SECOND MONETARY ZONE IN ECOWAS: ISSUES, PROGRESS AND PROSPECTS

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I INTRODUCTION

I.1 Background To The Creation of the Second Monetrary Zone

The Economic Community of West African States (ECOWAS), comprising fifteen states[1], was established in 1975 to accelerate economic growth and development of the sub-region through facilitation of economic and monetary cooperation which would progress to a monetary union when all member countries evolved/adopted a common currency under a unified exchange rate arrangement, and pursued a common monetary policy under a common authority.

I.2 Expected Benefits from Monetary Integration and ECOWAS Approach to Realizing Them

The benefits from such economic and monetary arrangements would include:

- enhancement of the payments system for goods and services in the sub-region, thereby promoting trade;
- creation of a larger regional market and widening of business/trade-related income-earning opportunities for the citizenry for improvement of their standard of living;
- facilitation of unhindered movements of persons and labour in the sub-region through dismantling of barriers, thereby strengthening cultural, economic, social and political cooperation (common central bank, judiciary, parliament, etc).
- Creation of a more favourable environment for collective pooling of resources for development of essential regional infrastructure - trans-regional highway, oil/gas pipe line, ECOAIR, ECOMARINE, etc; and
- enhancement of economic competitiveness, derivation of economics of scale, and reduction in transactions' costs.

In order to hasten the realization of afore-mentioned benefits of economic and monetary integration, the Authority of Heads of State and Government of ECOWAS IN 1987 adopted the ECOWAS Monetary Cooperation Programme (EMCP) with the specific objectives of improving and strengthening sub-regional payments systems under the West African Clearing House (now West African Monetary Agency - WAMA); introducing limited currency convertibility; establishing a single monetary zone (merger of French and English-speaking countries' monetary arrangements); creating a common central bank, and introducing a single common currency eventually. The EMCP contained a set of macroeconomic convergence criteria which member countries were expected to observe prior to the emergence of a common monetary authority and currency. Convergence criteria are a set of macroeconomic indicators which countries entering into a common economic and monetary arrangements are expected to satisfy in order to ensure the comparability of their macroeconomic performance. ECOWAS' convergence criteria are similar to those of the Second Monetary Zone discussed in section II of this paper.

1.3 Statement of the Problem

By 1999 it was generally observed that the pace of implementation of EMCP, especially the establishment of the single monetary zone, had not matched the expectations of the founding fathers. Some perceived major obstacles to successful implementation of the programme included lack of political will and commitment; non-uniform adoption of required macroeconomic framework and lack of policy coordination and harmonization between Francophone west African countries(with the exception of the Republic of Guinea), which had already established a monetary union (Union Monetaire l'Quest Africaine - UMOA in 1961) as well as an economic and monetary Union (Union Enomique et Monetaire l'Quest Africaine - UEMOA in 1994) and the non-UEMOA (Anglophone) countries. Another constraint was with holding of support for the EMCP by critics who maintained that the production of almost homogenous agricultural primary commodities by countries in the sub-region did not augur well for increased flow of and derivation of benefits from trade among the countries. The question, however, remained whether these countries could not add value to their primary commodities through further processing and whether their economies could not be diversified to produce other tradeable among them.

The recognition of this problem necessitated the Authority of Heads of State and Government of ECOWAS, in December 1999 at its 22nd Summit in Lome, Togo, to adopt a strategy of a Two-Track ("Fast-Track") approach (to economic and monetary integration) initiated by Nigeria and Ghana to implementation of the EMCP. The Government of the Gambia, Ghana, Guinea, Liberia and Sierra Leone undertook consultations, while the Heads of state and Government, at their summit in Bamako, Mali in December, 2000, agreed to the establishment of the West African (second) Monetary Zone, WAMZ; the setting up of a common central bank; and the introduction of single common currency in the zone in 2003, for eventual merger with UEMOA zone in 2004 under the ECOWAS integration programme. The West African Monetary Institute (WAMI) was, therefore, established in January 2001 to commence preparatory work towards the introduction of a single currency and a common central bank in the WAMZ.

