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Common Currency for the West African Sub-Region: Prospects for Nigeria

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COMMON CURRENCY FOR THE WEST AFRICAN SUB-REGION: PROSPECTS FOR NIGERIA

Abstract

An important element of the economic integration process in West Africa is the achievement of monetary co-operation which can take various forms such as the clearing house mechanism, European Monetary System Model, Parallel Union Currency Model and Common Currency Area. The paper traced the efforts by ECOWAS at evolving monetary co-operation and also analysed the prospects for Nigeria of a common currency in the West African sub-region. The paper identified and discussed the costs and benefits of a common currency to member nations, especially Nigeria. The costs include loss of autonomy by individual governments in major areas of monetary and fiscal policy, costly exchange rate adjustment and lower banking system credit to government. On the other hand, the beneficial effects include a possible increase in capital inflow and investment, an enlarged market for Nigeria's exports, reduction in smuggling and perhaps a more effective control of government deficit financing. On balance, however, the paper concluded that a common currency for the West African sub-region would be beneficial to all the countries within the Region and Nigeria in particular.

Introduction

A principal objective of the Economic Community of West African States (ECOWAS) has been the achievement of greater monetary co-operation through the harmonization and co-ordination of monetary and fiscal policies of its member States. In Article 2(h) of the Treaty establishing it, the Community pledged to ensure "the harmonization, required for the proper functioning of the community, of the monetary policies of member States." Also Article 36 1(b) provides that the Trade, Customs, Immigration, Monetary and Payments Commission among other things, should "as soon as practicable make recommendations for the harmonization of the economic and fiscal policies of the member States."

In furtherance of this objective, the Executive Secretariat of ECOWAS in collaboration with the Committee of Governors of Central Banks in ECOWAS has, in a number of studies undertaken with technical assistance from various international institutions, examined the broad principles and guidelines that could be adopted in achieving greater regional monetary co-operation.

The aim of this paper is partly to trace the efforts made so far by the Community at evolving a monetary co-operation programme for the sub-region, and partly to analyse the prospects for Nigeria of a common currency for the West African sub-region. For purposes of easy exposition, the paper is divided into 5 parts. Part I outlines briefly, the issues of concepts and alternative arrangements for monetary co-operation. Part II provides an historical analysis of the monetary co-operation effort so far made, which culminated in the recent adoption of the monetary co-operation programme by the Authority of Heads of State and Government at its meeting in Abuja. Parts III and IV examine the problems, costs and benefits of adopting a common currency. Part V provides the summary and conclusion.

PART I DEFINITION OF CONCEPTS

Monetary Zone

A monetary zone (union) may be defined as an area with a single currency or an area that has achieved monetary integration with complete exchange rate unification. Thus, two or more countries are said to have formed a monetary zone if they have agreed to introduce a common currency to replace their existing currencies, or in the alternative agree to a permanent monetary co-operation arrangement which ensures that their currencies are fully convertible at exchange rates which bear a permanently fixed relationship to each other and vary in unison against non-union currencies. Whatever form a monetary union may take, the following basic requirements must be satisfied:

(a) a common monetary policy;
(b) a common pool of foreign exchange reserves and common exchange rate policy;
(c) harmonization of domestic credit through the imposition of maximum credit ceilings;
(d) a common central bank;
(e) a common currency.

Alternative arrangements for Monetary Co-operation

There are various forms of monetary co-operation. The different forms may in a sense be viewed as stages or degrees of integration beginning with a very loose association that permits a great degree of independent national action in economic and monetary policy formulation and implementation to the fullest monetary and economic union. In increasing order of integration, the options may be listed as follows:

(a) monetary co-operation through a clearing house mechanism;
(b) European monetary system model;
(c) parallel union currency model;
(d) common currency area.

Clearing House Mechanism

A Clearing House system may be defined as an arrangement among central banks whereby intra-regional transactions are recorded and payments made on a pre-determined date when a reconciliation of the accounts is made and settlement of the net outstanding balances is effected. Examples of such clearing mechanism in Africa are the West African Clearing House (WACH), Central Africa Clearing House (CACH), and East Africa Clearing House (EACH). The main objectives of such Clearing House system are to increase the use of national currencies, and economise on the use of hard currencies, for the intra-regional trade, as well as encourage a greater trade liberalisation within the region or sub-region. Through this mechanism, national currencies achieve a form of limited convertibility within the region.

