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# Regional Economic Integration in West Africa

## Policy Coordination Framework for the Proposed Monetary Union in ECOWAS

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**Abstract** There is no doubt that regional economic integration and eventual monetary union would be generally beneficial to the economies of West Africa. Each country in the sub-region conceptualizes and implements its own monetary, fiscal and exchange rate policies, among others. There have been attempts in recent years by some countries to design such policies in line with efforts to meet both primary and secondary criteria for convergence. However, these policies seem not to be properly coordinated. They remain country specific and focused thus defeating the essence of moving towards a monetary union.

This paper attempts to show analytically that stability can be achieved through monetary union but at a cost; loss of ability to exploit monetary policy to boost output. However, effective risk-sharing mechanisms and economic policy coordination within a holistic framework would smooth the process towards a successful monetary union.

**Keywords** Monetary union • ECOWAS • Policy coordination

### 1 Introduction

Since the European Monetary Union Euro experiment of 1999, there has been increasing interest in monetary Union and common currency areas. The Economic Community of West African States (ECOWAS) was established in 1975 with the

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central goal of monetary and economic integration in West Africa. ECOWAS Monetary Cooperation Programme (EMCP) was established in 1987 with the intention to form one monetary zone and one common currency. The ECOWAS zone has two main blocs, namely Francophone and Anglophone countries. The Francophone countries established a monetary union in 1948 known as the WAEMU and adopted a common currency called CFA franc. The CFA zone maintain a fixed exchange rate with the CFA franc tie to the French franc at fixed parity, which was altered only once in 1994. Five non-WAEMU countries, in particular Nigeria, Ghana, the Gambia, Guinea and Sierra Leone, are in the process of forming the second monetary union to be known as the West African Monetary Zone (WAMZ) and adopting a common currency. Although the formation of a full-fledged WAMZ and a single-currency area has suffered many delays because the WAMZ member states failed to achieve the convergence criteria, it is believed that by forming a common currency, the zone can benefit immensely from enhanced trade, investment, fiscal discipline, economic growth and price stability.

In recent times, the ECOWAS countries, those within the proposed WAMZ in particular, have embarked on series of macroeconomic reforms to improve macroeconomic management of their domestic economies to attain the convergence criteria for monetary union and a common currency area. However, these reforms are not coordinated. A coordinated approach to policy is required to guide member states towards the attainment of the convergence criteria for the monetary union and thereafter for the smooth operation of the monetary union.

The main aim of this paper is to propose an economic policy coordination framework for the intended West African monetary union and common currency area. The experience of the European Monetary union has shown the economic policy coordination is essential for the success and sustainability of the monetary Union. The paper is organized thus: following the introduction, Sect. 2 reviews the literature on monetary union and optimum currency area while Sect. 3 presents the theoretical model. Section 4 focuses on the historical and institutional background of economic integration in West Africa. In Sect. 5, the experience of European Union with economic policy coordination is discussed while Sect. 6 summarizes useful lessons for the proposed ECOWAS monetary union. Concluding remarks are provided in Sect. 7.

## 2 Literature Review

The traditional literature on monetary union and optimal currency areas discusses the costs of forfeiting monetary policy autonomy and the corresponding importance of alternative adjustment mechanisms for external imbalances. In his pioneering study, Mundell (1961) emphasized labour mobility, as a crucial adjustment mechanism for idiosyncratic shocks, and therefore a key precondition for forming an optimum currency area (OCA). Price and wage flexibility were also seen as important for coping with idiosyncratic demand shocks. Because shocks were

more likely to be similar among highly integrated economies, McKinnon (1963) suggested the degree of openness as a key indicator in forming an OCA.

Completing the trilogy of classic OCA studies, Kenen (1969) introduced product diversification as an element of an OCA emphasizing that regions with a highly diversified production base should be better equipped to maintain a currency union than regions with low diversification because the latter were more vulnerable to asymmetric disturbances. In addition, he pointed out fiscal integration among regions as a mitigating factor because of the implied risk sharing.

More recent literature extended the basic economic insights from the classical OCA approach to incorporate new dimensions, including the effectiveness and credibility of monetary policy (Beetsma and Bovenberg 1999), the centrality of shock correlations (Alesina et al. 2002), and the endogeneity of OCA adequacy.

While it is generally understood that a higher correlation of shocks between countries makes monetary union more beneficial, Melitz (1991) shows that even if countries face identical shocks, they might still need different policy responses given different initial economic positions and country-specific transmission mechanisms.

Because OCA criteria are endogenous to the creation of a monetary union, a number of studies have suggested that monetary integration may be self-validating. Frankel and Rose (1997) argue that openness (degree of integration) and income correlation are linked because the correlation of business cycles across countries depends on trade integration. Frankel (1999) notes that the endogeneity of OCA criteria means that some parameters such as openness and income correlation are not irrevocably fixed, but instead they can change over time in response to countries' fundamental policies and to exogenous factors.