1.4 Objective of the Paper

The objective of this paper is to highlight the rationale for establishing the West African Monetary Zone (WAMZ), discuss its institutions, convergence criteria, the progress made so far, some major issues to be resolved in order to achieve the objectives of WAMZ, and the prospects.

1.5 Organization of Paper

The rest of the paper is organized into four sections. Section II discusses the composition and objectives of the West African Monetary Zone, institutions of the zone, and the stimulated convergence criteria. Section III focuses on some problems of macroeconomic convergence and other issues to be addressed in order to achieve the objectives of WAMZ, while Section IV discusses the prospects for operationalising the integration programme of the WAMZ. Section V summarizes and concludes the paper.

II THE WEST AFRICAN MONETARY ZONE (WAMZ): ITS COMPOSITION, OBJECTIVES, INSTITUTIONS AND CONVERGENCE CRITERIA.

II.1 Composition and Objectives

The WAMZ member countries comprise the Gambia, Ghana, Guinea, Nigeria and Sierra Leone. Liberia attends WAMZ meetings as an observer as she has not yet signed the instruments of membership. These countries account for about 60% of the population of the ECOWAS sub-region as well as its GDP.

A major objective of establishment of the WAMZ has been for its institutions, policies, political support, legal and administrative arrangements to serve as a catalyst which would hasten the attainment of monetary integration in the zone and the evolution of a common monetary authority for the realisation of the benefits of such integration (highlighted earlier). The ultimate objective of the WAMZ is to “fast track” the realisation of ECOWAS monetary integration project in the West African Sub-region through helping to create conditions which would make the process of unification of similar UEMOA and WAMZ monetary integration arrangements relatively easier and faster than to do otherwise.

II.2 WAMZ's Institutions and Facilities

Six institutions have been created under the WAMZ Agreement to facilitate arrangements for eventual introduction of a single currency in the zone. These are:

i) the Authority of Heads of States and Government - this is the political and supreme body of the zone, with the overall responsibility for the achievement of the objectives of the WAMZ;

ii) The Convergence Council of Ministers and Central Bank Governors - the Council is the supervisory authority of the WAMZ and its institutions. It has the responsibility for making recommendations to the Authority of Heads of State and Government;

iii) The Technical Committee - this is made up of technical officials from member countries. The Committee works in collaboration with WAMI, reviews and helps finalize policy and technical documents prepared by the Institute to facilitate the integration process. It has the responsibility of contributing to policy advice and recommendations to the Convergence Council;

iv) The West African Central Bank (WACB), when established, would be the common Central Bank of the zone, while the existing National Central Banks will be national branches of the WACB;

v) WAMZ Stabilization and Cooperation Fund (SCF) - This is a fund being set up to provide financial assistance to member states that may experience temporary disequilibria in their balance of payments. Its capital base of $100 million is being subscribed by member countries in two instalments of $50 million; and

vi) The West African Monetary Institute (WAMI) - is an interim institution established to carry out preparatory activities which would lead to the establishment of the West African Central Bank (WACB) and the introduction of a common single currency in the WAMZ.

WAMI, which is located in Accra, Ghana, commenced operation in March 2001. It has the mandate of articulating a policy framework and developing institutional structure for the WAMZ. Its major functions include:

a) Monitoring macroeconomic performance of and movement towards macroeconomic convergence by member countries and making appropriate observations and recommendations accordingly;

b) Facilitating the harmonization of financial and banking rules and regulations of the various member countries with the Agreement and Statutes of the WAMZ. The harmonization would be useful in the conduct of monetary policy when a common central bank is established;

c) Working out the modalities and analyzing the technicalities of establishing a common central bank and introducing a common currency. WAMI is also to articulate the monetary policy objectives and the appropriate monetary policy instruments for the envisaged common central bank as well as the transmission mechanism; and

d) Facilitating the sensitization of the citizenry of member countries on the monetary integration process and eventual introduction of the single currency in the zone.

II.3 Convergence Criteria Under The West African Monetary Zone

The Convergence criteria for the West African Monetary Zone focus on price stability, sustainability of fiscal deficit, limiting of deficit financing by the central bank and maintaining sufficient levels of gross official foreign exchange reserves. The Agreement establishing the Zone stipulates convergence criteria to be achieved and sustained within a given time frame. The convergence criteria are classified into primary and secondary.