European Monetary System (EMS) Model

The EMS is an arrangement by the participating European countries to ensure closer financial and monetary co-operation and create a zone of monetary stability in the European Community. The system involves the harmonization of exchange rates through co-operative intervention in their foreign exchange markets to minimize exchange risks in their trade and other economic relations. The EMS replaced the "Snake" which was a system set up to narrow fluctuations among the currencies of EEC countries. Under the EMS model, participating countries retain substantial national autonomy in most major areas of economic and financial policy formulation.

Parallel Union Currency Model

This is a system whereby a common union currency is issued to circulate side by side with national currencies to which it has a defined and fixed relationship. A major element of the system is the establishment of a union monetary authority with powers to issue the parallel as well as the national currencies.

In this system, national central banks will be retained but their existing autonomy in monetary and credit management will be reduced in favour of the union monetary authority.

The Single (common) Currency Model

This model involves an arrangement which groups a number of independent countries into a monetary zone with a single currency and a union central bank. The union central bank performs the primary functions of:

(a) issuance of the common currency;
(b) holding and management of the external assets of the member countries in a common pool;
(c) management of the monetary policy in order to facilitate monetary stability and the full and unlimited convertibility of their common currency against an external reference currency to which it is immutably pegged.

This model exists among the French-speaking countries of West Africa (WAMU), Central Africa and East Caribbean.

Evaluation of Options

Studies have indicated that of the above alternative models of integration, a single currency system, similar to the WAMU model, provides the most meaningful framework for translating the aspirations of the ECOWAS Authority into a concrete programme. It should be expected that there will be a short period of transition from a system of parallel currencies to a single currency system. In that period, both the common currency and the national currencies will circulate side by side until the national currencies are finally withdrawn from circulation.

PART II TOWARDS THE CREATION OF A SINGLE ECOWAS MONETARY ZONE

The proposal for a common currency for the West African sub-region dates back to May, 1983 when at its meeting in Conakry, the Authority of the Heads of State and Government of ECOWAS took a decision that studies be commissioned on the possibility of creating a single monetary zone in the ECOWAS sub-region. Following that decision, the Committee of Governors of Central Banks of ECOWAS at its meeting in Dakar in September 1983, set up a Study Group under the auspices of the ECOWAS Secretariat. The report of the Study Group was submitted in two phases. The revised Phase II report — the final report — was submitted to the committee of Governors at their meetings in Nouakchott, Mauritania, in April, 1987.

The Study Group in its reports proposed a monetary zone of the WAMU type for ECOWAS. It proposed a transitional period of five years (1988-1992) before the single ECOWAS monetary zone could be created. During that period, some countries, including Nigeria, are required to adopt specific corrective policy measures to remove sources of disharmony arising particularly from exchange rate and monetary and fiscal policies of the Government. The adjustment measures recommended are to be undertaken by the non-members of the l'Union Monetaire Ouest Africaine (UMOA) to harmonise their policies with those that obtain among the seven member French-speaking countries of the UMOA.

The policy measures include exchange rate adjustment; ceiling on government borrowing from the banking system; appropriate distribution of bank credit between government and private sectors; and fiscal harmonisation.

The monetary union envisaged is based on the common currency model with the following characteristics:

(i) a common central bank;
(ii) a common convertible currency to replace existing national currencies;
(iii) pooled external reserves;
(iv) the centralisation of short-term domestic and external liabilities of national central banks in the common central bank;
(v) the re-designation of existing national central banks; and
(vi) a convertibility guarantee agreement with the issuer of a major international currency in order to ensure stability and international confidence in the new common currency.

