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The West African Monetary Zone (WAMZ) convergence or divergence: which way forward

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THE WEST AFRICAN MONETARY ZONE (WAMZ)
CONVERGENCE OR DIVERGENCE:
WHICH WAY FORWARD?

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Macroeconomic performance in the WAMZ member countries has been generally disappointing over the reference period despite strong political commitment to achieve convergence in order to establish a "fast track" second monetary union. The road to economic convergence has been bumpy for all the members. To date, not a single country has succeeded in meeting the convergence criteria on a sustained basis. Overall, large swings have characterized the macroeconomic performance of the WAMZ member states. Notwithstanding the poor macroeconomic performance, I am optimistic that the WAMZ project is likely to succeed in the long run if the authorities persevere.

While enhance welfare gains will accrue to WAMZ citizens in the long-run, the short-term benefit of the project lies essentially, on improved macroeconomic environment and operational efficiency, which only peer group pressure can force on the WAMZ economic managers.

JEL Classification Number E.4, E, G2

INTRODUCTION

A monetary union is generally regarded as the last stage of economic integration. Typically, a monetary union is preceded by a custom union or a free trade bloc (Mundell, 1961) and (Mckinnon, 2000). The formation of the "fast track" second West African Monetary Zone (WAMZ), comprising: Nigeria, Ghana, The Gambia, Sierra Leone and Guinea, will indeed, represent a historical achievement, if the project becomes a reality within the stipulated time-frame.

The conception of the WAMZ project is predicated on the proposition that economic integration can indeed, enhance the prosperity and welfare of the citizens of the

member states. This optimistic conclusion has strong theoretical and empirical support. It was Adam Simith (1776), who noted centuries ago that it is not by the benevolence of the baker that we eat bread. Rather, individual bakers who strive to further their own self-interest unwittingly, enhance the welfare of all consumers of bread. Trade is indeed, beneficial to all and the use of a common currency, further enhances the benefits of trade.

Generally, the ability of monetary unions to perform optimally depends on the statutory powers and functions of the enabling institution. A stable single currency under a common central bank that will ensure price and exchange rate stability, represent the key instrument and institution that will guarantee the realization of the gains inherent in a monetary union.

Barring any policy change, 2004 will represent the defining moment for the realization of the (WAMZ). This is the year when the decision will be made – based on the convergence criteria, as to which countries will be eligible to join the ECOWAS monetary union. The ECOWAS convergence criterion is divided into primary and secondary criteria, with various target dates set for the different criteria. The primary criteria consist of four pillars – namely:

(1) Inflation
(2) Overall budget deficit to GDP
(3) Central bank financing of budget deficit and
(4) Floor on foreign exchange reserves.

The secondary criteria consist of six pillars – namely:

(1) zero domestic arrears
(2) ratio of Tax Revenue to GDP, (greater than 20 per cent)
(3) Wage bill/Total Tax Revenue (less than 35 per cent)
(4) Exchange rate stability, (defined as $\leq$ 15 per cent of quoted central rate as at April 1st 2002)
(5) Positive real interest (>0) and
(6) Public investment/tax revenue ratio (>20 per cent)[1]

Under the "Convergence, Stability, Growth and Solidarity Pact" adopted by the member countries, all the WAMZ member countries are required to fully meet the criteria by end-December, 2002. The West African Monetary Institute (WAMI), is charged with the

responsibility of monitoring macroeconomic developments in the member states. In addition, WAMI is also responsible for the preparation of the groundwork for the introduction of the single currency (ECO), and the establishment of the common central bank.

The emergence of a single currency and a common central bank presupposes the adoption of a common monetary and fiscal policy by all the member countries starting from 2004. What is the economic significance of the primary criteria? What are the consequences if member countries fail to converge? Can the policy of a single currency and a common central bank succeed if the members fail to meet the primary criteria? In other words, is the creation of the appropriate institutions a necessary and sufficient condition for the success of a monetary union? Finally, can a monetary union under a common central bank succeed in the absence of a political union?

These are the major questions which this paper shall attempt to answer. To achieve this objective, the rest of the paper is structured as follows: Part II will present a brief literature review and the theoretical framework. Part III X'rays the pillars under the primary convergence criteria and the rationale for the choice. Part IV appraises the macro-economic performance of the member states in general, and their achievement of the primary criteria in particular to date, while Part V concludes the paper.

Part II: Literature Review

Contemporary discussions on the creation of the WAMZ monetary union have tended to assume political over-tune. This is in contrast to the purely economic debate which was intended by Mundell (1961), in his seminal paper on the Optimum Currency Area (OCA). Several scholars: Corden (1993), Kenen (1995) and others, have noted that the core of Mundell's thesis is that countries stand to gain under a common currency arrangement when the real benefits for their economies of permanently fixing their exchange rates and a common currency outweigh the real costs associated with flexible exchange rate and asymmetric shocks.

Arising from the current political bias of the ongoing policy dialogue amongst WAMZ leaders, very little attention has been paid to the macroeconomic implications for an individual country surrendering its discretion over the use of monetary and exchange rate policy instruments, should the need for policy adjustment and fine tuning arise. Indeed, empirical evidence from the literature strongly suggests that while the achievement of the

convergence criteria by member countries represent a necessary condition, a critical success factor for a common currency or a single currency area still remains a high degree of factor mobility (Frankel and Rose, 1997).

On the basis of early Mundell OCA theory which was cast more or less on the stationary expectation framework, it would appear that the WAMZ member states would in fact, have very little to gain by forming a monetary union, given the vulnerability of the member countries to asymmetric shocks (Mckinnon, 2000). The loss of policy discretion to correct terms of trade shocks, or pursue special policy preferences (low inflation, growth and poverty reduction), is generally regarded by economists as one of the major draw-backs of belonging to a monetary union. This policy dilemma is properly captured by Eichengrecn (1997), when he observed that "policy makers balance the savings in transactions costs from the creation of a single money against the consequences of diminished policy autonomy. The diminution of autonomy follows from loss of exchange rate and an independent monetary policy as instruments of adjustment". He went on to emphasize that "that loss will be more costly when macroeconomic shocks are more asymmetric, when monetary policy is more powerful instrument for offsetting them and when other adjustment mechanisms like relative wages and labour mobility are less effective".