Mongelli (2002) qualifies their claim, showing that the endogeneity of OCA criteria depends on the pre-existing degree of convergence. De Grauwe and Mongelli (2004) focus on the endogeneity of economic integration, financial integration, symmetry of shocks and labour market flexibility. Blanchard and Wolfers (2000) point out the endogeneity of labour market institutions and Issing (2001) emphasizes the endogeneity of political integration.

Debrun et al. (2005) integrate traditional arguments against monetary union with potential benefits by modelling explicitly the substitutability between monetary integration and domestic institutional reforms. The DMP model compares the costs of sharing a single monetary policy in terms of foregone stabilization with the benefits of the policy coordination brought about by fixed exchange rates. They establish the relevance of asymmetries in institutional quality and in the credibility of monetary commitments to macroeconomic stability. In contrast to the OCA literature, they emphasize positive "monetary externalities" associated with larger monetary unions because of the greater gains from monetary coordination and from a more effective separation between monetary and fiscal powers.<sup>1</sup>

<sup>1</sup> See Beetsma and Giuliodori (2010) for comprehensive review of recent research on Optimum currency Area and monetary integration.

Economic and monetary integration of ECOWAS countries has been the subject of an extensive literature. Cham (2009) shows that the WAMZ has not fulfil the necessary conditions for macroeconomic convergence as well as the criteria for optimal currency area. This implies that policies must be geared towards reforming the economies of the respective countries in the WAMZ to satisfy the basic criteria for convergence and optimal currency area without which it would be counterproductive to adopt a single currency for the zone.

Taking the argument further, Masson and Pattillo (2001) and Debrun et al. (2002, 2005, 2008) develop a multi-country model of monetary union using a simple theoretical framework calibrated to reflect some of the prominent feature of African economies and political institutions, which are often ignored in the traditional EMU models. Using this model, Debrun et al. (2002, 2005) assess the proposed ECOWAS monetary unions and conclude that it would not be in the interests of other ECOWAS countries, unless it were accompanied by effective discipline over Nigeria's fiscal policies.

Debrun et al. (2010) probe the issue of a wider monetary integration in sub-Saharan Africa. The cost-benefit analysis of monetary integration indicates that the proposed monetary union would bring net losers and net gainers. They conclude that the potential gains of strengthening domestic macroeconomic frameworks do not significantly differ from those associated with monetary integration, thereby reducing the attractiveness of joining the proposed monetary unions.

Asonuma et al. (2012) using the DMP framework simulate the welfare effects of monetary integration on members of common monetary area (CMA). While the CMA taken as a whole benefits from the monetary union, some individual countries experience welfare losses.

### 3 Theoretical Model

In recent empirical literature on monetary union and optimum currency area, the Debrun et al. (2005) (here after DMP) model has received wide applicability. The reason for interest in this model is twofold. First, it emphasizes the role of commitment problems in macroeconomic policy, an aspect which is particularly relevant in Africa, where credible institutional fixes such as central bank independence and fiscal rules are harder to implement than in other regions. Second, it allows for analytical solutions while addressing at the same time the interaction between monetary and fiscal policies and international policy coordination (Debrun et al. 2008).

DMP assumes an  $n$ -good,  $n$ -country economic area that is small relative to the rest of the world. Countries differ in terms of size, economic governance, budget flows and terms-of-trade disturbances.

The underlying economic structure is built around a static new-classical Phillips Curve augmented with a distortionary tax and a negative externality capturing

competitive devaluations in trading partners and one-period budget constraint without public debt (see Eqs. 1 and 2).

$$y_i = y_N + c(\pi_i - \pi_i^e - \tau_i) - \sum_{k \neq i, k=1}^n \theta_{i,k} c(\pi_k - \pi_k^e) + \varepsilon_i, i = 1, \dots, n \quad (1)$$

$$g_i = \bar{p}_i + \mu\pi_i + \tau_i - \delta_i \quad (2)$$

Where  $\theta_{i,k}$  represent the marginal effect of a monetary policy action in country  $k$  on output in country  $i$ .  $\varepsilon_i$  is the term of trade shock,  $g$  is socially beneficial government expenditure in percentage of output,  $\delta$  is funds diverted from socially beneficial government expenditure in percentage of output,  $\pi$  is the inflation rate in country  $i$ ,  $T$  is tax revenue in percent of output,  $y$  is logarithm of output and  $p$  is permanent non-tax revenue from natural resource endowment in percentage of output.

National monetary policies in one country affect economic activity of other countries in the region negatively. For instance, an expansionary monetary policy by one country introduces a form of 'beggar-thy-neighbour' by reducing output of other countries in the region. On the contrary, fiscal expansions have no direct spillover effects.

In the benchmark case of flexible exchange rates with politically dependent central banks, monetary and fiscal policies are determined jointly by minimizing deviations of the effective tax rate, public expenditure and inflation from specific objectives.

$$U_i^G = \frac{1}{2} \left\{ -a(\pi_i - \tilde{\pi}(\varepsilon_i))^2 - b\tau_i^2 - \gamma(g_i - \tilde{g}_i)^2 \right\} + y_i \quad (3)$$

Equation 3 implies that the marginal benefit of output gain is constant whereas deviations of inflation, taxes and expenditure from ideal levels (denoted by a tilde) are increasingly costly.