After considering the report at the Nouakchott meeting, the Committee of Governors accepted the report and decided to adopt a phased approach to ECOWAS Monetary Co-operation. The phased approach, according to the Committee, is the gradualist one, reflecting the time profile of objectives to be pursued. The pursuit of the short-term objective will be directed towards improvement and strengthening of the West African Clearing House (WACH) mechanism to facilitate increased intra-regional trade and payments transactions through greater use of national currencies. In the medium-term, efforts will be made towards the achievement of limited convertibility, while the creation of a single monetary zone with a common currency is the long-term objective. The recommendation was submitted to the Finance Ministers of ECOWAS at their meeting in Abuja in June, 1987.

The Finance Ministers considered and adopted the recommendation, including the setting up of an interim co-ordinating committee comprising representatives of all the central banks, Ministries of Finance and the Executive Secretariat to undertake the necessary follow-up action on details of the programme. The Ministers of Finance submitted their recommendation to the 21st session of the Council of Ministers of ECOWAS which was held in Abuja from 3rd to 6th July, 1987.

In considering the report on the proposed monetary co-operation programme, the Council stressed the importance of monetary co-operation in view of the problems posed by the multiplicity of currencies to the sub-regional integration process. In this connection, the Executive Secretariat of ECOWAS was requested to develop the community co-operation programmes in trade, monetary, transport and communications sectors into coherent package to ensure the required complementarity. The Council underscored the need for strong political will in implementing the proposed monetary co-operation programme. The Council thereafter forwarded the proposals to the Authority of Heads of State and Government for consideration.

In considering the proposal, the Authority at its Tenth Ordinary Session held at Abuja from 7th to 9th July 1987, welcomed the progress recorded on the preparations towards the creation of a single monetary zone in West Africa. The Authority adopted the proposed ECOWAS Monetary Co-operation Programme. It decided, however, that the creation of a single monetary zone should be on a gradual and pragmatic basis.

The above narrative on the creation of a single ECOWAS Monetary zone, however, will be incomplete if it is silent on two unanswered questions. These relate to the convertibility guarantee for the common currency and the pooling of foreign exchange reserves of member states in the common central bank. Agreement has not been reached with any country or group of countries on convertibility guarantee. Although the report of the Study Group suggests that the European Economic Community (EEC) could be contacted over the issue, this has not been done. Also problematic is the pooling of external reserves. In this case, the exact modalities for the management and utilisation of the pooled reserves are yet to be agreed upon. It is to be hoped, nonetheless, that these issues will be pursued by the proposed interim co-ordinating committee during the five-year transitional period 1988-1992.

PART III COSTS OF ADOPTING A COMMON CURRENCY FOR ECOWAS

There will be costs as well as benefits for Nigeria, like every other country in ECOWAS, in adopting a common currency for the sub-region.

The costs are in the form of some painful policy adjustment measures that have to be undertaken by the non-UMOA countries of the sub-region during the transitional period and the permanent loss of sovereignty over the conduct of monetary and fiscal policies.

Initial Adjustment Measures to be undertaken by Member States

(a) Exchange Rate Adjustments

The Study Group Report considered exchange rate adjustment by the non-UMOA member countries of ECOWAS as the most important of the adjustments to be made before the formation of the proposed ECOWAS Monetary Zone. This stemmed from the report of the Group which found large divergences in the exchange rate policies of ECOWAS member countries and that the exchange rates of most of the non-UMOA countries were over-valued. Using the exchange rate of the CFA franc as a benchmark and on the basis of data for end-1985, the report, for example, recommended that Ghana should devalue its currency from that date by 61.3 per cent, Sierra Leone by 51.7 per cent, while Nigeria was to devalue the naira by 74 per cent. The report, however, found that the Gambian Dalasi was under-valued and recommended that it be re-valued by 59.2 per cent. The purpose of the exchange rate adjustment by the non-UMOA countries was to align the currencies of all member countries of ECOWAS to the CFA franc. It was also to bring the exchange rates of all currencies in the sub-region into harmony with an existing major regional convertible currency, the CFA franc, which is collectively managed in a manner similar to that envisaged in the proposed ECOWAS monetary zone.

The dramatic fall in the value of the naira, particularly since the introduction of the Second-Tier Foreign Exchange Market, will make any further adjustment of the naira rate unnecessary. For instance, between December 1985 and September 26, 1986, the naira depreciated by 38.8 per cent against the dollar (See Table 1). Following the introduction of SFEM, the naira depreciated against the dollar more sharply, resulting in a total depreciation of 74.7 per cent between December 1985 and July 1987. The recommended reduction in the value of the naira has therefore been met.

