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Problems of Monetary and Financial Integration in ECOWAS

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PROBLEMS OF MONETARY AND FINANCIAL INTEGRATION IN ECOWAS[1]

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Abstract

The paper examines the problems of monetary and financial integration in the ECOWAS sub-region. It traces the origins of these problems to the post-colonial era when sentimental attachment to issues of sovereignty, development of national currencies and the imposition of payments restrictions took their roots. Given the background of these problems, the paper makes a number of recommendations, such as the need to adopt a common currency and more realistic exchange rates, for forging greater monetary co-operation in the sub-region.

Introduction

Since the inception of the Economic Community of West African States on May 28, 1975 and the later adoption of the protocols in Accra, the community has continued to grapple with problems. A great many public servants and African scholars in particular have dwelt exhaustively on the potentialities of the community for realising the global objective of raising the standard of living of the ECOWAS citizens and of contributing to Africa's development. A major channel for achieving this as contained in the Treaty includes the elimination of all types of obstacles to the free movement of goods, capital and persons.

However, there are a number of constraints, economic, social and political, that are likely to limit the quick realisation of the economic union. The focus of this paper is largely on the monetary and financial constraints. For purposes of easy exposition, the paper has been divided into five parts. Part I highlights the theoretical concepts of integration. Part II discusses early attempts at monetary integration. Part III focusses on the problems of integration. Part IV highlights the institutional arrangement, the West African Clearing House (WACH), designed to accelerate integration efforts. Part V contains the paper's conclusions and recommendations for policy.

PART I

Concept of monetary integration

Monetary integration is the monetary unification of participating member countries in an ecomonic union and involves the adoption of common currency, co-ordinated exchange-rate policies, and harmonization of fiscal and monetary policies.[3] It is a process that can only be envisaged during the final stages of economic integration.

The final stages are those of an "economic union" and "total economic integration".[4] Under the stage of an economic union, restrictions on commodity and factor movements are abolished among member states and some degree of harmonization of economic, monetary, fiscal and social policies is undertaken. The highest degree of economic integration — the last stage — is total economic integration which involves the unification of monetary, fiscal, social and other policies and requires the establishment of a supra-national agency whose decisions are binding on all member states.

Corden[5] is agreeable with Nana-Sinkam on the above definition of monetary integration but emphasizes that the concept essentially involves:

(i) an exchange-rate union, ie. an area within which exchange rates bear a permanently fixed relationship to each other even though the rates may, in unison, vary relative to non-union currencies; and

(ii) convertibility — the permanent absence of all exchange controls, whether for current or capital transactions, within the area.

Thus the adoption of fixed exchange-rate margins among the currencies of member states, or the adoption of a common single currency, the pooling of foreign exchange reserves, a common Central Bank, factor mobility and harmonization of monetary and fiscal policies are the key ingredients of a durable monetary union.

There is, however, a related but wider concept of financial integration. This is the integration of organised or formal capital markets such as the Stock exchange in the participating member countries of the economic union. Such integration would involve a harmonization of regional financial markets, particularly with respect to interest rates on securities and capital transactions. Financial integration also involves co-ordination of trading in community securities, of issuance of financial instruments to finance community projects at agreed locations, etc.[6]

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[1]Also presented at the 4th Biennial Conference of the West African Economic Association held at Lome, Togo in March, 1987.

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[3]S. C. Nana-Sinkam, *Monetary Integration and Theory of Optional Currency Areas in Africa*, Mouton Publishers 1978, The Hague.

[4]The first three stages of economic integration identified in the literature are the free trade area where tariffs and other trade restrictions between members are abolished; the Customs Union which involves the abolition of discrimination in movements of commodities and the erection of a common tariff wall against non-members; the third stage is the common market where trade restrictions and impediments to factor movement are abolished.

[5]Corden, W. M., *Monetary Integration*, Essays in International Finance, N.93, Princeton University; Princeton, 1972 P.2.

[6]Basch, A., *Capital Markets of the European Economic Community — Problems of Integration*, Graduate School of Business Administration, The University of Michigan, 1965.

PART II

Monetary zones in the sub-region

Having discussed, albeit briefly, the theoretical concepts of monetary and financial integration, we shall in this section dwell on monetary zones in the sub-region — the source of major problems of monetary integration.