However, as aptly noted by Mckinnon (2000), the stationary expectation assumption which characterized Mundell's seminal work has now given way to a dynamic perspective. Focusing on the economy of scale derivable from membership in a currency union – especially, how future exchange rate volatility and transaction costs can disrupt international capital market by constraining portfolio diversification, Mundell has affirmed that a currency union can indeed, mitigate asymmetric shocks by pooling reserves of member countries optimally. Furthermore, he argued that a "country suffering an adverse shock can better share the loss with a trading partner because both hold claims on each others output in common currency. Whereas, under a flexible exchange rate, a country facing an adverse shock finds that its domestic currency assets buy less on world markets. The cost of the shock is now more bottled up in the country where the shock originated".

Under what circumstances might a country decide against joining a monetary union? Mundell's response to this question which I consider to be very apt in this study is reproduced below. According to Mundell (1977), a country might decide against joining a currency union if:

(1) It wants an inflation rate different from the currency area.

(2) It wants to use the exchange rate as an instrument of employment policy to lower or raise wages

(3) It wants to use the exchange rate as a begger-thy-neighbor instrument to capture employment from other countries,

(4) As a large country, it does not want an unfriendly country to benefit from the economies-of-size advantages of the large currency area, or because it fears that the addition of another currency will complicate national macroeconomic policymaking.

(5) It wants to use the money-expansion or inflation tax to finance government spending, and it would be prevented from doing so to the extent desired by the discipline of fixed exchange rates;

(6) The country, especially if it is large – does not want to sacrifice seignoirage from the use of its money as an international means of payment;

(7) The government wants to use seigniorage as a source of hidden or off-budget funding for personal use by members of a corrupt dictatorship or naïve democratic government;

(8) A regime of fixed exchange rates could conflict with the required policies of a central bank that had a constitutional mandate to preserve price stability;

(9) Monetary integration with one or more other countries would remove a dimension of national sovereignty that is a vital symbol of national independence;

(10) It wants to optimize the currency denominations appropriate to its per capita income;

(11) It wants to maintain monetary independence to use the money expansion or inflation tax in the event of war;

(12) It wants to protect the secrecy of its statistics as when the Soviet Union opted out of the IMF and forced its Eastern European satellites to do the same;

(13) There is no domestic political and economic leadership capable of maintaining a fixed exchange rate system in equilibrium;

(14) The political authorities cannot achieve budget balance and/or establish confidence in the permanence of budgetary equilibrium or the viability of fixed exchange rates;

(15) The partners in the prospective currency area are politically unstable or prone to invasion by aggressor countries;

(16) The partner countries are poorer and will expect aid, "equalization payments," or otherwise an unduly large proportion of OCA's expenditures; and

(17) It does not want to accept the degree of integration implied by the OCA agreement, such as common standards, immigration, labour, or tax legislation.

Looking backwards, it does not appear that the macroeconomic policies of the WAMZ member countries have been significantly different from each other, over the years. Historically, available data reveal that the economies have been largely characterized by high inflation, low growth, exchange rate volatility and external imbalance. Similarly, in terms of per capita income and standard of living, the WAMZ member countries are generally at par. Given the shared characteristics the case for belonging is stronger than otherwise.

Whereas the case against joining a monetary union can be rationalized in terms of socio-political considerations, Mundell's case for countries belonging to a monetary union is cast in rational economic logic and very compelling. The following are the reasons provided by Mundell:

(1) To gain the inflation rate of the OCA;

(2) To reduce transactions costs in trade with a major partner;

(3) To eliminate the cost of printing and maintaining a separate national currency;

(4) To participate in a purchasing power parity area, which would be fostered by fixed exchange rates even more by monetary union;

(5) To establish an anchor for policy, a fixed point around which expectations can be formulated and policies can revolve;

(6) To remove discretion from monetary and fiscal policy authorities;

(7) To keep the exchange rate from being kicked around as a political football by vested interests that want depreciation to boost profits or to bail out debtors;

(8) To establish an automatic mechanism to enforce monetary and fiscal discipline;

(9) To have a multinational cushion against shocks;

(10) To participate more fully and on more equal terms in the financial center and capital market of the union;

(11) To provide a catalyst for political alliance or integration;

(12) To establish a power bloc as a countervailing influence against the domination of neighbouring powers;

(13) To share in the political decision of determining the OCA's inflation rate;

(14) To establish a competing international currency as a rival to the dollar, and earn, instead of pay, seigniorage;

(15) To reinforce or establish an economic bloc that will have clout in international economic discussions and have greater power to improve, by its trade policy its terms of trade;

(16) To delegate to a mechanism outside the domestic political process the enforcement of monetary and fiscal discipline; and

(17) To participate in restoring a reformed world monetary system.

Generally, a critical appraisal of Mundell's case for and against joining a monetary union suggests that the jury of public opinion would definitely decide in favour of membership, given the poor macroeconomic performance of WAMZ member countries in the areas of inflation, exchange rate management and inappropriate management of monetary and fiscal policy regimes since their attainment of political independence. The next section examines the requirements to be fulfilled if countries are to become an integral part of the WAMZ monetary union. The essence of the review is to ascertain inter alia: the achievability of convergence within the timeframe specified under the convergence treaty.

PART III
First Pillar : The Primary Convergence Criteria

The first pillar of the WAMZ convergence criterion is inflation – defined as the increase in the price level, based on the changes in the Consumer Price Index (CPI), between successive end-periods (viz. point-to point). Under the treaty, member countries are required to achieve a single digit inflation by end-2000 and specifically, 5 per cent by end-2003. Generally, inflation is an important backward and forward looking key economic indicator; which can be readily employed to ascertain past policy preference of the national authorities. Since price stability is a pre-requisite for the achievement of non-inflationary growth, the indicator can also be used to peer into the future in order to ascertain if macroeconomic stability can be sustained in the monetary union in the long run.

