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Monetary Unions and its Discontent: An Institutional Analysis of the West African Monetary Institute

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Abstract

The mission of the West African Monetary Institute (WAMI) is to create a common Central Bank and monetary unit for the regions member countries. In recent years, we have seen regional blocs forge agreements to strengthen their competitive advantage. In the West African region, member states have begun the consolidation process with limited success. The recent Euro crisis has given monetary unions globally an opportunity to reexamine their goal of convergence. In this study, the researcher conducts an institutional analysis to examine the ongoing pursuit of monetary and fiscal convergence among member countries. Finally, it is important to note that monetary convergence is of paramount importance because West African countries are too small to achieve economies of scale.

Keywords: Monetary Union, Negotiation strategy, Leadership, Culture, Conflict

1. Introduction

The West African Monetary Institute (WAMI) was formed in April of 2000 to create a common currency and Central Bank in the region. Currently, member countries such as Ghana, Liberia, Nigeria, Sierra Leone, Guinea and the Gambia operate autonomously with separate currencies, and monetary/fiscal policies. The WAMI was ultimately created as a temporary institution responsible for member country convergence, regulation and design of policy framework, exchange rate mechanisms, design of new currency, and finally creation of a new Central Bank in the region. Indeed, the West African region needed an integrated platform which would give a competitive advantage at the global stage. Now, with

the ongoing European zone crisis, the West African monetary zone (WAMZ) needs to reexamine their strategic positioning in order to avoid a future crisis of their own.

Some of the major attractions of a monetary union include: (a) the creation of a common economic space which enhances the achievement of economy of scale and space; (b) reduction in transaction cost and elimination of exchange risks; (c) achievement of low inflation rate; (d) increasing intra- regional trade transactions; (e) sustaining monetary and fiscal discipline amongst the member states; promotion of capital and technological transfers and (f) serving as a power bloc and countervailing influence against other blocs etc. To that effect, it is important to note that the benefits of belonging to a monetary union are not evenly distributed amongst member countries. For instance, the European monetary union is now faltering because some of its smaller member states (Greece and Spain etc.) did not meet the critical convergence criteria especially, the prescribed fiscal and inflation targets. Overall, the down side risk of a monetary union is the complete surrender of national sovereignty over the formulation of monetary and fiscal policy, by the participating states to the central bank of the monetary union. This implies that member countries in a monetary union cannot resort to the imposition of inflation tax to finance its budgetary deficit. Indeed, the benefits of convergence ultimately accrue proportionately to the participating member countries depending on: their state of preparedness, the relative size of their economies, as well as the mix of internal macro- economic policies which the member states are pursuing. Ultimately, the successful achievement of macroeconomic convergence is critical for the sustenance of a monetary union.

The challenges monetary unions face is arguably insurmountable, yet in recent years we have witnessed more regions attempting to converge. Consequently, this paper critically analyzes the internal/external mechanisms utilizing an institutional analysis framework to examine the WAMZ. Furthermore the paper examines the various setbacks the WAMI has faced to achieve its goal of full convergence.

2. Currency Convergence

According to Meade (2009), a monetary union is established to replace its members' national currencies with a single currency and establish a single central bank responsible for the monetary policy for the region. In a scenario whereby member states experience large idiosyncratic shocks, the union's monetary policy will not always be optimal for each member (Kenen & Meade, 2008). In this regard, the benefits of monetary union are more likely to outweigh the potential costs. Yet the adoption of a single currency is apt to foster further integration, including the integration of the financial sector, as is now occurring in Europe.

As it pertains to the West African Monetary Zone (WAMZ), the monetary union agenda had been in gestation long before the current Euro crisis. The effort to forge a monetary union in the WAMZ started with the Bamako treaty of 2000. Despite the current challenges faced by the Euro zone, various researchers such as (Nnanna, 2006, Kenen, & Meade 2008, Ugwu, & Allie 2009) assert, the benefits of a monetary union far outweigh its cost. To reiterate, some of the major attractions of a monetary union include: (a) the creation of a common economic space which enhances the achievement of economy of scale and space; (b) reduction in transaction cost and elimination of exchange risks; (c) achievement of low inflation rate; (d) increasing intra- regional trade transactions; (e) sustaining monetary and fiscal discipline amongst the member states; promotion of capital and technological transfers and (f) serving as a power bloc and countervailing influence against other blocs etc. (Nnanna, 2006). It is important to note that the benefits of belonging to a monetary union are not evenly distributed amongst the member countries. The benefits will accrue proportionately to the participating member countries depending on: their state of preparedness, the relative size of their economies, as well as the mix of internal macro- economic policies which the member states are pursuing. Successful achievement of macroeconomic convergence is critical for the sustenance of a monetary union.