These objectives are non-negative constants except for inflation, which fluctuates to partly accommodate Phillips curve (supply shocks). This captures the preferred trade-off between the variability of inflation and that of output.

$$\pi(\varepsilon_i) = -\eta\varepsilon_i, \text{ so that } \pi(0) = 0 \text{ and } \pi'_{\varepsilon_i} < 0 \quad (4)$$

A negative (positive) output shock thus induces the policymaker to tolerate positive (negative) inflation. Finally, governments prefer output expansions to contractions. Technically the marginal utility of an increase in output is constant and equal to 1 for simplicity.

Equilibrium policies deviate systematically from the first best, reflecting the government proclivity for using monetary policy to boost activity beyond its potential and the inflationary impact of the waste of tax money levied through distortionary instruments. In other words, instead of pursuing a policy of

ommitment to full structural reforms which may be costly in the short term but beneficial in the longer term, the authority may opt for inflationary tax which would face less opposition and counterproductive in the long run.

A vast literature suggests that the solution to this inflationary bias lies in the delegation of monetary policy to an agency (an independent central bank) whose motivations differ from the policymakers' objective (DMP 2008). The main drawback of the independent central bank model is that independence could be threatened when the incentive to engineer a monetary expansion overwhelms the cost of reverting to pure discretion (McCallum 1995). In other words, central bank independence can only tame inflationary bias if the costs of removing such independence are large enough.

Another solution to the inflationary bias problem, when national reform is impossible or incredible is the formation of a regional monetary union. In a monetary union, monetary policy is formulated by a regional/supranational central bank, whose actions maximize a weighted average of individual governments' utility functions.

$$U^{RCB} = \sum_{i=1}^n \omega_i U_i^G \quad (5)$$

With  $\omega_i > 0, \forall i$  and  $\sum_{i=1}^n \omega_i = 1$

The Phillips curve faced by the supranational central bank for each member of the monetary union (M) becomes:

$$y_i = y_N + c(1 - \theta_i^M)(\pi_M - \pi_M^e) - ct_i - \sum_{k \in M} \theta_{i,k} c(\pi_k - \pi_k^e) + \varepsilon_i, \forall i \in M, \quad (6)$$

With  $\theta_i^M = \sum_{k \in M} \theta_{i,k}$

The time consistent policy mix yields the following solution for common monetary policy inflation rate:

$$\pi_{MU}^* = \frac{\gamma \mu b}{\Lambda} \tilde{g}_{G,A} + \frac{\gamma(1 + \mu) + b - \theta_A(b + \gamma)}{\Lambda} c - \frac{\eta a(b + \gamma)}{\Lambda} \varepsilon_A \quad (7)$$

$\theta_A$  captures the extent of the monetary policy externalities internalized through participation in the monetary union. A higher  $\theta_A$  will ensure that average equilibrium inflation in the union is lower.  $\theta_A$  is determined by the size of the union and the intensity of intra-regional trade linkages. All things being equal, the model implies that a large group of high-inflation countries with strong regional trade linkages would expect to gain more from monetary unification than a small group of low-inflation countries with limited regional trade. DMP model, in a nutshell, demonstrates that centralized monetary policy brings about lower inflation across

the union but it is less effective at stimulating output in each individual country because there is no gain to expect from a depreciation of the national currency against trading partners in the region. The major cost of unification lies in the inadequacy of the regional monetary policy in the face of country-specific shocks. Hence, pointing to the importance of countercyclical fiscal policies, effective transfer and risk-sharing mechanisms.

### 3.1 The Challenge of Fiscal Policy Coordination

The DMP model assumes away fiscal policy yet this aspect is important if monetary union is to be effective. However, regional fiscal policy coordination is difficult to implement; each country prefers dealing with fiscal policy rather than surrender it to a regional group. Apart from the seeming loss of sovereignty, the characteristics of countries are dissimilar across, for example, countries may be at different stages of economic development. Furthermore, priorities of countries differ. Within each country, it is rather difficult to coordinate fiscal policy. Theoretically, macroeconomic management implies the coordination of fiscal and monetary policy by the finance arm of government and the central bank. However, in practice, even in countries with central bank independence, the coordination is generally not smooth and more often the pressure comes from the fiscal side of the equation. Where there are huge deficits, the implementation of monetary policy becomes challenging. Table 3 below shows that all the countries in the WAMZ were unable to satisfy the deficit/GDP criteria for convergence indicating the presence of fiscal dominance. It is, therefore, apparent that regional fiscal policy coordination is crucial for the 'success' of a monetary union. But to formulate and implement such a policy remain an onerous task (Ekpo and Afangideh 2010a; Ekpo and Afangideh 2010b; Ekpo 2011).

## 4 Monetary Integration in West Africa

### 4.1 Historical and Institutional Arrangements

Countries in West Africa have been experiencing one form of economic integration or the other since the colonial era. The colonial administrations (French, British, Portuguese, Spanish, etc) tried to integrate the colonies into their economies as suppliers of raw materials and consumers of their finished products and even replaced the local currencies (e.g. cowries) with their currencies (British pounds sterling, French franc, Portuguese real and Spanish silver dollars).