Banking System Credit to Government

The Study Group proposed adjustment in fiscal policies aimed at monetary stability and sustainable economic growth. Specifically, the Group recommended that ceiling on Central Bank credit to Government should not exceed 20 per cent of previous year's fiscal revenue during the transitional period. The 20 per cent ceiling was chosen by the Study Group to bring all ECOWAS countries in line with the practice in UMOA countries.

However, the Committee of Governors at the Nouakchott meeting modified the recommendation of the Study Group by agreeing that the 20 per cent ceiling should apply to credit from both central bank and commercial banks to government. When we examined the effects of limiting the Federal Government borrowing from the banking system to only 20 per cent of the preceding year's fiscal revenue defined as federally-collected revenue, for the period 1982-1986, we found that this would have constrained Government expenditure severely. A comparison of the actual banking system's credit to Government in the period with the proposed 20 per cent ceiling shows that the actual was higher than would have been allowed in every year except 1986. The highest deviation was in 1983 when actual credit exceeded the 20 per cent benchmark by 27.7 percentage points.

The constraint on Government expenditure becomes even more serious when federal-retained revenue which appears more relevant in the case of Nigeria is used as fiscal revenue in the analysis. In this, we found that the banking system's credit to Government as a proportion of previous year's fiscal revenue averaged 40.6 per cent between 1983 and 1986. On this basis, the actual credit to government exceeded the 20 per cent ceiling by very wide margin. It is obvious that the 20 per cent ceiling would impose severe restraint on government deficit financing. However, under the structural adjustment programme, Government deficit financing is being reduced. Thus, further reduction to meet ECOWAS requirement will not be as severe as it would have been.

Permanent Costs

As indicated above, these costs include the loss of autonomy by individual national governments in major areas of monetary and fiscal policies to a supra-national central authority, loss in the use of exchange rate policy as an instrument for balance of payments adjustment. Other costs may arise from the problems of acceptability of the common currency and the convertibility guarantee agreement to be reached with the issuer of a major international currency.

Constraints on monetary and fiscal policies

A monetary union, as mentioned earlier in this lecture, requires the establishment of a central monetary authority for the sub-region. As a result, decisions relating to monetary policies would have to be made at the central monetary authority level and the flexibility for individual country's budgetary deficits would be limited through collective decision making. Every independent country ordinarily wants to be able to control the volume of money in the economy according to its perceived need of the economy. This national independent discretion will no longer be possible in a currency union. Similarly, the flexibility of fiscal policy in the union will be constrained by the limits set collectively on banking system financing of government budgetary deficits.

Loss of the use of Exchange Rate as an internal Policy Instrument for Balance of Payments Adjustment

Exchange rate is an important internal policy instrument for moderating imported inflation and also for controlling imports into the country. It has also been used to boost non-oil exports. This internal policy instrument for adjusting our balance of payments position will no longer be available with the adoption of a common currency.

Partial Surrender of national sovereignty

A national currency is regarded as a symbol of sovereignty and the replacement of the national currency by a common currency issued by a supra-national body is a surrender of sovereignty in this regard. The transfer of autonomy in the major areas of the monetary policy to a central monetary authority already mentioned is included in the partial surrender of sovereignty.

This, no doubt, is the highest price that Nigeria, like all the other non-UMOA countries of the sub-region, has to pay for entering into the ECOWAS monetary union. In fact, whether the monetary zone programme is realised or not will depend largely on the willingness of the governments concerned to surrender autonomy in this regard.

Convertibility Guarantee Agreement

The convertibility guarantee agreement recommended to be made with the issuer of a major international convertible currency will no doubt serve to ensure the stability and convertibility of the ECOWAS currency. The agreement will, however, have both economic and political costs. No country of group of countries will give such a guarantee without setting conditions. For example, under a co-operation agreement signed by individual member countries of the West African Monetary Union with France, the latter guarantees the full convertibility of the CFA franc at a fixed rate of exchange, while the member states of the Union are under obligation to keep their common external reserves in an "Operations Account" maintained with the French Treasury. However, there have been some modifications to this since that agreement was first signed. The BCEAO , the Union's Central Bank, is now permitted to invest up to 35 per cent of its reserves in short-term liquid assets of two years maturity in the international financial markets in which member countries are participating. From this, it could be expected that any country guaranteeing the convertibility of the common currency will set some conditions, which may have impact on the autonomy of the individual ECOWAS countries.

