unions among developing countries will encourage the mobilization and efficient utilization and management of human and financial resources. Available resources in this group of countries, especially in the Africa Region, are either inefficiently utilized or allowed to flow to the developed economies because of limited opportunities. This coupled with the asymmetrical pattern of international trade, which places developing countries at a disadvantage underlies the need for greater economic and monetary integration efforts among developing countries particularly among African countries.

Third, the dynamics of the world economy, which in the last three decades have witnessed increased economic and monetary integration efforts among the developed nations, serve as a more compelling reason for greater economic cooperation efforts among developing countries. Indeed, the economies of this former group of nations have become stronger and resulted in improved economic performance, rapid technological advancement and overbearing influence in global economic issues. Developing countries and, indeed, African countries can take a cue from this to forge a united front through greater economic and monetary integration if they are to make any meaningful impact on the resolution of such important issues as debt overhang, resource flows to their economies, secular decline in primary commodity prices which tend to affect their economies adversely and the reform of the international financial system that has been on the drawing board for some time now.

Against the foregoing, what are the challenges of MU? In order to identify these challenges, it is imperative to ask the related questions: are there benefits to be derived from forming a monetary union even in regions with so much diversity as Africa? Are there costs to be borne by countries joining a monetary union? We take up these issues in the remainder of this paper. However, before looking at the challenges it is pertinent to first highlight the benefits/costs of MU since these will naturally throw up the challenges.

III. COSTS AND BENEFITS OF MU

De Grauwe (2000), in the context of the EMU, has asked the question, **does** a nation increase its welfare when it abolishes its national currency and adopts some currency of a wider area? He notes that the eleven EU-countries that joined EMU on 1 January 1999 have given a positive answer. Other EU-countries like the UK, Denmark, and Sweden continue to struggle with this question. While Central European countries that are ready to join the European Union will have to analyze that same question.

According to him, the issue of whether nations gain by relinquishing their national currencies immediately leads to a new question. Where should the process of monetary integration stop? Should there be one currency for just eleven countries of the present EMU, or for the EU, or for the whole of Europe, or maybe for the whole world? This problem leads to an analysis of what constitutes an optimal monetary area.

In order to tackle all these problems, writes De Grauwe, a systematic analysis of what the costs and benefits of having one currency should be undertaken. There are economic costs and benefits as well as political costs and benefits.

Perhaps the single most important cost of a monetary union derives from the fact that when a country relinquishes its national currency, it also relinquishes an important instrument of economic policy, that is, it loses the ability to conduct a national monetary policy. In other words, in a full monetary union the national central bank either ceases to exist or will have no real power. It loses national sovereignty in the use of monetary instruments, such as the exchange rate and the interest rate. This implies that a nation joining a monetary union will not be able any more to change the price of its currency (by devaluations and revaluations), or to determine the quantity of the national money in circulation.

The use of the exchange rate and interest rate as policy instruments, for example, is useful for an individual country because nations are different in several respects that could require changes in these key price variables to occur. Such areas include shifts in demand, different preferences of countries about inflation and unemployment, differences in labour market institutions, differences in legal systems, differences in growth rates and different fiscal systems and the seigniorage problem. Thus, the loss of independent monetary policy may constrain the ability of individual countries in a monetary union to tackle these issues.

Another potential cost of MU is related to the likelihood of the economies in the monetary union facing different shocks. This is the problem of asymmetric shocks, i.e. shocks which tend to hurt some members but not the others, and here the use of exchange rate is useful. Since economies linked by a monetary union must necessarily adopt the same monetary policy, such a monetary policy may inevitably prove inappropriate in the face of very different shocks. The larger and more asymmetric the shocks, the greater the cost of a fixed exchange rate since the economies experiencing the most shocks do not have the luxury of adjusting the exchange rate to address the problem. For the proposed WAMZ countries, the problem of asymmetric shock is real especially because these countries export mainly primary commodities whose terms of trade shocks have been substantial over time and their economies are less diversified.