In the 1970s, three economic groupings emerged: the first, established in 1972, was West African Economic community (presently known as West African

Economic and Monetary Union (WAEMU) or UEMOA (French acronym)). The second was ECOWAS founded in 1975 and the last was Mano River Union founded in 1976.

Over the years, the francophone countries have maintained their WAEMU backed by France and later the European Union. ECOWAS has been less successful in achieving its primary goals of greater economic and monetary integration due to some factors including, the low level intra-regional trade, unsatisfactory implementation of the trade liberalization scheme, parallel monetary arrangements and lack of political will (WAMI 2004).

In 1999, five of the non-WAEMU ECOWAS countries opted to start the process that would launch a second monetary union to be named WAMZ. Initially scheduled to be actualised in 2003, the WAMZ programme has been extended more than twice, to 2005, 2009 and now 2015 as a result of the poor performance of the member countries on the macroeconomic convergence criteria.

To complement efforts at economic integration and foster the realisation of improved economic growth and welfare of the citizens of the member countries, ECOWAS monetary Cooperation Programme was launched in 1987. The main goal of EMCP was the introduction of the ECOWAS common currency within 5 years of its implementation. This terminal date has since been revised several times and it is now pending the full-fledged operation of the WAMZ and common currency.

Some of the institutional and policy measures implemented in pursuit of the ECOWAS monetary Cooperation Programme include the following:

- (a) Establishment of the West African Monetary Agency (WAMA) in 1995
- (b) Trade and exchange controls
- (c) Exchange Rate Alignment
- (d) Market-oriented monetary controls
- (e) Payments system improvement
- (f) Design of an ECOWAS Exchange Rate Mechanism (EERM)

## 4.2 Macroeconomic Convergence

According to European Union Commission (1990, pp. 4–28), monetary union requires virtually complete convergence of economic variables. The well-functioning of a monetary union is not limited to macroeconomic convergence of its member countries alone, but it demands the convergence in policy preferences, or at least agreement on the policy objectives and therefore on the weighting of targets and choice of instruments of economic policy.

Some scholars, like De Grauwe (2006), have argued vehemently that political and fiscal convergence is critical for a sustainable monetary convergence process. They argue that political union would allow for the establishment of the systems of fiscal transfers which could help deal with asymmetric shocks and create mechanisms for mitigating cases of moral hazard arising from these transfers. The success of the German political and monetary unification and failure of

previous monetary convergence projects like the Latin and Scandinavian monetary unions support De Grauwe's argument.<sup>2</sup> In the contemporary era, the Euro Sovereign Debt Crisis in Euro Zone further supports the need for political and fiscal convergence as the basis for successful monetary convergence.

Given that meeting the macroeconomic convergence criteria is very crucial for entry into monetary union, and a guarantee of its smooth functioning, member countries must attain and comply with certain target requirements that need to be satisfied before and after launching the monetary union.

For West Africa, these criteria have been classified into two groups: the primary and secondary criteria. The primary criteria are four, namely:

- Criterion on single digit inflation rate
- Criterion on Budget deficit as a percentage of GDP
- Criterion on central bank financing of government deficit
- Criterion on Gross reserves/import cover

The secondary criteria, though important, are not necessarily required to be achieved before launching the monetary union. Examples include:

- Ratio of tax revenue to GDP target
- Wage bill criterion
- Criterion of public investment financed from tax revenue
- Interest rate criterion
- Stock of domestic arrears criterion

ECOWAS countries are still currently far from achieving the criteria. Tables 1, 2 and 3 show the macroeconomic performances of ECOWAS member states in pursuit of the convergence criteria. Most of the countries in the CFA zone met the central bank financing criterion but not the fiscal deficit and foreign reserve criteria. The non-WAEMU countries did not satisfy most of the criteria either.

The failure of the countries within the sub-region to comply with the convergence criteria should be thoroughly investigated. Perhaps one of the biggest flaws that have marked the failure of most monetary union process is lack of commitment to the convergence rules. Fiscal discipline and political will are required on the part of the integrating countries to reap the benefits of common currency area.

Unlike monetary policy, fiscal policy is infinitely more complex, involving many trade-offs among competing interests. At the national level policy is constrained tightly by various pressure groups and political priorities (Devereux and Wilson 1989). Thus, international pressure to comply with convergence rules is inevitably overwhelmed by domestic considerations. For instance, the Maastricht rules that bound the Euro countries together were almost immediately broken by

<sup>2</sup> Latin Monetary Union existed from 1865 until 1927, with Belgium, France, Italy and Switzerland as members and later joined by Bulgaria, Greece, Romania, San Marino, Serbia, Spain and Venezuela. The Scandinavian monetary union existed between 1873 and 1914 with membership comprising Denmark, Sweden and Norway (Jacicovic 2012).