Price stability is indeed, a mark of good macroeconomic policy house keeping. However, if the inflation indicator is to represent policy commitment to price stability, there is need to harmonize the base year and the CPI index of the WAMZ member states. Presently, a closer examination of the index of the member countries reveal serious lack of uniformity. Consequently, the absence of a harmonized index implies that the primary indicator can at best measure the absolute rather than the relative convergence which is intended. The inability to achieve relative convergence will pose serious policy difficulties in the labour market (wage policy), money market (interest rate policy), and the product market (exchange rate policy), of the future monetary union, if corrective policy actions are not taken immediately.

Notwithstanding the measurement problem arising from the lack of comparability of the inflation indicator, an analysis of the historical data (Table 1), reveals that the maintenance of price stability has actually, not been regarded as a top policy priority by the WAMZ member countries.

Table 1
Inflation Rates (%)

Year	The Gambia	Ghana	Guinea	Nigeria	Sierra Leone
1981	5.3	109.9	32.5	20.1	22.2
1982	8.9	35.8	35.0	7.8	27.4
1983	13.7	114.6	30.0	23.5	64.3
1984	21.3	10.9	30.3	39.6	69.6
1985	17.3	-11.1	26.0	7.5	76.9
1986	60.1	20.3	19.1	5.7	78.2
1987	23.4	38.5	64.7	11.2	181.3
1988	12.7	34.1	27.3	54.4	31.2
1989	6.92	25.1	35.5	50.5	62.8
1990	14.1	40.1	13.0	7.4	110.9
1991	8.3	9.0	19.3	13.0	102.9
1992	8.6	10.4	16.9	44.7	65.5
1993	8.6	24.9	7.4	57.4	22.2
1994	-1.2	25.9	4.1	57.0	24.2
1995	8.6	62.2	5.4	72.8	25.9
1996	1.1	35.8	3.2	29.3	23.1
1997	1.4	21.0	1.9	8.2	15.0
1998	3.6	30.8	5.1	10.3	35.7
1999	2.7	12.4	4.0	6.7	34.4
2000	0.73	26.2	6.8	4.9	-3.7
Average	11.0	35.3	19.4	26.6	53.5

Source:-African Development Bank (ADB) "Selected Statistics on countries", 2001

-International Monetary Fund (IMF) "International Financial Statistics (IFS)", October 2000
-West African Monetary Institution (WAMI) "Convergence Reports on member countries' economies for 2000"
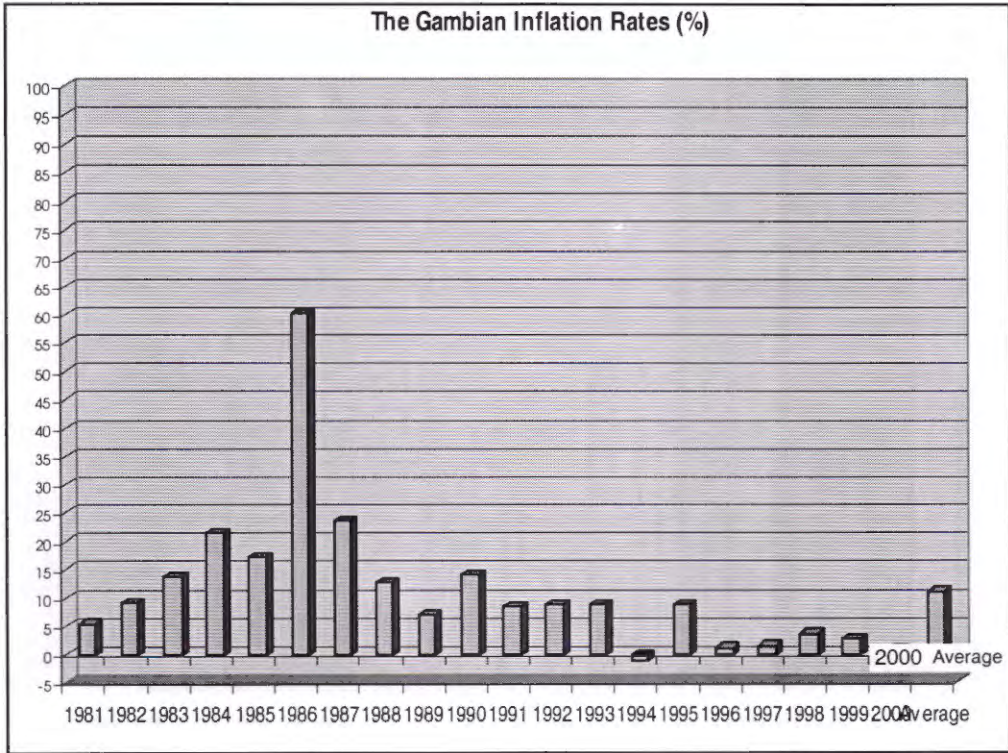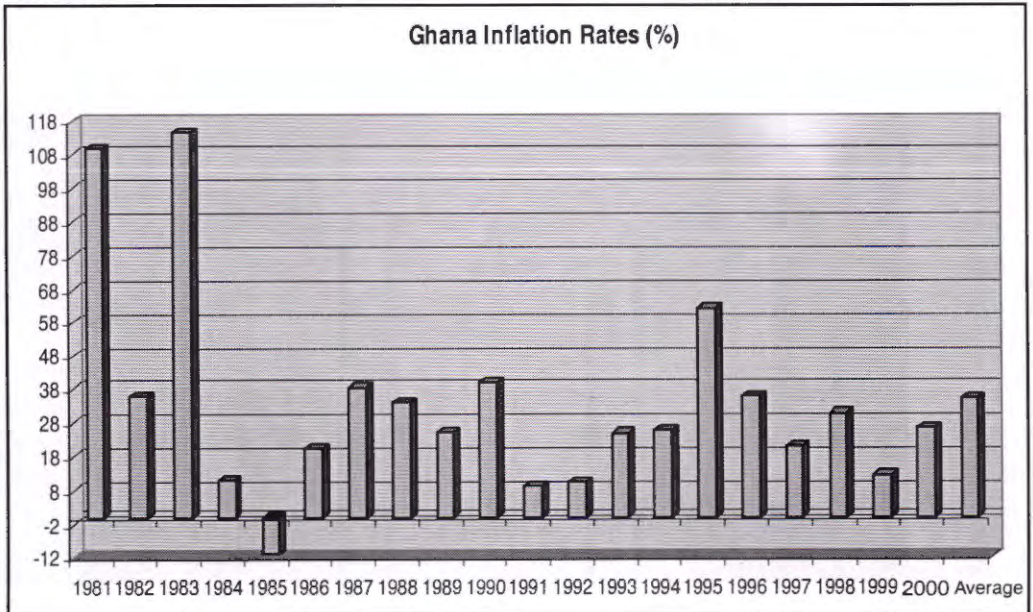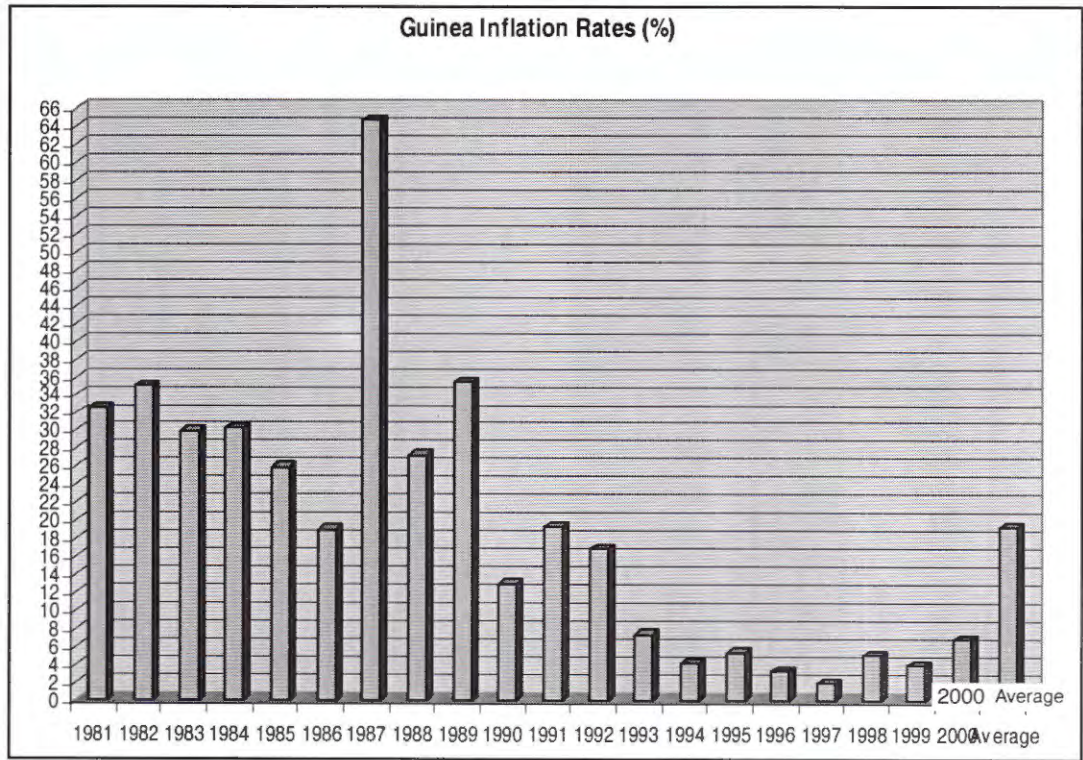
Chart 1a