II.3.1 Primary Criteria

These are:

i) single digit inflation rate by 2000 and 5.0 per cent by 2003;
ii) fiscal Deficit (excluding grant)/GDP ratio of equal to or less than 5 per cent by 2000, and 4.0 per cent by 2002;
iii) a ceiling on central bank financing of budget deficit of equal to or less than 10 percent of previous year's tax revenue by 2000; and
iv) maintenance of official foreign reserves of equal to or greater than 3 months of imports by 2002; and at least 6 months by 2003.

II.3.2 Secondary Criteria

The following six secondary criteria would also be observed in support of the primary criteria:

i) prohibition of new domestic debt arrears and liquidation of all existing ones by end of 2003;
ii) tax revenue to GDP ratio to be equal to or more than 20%;
iii) wage bill to total tax revenue ratio to be equal to or less than 35 per cent ;
iv) public investment as a ratio of total tax revenue to be greater than 20 per cent;
v) maintenance of exchange rate stability; and
vi) achievement of positive real interest rates.

The progress towards the meeting of necessary convergence criteria, outstanding problems in that regard, and other issues requiring resolution before movement into the final phase of monetary integration in the WAMZ, are covered in the next section.

III PROBLEMS OF MACROECONOMC CONVERGENCE AND OTHER ISSUES BEFORE THE WAMZ

III.1 Status of Macroeconomic Convergence: 2000 to June 2002

a) Primary Criteria

A general picture of the status of compliance with the primary convergence criteria from 2000 to June 2002 is presented in Table 1 below. The results are mixed. Some countries made progress with respect to some indicators in one year, while slippages occurred in subsequent years.

The year 2000 marked the beginning of the observance of the convergence targets in the WAMZ. Assessment of macroeconomic performances under the primary criteria indicates that out of the four criteria, the price stability target was satisfied by three out of five countries. This was followed by the limit on central bank financing of fiscal deficits, satisfied by three countries. The limit on budget deficit/GDP ratio and the floor on the import cover of foreign exchange reserves were met by two countries (see Table 1).

Table 1
Macroeconomic Convergence indicators: 2000 - 2001

Criteria/Target	**The Gambia**	**Ghana**	**Guinea**	**Nigeria**	**Sierra Leone**
Inflation(Single Digit-End Period) 2001 2002 (June) Budget Deficit/GDP 5% or Less 2000 2001 2002 (June) Central Bank Financing 10% or Less, Previous Yr. Tax Rev. 2000 2001 2002 (June) Foreign Reserves/Imports (3 months or more) 2000 2001 2002 (June)	0.2 8.1 6.5 3.6 11.1 10.5 0.0 0.0 0.0 7.5 4.9 4.3	**Ghana** 40.5 21.3 13.7 8.5 7.3 3.0 57.9 0.0 15.9 1.0 1.5 1.3	**Guinea** 7.2 1.1 2.6 5.2 7.8 4.2 17.2 0.0 5.5 2.2 2.8 2.4	**Nigeria** 14.5 16.4 12.2 3.1 4.7 4.2 0.0 0.0 0.0 12.9 12.0 8.2	**Sierra Leone** -2.8 3.4 -2.9 17.3 16.7 5.6 32.7 8.9 19.1 2.8 2.3 1.3

Source: Computed from the Study Reports of the West African Monetary Institute (WAMI).

No country met all four convergence criteria in 2001. All countries satisfied the limit on central bank financing, while only Nigeria met the fiscal deficit/GDP ratio. Three countries, The Gambia, Guinea and Sierra Leone satisfied the target on single digit rate of inflation, while two countries, Nigeria and the Gambia met the floor on foreign exchange reserves of 3 months of imports. In the first half of 2002, three countries met the inflation criterion, the budget deficit requirement, and the stipulation on central bank financing. Two countries satisfied the foreign reserves requirement. A further analysis by criterion is made below:

a) Inflation (Single Digit)

Only three countries, The Gambia, Guinea and Sierra Leone met this target in 2000, 2001 and in the first half of 2002.

