The Eco and Ghana: West Africa's single currency

J. Atsu Amegashie

First version: September 8, 2019
Revised version: June 5, 2020

At the end of an ECOWAS summit in Abuja, Nigeria on June 29, 2019, fifteen countries in West Africa, including Ghana, agreed to adopt a single currency called the Eco in 2020. Negotiations for a single currency or monetary union in West Africa began about thirty years ago.

Sovereign nations other continents or subregions have adopted single currencies. Since January 1999, nineteen countries in Europe have surrendered monetary sovereignty through the European Economic and Monetary Union. They use a currency called the Euro. The CFA Franc Zone in West Africa is a group of countries with a similar arrangement.

What are the benefits of relinquishing monetary control? Should Mexico, Argentina, and even Canada abandon their national currencies and adopt the US dollar? The analytical framework for examining the pros and cons of a single currency was developed more than five decades ago by the Canadian economist and Nobel prize-winner, Robert Mundell in a 1961 article titled "A theory of optimum currency areas."

To examine the economics of a single currency, it is important to ponder a fundamental question. What is the function of a common medium of exchange such paper money? A key function of money is that it facilitates trade or economic transactions. A common currency facilitates trade among the countries in the currency union. For example, if Ghana and Nigeria adopt a common currency, trade between them will be much quicker and easier; this will increase the volume of trade. Under the current arrangement, buyers and sellers in both countries have to undertake foreign exchange transactions before trade can take place. A buyer in Ghana needs to convert her Cedis into Naira before completing a transaction with a seller in Nigeria. A common currency does not require the time, administrative work, and effort required for these foreign exchange transactions. It also means that economic agents within the monetary union do not have to worry about foreign exchange risk between any two member countries.

On the preceding point, a body of academic work has shown that the adoption of the Euro boosted trade among Eurozone countries. However, without the removal of restrictions (e.g., import quotas, tariffs, duties, etc) on the movement of persons, goods, and capital, the necessary conditions for a single currency to boost trade may not exist. There is no evidence that the CFA Franc has boosted trade among the countries in the CFA monetary union. The African Continental Free Trade Area, whose secretariat will be in Accra, offers some hope.

While a common currency facilities trade among countries, it has a major disadvantage. By belonging to a currency union, Ghana and Nigeria will each lose monetary control. The Bank of Ghana and the Central Bank of Nigeria will cease to exist or will become part of the Central Bank of West Africa. Each country can no longer conduct an independent monetary policy in

response to country-specific macroeconomic imbalances. Suppose there is an increase in unemployment in Nigeria. If Nigeria has its own currency, it could manipulate its interest rates, expand its money supply, etc to stimulate the economy. It could also allow its currency to adjust to boost the economy, if it has a floating exchange rate. In a currency union, it gives up this autonomous monetary authority. However, if there is sufficient labor mobility between Ghana and Nigeria, then the cost of losing monetary control will be very low. In the example above, the unemployment problem in Nigeria will be less severe if Nigerian workers could easily move to Ghana for employment. But can they freely move to Ghana for jobs?

Furthermore, the loss of monetary control will not be a big problem if the economic cycles (i.e., recessions and booms) of Ghana and Nigeria are synchronized. If a recession occurs simultaneously in both countries, then the central monetary authority (i.e., the Central Bank of West Africa) will implement a policy in the interest of both countries. The problem arises when economic cycles are not synchronized. Under these circumstances, the economic interests of both countries diverge resulting in the need for different monetary and exchange rate policies. At the height of the recent financial crisis in Greece, some economists complained that being in the Eurozone constrained what Greece could do. They argued that if it had its own currency (e.g., Drachma), it could have allowed it to adjust to boost exports.

Thus, a single currency is unlikely to work well if the countries in a currency union have very different macroeconomic conditions. This is why, like the Maastricht criteria or the euro convergence criteria, a country must meet some common macroeconomic criteria to join the West African monetary union. These are a budget deficit of not more than 3%; average annual inflation rate of less than 10%; Central Bank financing of budget deficits should be no more than 10% of the previous year's tax revenue; and gross external reserves worth at least three months of imports must be available. But what if a country met these conditions when it joined the union but countries but failed it to meet them in subsequent years?

To ensure compliance with the rule that a country's budget deficit should not exceed 3% of its GDP, the European Commission has "The Excessive deficit procedure ... an action ... against any European Union (EU) Member State that exceeds the budgetary deficit ceiling imposed by the EU's Stability and growth pact legislation. The procedure entails several steps, potentially culminating in sanctions, to encourage a Member State to get its budget deficit under control, a requirement for the smooth functioning of Economic and monetary union (EMU)." In a recent report, the European Commission concluded that that 10 of the proposed budgets of member countries, including that of Greece, were fully compliant with the provisions on debt and deficit set by the Growth and Stability Pact. Three states were "broadly compliant" and five states – Belgium, France, Portugal, Spain and Slovenia – were warned that they risk "non-compliance" and should adjust their plans.[1]

Will any Ecowas member country, say Ghana or Nigeria, accept these instructions from the ECOWAS equivalent of the European Commission? In any case, why are such rules on budget deficits required in a monetary union like the Eurozone but not in a monetary union like Canada, Ghana, or the USA? The federal government of Canada does not put restrictions on the budget