The Gambian Inflation Rates (%)

Chart 1b

Ghana Inflation Rates (%)

Chart 1c

Guinea Inflation Rates (%)

Chart 1d

Nigerian Inflation Rates (%)

Chart 1e

Sierra Leone Inflation Rates (%)
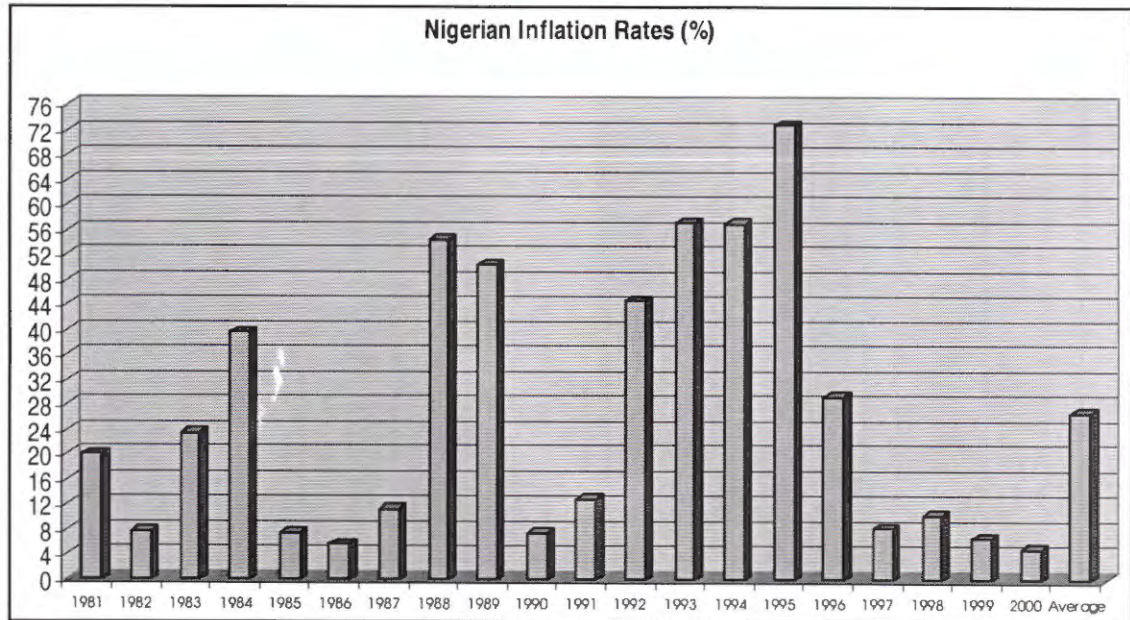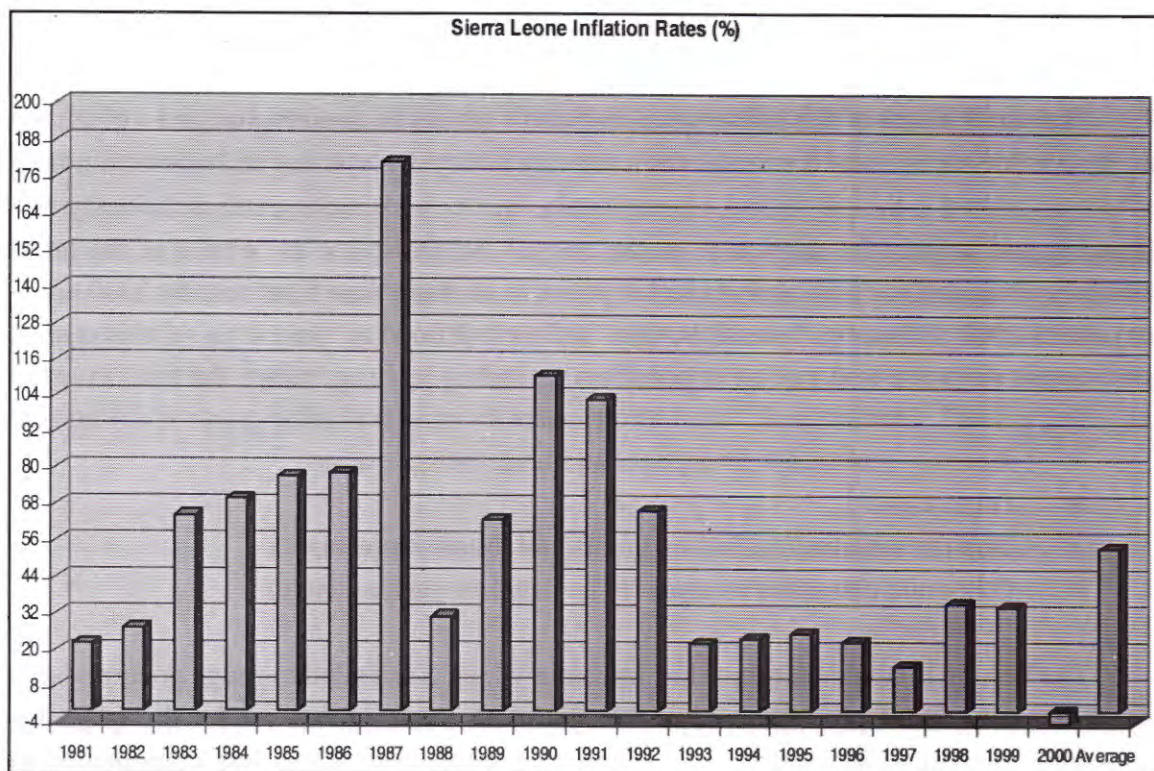

As already indicated, the inflation data of the member countries presented on Table 1 and charts (1a-1e), above was not derived from a harmonised index of consumer prices as required by international best practices. In fact, a harmonized index is required under the European Monetary union treaty. Despite this shortcoming, the historical data is very revealing. During the two-decade timeframe, not a single WAMZ member state was able to sustain a single digit inflation. The best performance was posted by The Gambia, which managed to achieve a spasmodic single digit in thirteen years out of twenty. Guinea also managed to post eight years of single digit inflation out of twenty, whereas, the two major members – Nigeria and Ghana posted seven and two years of single digit inflation in two decades respectively. As for Sierra Leone, its poor performance and bouts of hyper inflation can be blamed on its prolonged political crises and civil war. Nevertheless, the fundamental fact is that none of the countries had price stability as its major policy preference during the two decades of review. It is logical to enquire at this juncture how these countries can succeed to achieve convergence and sustainability under the ECOWAS treaty in order for the monetary union to be actualised in 2004.

Second Pillar:
Restriction on the Overall Budget Deficit

The significance of this convergence indicator cannot be overemphasized – given the negative influence of fiscal dominance on monetary policy in particular and macroeconomic stability in general in the sub region. Operationally, the treaty excludes grants in the budgetary financing and defines the restriction on the overall budget deficit as "a ratio of the gross domestic product (GDP), at current market prices to no more than 5 per cent by 2000 and 4 per cent by 2002. Similarly, "overall budget" deficit is defined as "the excess of total central government recurrent and capital expenditure including lending, minus the total revenue excluding grants". Furthermore, "total government revenue excluding grants is defined as:

➤ Revenue from taxes on income and other remuneration
➤ Other taxes
➤ Non tax revenue (excluding grants and divesture receipts)
➤ Other non classified receipts (to be listed by each country)

The Second Pillar constitutes a key indicator which is intended to gauge government's commitment to fiscal prudence. However, the data requirements render the indicator vulnerable to creative accounting. An alternative measure which is less complicated to compute, would have been a restriction on the overall budget deficit as a ratio of the real gross domestic product of not more than 3 per cent. This is generally the measurement adopted by most international financial organizations, including the IMF and the EU.

Accordingly, we have applied this framework to ascertain the fiscal performance of the WAMZ member states in the past, in order to determine the sustainability of the convergence criterion in the future.

Table 2
Fiscal Deficit As % of Real GDP

	1993	1994	1995	1996	1997	1998	1999	2000	Average
Nigeria	-5.0	-4.8	3.5	2.6	-1.0	-9.1	-8.5	2.2	-2.5
Ghana	-9.9	8.9	-6.4	-9.5	-10.3	-8.1	-8.2	-7.9	-8.7
Guinea	-3.7	-3.6	-2.7	-3.0	-3.0	-0.7	-3.0	-3.0	-2.9
The Gambia	1.6	1.0	-3.3	-9.6	-6.1	-2.4	-3.5	-3.5	-3.0
Sierra Leone	-5.1	-4.0	-6.3	-5.1	-7.0	-104	-9.3	-9.5	-7.1

If the past fiscal performance is presumed to be indicative of the future, clearly, the verdict of the jury is that the fiscal positions of the WAMZ member states as shown by the data on Table 2 above is not sustainable. On the average, only the oil-rich Nigeria was able to stay comfortably below the ratio of 3.0 per cent of the GDP, during the eight-year period of review. Whereas, the performance of Guinea and The Gambia were on the average marginal, Ghana and Sierra Leone missed the target by wide margins. Overall, none of the member country achieved sustained fiscal consolidation. The impact of fiscal dominance in the member states was also reflected in the expansionary monetary policy regime adopted by all the countries – as shown on Table 3.