Migration of the nationals of other countries of the sub-region into Nigeria

There is some concern that adopting a common currency in the sub-region will lead to an influx of other nationals of the sub-region into Nigeria. Nigeria, of course, is the most developed country in the West African sub-region, enjoying a more advanced infrastructure and industries. It is also probably the most wealthy of the countries in the sub-region. As a result, other nationals have been coming into Nigeria to obtain employment. The adoption of a common currency will make it earlier for other nationals to come and settle in the country. With time, however, some Nigerians will also move out to other countries of the sub-region to take up foreign jobs, though there is likely to be a net migration of labour into Nigeria.

PART IV BENEFITS FROM COMMON CURRENCY IN ECOWAS

Nigeria will certainly derive some benefits from the proposed adoption of a common currency for ECOWAS. The likely benefits are discussed briefly below.

(a) Monetary and Fiscal Policies

The loss of control over major areas of monetary and fiscal policies by the Nigerian Government under the common currency system was described above as the highest price to pay. However, looked at from another angle it would be seen that it confers some significant benefits. For instance, the fixing of a ceiling on Government borrowing from the banking system by ECOWAS central bank would lead to a more effective control of government deficit financing and inflationary pressures in the economy. The history of inflation in the Nigerian economy in recent years shows that inflationary pressures were fuelled by excessive government deficit financing. An effective control of banking system credit to government is also likely to make government more cost-conscious and avoid wasteful spending. It may also induce government to increase its drive in raising revenue. Moreover, a better control of credit to government will also tend to reduce pressures on the balance of payments. Also, the distribution of bank credit between the private and government sectors will be more objective and beneficial. It must also be noted that the loss over monetary and fiscal control will not be a total loss since the Nigerian Government will be represented at the policy making body of ECOWAS central bank.

Increase in capital inflow and investments

The common currency envisaged for the sub-region will be externally convertible through the convertibility guarantee agreement. This will certainly be a major benefit. The discipline imposed on member countries by the limits set by the collective decision-making process on the ability of any one member to follow excessively expansionary policies will have positive effects on both external and internal financial stability. All these will enhance the inflow of capital that will lead to increased investments. Also the presence of many industries already in Nigeria would provide external economies to new industries, and thus could make the industrial sectors in Nigeria, areas of growth within the sub-region, attracting capital and investment.

Large Market for Nigeria's exports on the West Coast

One of the reasons for the low level of intra-West African sub-regional trade is the multiplicity of inconvertible currencies in the sub-region. The adoption of a single currency will therefore facilitate intra-subregional trade. Nigeria will be one of the greatest beneficiaries because of its export potential in the sub-region.

Intensification of efforts in promoting exports to the industrial countries is not likely to be very successful because of protectionist measures in the industrial countries. In any case, a recent UNCTAD study has shown that African countries in particular have little or no chance of penetrating industrial countries markets as did Taiwan, South Korea and Hong Kong for both economic and political reasons. If the objective of increasing Nigeria's non-oil exports is to be achieved our export promotion drive would have to be directed more to the developing world and more especially to the ECOWAS countries. The adoption of a common currency will facilitate and promote this drive.

Reduction in smuggling and incidence of illegal trafficking

The Centralised monetary and fiscal management strategies required under a common currency have a better ability to reduce the basic imbalance in the economies of member states of the union. Smuggling of goods and currency trafficking will therefore be considerably reduced. There will be no incentive to smuggle to earn other member countries' currency in order to buy their goods or to smuggle currency for exchange into hard currencies.

Increase in tourism

A common currency will encourage free movement of people within the sub-region. With the movement, more tourist attraction will be discovered and Nigeria has many.