b) Fiscal Deficit/GDP ratio (5% or less)

In 2001, only Nigeria satisfied this criterion, whereas two countries, The Gambia and Nigeria met this criterion in 2000. Guinea, Ghana and Nigeria, however, met the target in the first half of 2002.

c) Central Bank Financing (10% or less)

In 2001, five countries, The Gambia, Ghana, Guinea and Nigeria and Sierra Leone satisfied the limit on central bank financing of government deficit as against only two countries, The Gambia and Nigeria in 2000.

d) Foreign Reserves/Imports (3 months or more)

Only two countries, Nigeria and the Gambia met the criterion on foreign exchange reserves of 3 months of imports in 2000, 2001 and the first half of 2002 .

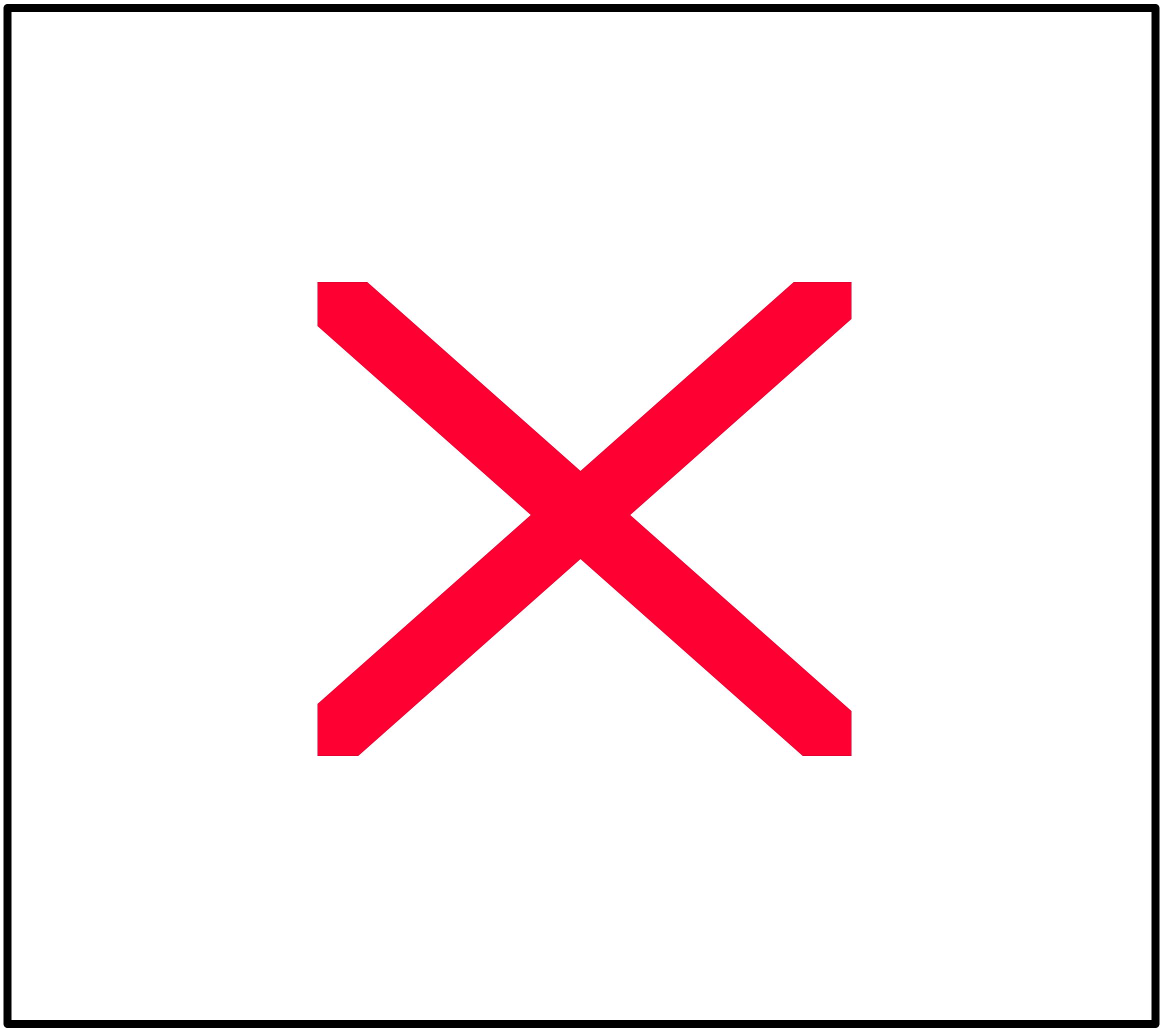
b) Secondary Criteria

As regards the status of achievement of Secondary Criteria, the data in Table 2 show that with the exception of The Gambia in 2000, all WAMZ countries have not been able to raise the level of tax revenues as a percentage of GDP to 20 per cent. Furthermore, the wage bill/tax revenue ratio has not been adhered to by all member countries, except in the Gambia where the target was attained only in 2000.

Public investment/tax revenue was kept above 20 per cent by Ghana in 2000 and in the first half of 2002, while Nigeria met the requirement in 2000 and 2001 only. Real interest rates have generally been positive except in Nigeria and Ghana. Insufficient and tentative data in many of the countries of the WAMZ make it difficult to assess the problem of arrears. Indeed the data on primary convergence criteria (Table I) and secondary criteria could be considered as illustrative of the prevailing situations as efforts are on-going to harmonize statistical data in the WAMZ, resolve the problem of base year, and components of the baskets for computation of consumers= Price Indices in the various countries as well as associated weights.

Several factors have compounded the ability of the various countries to meet the stipulated convergence criteria. Among these are laxed fiscal policies which have tended to weaken relatively tight monetary policies adopted, falling commodity prices and other external terms of trade shocks, political and social conflicts (as in Guinea, Liberia and Sierra Leone) and poor state of infrastructure unconducive to investments and economic growth. These are serious constraints which need urgent solution in addition to other issues discussed in the next section if significant progress is to be made towards the realisation of monetary integration in the WAMZ.

Table 2
Secondary Convergence Indicators: 2000- June 2002



Source: Computed from the Study Reports of the West African Monetary Institute (WAMI).
* Derived as 48.5% of Petroleum Prof. Tax & Royalties + Non-oil Rev./GDP.
** (+) appreciation; - (depreciation).

III.2. Other Issues Before the WAMZ