[1]https://www.irishtimes.com/business/economy/irish-budget-wins-blessing-of-european-commission-1.3705553

deficits of the provincial governments of Manitoba, Ontario, Alberta, British Columbia, etc. This, in part, is because a country like Canada or Switzerland is not only a monetary union but also a fiscal union. These countries have fiscal tools at the federal level (in addition to monetary tools) to deal with economic shocks and disparities and also incentivize these sub-national governments. For example, under Canada's system of Fiscal Equalization Payments, the federal government transfers federal tax revenues to various provinces (regions) to equalize fiscal capacities across provinces. Section 36(2) of Canada's Constitution Act (1982) states that "Parliament and the government of Canada are committed to the principle of making **equalization payments** to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

It is instructive to look at the organizational structure of European Central Bank (ECB). The ECB, headquartered in Frankfurt (Germany), is the central bank of the 19 European Union countries which have adopted the euro as their common currency. Its main task is to define and implement monetary policy for the euro area and carry out a number of other tasks, ***including banking supervision***. It is formally accountable to the European Parliament.

The Governing Council of the ECB is the main decision-making body of the ECB. It consists of six members of an Executive Board (which includes the president, currently the former IMF boss, Christine Lagarde, and a vice-president) and the governors of the national central banks of the 19 euro-area countries. The six members of the Executive Board have permanent voting rights (i.e., have the right to vote at every meeting). The 19 governors of the national central banks do not have permanent voting rights. They take turns to vote on a monthly rotation. In principle, the six members of the Executive Board – unlike the governors of the national central banks -- do not represent any country. Thus, they are ***expected*** to act in the interest of the Eurozone and their permanent voting rights is intended to ensure that this encompassing objective is achieved. In this system, each national central bank is subordinate to the ECB and has no autonomy over monetary policy, banking supervision, payment systems, foreign exchange rules, etc.

If the ECOWAS central bank will have a structure that is similar to the ECB's structure, it must determine the allocation of voting rights among its 15 national banks. In the Eurozone, countries are divided into groups according to the size of their economies and financial sectors. The governors from countries ranked first to fifth – currently, Germany, France, Italy, Spain and the Netherlands – share four voting rights. The other 14 countries share 11 voting rights.

A monetary union comes with certain challenges. It is not surprising that the launch of West Africa's single currency has been postponed several times. **The challenges of the Eurozone and the European Union (EU) also offer food for thought**. According to a November 2019 article by Gyorgy Matolcsy, Governor of the Central Bank of Hungary, the single currency in the Eurozone was created primarily for political reasons. He opined that:

"… a common currency was needed to strengthen the bond between European powers and defend the EU against the Soviets. ... There was only one snag: the final decision to create the euro was made in Maastricht in 1992, as the Soviet Union collapsed. ... Europeans must give up their risky fantasies of creating a power that rivals the US."

It is also important to note that the eurozone has 19 of the 27 members of the European Union. For example, the Scandinavian countries (Denmark, Norway, Sweden) and Switzerland are members of the EU but are not members of the Eurozone. And the UK was a member of the EU but it left in 2019 in what is known as "Brexit".

During the 2008-2010 financial crisis, the relatively fiscal responsible northern states like Germany and France felt that fiscally irresponsible southern states like Greece, Spain, and Portugal were not pulling their weight. This was a source of tension. And in May 2020, the German Constitution Court (GCC), based in Karlsruhe, ruled that the European Central Bank's (ECB) bond-buying program — which has helped to prop up the European single currency — failed a "proportionality test" by not taking into account its broad economic effects. It also stated that the European Court of Justice (ECJ), based in Luxembourg, had been acting beyond its authority, when it declared the ECB's bond-buying legal. In response, European Court of Justice stated that it has always held that the legality of the acts of EU bodies can only be determined by the European Court, not national courts in order to prevent the chaotic situation where EU acts are legal in one state and not another. Hungary and Poland — whose governments are rapidly eroding their national democracies — have both seized upon the GCC's ruling to justify their own efforts to ignore EU law. A clash between national law and EU law, a threat to the cohesion of the EU and Eurozone.

In August 1997 (one-and-half years ***before*** the euro was introduced in 1999), the late Milton Friedman, then at the University of Chicago, wrote an article titled "**The Euro: Monetary Unity To Political Disunity?**". After a thorough analysis, partly informed by the theory of optimum currency areas, he concluded his essay as follows:

"The drive for the Euro has been motivated by politics not economics. The aim has been to link Germany and France so closely as to make a future European war impossible, and to set the stage for a federal United States of Europe. ***I believe that adoption of the Euro would have the opposite effect. It would exacerbate political tensions by converting divergent shocks that could have been readily accommodated by exchange rate changes into divisive political issues**.*

To summarize, it is in the interest of a group of countries to adopt a common currency if (i) labor is sufficiently mobile among the them, (ii) their economic cycles are sufficiently synchronized, and (iii) there are fewer market frictions in the monetary union.

There is no Asian monetary union. Yet, it is a fairly prosperous region with at least eight economic "Tigers": China, Hong Kong, Singapore, Malaysia, Japan, Vietnam, Taiwan, South Korea, etc. We can't cut corners.

*J. Atsu Amegashie is a professor of Economics at the University of Guelph in Canada.