Sterling Monetary Zone

The Currency Board system marked the beginning of monetary integration in British West Africa. For approximately fifty years, monetary integration was operated but it had defects. Commenting on the Board system, J. Mars,[1] a writer on colonial currency system observed that:

> The West African Currency Board is in fact not a money issuing bank with power to vary the amount of currency at will but merely a passive money changer which receives superior money ie. London sterling and gives in return token money ie. West African Currency.

However, with the advantage of hindsight the currency Board system had some merit. It provided confidence in the currency and ensured to a large extent stability in the internal and external value of the local currency, for instance, and was convertible in all parts of Africa and Europe through its link to sterling. It also provided a good basis for economic integration of the member countries.

The Franc Monetary Zone

Before 1945 the currency arrangement evolved by France for her colonial territories in West Africa was handled by the Bank of West Africa established in 1901 exclusively to issue Franc notes into circulation in French West Africa colonies.[2] The Bank which absorbed the Bank of Senegal established earlier in 1856, had its head office in Paris, with branches in Conakry, Port Novo, Dakar, Grand-Bassam and Duala.

In 1955, the right of note issue was, however, transferred from the Bank of West Africa to a publicly-owned institution Institut d'Emission de l'Afrique Occidentale Francaise et du Togo. This bank was given an additional function of a bank of last resort. Its name was changed to la Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) in 1959

The Currency System of the Post-Independence period

Soon after the attainment of political independence by countries of West Africa, the colonial currency system of British West Africa crumbled in the wake of establishment of national Central banks in all West African countries as well as indigenous and state-owned commercial and development banks. During this period, Ghana departed in 1957 from the inherited systems of monetary integration by pulling out of the West African Currency Board system. She was followed by Nigeria in 1959, Sierra Leone in 1963, and The Gambia in 1975. The abandonment of currency integration policies in British West African countries reflected largely the desire of those countries to assert political independence, thus bringing an end to the pre-independence monetary integration that existed in the Anglo-phone zone.

On May 12, 1961, France concluded an agreement on economic, financial and monetary co-operation with the Frnch-speaking countries of West Africa to form a monetary union, namely, the West African Monetary Union (Union Monetaire l'Ouest Africaine — UMOA), embracing Benin, Ivory Coast, Niger, Mauritania,[3] Senegal, Upper Volta (now Bourkina Fasso) and Togo. The powers of BCEAO were widened to include the functions of a common Central bank for the seven member states. The bank's functions include the issue of a common currency, the Communaute Financiere Africaine or CFA Franc. Some other features of this Bank are as follows:

(i) The CFA Franc is fixed to French Franc and equals 0.02 of the French Franc; or 50 CFA Franc to 1 French Franc;

(ii) The external reserves of all the participating countries are pooled under the control of BCEAO and are held exclusively in the form of French Francs;

(iii) Payments and receipts in foreign currency of the BCEAO are settled through an account called the Operations Account with the French Treasury;

(iv) France guarantees unlimited conversion of the CFA Franc into French Franc. This guarantee operates through the French Treasury providing automatic overdraft facilities to the BCEAO especially when the Operations Account goes into red;

(v) In line with other Central banks in the Anglophone area, the BCEAO is empowered to exercise credit controls and to prescribe credit ceilings not only for each country but also within each country for each bank and enterprise. The BCEAO can also vary the rediscount rate and it can also prescribe liquidity ratios for banks;

(vi) The monetary management system of the UMOA does not permit exchange rate changes as a policy option nor is there freedom for individual countries to pursue unco-ordinated monetary expansion. Rather the member countries have accepted the beneficial discipline arising from the collective use of strict fiscal, monetary and pricing policies for the management of their economies;

(vii) The development of the less developed members of UMOA is encouraged by a resource transfer strategy that employs a less stringent application of the fiscal rules on such countries. This process is further directly assisted by the industrial redistribution strategies of the West African Development Bank (BOAD), the investment banking counterpart of the BCEAO within UMOA.

The UMOA arrangement remains in force although Guinea, Mali and Mauritania broke away from the franc zone at different times. However, Mali re-entered the union in July, 1984.