**Table 1** ECOWAS countries position with respect to the convergence criteria, 2005–2009 averages (inflation rate)

WAEMU	Inflation rate (in percent)
Benin	4.1
Burkina Faso	4.4
Cote d'Ivoire	3.1
Mali	4.1
Niger	4.7
Senegal	2.9
Togo	4.1
Average	3.9
<b>Non-WAEMU:</b>	
Guinea	11.5
Nigeria	10.9
Ghana	14.5
Guinea-Bissau	3.7
Cape Verde	3.6
Sierra Leone	11.9
The Gambia	4.3
Average	8.6
ECOWAS average	6.3
Target for end-2009	≤5

Source: African Development Indicators 2011

France and Germany in response to domestic economic and political pressures.<sup>3</sup> If compliance posed a challenge to European countries with more developed political and economic institutions, there is no reason to expect faster progress towards convergence from Africa.

## 5 The European Experience with Economic Policy Coordination

In the context of the European Union, economic policy coordination is explicitly mentioned in the Treaty of Maastricht, Articles 103(1) and 103(3) as a common objective of member countries. According to the economic coordination framework, the European Central Bank (ECB) takes charge of designing and implementing single monetary policy while other economic policies notably budgetary and structural policies as well as labour market and wage determination remain the responsibility of individual national governments.

The European Economic and Monetary Union (EMU) also has a comprehensive system of coordination procedures. Within the system, interactions among policy actors, including monetary and fiscal actors and the European Commission as

<sup>3</sup> Adherence to the convergence criteria is more strictly enforced these days following the Euro zone debt crisis.

**Table 2** ECOWAS countries position with respect to the convergence criteria, 2005–2010 averages (other indicators)

WAIFEM countries	Central bank financing/ total revenue	(Budget deficit)/GDP (fiscal balance/GDP)	Foreign reserve (months of import cover)
The Gambia	10.6	0.8	4.7
Ghana	2.9	10.4	3.1
Guinea	15.0	4.6	1.6
Liberia	–	(0.7)	2.0
Nigeria	–	1.7	15.8
Sierra Leone	8.6	6.5	4.9
<b>CFA countries</b>			
Benin	1.3	3.3	9.2
Burkina Faso	2.0	9.0	5.7
Cote d'Ivoire	2.5	1.4	3.1
Guinea Bissau	6.2	11.4	6.6
Mali	1.6	5.4	5.2
Niger	2.1	5.8	3.8
Senegal	–	5.9	3.7
Togo	4.4	2.1	4.0
<b>Others</b>			
Cape Verde	–	8.4	3.5
Target	≤10 %	≤4 %	≥6 %

Source: Central banks, WAMA, World Bank and regional economic outlook

**Table 3** Fiscal deficit (excluding grants) as % of GDP in the WAMZ

Country	2005	2006	2007	2008	2009	2010
The Gambia	–7.4	–2.7	–1.0	–3.3	–8.6	–8.5
Ghana	–6.9	–7.0	–9.5	–10.6	–7.0	–8.2
Guinea	0.0	–0.3	0.4	–1.2	–6.5	–14.5
Nigeria	1.2	1.3	–0.6	–0.2	–3.3	–5.8
Liberia	–0.5	12.4	12.4	–2.3	1.1	6.8
Sierra Leone	–1.4	–1.6	–0.8	–3.4	–3.0	14.1

Source: WAMI's data base

representative of the common interest are well spelt out. Methods used in policy coordination vary from information exchange, discussion of best practices, policy dialogues and peer review to policy rules and objectives as well as other jointly determined actions, when appropriate.

In the process of policy coordination the principle of subsidiarity and differences in national preferences are respected. The degree and mechanisms for coordination differ according to how persuasive the economic justification for coordination in the particular policy area is. Relatively strong forms of coordination are applied where spill-overs are obvious. For instance, the severity of the danger posed by fiscal risk justifies close rule-based coordination of macroeconomic matters regarding budgetary policies. In structural policy field, weak coordination in the form of information exchange, peer review and discussion of best practices, are adopted. Nonetheless, to provide a level playing field, some structural policies like those

relating to labour, product and capital markets are subjected to relatively stronger forms of coordination (see Table 4).

The broad economic policy guidelines (BEPGs) serve as the central guidance for economic policy coordination process in the EMU. BEPGs aim at presenting integrated broad recommendations for policy actors on macroeconomic and structural policies; and providing benchmarks for ex-post assessment in the context of multilateral surveillance. Unfortunately, the BEPGs are not legally binding. Compliance is voluntary and based on political will and peer pressure.

The annual coordination process starts and ends with the BEPGs. The coordination process starts in June with the adoption of BEPGs by the ECOFIN to provide inputs in the budgets' preparations, employment guidelines, macroeconomic dialogues and economic reforms in product and capital markets. Between October and December, member states submit updates on stability and convergence programmes as well as progress report on economic reforms. These are assessed by European Commission and ECOFIN in January. Between December and February, Employment Council adopts the Employment Guidelines. By March, member states are expected to submit their National Action Plans and Macroeconomic dialogue begins at technical level and at political level in May. Adoption of the BEPGs by ECOFIN takes place in June and the cycle continues.