The renewed political commitment which led to the adoption of a fast-track approach to the integration process in ECOWAS has energized the programme of establishing a single currency in the WAMZ. In addition, the successful introduction of the Euro, the common currency of the European Union, has helped to demonstrate that monetary integration could be made to work when the will exists to meet the preconditions. There are, however, some key existing issues that would need to be resolved to move the project in the desired direction. These include:

i) Maintenance of track record of compliance with macroeconomic convergence criteria: the achievement of economic convergence is critical for the integration process in the WAMZ. Economic convergence is necessary to ensure internal and external balance, a prerequisite for the take-off of the single monetary zone, and to instill the necessary macroeconomic discipline. Despite concerted efforts to achieve sustained macroeconomic stability, economic performance of member countries of the zone at end of June 2002 was not encouraging. On the basis of current economic conditions, the probability of all member countries not meeting the convergence criteria during the stipulated take-off date of the single monetary zone is high. The issue goes beyond the countries meeting all the convergence criteria at a point in time, but requires a track record of meeting the criteria for a considerable period of time;

ii. Prevalence of civil disturbances in some countries of the zone - this Problem has tended to divert resources meant for fiscal consolidation and investments to the prosecution of wars. A perception of insecurity to life and property in the sub-region will not facilitate the flow of much needed investments; and

iii. Non-stepping up of essential complementary programmes within ECOWAS - the development of transport and communication facilities needs, be stepped up in the zone so as to enhance the level of intra-regional trade. Other issues to be addressed include: the speedy implementation of ECOWAS programmes on the Trade Liberalization Scheme (TLS) and the Protocol on the free movement of persons, goods and services.

iv. Political factors - the integration efforts of the WAMZ have been mainly spearheaded at the executive level by Heads of State and Government, some Ministers (Finance, Planning and Integration, Trade/Commerce, and Foreign Affairs), Central Bank Governors and Senior Government officials. National Legislatures and Parliaments as well as the general public in the member countries are yet to be fully brought into the picture to take ownership of project and lend essential support.

v No member country has yet paid her share of capital contribution to the WACB, while only two countries have paid their first tranche for The Stabilization Fund. The political decision on the location of the WACB is yet to be made. These notwithstanding, progress so far made is discussed below.