In what follows a discussion of the numerous problems of monetary integration including monetary credit and fiscal disharmony emanating from the above post-independence monetary systems of the sub-region, is undertaken.

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[1]J. Mars, *Mining, Banking and Commerce in Nigeria*, 1948.

[2]The French West Africa consisted of Dahomey (now Benin), Guinea, Ivory Coast, Mali, Mauritania, Niger, Senegal, Upper Volta (now Bourkina-Fasso). Togo was later included.

[3]Mauritania withdrew from the union in 1972.

PART III

Problems of monetary and fiscal disharmony

Monetary constraints

It was mentioned in Part I of this paper that while the French-speaking countries in the UMOA in the sub-region continue to use the CFA franc as their common currency, countries in British West Africa adopted their individual currencies soon after attaining political independence. The multiplicity of these currencies and the inconvertibility of most of them create problems for payments arrangements and inter-state commercial transactions. Currency inconvertibility impedes a free flow of goods and services and capital movements and unilateral transfers. Thus, ECOWAS member states have had to settle most of their foreign trade balance in scarce non-regional currencies such as the Pound Sterling, the French Franc and the U.S. dollar.

The best way to avoid the above problems is to adopt a monetary union. However, the road to monetary union is a very difficult one: For instance, under a monetary union individual member countries would forgo their rights to determine their credit policy. Instead such policy would have to be determined by a centralised body. Here we are faced by the problem of ascertaining the rate of credit expansion that is adequate for each economy.

A monetary union calls for uniformity in interest rates in order to avoid distortions from capital flows within the union. Again, this is problematic since in reality the same interest rate cannot meaningfully hold for each country in the sub-region. An appropriate interest rate level in one country may be inappropriate for another, given differing levels of infrastructural development. Thus the problem of harmonization of interest rates constitutes a major constraint to monetary integration.

Fiscal Policy Constraints

In the sub-region there exists a panoply of different tariff arrangements with differing rates of customs duties. The duties are designed partly to earn increased revenue for government and partly to shield domestic industries from competition from foreign producers. In a monetary union, there is the problem of lowering of tariff walls under the union policy of trade liberalisation. This problem derives from the fact that most countries of the sub-region depend largely on customs and excise duties as sources of revenue.

There are asymmetries in overall tax structures in the sub-region and size of government budgets varies from country to country. There is then the problem of devising ways of harmonizing the tax structures, sizes of government budgets including different profiles of overall borrowing requirements of each government in the union.

Exchange rate constraints

There exist different exchange rate regimes[1] in the sub-region. By and large, four exchange rate regimes in ECOWAS have been identified. (See Table I, Appendix). These include currencies that are pegged to major traded currencies; currencies that are pegged to the SDR; currencies that are pegged to a basket of currencies; and finally, currencies of which the exchange rate is determined by a managed or independent float. The regimes have implications for the degrees of overvaluation or undervaluation of the various currencies. The francophone member countries of the UMOA group tend to maintain undervalued exchange rates whereas different degrees of overvaluation characterise the exchange rate regimes of the Anglophone members of ECOWAS — Ghana, Nigeria and Sierra Leone. Interestingly, the non-UMOA countries of The Gambia, Liberia and Mauritania tend to maintain currencies that are substantially undervalued.[2] There is then the problem of arriving at an exchange rate for each member country currency that would "equilibrate" the balance of payments not only for her economy but for the sub-regional economy as a whole.

It will be observed that member countries of ECOWAS are at different levels of economic development. Thus maintaining a common exchange rate in line with the requirements of a monetary union could result in undesirable distortions, as the common rate may tend to favour some member countries.[3]

Problems of financial integration

Financial integration involves the harmonization of the capital markets in the sub-region. It suggests *inter alia* the need for member states to streamline real interest rates on securities of the same type and quality throughout the community. It also calls for elimination of any asymmetries that exist in the interest rates charged on capital transactions. Financial integration also suggests the need for joint issuance of financial instruments when the need to finance community projects arises.

Besides the obvious problems inherent in the above, largely problems of implementation, there are in ECOWAS member countries a number of legislations discriminating against foreign securities or against the export of domestic securities. These laws have to be reviewed; in particular, company law and tax laws need to be harmonized.