It should be noted that economic policy coordination process is a learning-by-doing process and through regular review and information obtained from Implementation Reports subsequent BEPGs have been re-shaped in line with future focus and needs.

There are limitations associated with this model of coordination. First, it is based on one-size-fits-all approach that a sound economic policy can be determined for all countries at all times. Second, the fiscal criteria for convergence (such as deficit as percent of GDP of 3 %, debt ratio of 60 % and a fiscal balance of near zero) are not derived from explicit principles and objectives of economic policy. Third, it reduces the interaction between monetary and structural policies to a one-way relationship from structural policies to monetary policy ignoring the fact that monetary policy can be instrumental in providing the proper incentives for structural reform.

The Eurogroup tasked with the responsibility for economic policy coordination has not been given sufficient decision power. Hence despite some progress in statistical information, it has not been able to establish collective vision of the global economic situation of the Eurozone (Jacquet and Pisani-Ferry 2000).

The introduction of the Euro in 1999 offered great economic attraction in terms of countries credit rating and trade gains. Countries with lower credit ratings were able to borrow money hiding behind the superior rating of the stronger member states. In addition, the currency prevented competitive devaluation among member states. Thus, the attractive economic gains from admittance to the Eurozone without sufficient enforcement mechanism for nations failing to meet the convergence criteria created strong incentive for nations to lie their ways into the Eurozone. For instance, Eurostat reported that Greece's 2003 budget deficit was actually 4.6 %

Table 4 Forms of economic policy coordination in EMU

Policies	Form of coordination	Mode of co-ordination	Actors involved	Procedures
<b>Single policy</b>				
<b>Monetary policy</b>	Single policy (euro area)	Single institution	ECB	
<b>Exchange rate</b>	Single policy (euro area)	Coordination in the council	Council ECB	
<b>Competition policy</b>	Single policy	Implementation by the commission	Eurogroup Commission Member states Commission Council	
<b>Close co-ordination</b>				
<b>Budgetary policy (balances)</b>	Treaty rules Commonly agreed rules and objectives	Coordination in the council	Member states Commission Council	Excessive deficit procedure, stability and growth pact, Broad Economic Policy Guidelines (BEPGs)
<b>Structural policies</b>	Information exchange Peer review Rules Joint decisions Council directives Peer review	Joint fora Coordination in the council	Eurogroup Member states Council Commission ECB Commission Council Eurogroup Social partners	
<b>Weak co-ordination</b>				
<b>Policy-mix</b>	Dialogue Information exchange	Joint fora	Commission Council Eurogroup Social partners	

(continued)

Policies	Form of coordination	Mode of co-ordination	Actors involved	Procedures
Budgetary policy (quality of public finances)	Commonly agreed objectives	Coordination in the council	Member states Commission Council	BEPGs, stability and growth pact
Wage developments	Dialogue Information exchange	Joint fora	Eurogroup Social partners Commission Council ECB	Macroeconomic dialogue (Cologne process), BEPGs
Labour market policies	Information exchange Discussion of best practices Guidelines Peer review	Coordination in the council	Member states Commission Council Social partners	Employment guidelines (Luxembourg process), BEPGs
Product and capital market policies	Information exchange Discussion of best practices Guidelines peer review	Coordination in the council	Member states Commission Council	Reports on economic reform (Cardiff process) BEPGs
External representation and communication	Agreement on a common understanding	Joint fora	ECB Eurogroup Commission	

Source: Culled from *Europapers*, "Coordination of economic policies in the EU: a presentation of key features of the main procedures," European Commission: Directorate-General for Economic and Financial Affairs, July 2002

of GDP, rather than the 1.7 % of GDP previously reported (European Commission 2004).

This example demonstrates the risk involved in the monetary unification. The monetary unification strips national governments of the natural macroeconomic stabilization weapon (monetary policy) and leaves them with the singular option of a national fiscal policy. Though the Maastricht Treaty organizes a common surveillance of national fiscal policies, with ceilings for budgets and public debts, lack of proper communication and cooperation from the union members engender uncertainty and wrong prediction of national policies with dire consequences like the Greece's case. Hence, Sachs and Sala-i-Martin (1991) have suggested that the monetary union is a risky programme if not accompanied by the development of a federal fiscal system.

## 6 Lessons for the Proposed ECOWAS Monetary Union

In designing the policy coordination framework for the proposed ECOWAS monetary union, the following should be learned from the European experience. First, in order to strengthen the coordination process, members of the proposed MU need to gradually develop an economic policy philosophy that goes beyond mere procedures and criteria. It will make economic policy system of the MU transparent and reduce uncertainty on the future orientations of monetary and fiscal policies in the union. It is equally important to evolve principles that guide economic policy decision and market expectations.

Second, the formulation of these principles should be entrusted to a group of qualified experts and unquestionable personalities. The final outcome of series of debates and discussions will form a draft economic policy charter. The economic policy charter should amongst other things include: (i) assignment principles for responding to economic shocks; (ii) rules of conduct for fiscal policy behaviour that would make clear how the budget is managed over the cycle and how governments envisage to respond to unexpected revenue windfalls (shortfalls).