Other associated costs of MU that have been identified in the literature include: higher real exchange rate persistence, which implies that real exchange rates adjust more slowly to shocks in member countries of currency unions; loss of seigniorage; and potential for political tension. Itsede (2001) adds as potential costs the possibility of importing inflation from high inflation union countries, loss of location of industries to more economically viable regions, and spatial changes in population distribution as labour migrates to "*action spots*".

According to De Grauwe, whereas the costs of MU have much to do with the *macroeconomic* management of the economy, the benefits are mostly situated at the *microeconomic* level. Thus, eliminating national currencies and moving to a common currency can be expected to lead to gains in economic efficiency. These gains in efficiency have two different origins. One is the elimination of the transaction costs associated with the exchanging of national moneys. The other is the elimination of risk coming from the uncertain future movements of the exchange rates.

The traditional OCA literature (Mundell 1961, Mckinnon 1963) argues that countries joining a monetary union will benefit from lower transaction costs associated with trading goods and assets in different currencies. Lower transaction costs would enhance trade and, therefore, generate higher benefits from economic specialization. Transaction costs (the cost of foreign exchange transactions or the cost of exchange rate cover or inter-bank transactions) will disappear altogether within the monetary union. Eliminating the costs of exchanging one currency into another is certainly the most visible (and most easily quantifiable) gain from a monetary union. We all experience these costs whenever we exchange currency. The elimination of transaction costs will also have an indirect gain, in the form of reducing the scope for price discrimination between national markets.

It is believed that MU can provide a stimulus to growth and employment. It will promote investment and employment in two ways: first, because it is based on a solid economic framework that puts public sector deficits under control and price stability secured, MU will foster trade, improve the allocation of resources, encourage increased savings, enhance growth and in the end create more employment and higher living standards. Second, because the common central bank will have the means to fulfil its primary objective of ensuring price and monetary stability throughout the union, it will foster market confidence, which in turn should be conducive to low interest rates, particularly long term rates.

MU has the potential of promoting greater trade between union members and greater regional integration more broadly. Recent empirical evidence suggests large positive effects of currency unions on trade and income (Rose 2000, Glick and Rose 2002, and Frankel and Rose 2002) This evidence has, however, been questioned, as new evidence suggests that Rose and associates may have grossly exaggerated the impact of currency unions on trade due to sample selection and non-linearities and the endogeneity of the decision to join the union (Persson 2001 and Tenreyro 2001).

Other potential microeconomic efficiency gains from joining a currency union are due to elimination of nominal exchange rate volatility and hence lower interest rates, lower real exchange rate volatility, deeper financial integration, and (in the case of joining a dominant currency area, like the euro) international acceptance of the currency. Indeed, De Grauwe has argued that if the new common currency graduates to a truly global currency, additional benefits can be reaped in the form of government revenues and an expansion of the financial industry in the union.

By reducing price uncertainty, a common currency will improve the allocative efficiency of the price mechanism and, thus, improve welfare. It is, however, difficult to quantify this effect. Also, the greater price transparency provided by the use of a common currency is likely to increase competition, benefiting consumers.

In the context of the ECOWAS monetary zone, Itsede (2001) summarized the benefits of MU as follows:

- elimination of currency inconvertibility and its tendency to limit trade, economic, social and political interaction between countries that are otherwise contiguous;
- reduction in speculative capital flows;
- enhancement of efficiency in domestic and regional resource allocation;
- improved productivity through free factor mobility;
- increased trade and investment flows;
- increased resource savings from pooling of external reserves;
- centralization of monetary policy;
- reduction in non-tariff barriers to trade; and coordination of macroeconomic policies.