PART V SUMMARY AND CONCLUSION

This paper has traced briefly from the genesis to the current position of the monetary co-operation efforts in the West African sub-region. It has also attempted an analysis of the practical problems, costs and benefits for Nigeria on entering ECOWAS monetary union.

It is shown that the subject of monetary co-operation in ECOWAS sub-region has been extensively studied by financial experts, and that the experts' reports (in two phases) have, after necessary revision, been accepted by the ECOWAS political leaders — the Council of Ministers and the Authority of the Heads of State and Government. A programme of phased approach to the creation of an ECOWAS monetary zone was finally approved by the Authority of the Heads of State and Government at its 10th ordinary session at Abuja, Nigeria, in July 1987. The Authority, however, stressed that the creation of an ECOWAS monetary zone must be pursued on a gradual and pragmatic basis.

An ECOWAS Monetary Union will impose some costs on Nigeria and also confer some benefits. The main costs are in terms of some painful initial economic measures it will be required to take and the loss of autonomy over the conduct of monetary, fiscal, and exchange rate policies, which has to be surrendered to a supra-national ECOWAS Central Bank.

On the other hand, the benefits that will accrue to Nigeria on joining the ECOWAS Monetary Union appear considerable. The most obvious ones include a large market covering the whole of West Africa, more effective and objective control on government deficit financing, consequently leading to more monetary stability and reduction in inflationary pressures. Others are reduction or elimination of currency trafficking and smuggling of goods across the borders; thanks to having a convertible currency for the whole sub-region. Other benefits include increased capital inflow and investment.

It would thus appear from the foregoing analysis that the prospects for Nigeria in joining the ECOWAS Monetary Zone are bright. A major barrier to intra-ECOWAS trade has been shortage of foreign exchange. Thus a common convertible currency for the sub-region which is one of the collective actions for self-reliance being pursued in the sub-region must, if properly implemented, be beneficial to all concerned. In order to maximise this benefit, other barriers to trade within the sub-region — both financial and non-financial — must be removed.

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NAIRA EXCHANGE RATE DEVELOPMENTS SINCE DECEMBER 1985 Table 1

Dates	Rates	Depreciation from December 1985
December 1985	₦1.0 = $1.0422	—
September 26 1986	₦1.5691 = $1.0	−38.8
September 29 1986	₦4.6174 = $1.0	−79.2
December 1986	₦3.3166 = $1.0	−71.0
May 14 1987	₦4.1617 = $1.0	−76.9
June 4 1987	₦4.3637 = $1.0	−78.0
June 18 1987	₦3.7375 = $1.0	−74.3
July 2 1987	₦3.9899 = $1.0	−75.9
July 16 1987	₦3.5354 = $1.0	−72.8
Average SFEM/FEM Rate (September 29, 1986 — July 16, 1987)	₦3.7985 = $1.0	−74.7

GOVERNMENT REVENUE AND GROSS BORROWING, 1981-1986 Table 2

	1981	1982	1983	1984	1985	1986
Federally-collected Revenue (₦' Million)	12,180.2	11,764.4	10,508.7	11,133.7	14,606.1	14,189.9
Federal Govt. Borrowing from:[1]						
The Banking System	—	2,989.2	5,616.1	2,892.5	2,491.4	498.9
(1) Central Bank	—	(1,975.9)	(3,324.9)	(−646.0)	(820.5)	(6,199.7)
(2) Commercial Banks	—	(1,013.3)	(2,291.2)	(3,538.5)	(1,670.9)	(5,700.8)
			PERCENTAGES			
Federal Government Borrowing as percentage of Federally collected revenue in previous year:						
From the Banking System	—	24.5	47.7	27.5	22.4	3.4
(1) Central Bank	—	(16.2)	(28.2)	(−6.1)	(7.4)	(42.4)
(2) Commercial Banks	—	(8.3)	(19.5)	(33.6)	(15.0)	(−39.0)
Permissible Borrowing under the proposed 20% ceiling	—	2,436.0	2,352.9	2,101.7	2,226.7	2,921.2

[1] This measures changes in holding of Government Securities. It is not adjusted for Federal Government deposits or for Federal borrowing on-lent to State Governments.

Source: Central Bank of Nigeria