Third, coordination requires more transparency and predictability in economic decision makers not necessarily change of their decisions according to the common good. The quality of policy-mix can be greatly improved with transparency and predictability of each decision maker orientations and reactions to shocks. To achieve greater transparency and predictability, progress must be made in the following areas:

- The quality and homogeneity of statistical information must be improved
- Qualitative advances with respect to infra-annual information on public finances are required for national budgets to be monitored effectively
- The common central bank policy needs to be clarified. For instance, inflation target should be more precise and when undershooting or overshooting occurs it must be corrected with much vigour.
- Member states should adopt contingent fiscal policy principles.



Fourth, a collective executive body should be formed to organize the executive function needed to define and implement economic policy orientations or joint decisions according to the guidelines. The executive body would associate national finance ministers and would make fiscal policy recommendations to the monetary union member states. This collective executive body must be able to adopt strategic economic policy guidelines, white papers on structural reform, as well as specific economic policy resolutions or recommendations. It must also be able to take a position on international policy coordination and exchange rate issues.

Fifth, there should be better interaction between the monetary union procedures and national decisions. For instance, national public finance programmes should be collated at the regional level to enable a review of the aggregate union fiscal prospects and policy stance before the national programmes are scrutinised.

## 7 Conclusion

The paper examined monetary unification and the role of economic policy coordination. From the theoretical exposition, monetary unification has substantial benefits in terms of lower inflation rate and macroeconomic stability. However, these gains come with the sacrifice of the ability to implement national monetary policies to counter country-specific output shocks. Drawing from the experience of European monetary union, the paper argues that with appropriate economic policy coordination framework, monetary unification can become a win-win situation with benefits accruing to the entire monetary zone. The lesson for the ECOWAS countries is that monetary unification is not a substitute for domestic economic reforms. The structural reforms must take place first to provide the infrastructure for a more fruitful unification.

However, the key to a desirable holistic policy coordination framework is in examining the fiscal side of the equation. Coordination implies that each country's deviation from fiscal target is checked to maximize the welfare of the entire monetary zone. Regional fiscal policy coordination is necessary if monetary union is to be successful. A regional fiscal coordination framework could serve as a catalyst and political economy driver of useful public financial management reforms to ensure fiscal discipline and improve service delivery in Monetary Union member countries. Whether countries are willing to allow for such coordination is the big question?.

## Appendix

■ ECOWAS countries position with respect to the convergence criteria, 2005–2010 (overall budget deficit)

WAIFEM countries	(Budget deficit)/GDP (Fiscal balance)/GDP $\leq 4$ %						Average
	2005	2006	2007	2008	2009	2010	
The Gambia	(8.4)	2.7	1.0	2.7	4.0	2.9	0.8
Ghana	6.9	12.9	14.5	19.50	4.30	4.10	10.4
Guinea	1.6	2.0	0.9	1.7	7.5	14.0	4.6
Liberia	0.9	(3.0)	3.4	2.0	(1.1)	(6.6)	(0.7)
Nigeria	1.3	0.6	1.2	0.20	3.30	3.80	1.7
Sierra Leone	9.5	8.5	5.0	7.1	2.7	6.1	6.5
<b>CFA countries</b>							
Benin	4.6	2.5	1.8	3.5	4.9	2.5	3.3
Burkina Faso	9.1	10.5	12.1	8.3	6.2	7.5	9.0
Cote d'Ivoire	2.7	1.5	1.4	2.2	(0.9)	1.6	1.4
Guinea Bissau	24.2	18.7	13.7	12.2	(1.8)	1.1	11.4
Mali	7.3	7.9	5.6	2.8	5.1	3.8	5.4
Niger	9.6	6.4	6.7	4.2	5.7	2.4	5.8
Senegal	4.7	6.8	7.1	7.2	4.9	4.6	5.9
Togo	4.1	4.0	2.3	2.3	0.6	(0.6)	2.1
<b>Others</b>							
Cape Verde	11.0	10.4	3.6	6.5	6.8	12.0	8.4

■ ECOWAS countries position with respect to the convergence criteria, 2005–2010 (foreign reserve/imports)

WAIFEM countries	Foreign reserve(months of imports cover) $\geq 6$ %						Average
	2005	2006	2007	2008	2009	2010	
The Gambia	3.8	4.7	4.9	3.4	5.2	6	4.7
Ghana	3.4	3.3	3	1.8	3.2	3.7	3.1
Guinea	0.9	1.4	1.1	1	3.1	1.9	1.6
Liberia	0.8	1.6	2.2	0.9	2.4	4.3	2.0
Nigeria	10	22.9	21.6	15.9	16.3	7.8	15.8
Sierra Leone	4.5	4.5	4.5	4.4	7.0	4.6	4.9
<b>CFA countries</b>							
Benin	7.7	10.5	12.2	7.7	7.8		9.2
Burkina Faso	3.8	4.3	7.3	5.1	7.8		5.7
Cote d'Ivoire	2.2	3	3.4	3	3.9		3.1
Guinea Bissau	6.4	6	7.2	6.8	6.6		6.6
Mali	5.5	5.6	5.6	3.7	5.6		5.2
Niger	2.9	4.3	4.2	4.3	3.3		3.8
Senegal	3.9	3.9	3.9	2.7	4.3		3.7
Togo	1.9	3.4	3.9	4.8	5.9		4.0
<b>Others</b>							
Cape Verde	3.2	3.8	4.4	2.7	2.8	4.2	3.5