IV. CHALLENGES OF MU AND HOW TO RESPOND TO THEM

The discussion, thus far, in the paper has been cast in a fairly general manner with little attention paid to its relevance to the proposed second MU among the six of the 15-member countries of the ECOWAS and the eventual establishment of single monetary zone with the merger of the second MU and the WAEMU by 2004. In this section of the paper, we draw on the general focus of the preceding sections to underline the major challenges, risks and pitfalls that confront the proposed WAMZ and then attempt to proffer suggestions on how to respond to them.

The six countries of the second monetary zone, namely, The Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone, have pledged to adopt a common currency by January 2003 and to work assiduously toward merging their planned MU with the existing WAEMU by January 2004. In April 2000, these countries signed the Accra Declaration on a second monetary zone, committing themselves to restructuring their economies to meet the following stringent convergence criteria one year ahead of the ECOWAS goal of launching the single monetary zone (and the introduction of a single currency) in the sub-region:

- maintain single-digit inflation by the end of 2000 and an inflation rate of no more than 5 percent by 2003;
- maintain gross foreign currency reserves to cover at least three months' worth of imports by the end of 2000 and six months' worth by the end of 2003;
- limit central bank financing of the budget deficit to 10 percent of the previous year's tax revenue; and
- maintain a maximum budget deficit-to-GDP ratio of 5 percent by the end of 2000 and 4 percent by the end of 2003

Meeting the above macroeconomic convergence criteria, which will culminate in an economic and monetary union especially within the time frame envisaged poses an enormous challenge for the economies of the sub-region. This is particularly so because having common economic policy goals is important to the success of a monetary union, hence the important role for the convergence criteria cannot be overemphasized. Indeed, the risk there is how to get the member states to implement the necessary economic policy measures that would steer them toward meeting these criteria. This is because the economies of the countries that align for such a union are too fragile or too weak to undertake the necessary macroeconomic adjustments required for the union. It is possible that while some countries may be able to meet the targets within the stipulated time frame, others might not, which may call for special efforts on the part of these countries to meet the convergence criteria. Under this circumstance, it may be expedient for member countries to determine how to move forward, taking into account the factors (whether internal or external) that may have constrained the ability of those countries to meet those criteria.

Apart from this transitional challenge, there are other challenges that transcend political, economic, institutional, socio-cultural (including language barriers) arena, which on the surface may appear trivial, but indeed have implications for the long-term sustainability of the monetary union. One such challenge is the political will and commitment on the part of member states. It must be acknowledged that the six countries of the second MU, and particularly so on the part of Ghana and Nigeria, have demonstrated strong political will and greater and more specific commitments to proceed with the monetary integration. Indeed, such political will and commitment are unparalleled in the history of the formation of monetary unions. What is essential, therefore, is how to translate these to the larger group of the ECOWAS membership so that the planned single monetary zone comes to fruition at the proposed date or with minimal delay. In reality, with the increased globalization and the rise in regional economic blocs, it would appear that member states of the ECOWAS sub-region are left with little choice, but to act quickly on the monetary union and other economic integration objectives. Public administrators must act as leaders and catalyst to the whole integration process since anything short of that may derail the process. Thus, building up political credibility is both a challenge and a risk that MU members would have to contend with.

Related to the issues of political will and commitment is that of communication with the general public and how to deal with the uncertainties and public apprehension about relinquishing their national currencies with the introduction of a single currency. How do you encourage the public to accept the technical feasibility of the transition to a single currency? To deal with these issues, authorities in member countries will have to embark on extensive public enlightenment campaign to get the general public buy into the whole monetary integration process. The public must be carried along otherwise the whole integration effort will come to naught, as exemplified by the experience of the failed ECOWAS Travellers' cheque. It makes no sense to demonstrate strong political will and commitment at the highest level without the confidence of the public in the project. Central to this is also the issue of consumer protection. They must be guaranteed that there will be no added cost or special charges for the changeovei to a single currency. The support of all citizens is crucial to the success of monetary union.