IV. PROGRESS/PROSPECTS IN ACTUALIZING THE SINGLE CURRENCY OBJECTIVE OF THE WAMZ

IV.1 Progress

The Authorities of WAMZ have programmed several actions to be taken to strengthen macroeconomic convergence and stability. The WAMI, in collaboration with Experts from member countries and the Technical Committee, has been taking concrete steps and providing some viable solutions to various technical issues involved in the arrangement. These are as follows:

i) A process has been started to harmonise the legal frameworks of member countries to strengthen the monetary and other financial policies as well as the banking rules and regulations of the zone. Following the identification of a Central Bank system envisaging a unified structure, and articulation of same in the Statutes of the WACB, that structure of the Common Central Bank has been approved by the Heads of State of WAMZ. The legal Experts of member countries have embarked on the harmonization of the legislation and that task is expected to be completed before the end of 2002 during which period the ratification of the Agreements of the WAMZ and Statutes of the WACB by member states would have taken place;

ii) Technical issues relating to the currency operations in the zone are being worked out by WAMI, in collaboration with Technical Experts from member central banks;

iii) An Exchange Rate Mechanism (ERM) has been put in place since April 2002 to enhance macroeconomic convergence;

iv) A decision has been taken to adopt a market-based monetary management strategy under the unified monetary and exchange rate policy regime being envisaged;

v) Agreement has been reached that the primary goal of the common central bank, the WACB, would be maintenance of price stability. This would be accompanied through a phased movement towards inflation targeting;

vi) To ensure effective banking operations in the zone, WAMI in collaboration with Experts from member countries, has embarked on the harmonization of the payments systems in the zone. Committees have been established at zonal and national levels to supervise the harmonization process; and

vii) A framework of prudential supervision and regulation of banks and other financial institutions, to enhance the efficiency of the payments systems, limit the risks of the financial sector, maintain public confidence and enhance the intermediary role of the financial sector in the zone is being developed for eventual application. To this end, an external supervisory agency for banking supervision in the zone, the West African Financial Supervision Authority (WAFSA) would be established as well as a deposit insurance scheme.

IV.2 Prospects

Apart from the major outstanding issues highlighted above and which require resolution before the commencement of the WAMZ monetary arrangement in January 2003, it was envisaged that the establishment of the WACB would take place by the end of 2002, with key personnel appointed to start operation on the said date. It is highly unlikely that, that feat would be accomplished in the remaining two and half months of 2002. A modest extension of time for meeting the convergence criteria by member countries may have to be considered.

Should that happen, and extra efforts are made by members to achieve convergence and meet necessary financial, legal and political requirements, monetary integration in the WAMZ would become a reality in the near future.

V. SUMMARY AND CONCLUSION

The paper outlined the major elements of the framework and some of the critical issues for achieving the objectives of economic integration in the sub- region and introduction of a single currency in the West African Monetary Zone. The rationale for setting up the WAMZ as well as its objectives, strategies and key institutions were highlighted. WAMI in collaboration with Experts from member countries of the zone, has been providing support to the integration process by undertaking relevant studies, which proffer viable solutions to some outstanding technical issues.

Analysis of macroeconomic performance indicated that member countries needed to sustain their current economic policy reforms to enhance their overall economic performance and to facilitate the process of economic convergence. The performance of member countries under the convergence criteria during 2001 - 2002 is crucial for determining the take-off date of the single monetary zone. The support already given to WAMI by member countries, especially the National Central Banks, needs to be sustained and enhanced to enable the Institute fulfil its mandate. The introduction of a common WAMZ currency and the establishment of the WACB could only be feasible after a prolonged period of meeting the stipulated convergence criteria by the member countries.

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