Fourth, a collective executive body should be formed to organize the executive function needed to define and implement economic policy orientations or joint decisions according to the guidelines. The executive body would associate national finance ministers and would make fiscal policy recommendations to the monetary union member states. This collective executive body must be able to adopt strategic economic policy guidelines, white papers on structural reform, as well as specific economic policy resolutions or recommendations. It must also be able to take a position on international policy coordination and exchange rate issues.

Fifth, there should be better interaction between the monetary union procedures and national decisions. For instance, national public finance programmes should be collated at the regional level to enable a review of the aggregate union fiscal prospects and policy stance before the national programmes are scrutinised.

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However, the key to a desirable holistic policy coordination framework is in examining the fiscal side of the equation. Coordination implies that each country's deviation from fiscal target is checked to maximize the welfare of the entire monetary zone. Regional fiscal policy coordination is necessary if monetary union is to be successful. A regional fiscal coordination framework could serve as a catalyst and political economy driver of useful public financial management reforms to ensure fiscal discipline and improve service delivery in Monetary Union member countries. Whether countries are willing to allow for such coordination is the big question?.

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WAIFEM countries	(Budget deficit)/GDP (Fiscal balance)/GDP) ≤ 4 %						
	2005	2006	2007	2008	2009	2010	Average
The Gambia	(8.4)	2.7	1.0	2.7	4.0	2.9	0.8
Ghana	6.9	12.9	14.5	19.50	4.30	4.10	10.4
Guinea	1.6	2.0	0.9	1.7	7.5	14.0	4.6
Liberia	0.9	(3.0)	3.4	2.0	(1.1)	(6.6)	(0.7)
Nigeria	1.3	0.6	1.2	0.20	3.30	3.80	1.7
Sierra leone	9.5	8.5	5.0	7.1	2.7	6.1	6.5
<b>CFA countries</b>							
Benin	4.6	2.5	1.8	3.5	4.9	2.5	3.3
Burkina Faso	9.1	10.5	12.1	8.3	6.2	7.5	9.0
Cote d'Ivoire	2.7	1.5	1.4	2.2	(0.9)	1.6	1.4
Guinea Bissau	24.2	18.7	13.7	12.2	(1.8)	1.1	11.4
Mali	7.3	7.9	5.6	2.8	5.1	3.8	5.4
Niger	9.6	6.4	6.7	4.2	5.7	2.4	5.8
Senegal	4.7	6.8	7.1	7.2	4.9	4.6	5.9
Togo	4.1	4.0	2.3	2.3	0.6	(0.6)	2.1
Others							
Cape Verde	11.0	10.4	3.6	6.5	6.8	12.0	8.4

■ ECOWAS countries position with respect to the convergence criteria, 2005–2010 (foreign reserve/imports)

WAIFEM countries	Foreign reserve(months of imports cover) ≥ 6 %						
	2005	2006	2007	2008	2009	2010	Average
The Gambia	3.8	4.7	4.9	3.4	5.2	6	4.7
Ghana	3.4	3.3	3	1.8	3.2	3.7	3.1
Guinea	0.9	1.4	1.1	1	3.1	1.9	1.6
Liberia	0.8	1.6	2.2	0.9	2.4	4.3	2.0
Nigeria	10	22.9	21.6	15.9	16.3	7.8	15.8
Sierra leone	4.5	4.5	4.5	4.4	7.0	4.6	4.9
<b>CFA countries</b>							
Benin	7.7	10.5	12.2	7.7	7.8		9.2
Burkina Faso	3.8	4.3	7.3	5.1	7.8		5.7
Cote d'Ivoire	2.2	3	3.4	3	3.9		3.1
Guinea Bissau	6.4	6	7.2	6.8	6.6		6.6
Mali	5.5	5.6	5.6	3.7	5.6		5.2
Niger	2.9	4.3	4.2	4.3	3.3		3.8
Senegal	3.9	3.9	3.9	2.7	4.3		3.7
Togo	1.9	3.4	3.9	4.8	5.9		4.0
Others							
Cape Verde	3.2	3.8	4.4	2.7	2.8	4.2	3.5

■ ECOWAS countries position with respect to the convergence criteria, 2005–2010 (central bank financing/total revenue)

WAIFEM countries	Central bank financing/total revenue $\leq 10\%$						
	2005	2005	2005	2005	2005	2005	2005
The Gambia	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ghana	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Guinea	(8.8)	(8.8)	(8.8)	(8.8)	(8.8)	(8.8)	(8.8)
Liberia	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nigeria	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sierra Leone	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>CFA countries</b>							
Benin	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Burkina Faso	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cote d'Ivoire	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Guinea Bissau	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Mali	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Niger	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Senegal	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Togo	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others							
Cape Verde	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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