Another major challenge that must be tackled is that of distrust and suspicion between member states Smaller economies/countries often fear domination by the large ones. This fear of domination can also be seen within groups of countrics from a monetary union. Such fears might be compounded by socio-cultural, historical and language difference in the case of ECOWAS countries where there exists strong potential for one group to fight to dominate the other, i.e. the Anglophone vis-à-vis the Francophone countries. For example, the distrust and suspicion between the Anglophone and Francophone countries of ECOWAS may have undermined the efforts at establishing a Free Trade Area as well as the efforts made by some member states to enhance intra-regional trade within the region through the introduction of ECOWAS Travellers Cheque prior to the introduction of a monetary union. Thus, the authorities of the member states of the proposed MU must play the catalytic role and turn these potential barriers to an advantage rather than destabilizing factors.

In addition to the issue of political credibility alluded to above, the proposed single ECOWAS monetary zone have to contend with the issue of importing monetary policy credibility to the monetary union. The question is, do some member countries have well-established and credible independent monetary policies that could be imported into the MU when a single currency is eventually adopted so as to reduce country risk premium, that are possibly associated with depreciation risk? In this regard, therefore, the experience of the CFA franc zone (or WAEMU) in maintaining a credible monetary policy environment since its existence becomes useful and, thus, capable of giving added credibility to the larger monetary union when it eventually comes on board.

The biggest challenge posed by currency union arrangements is traditionally seen to be how to cope with the divergence of national developments from those of the currency union on average, when national monetary policy was no longer available as an economic policy tool. Basically, this concerns the issue of how to handle asymmetric shocks. Should there be particular measures for dealing with the adjustment costs associated with asymmetric shocks or not? Researches have portrayed asymmetric shocks as unambiguously undesirable on the grounds that they raise the costs of membership in a currency union. It has been suggested that monetary union members can respond to such shocks through fiscal, price and wage policies. While this may be true, it may not be so in all circumstances thus requiring other initiatives to deal with the problem. In this context, therefore, the plan by the ECOWAS members to set up a regional stabilization and cooperation fund, as a buffer to temporary shocks and adverse balance of payments situations would certainly help. The effectiveness of such a fund, however, presumes that each member must demonstrate strong commitment to helping its neighbours. Thus, a country like Nigeria with its very large economy and oil resources should be able to play the "big brother" role when smaller economies within the union experience adverse shocks.

In addition to the "bail out", ensuring unimpeded regional labour (and possibly other factors) mobility could assist in cushioning shocks that affect the economies differently. This calls for labour market reforms in the converging economies to facilitate movement of people across industries and national borders where necessary to find jobs and, thus, making the labour markets more flexible. It is pertinent to note here that on paper ECOWAS has indeed facilitated mobility by the elimination of visa requirements, but in practice there is some visible resistance to labour mobility within the sub-region in addition to the other administrative bottleneck encountered by citizens of other countries seeking to establish residency in another as well as outright hostile response against large-scale immigration from neighbouring countries. These attitudes need to change among the union members for the monetary union to be sustainable. Thus, harmonizing immigration laws and implementing already established protocols remains a major challenge.

With respect to the conduct of national fiscal polices in a MU and the credibility and sustainability of fiscal policies, the following questions must be answered. What is the role of fiscal policy in the MU? How independent can national fiscal policies be? Does MU reduce or increase fiscal discipline? And what rules, if any, should be used to restrict national fiscal policies? Should there be a Stability Pact akin to the EU Stability Pact? How should the issue of risks of default and bailout be handled in a MU? Indeed, some of these issues are already receiving attention, as indicated by the convergence criteria, where a rule on government budget deficits has been set. The views on the relevance of a fiscal policy rule have been divergent, but there is now a growing literature on why fiscal policy rules make sense in a monetary union. This view is based on a number of issues including financial markets imperfection and the pricing of sovereign credit risks, and the insufficiency of a restrictive monetary policy, which yields a small inflation tax (seigniorage) only, to balance exogenously determined primary public deficits, leading to explosion in public debts (See Sargent and Wallace 1981). All the questions raised above must be addressed in a holistic manner by the converging economies for the MU to be sustainable.