Political problem

Although ECOWAS is eleven years old, nation states in the community still seem to guard their sovereignty. An integration problem would arise where the expected co-operation in implementing agreed-upon protocols is not forthcoming from member states because of their strong attachment to notions of sovereignty. Thus the pace and successful implementation of monetary integration in the community would depend largely on political will.

[1]An exchange rate regime may be defined as or denoted by the system or method by which the exchange rate is determined.
[2]ECOWAS, *Creation of a Single ECOWAS Monetary Zone*, Lagos February, 1986. (Unpublished ECOWAS Study).
[3]S. M. Nsouli, Ibid. P.44.

PART IV

Problems of the West African Clearing House (WACH)

An analysis of the problems of monetary integration would be incomplete if mention is not made of an institutional arrangement — the WACH — established and designed to foster monetary co-operation within the sub-region. This section therefore discusses the WACH and the problems encountered in its efforts at promoting sub-regional limited currency convertibility.[1]

Established in 1975 under an agreement by the West African Central Banks, the WACH had the following aims and objectives:

(a) to promote the use of the currencies of the members of the Clearing House[2] for sub-regional trade and other transactions;

(b) to bring about economies in the use of foreign reserves of members of the Clearing House;

(c) to encourage the members of the Clearing House to liberalise trade among their respective countries;

(d) to promote monetary co-operation and consultation among the members of the Clearing House.

Of these objectives, the most important, at least, from the point of view of this paper, is that of the promotion of convertibility of regional currencies and thereby the saving in the use of foreign exchange such as the U.S. dollar, Pound Sterling, French Franc, etc. However, being themselves very conscious of the shortage of convertible currencies in the region, the Central Banks were of the view that the best means of ensuring regional convertibility was to enforce prompt settlement. Therefore, the settlement rules in WACH were designed to ensure the minimum of delay.

Unlike some clearing systems in other third world regions[3] WACH made no provision for the creation of a fund or direct bilateral contributions to facilitate the settlement of protracted debtor balances. The credits available in the system are related to volumes of previous transactions and stipulate a country minimum of 500,000 WAUA[4] (West African Unit of Account) for debit positions and 1,000,000 WAUA for creditors. All debtor positions are expected to be settled monthly and promptly on demand and not later than 15 days after the month to which the debt relates. The WACH's function is to monitor these transactions in a capacity little more than that of an accounting office.[5]

Problems of WACH

A major problem which frustrates the realisation of the principal objective of the WACH, namely, promotion of larger use of regional currencies in regional transactions, has been the observed low and reducing volumes of compensable trade.[6] This means that adequate volumes of intra-regional exports do not compensate the volume of imports and vice-versa. Thus trade between the member countries was not balanced, so that very large amounts of merchandise trade still had to be settled by the use of external (non-regional) convertible currencies, (see Tables 2 and 3).

As is evident in Table 2, trade imbalances were, for instance in 1980, most pronounced in intra-regional trade relations with Nigeria, Ghana, Mauritania and Sierra Leone. Thus the need for non-regional currencies for the settlement of trade with those countries was quite high as figures in column 5 of the Table show. The observation was also true for the UMOA countries as a group. The analysis in Table 3 line 9 shows that in the WACH the percentage of transactions that require non-regional currencies to settle trended upward in the quinquennium 1976-1980. Since 1980 there has been no reversal of the trend. Thus the achievement of the cardinal objective of limited currency convertibility has eluded the WACH mechanism.

A related problem confronting the WACH has been the accumulation of debtor balances. This again contradicts an important condition for limited convertibilty of soft currencies within the clearing house, namely, the undertaking at Central bank level for prompt settlement as advised by the Clearing House in accordance with the provisions of Articles VIII and IX of the Clearing House Agreement. The debts have been owed largely to BCEAO and National Bank of Liberia.

The reality, however, that WACH is merely a clearing agency has not helped matters. This is so because the WACH has no provision in the Agreement for the creation of a fund or direct bilateral contributions to facilitate the settlement of debtor balances. Thus, as presently constituted the WACH mechanism is fraught with difficulties that constrain its role as an instrument of monetary co-operation in the sub-region.