Table 3
Growth Rate In M2 (1990 – 2000) (Per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Nigeria	32.7	37.4	59.1	53/8	34.5	19.4	16.2	16	22.3	33.1	48.1
Ghana	13.3	16.7	52.2	26.4	45/7	40.4	32.6	45.5	26.1	16.2	38.4
Guinea	--	--	23.3	22.8	-3.4	11.3	3/6	8.2	6.4	6.4	--
The Gambia	8.4	25.7	13.8	12.8	-3.8	14.2	5.8	23	10.2	10.2	34.8
Sierra Leone	74	76.2	33.2	21.9	8.8	19.6	29.7	47.1	11.3	11.3	12.1

Source: International Financial Statistics 2001

Third Pillar: Ceiling On Central Bank
Financing of Budget Deficit

In order to ensure sustained fiscal prudence, the convergence treaty also stipulated a ceiling on national central banks' financing of budget deficits to 10 per cent of previous year's tax revenue. This target was expected to have been achieved by 2000 and sustained thereafter. Operationally, "government" is defined under the treaty to include both state and local governments – but excluding non-financial public enterprises. This performance criterion has serious implications for Nigeria's fiscal federalism – because, it implies that the federal government may not be in the position to bail-out a financially distressed state or local government, if and when such a bail-out becomes necessary and if it would breach the provision.

Central bank's lending is generally reflected in the monetary survey as the change in the net claims on government between two periods. The net claims is defined as the gross claims of the central bank which consist of (a) its holdings of government's debt instruments (Treasury bills, bonds and certificates) including Ways and Means advances, less government deposits with the central bank.

Historical data are not readily available to enable us ascertain how the WAMZ member states performed in the past. However, we can reasonably assume that given the lack of operational autonomy of the national central banks, the temptation for the fiscal authorities to rely on inflation tax (seiniorage), to finance their budget deficits which hovered over 3 per cent of GDP on the average for nearly a decade, was very high. In fact, this assumption is consistent with the uniform expansionary monetary policy which the WAMZ authorities also pursued.

Fourth Pillar: A Floor on Foreign Exchange Reserves

Generally, this economic indicator is intended to ensure that the WAMZ authorities pursue policies that will enhance sustained external balance. The stock of foreign exchange reserves is specifically, expressed in terms of at least 3 months of imports (CIF), by 2000 and 6 months by 2003. Accordingly, the stock of reserves includes: monetary gold, special drawing rights (SDR) holdings, foreign currency deposits, foreign bank balances and holdings of foreign securities.

It is noteworthy that all the WAMZ member states are vulnerable to external shocks, because of their dependence on mono export product. For example, Nigeria relies on oil export which accounts for 95 per cent of its export earnings. Ghana depends largely on cocoa and gold, The Gambia, on tourism and peanut. While Guinea and Sierra Leone rely on bauxite and diamond respectively. Consequently, given their vulnerability to asymmetric shocks, meeting this convergence criterion has always been problematic, as shown on Table 4 below.

Table 4: External Reserves: Months of Imports

	1993	1994	1995	1996	1997	1998	1999	2000	Average
Nigeria	2.4	3.0	2.1	7.6	9.6	9.2	7.6	12.9	6.8
Ghana	3.4	5.0	5.5	4.7	2.0	1.9	1.4	1.0	3.1
The Gambia	0	6.0	7.8	6.0	6.5	5.8	7.3	7.5	6.7
Guinea	2.6	1.8	1.8	2.5	3.2	3.3	2.7	2.2	2.5
Sierra Leone	2.3	3.7	3.5	1.7	3.8	3.1	2.0	1.8	2.7

Sources: -   ADB Statistics – Pocketbook (2002)
            -    CBN Annual Reports (various issues)

The data reveal that during the eight-year reference period only two countries (Nigeria and The Gambia), were able to maintain their levels of reserves to meet this criterion. Both countries achieved on the average, reserve levels equivalent to finance 6.8 and 6.7 months of imports. Ghana maintained an average of 3.1 months of imports – whereas Guinea and Sierra Leone fell below the treaty requirement. However, only The Gambia was capable of meeting this requirement on a sustained basis during the entire eight-year timeframe. The inability of the countries to satisfy this convergence criterion is indicative of the vulnerability of their economies to external shocks and the inappropriate fiscal and monetary policies which they had pursued during the period under reference. Similarly, an examination of the movement in the exchange rate and short-term interest rate differentials suggests the persistence of underlying macroeconomic instability and the need for the countries to embark on meaningful structural reform and fiscal consolidation to enable them meet the requirements of the treaty.

Part IV:
Convergence or Divergence Progress Report

In this section, we present country by country performance based on available country data relating to the primary convergence criteria of: inflation, budget deficit as a ratio to GDP, central bank financing of government and gross external reserves.

In the previous section, we undertook a review of historical macroeconomic performance of the WAMZ member countries. The backward-looking longitudinal analysis was intended to assist us ascertain if current performance was due to the structural adjustment efforts of the authorities, or otherwise. This "before" and "after" analytical

framework is essential in determining the sustainability of the primary convergence criteria in the medium to long-term. Against this background, there is need to emphasize that the achievement and sustenance of the convergence criteria critically hinges on the adoption of sound structural reform and pursuit of prudent fiscal and monetary policies on sustained basis by the WAMZ member countries. Overall, a close examination of the statistics shown on Table 5 clearly reveals that the journey towards convergence has been generally bumpy. The strong political will which gave birth to the "Fast-Track" second monetary zone in 1999 has not been fully translated into positive actions.