Related to the role of fiscal policy is how to conduct monetary policies in a union where asymmetric shocks occur and where the same shocks are transmitted differently among member-countries. Should there be a common central bank or a coordination of the central banks of individual member countries? If a common central bank is required, what monetary policy strategy should it adopt, what should be the ultimate and final targets of monetary policy, and what instruments should it use to achieve these targets? Should there be a single objective or multiple objectives that will encompass price stability, stabilization of business cycle, maintenance of high employment, and financial stability, etc? Should the common central bank be completely independent and accountable or have the necessary powers to carry out its assigned responsibilities and build up credibility? What will be the interaction between the common central bank and the national fiscal authorities and how are conflicts to be resolved, particularly as it concerns enforcing access to monetary financing?

Finally, there is also the challenge of financial markets integration and supervision. Financial markets integration—bonds and equity markets and banking sectors—is of great importance for the smooth functioning of the MU and it can facilitate adjustment to asymmetric shocks. Financial markets integration is a worldwide phenomenon, driven by globalization and technological progress. Adoption of a single currency adds another catalytic dimension for financial markets integration in the ECOWAS monetary zone. The ECOWAS cross-border clearing and settlement infrastructure, which is essential for the smooth and efficient functioning of the securities markets remains fragmented and rudimentary. Major steps in integrating and upgrading the infrastructure must be taken by member countries while at the same undertaking an adjustment of the structures and operating procedures of financial markets.

The unified monetary policy of the ECOWAS monetary zone will also be confronted with regulatory and supervisory authorities, which specialize in both national and across sectors. This may not pose a great problem if financial markets remain nationally segmented. In this case, the principle of home country control and host country responsibility greatly overlap (De Grauwe 2000). However, increasing cross-border mergers or market integration blur responsibilities and may contribute to slower and less efficient crisis management. Thus, there is need for clearly defined areas of responsibilities among national authorities and supervisory and regulatory agencies. This will of necessity require building needed capacities in individual member countries of the monetary union.

All the risks, pitfalls and challenges identified above are not insurmountable provided the political will and commitments are there on the part of individual members of the proposed monetary union.

V. CONCLUDING REMARKS

The main focus of the paper has been to highlight what challenges, risks and pitfalls that may face the proposed ECOWAS monetary union, and propose how the member countries should respond to them. To achieve the above objective we defined a monetary union and attempted to identify the main features/characteristics of a monetary union. We then reviewed the costs and benefits of joining a monetary union, noting that ultimately, the decision to join a MU is more political than economic, but observed that for monetary union to be credible and strong, it must encompass countries which are pursuing sound macroeconomic policies and must also encompass strong political will and commitments on the part of members countries.

We also highlighted the convergence criteria stipulated by the six member countries of the proposed second monetary zone as a prelude to identifying the challenges facing the enlarged monetary union when it eventually takes off in January 2004. We noted that meeting these criteria by the deadline remains a major challenge for the sustainability of the monetary union, while sustaining the strong political will and commitments shown, thus far, by the six countries pushing for accelerated monetary integration in the sub-region and at the same time ensuring that such strong political will and commitments are reciprocated by the membership of the existing WAEMU is imperative. Other challenges, risks and pitfalls identified in the paper cover such issues as making sure that the generality of the public are carried along, tackling the apparent mistrust and suspicion between member states and the fear of domination by larger economies in the sub-region, building political credibility as well as macroeconomic policies credibility, and strategies for coping with asymmetric shocks that may affect economies of member states. Other challenges include: harmonizing labour market issues, making labour mobility in the sub-region less cumbersome, how to conduct monetary and fiscal policies in the MU and the relationship between them and addressing the problems of fragmented financial markets, inadequate financial markets infrastructure, as well as regulatory and supervision of cross-border and national financial markets activities.

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