[1] Limited currency convertibility may be defined as "the unrestricted exchange and use of the currencies of countries within the region vis-à-vis each other ie. where all exchange restrictions vis-a-vis the other currencies of the group have been eliminated". For further details see IMF, *Currency Convertibility in the Economic Community of West African States*, 1980 (Unpublished IMF Study for Executive Secretariat of ECOWAS).

[2] The list of member Central Banks of the WACH is as follows: Central Bank of West African States (BCEAO), Central Bank of The Gambia (Gambank), Bank of Ghana (Ghanabank), Central Bank of the Republic of Guinea (Bareg), National Bank of Guinea Bissau (Banguine), National Bank of Liberia (Batbank), Central Bank pf Mauritania (Rimbank), Central Bank of Nigeria (Cenbank) and Bank of Sierra Leone (Coppersafe).

[3] Examples of clearing systems with credit facilities include the CARICOM Multilateral Clearing facility established in 1977 for member states of the Caribbean Community; the Central American Clearing House (1981), the ALADI Clearing System established in 1969 and revised in 1981 for the eleven Latin American countries.

[4] 1 WAUA=SDR 1

[5] J. Frimpong Ansah, *A Preliminary Study on Financing Mechanisms at Central Bank level in the ECOWAS Sub-region in support of a process of Trade Liberalization and for the settlement of Debtor Balances in the West African Clearing House*; UNCTAD Study Project RAF/77/032, February 1983 (Unpublished mimeo).

[6] Compensable trade is the volume of merchandise transactions which go through the clearing mechanism and which are settled in regional currencies. The concept is different from that of "settled trade" which is the proportion of ECOWAS regional total trade that is settled in convertible non-regional currencies such as the U.S. dollar, Pound Sterling, etc.

PART V
Conclusions and Recommendations

This paper has examined the problems of monetary and financial integration in the ECOWAS sub-region. In the process, it made forays into early attempts at monetary co-operation through institutional arrangements such as the BCEAO — the common Central bank of the francophone West African countries — and the defunct West African Currency Board which served the Anglophone countries in the sub-region. However, with the attainment of political independence by the nation states of ECOWAS, the Anglophone countries among them established their individual Central banks and abandoned the West African Currency Board system.

Such was the genesis of the current problems of the sub-regional monetary and fiscal disharmony. The assertion of the freedom of independence and the needs for economic management of fledgling economies, particularly among the Anglophone countries were reflected in the establishment of various national currencies and the emergence of payment restrictions designed to protect nationalistic interests. The sentimental attachment to issues of sovereignty, development of national currencies, and existence of exchange rate regimes and payments restrictions have featured prominently in the mainstream of problems that could frustrate the achievement of a monetary union in the sub-region.

The paper has also discussed the WACH mechanism which is an institutional arrangement designed to foster intra-regional trade through *inter alia* the promotion of the use of currencies of member countries of ECOWAS. Even so, this instrument of monetary co-operation is beset with problems: they range from excessive recourse to use of non-regional currencies following the observed low and reducing volumes of compensable trade to WACH's inability to arrest the accumulation of debtor balances through prompt settlement.

Therefore, in order to minimise the above problems and forge monetary co-operation for purposes of increased intra-regional trade and enhanced standards of living of citizens in the community, the following recommendations are suggested:

1. In view of the serious problems inherent in the existence of many currencies with varying degrees of convertibility, there is need to adopt a common currency. The common currency may be modelled after the UMOA common currency system. The current ECOWAS study on the creation of a single ECOWAS monetary zone should be pursued vigorously with a view to finding a suitable way of adopting a common currency and resolving the common currency guarantee problem;
2. Given the need to attract increased trade to WACH, illegal border trade would have to be seriously curtailed through the adoption by member countries of more realistic and market-related exchange rates. Such rates could also minimise considerably the problems of overvaluation of national currencies, especially those of the Anglophone countries. Countries in the ECOWAS sub-region may thus have to accept to undergo the discipline of exchange rates adjustments through substantial devaluations of their currencies;
3. Considering the existence of disharmony in member countries' monetary, credit and fiscal policies, some form of harmonization is required in these areas to serve the overall interests of member countries of the sub-region;
4. The WACH would further the achievement of limited currency convertibility if it is endowed with capacity to provide short-term financial support or credit to clear debit positions in situations of temporary liquidity shortage of debtor countries. This will encourage member countries to increase and liberalise their intra-regional trade as they can find an assured source of short-term trade finance. The burden of creditor countries in extending involuntary short-term credit will also be lightened. Thus WACH would be not only a clearing but also a settlement agency. It should be noted, however, that given the seemingly permanent debtor positions of some member countries, the creation of a special fund to finance the deficits may serve only as mere palliatives to the problem;
5. There is need for member states to exercise a greater degree of co-operation than is the case at present, such that agreements regarding protocols, etc. are not frustrated by lack of political will to implement them. Certainly, implementation would involve, in some cases, surrender of part of absolute sovereignty; but this short-term cost is inevitable so long as member states are really determined to forge a monetary union with all expectations of long-term benefits to the community.