NIGERIA

Price Developments

Over the reference period (2000 – end-June 2002), the average rate of consumer price inflation in Nigeria was 14.4 per cent – which is significantly above the 10.0 per cent target prescribed under the treaty. Looking backwards, Nigeria has had a history of double-digit inflation, especially during the decades of the 1980s and 1990s. This experience of inflationary pressures reflects the authorities policy preferences and orientation towards expansionary fiscal and monetary policies. Although an attempt was made in sustaining macroeconomic stability, however, the vulnerability of the economy to external shocks, resulted to policy slippages. Looking at current and future inflationary forecast, we can safely assume that single digit inflation cannot be achieved on a sustained basis until the authorities embark on a genuine structural reform, and fiscal consolidation. These measures will compliment the sound monetary and exchange rate policies which the monetary authorities are currently pursuing.

Fiscal Developments

The central government's fiscal operations resulted on the average to a deficit of 4.0 per cent of the GDP during the reference period, which is within the target set under the convergence treaty. However, the inability of the authorities to achieve a balanced budget, or a marginal surplus at a time of huge oil revenue windfall is indicative that the fiscal performance will become unsustainable should the economy experience adverse terms of trade shock. Furthermore, the unsustainability of Nigeria's fiscal policy could also be exacerbated by its huge external debt burden and low GDP growth rate which has averaged about 3.3 per cent over the reference period.

Gross External Reserves

Nigeria's external reserves in months of imports averaged eleven, which was almost four times the stipulated target under the convergence treaty. This performance was achieved as a result of the prudent monetary and exchange rate policies which were adopted by the central bank during the period, as well as the favourable oil market conditions during the period. However, the decline in the external reserves from approximately $10.5 billion as at end-December 2001 to $8.0 by end-June is indicative of the underlying aggregate demand pressures in the economy and the fragility of the reserve position in the medium to long-term.

Overall, Nigeria met all the four convergence criteria in 2000, but was only able to meet 3 in 2001 and 2 by end-June 2002. To the extent that the convergence treaty requires member countries to meet all the criteria on a sustained basis, Nigeria's performance represents "divergence" and not convergence.

GHANA

Price Development

Ghana's performance over the reference period (2000 –end-June, 2002), was generally disappointing. Ghana's average rate of consumer inflation was 25.2 per cent, more than twice the prescribed ceiling. Looking backwards into the 1990s, consumer price inflation in Ghana had remained consistently in the high double-digit rate. This represents a clear evidence of inappropriate macroeconomic policy regime and fundamental structural imbalance. This experience of persistent high inflation reflects several policy preferences – notably, fiscal dominance and accommodating monetary policy which has tended to destabilize the exchange rate regime, with its implication on the domestic prices of imported goods. For a country which depends on imports for production and consumption, persistent volatility of the exchange rate will continue to impact adversely on the domestic price level, if it continues to rely on its national currency as a medium of exchange.

Fiscal Development

Table 5 clearly shows that the general government budget balance showed a deficit of 6.3 per cent (average), of the GDP. Thus, the 5 per cent reference target was substantially,

missed. Compared with the historical past, the budgetary operations seemed to have remained unchanged, despite the expression of political will to join a monetary union. There is need for Ghana to embark on a serious structural reform and fiscal consolidation in order to enable her meet this criterion.

Gross External Reserves

Ghana achieved an external reserve which could barely finance 1.3 months of imports during the reference period. Generally, this poor performance was caused by a combination of exogenous and endogenous factors – notably, adverse terms of trade shocks and expansionary fiscal and monetary policy pursued by the authorities before and during the period under reference. Ghana has experienced long episodes of exchange rate volatility, which does not generally augur well for foreign direct investment inflows and achievement of balance of payments surplus.

Overall, Ghana's performance has been dismal. Ghana did not meet a single convergence criterion in 2000 and barely met one each in 2001 and end-June 2002.

THE GAMBIA

Price Developments

Consumer price developments in the Gambia over the reference period averaged 4.9 per cent, compared with the 10 per cent, (or less), target required under the convergence treaty. With the exception of Sierra Leone where a deflation was recorded, The Gambia's performance was indeed exemplary in the sub-region. Seen over the past two decades, inflation in The Gambia has been generally low compared with its WAMZ neighbours. For example, between 1981-2000, The Gambia recorded an average inflation rate of 11 per cent. This performance contrasted very sharply with the inflation rate of 35.3, 19.4, 26.6 and 53.3 per cent for Ghana. Guinea, Nigeria and Sierra Leone respectively, over the same time frame. Typically, fiscal and monetary policy in the Gambia has been consistently geared towards price stability.

Fiscal Developments

In the reference year 2000, the central government deficit to GDP ratio was 3.6 per cent and below the 5.0 per cent level stipulated under the convergence treaty. However, The Gambian authorities suffered policy slippages in 2001 and 2002, as the deficit ratio rose to 11 and 10.5 per cent respectively. This negative development was largely attributed to adverse terms of trade shock which impacted negatively on government revenue. Looking backwards over the period 1993-2000, The Gambia recorded a fiscal deficit which averaged 3.0 per cent of the GDP. This impressive tack record is indicative that The Gambia is capable of re-establishing fiscal sustainability in the medium –to long-term.

External Reserves

The Gambia's stock of external reserves in months of imports averaged 5.6 – a level which is significantly higher than the required 3 months of imports. This outcome is also consistent with its historical performance. Between 1993-2000, The external reserves were equivalent to 6.7 months of imports – the same level with oil-rich Nigeria. The reserves were also, two times the size of Ghana and two and half times the size of Guinea and Sierra Leone respectively. The exchange rate of the national currency had remained relatively stable over the historical past and also during the reference period.

Overall, economic performance in The Gambia has been impressive. It met the entire convergence criteria in 2000 and barely missed one in 2001 and by end-June, 2002.

GUINEA

Price Developments

Guinea maintained a single digit inflation rate during the reference period. Overall, consumer price inflation averaged 3.6 per cent –substantially below the maximum target of 10 per cent prescribed under the convergence treaty. This current development contrasts very sharply from Guinea's past history of high double-digit inflation. For example, inflation rate in Guinea averaged 19.4 per cent between 1981-2000. Hence, its good performance during the reference period is indicative of the authorities' commitment to the WAMZ treaty.