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Appendix

Table 1

Types of Exchange Regimes in ECOWAS

Country	Pegged to Major Currencies	Pegged to SDR	Pegged to a Basket of Currencies	Flexible Exchange Rate
Benin	X			
Cape Verde			X	
The Gambia	X			
Ghana				X
Guinea		X		
Guinea Bissau		X		
Ivory Coast	X			
Liberia	X			
Mali	X			
Mauritania			X	
Niger	X			
Nigeria				X
Senegal	X			
Sierra Leone	X			
Upper Volta (now Bourkina Fasso)	X			

X = indicates applicable exchange rate regime.

Table 2

ECOWAS REGIONAL TRADE (INCLUSIVE OF OIL) THEORETICAL MAXIMUM COMPENSABLE TRADE

1980 **$ million**

	Imports (1)	Exports (2)	Total (3)	Compensable (4) (lower x 2)	Settled (5) (3–4)	% Settled (6) (5÷3)
UMOA (incl. Mali[1])	136.05	67.12	203.17	134.24	68.93	33.93
Cape Verde	0.40	—	0.40	—	0.40	100.00
Gambia	5.76	6.20	11.96	11.52	0.44	3.68
Ghana	241.00	40.40	281.40	80.80	200.60	71.29
Guinea	3.88	1.68	5.56	3.36	2.20	39.57
Guinea-Bissau	2.74	1.48	422	2.96	1.26	29.86
Liberia	12.50	9.80	22.30	19.60	2.70	12.11
Mauritania	2.78	0.06	2.84	0.12	2.72	95.77
Nigeria	83.00	448.00	531.00	166.00	365.00	68.74
Sierra Leone	53.52	—	53.52	—	53.52	100.00
TOTAL	541.63	574.74	1,116.37	418.60	697.77	62.50

Source: Direction of Trade Statistics Year Book, IMF 1981
[1] Excludes intra UMOA-Mali trade.

Table 3

PERFORMANCE OF THE WEST AFRICAN CLEARING HOUSE (TRADE INCLUSIVE OF OIL)

Calendar Year Million WAUA (= SDR)

	1976	1977	1978	1979	1980
1. Exports (FOB)	251.29	307.57	286.24	340.71	438.01
2. Imports (CIF)	222.77	342.01	278.88	323.53	412.78
3. Total Intra-regional Trade (1+2)	474.06	649.58	565.13	564.24	850.79
4. Compensable trade	225.89	281.21	247.50	272.86	319.78
5. % Compensable trade (4÷3)	47.56	43.29	43.80	41.08	37.58
6. Total transactions channelled through WACH	18.40[1]	45.20	52.00	72.82	162.69
7. Of which trade transactions channelled	10.90[1]	35.00	35.70	45.52	50.42
8. Transactions cleared	4.27	13.09	14.15	18.04	23.70
9. Transactions cleared as % of total transactions (8÷6)	23.21[1]	28.96	27.21	24.77	14.57
10. Trade transactions as % of total transactions channelled (7÷6)	59.24	77.43	68.65	62.51	30.99
11. Trade channelled as % of total intra-regional trade (7÷3)		5.39	6.32	6.85	5.93
12. Trade channelled as % of compensable trade (7÷4)		12.45	14.42	16.68	15.77

[1]Covers only last 6 months of 1976
Source: Direction of Trade Statistics Year Book, IMF, 1981.