Fiscal Developments

At an average of 5.7 per cent, the central government's budget was marginally above the 5.0 per cent benchmark. This development contrasts sharply with the historical past when the authorities maintained an average of 2.9 per cent deficit/GDP ratio, during the period 1993-2000. Overall, the prospects of achieving fiscal sustainability in Guinea are indeed, very good.

Gross External Reserves

Guinea's external sector has always been fragile. Between 1993-2000, its stock of reserves was barely equivalent to 2.5 months of imports and below the benchmark of 3 months. Similarly, during the reference period (2000-2002), the stock of reserves stagnated at an average of 2.5 month of imports. Like most WAMZ member countries, Guinea is highly vulnerable to terms of trade shocks and exchange rate volatility.

Overall, Guinea's performance was below average. It met only one convergence criterion in 2000 and two criteria each in 2001 and by end-June 2002.

SIERRA LEONE

Price Developments

Sierra Leone has a checkered history of macroeconomic performance. Even before its recent political crisis and civil war, the economy was characterized by hyperinflation. For example, between 1983-1991, the average rate of inflation in Sierra Leone was 79.5 per cent – the highest among the WAMZ member states. However, during the reference period, which coincided with the cessation of hostilities, the economy witnessed relative deflationary pressures, arising from lack of aggregate demand. Consequently, a deflation of –2.8 per cent was recorded in 2001. In 2001, the consumer price index sharply rose to 3.4 per cent, while the end-June data indicates a deflation of –2.9 per cent. Generally, a deflation and a double-digit inflation rate represents symptoms of inappropriate macroeconomic policy mix and as such, inconsistent with the policy objectives of the WAMZ. Accordingly, if the CPI data is actually what it is reported to be, then the authorities should embark on monetary policy ease and devaluation of the Leone.

Fiscal Developments

Largely influenced by the need for rehabilitation and reconstruction of the war-ravaged economy, the fiscal operations of the central government were expansionary during the reference period of 2000-2002. The budget-to-GDP ratio was 17.3 and 16.7 per cent in 2000 and 2001 respectively. By end-June 2002, the authorities had recorded a deficit of 5.6 per cent. The average for the period was 13.2 per cent, which is significantly above the 10 per cent convergence target. Given its post-war reconstruction requirements, it is unlikely that Sierra Leone can meet the fiscal target in the medium term.

Gross External Reserves

During the reference period, Sierra Leone's gross external reserves in months of imports averaged 2.1, which is below the prescribed target of 3 months and above. However, this weak performance is reflective of the country's poor economic environment and dearth of foreign investment flows into the critical mining (diamond), sector of the economy.

Overall, Sierra Leone barely met one convergence criterion in 2000, two criteria in 2001 and provisionally one criterion by end-June 2002.

THE WAY FORWARD

Monetary union represents the last stage of economic integration, and it is rarely achieved in circumstances of incomplete political integration and factor mobility. The WAMZ project though laudable and ambitious suffers from these draw-backs. Of all the benefits which come from economic integration and trade, such as enhanced economies of scale and specialisation of production according to comparative advantage, the achievement of forced changes in efficiency in fiscal and monetary policy implementation, arising from competition and peer group pressure, represents the utmost benefit which the WAMZ member countries will gain if and when the WAMZ monetary union finally crystallizes.

To date, there exist eight different currencies in the ECOWAS sub-region comprising 15 sovereign nations. The major currency unit is the CFA Franc, which is the

common currency of the Franco-phone West African Economic and Monetary Union (WAEMU). Despite the lack of sustained economic convergence amongst the WAEMU countries, the monetary union has survived largely as a result of the French government's interventions at the critical moments. The CFA monetary union has endured largely as a result of the positive role which France plays as an anchor nation. The absence of an anchor nation for the WAMZ project may prove to be fatal, if the convergence requirement is glossed over or rushed.

Overall, large swings have characterized the macroeconomic performance of the WAMZ member states. Available data reveal that policies in the member states have been implemented in fits and starts and in ways that have sustained divergence, rather than convergence. The expression of strong political will for convergence has not been translated fully into concrete economic achievement.

Looking ahead, the challenges in achieving convergence, are numerous and difficult, though, not insurmountable. The WAMZ member countries clearly meet Mundell's conditionality foi an optimum currency area. Consequently, every effort should be made by the authorities to bring the WAMZ project to successful conclusion. We predict that the monetary union shall come to fruition before end-2007 – barring any unforeseen negative political development in the key countries of Nigeria and Ghana.

Table 5
Primary Convergence Criteria: Summary of Country Performance

Criteria	Inflation			Budget Deficit/GDP			Central Bank Financing			Gross Ext. Reserves (Months of Imports)			Number of Criteria achieved		
Target	<10%	<10%	<10%	<5%	<5%	<4%	<10%	<10%	<10%	>3	>3	>3			
Years	2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002
Nigeria	14.5	16.4	$12.21^{1/}$	-3.1	4.7	$-4.2^{1/}$	0.0	0.0	0.0	12.9	12.0	$8.2^{1/}$	4	3	2
Ghana	40.5	21.3	$13.7^{1/}$	-85	-7.3	$-3.0^{1/}$	57.9	0.0	$15.9^{1/}$	1.0	1.5	$1.3^{1/}$	0	1	1
The Gambia	0.2	8.1	$6.5^{1/}$	-3.6	-11.1	$-10.5^{1/}$	0.0	0.0	0.0	7.5	4.9	$4.3^{1/}$	4	3	3
Guinea	7.2	1.1	$2.6^{1/}$	-5.2	-7.8	$-4.2^{1/}$	17.6	0.0	$5.5^{1/}$	2.2	2.8	$2.4^{1/}$	1	2	2
Sierra Leone	-2.8	3.4	$-2.9^{1/}$	-17.3	-16.7	$-5.6^{1/}$	32.7	8.9	$19.1^{1/}$	2.8	2.3	$1.3^{1/}$	1	2	1
No of Countries that met the Criteria	3	3	3	2	1	1	2	5	3	2	2	2			

Source: WAMI Secretariat and Country Reports

1/ end June

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