3. WAMI Role in the Region

Monetary union is primarily driven by shared political and economic interests and sustained by political leadership. Typically, political-economy is at the heart of a monetary union and as such, the process is essentially 'rule based.' The rules of the game are governed by: international agreements, treaties and conventions.

The principal function of WAMI is purely technical and non- discretionary. Article 4 of the WAMI statutes specifies as follows: (1) undertake all the preparations necessary for the take-off of the West African Central Bank. (2) Monitor and assess compliance with the convergence criteria (3) adopt price stability as its central objective and strengthen the coordination of monetary policies in order to achieve that objective. (4) Make the necessary preparations for the conduct of a common monetary policy (5) make preparations for the issue of a common currency and (6) supervise the development of an Exchange Rate Mechanism and a West African Monetary Unit for settlements in the Zone. Article 6 of the WAMI statutes also confers it with advisory functions as follows: (i) The Management of WAMI may make recommendations or offer opinion concerning the monetary and exchange rate policy and related measures in each Member State. (ii) WAMI may make recommendations or offer opinions to governments of Member States and to the Council on such policies as might affect the internal or external monetary situation the Zone and as they affect the WAMZ program and the Zone's exchange rate system. (iii) The Management of the WAMI may also make recommendations to the monetary authorities of the Member States concerning the conduct of their monetary policy. (iv) Member States and their authorities shall consult with WAMI on any draft legislative provision or related legislation falling within the areas of competence of WAMI.

4. Key Convergence Criteria

The convergence criteria for the West African Monetary Zone (WAMZ) have two components: namely, the quantitative and qualitative convergence criteria. The quantitative convergence criteria are 10 consisting of 4 'primary' pillars and 6 'secondary' convergence criteria respectively. The 'primary' criteria consists of the following pillars: (a) the achievement of a single digit inflation rate, (b) maintenance of a fiscal deficit/GDP ratio (excluding grants) of less or equal to 4% (c) Central Bank financing of fiscal deficit as percent of previous year's tax revenue of less or equal to 10% and (d) maintenance of gross external reserves of at least three months of imports. The secondary convergence criteria are as follows: (1) maintenance of zero domestic arrears – implying a prohibition of domestic debt contraction by the government (2) achievement of a tax revenue to GDP ratio of greater than 20 per cent (3) wage bill to total tax revenue ratio of less than or equal to 35 per cent (4) achievement of exchange rate stability (defined as a variability of plus/ minus 15 per cent from the base) (5) maintenance of a positive real interest rate and (6) achievement of public sector investment equal or greater than 20 per cent of total tax revenue per annum. The WAMZ statute stipulates that each member country must achieve the primary quantitative convergence criteria within the specified timeframe – initially, three years (2000-2003) and later extended to 2009 and now to 2015) in order for the monetary union to take off. The successful achievement of the primary convergence criteria by the member countries is indicative that the countries have reached a state of fiscal discipline. However, the commencement of the monetary union is not predicated on the achievement of the secondary and qualitative convergence criteria by the WAMZ member states.

The data below represents the real GDP in % of growth for the member countries.

Table 1. Performance Indicator

WAMZ	Real GDP Growth (%)										10 Yr avg
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	
The Gambia	-3.2	6.7	7.7	5	5.1	6.5	4.7	5.6	6.3	6.1	5.05
Ghana	4.5	5.2	5.5	5.6	5.7	5.3	4.8	5.1	6.5	7.8	5.6
Guinea	4.2	1.3	2.5	3.2	3.1	2.4	1.8	4.5	1.2	3.8	2.8
Nigeria	1.5	10.7	3.5	7.4	7.7	6.1	7.8	7.1	7.67	8.6	6.807
Sierra Leone	27.5	8.6	7.4	7.5	7.4	4.3	8	5.4	3.2	5.3	8.46

Source: African Development Bank

The ‘qualitative’ convergence criteria comprised the adoption: of the Economic Community of West African States (ECOWAS) common external tariff, statistical harmonization, adoption of ECOWAS trade liberalization scheme (ETLS), harmonization of the payments system infrastructure, unification of the financial system regulatory framework and unification of the capital markets. Overall, fiscal pressures, external debt burden, political and social instability and lack of institutional capacity are factors which have contributed to the failure to achieve the primary quantitative convergence criteria in the WAMZ.

5. WAMI and the Central Banks

It is now common knowledge that the Director General at WAMI must work with the various Central Bank heads in the region in order to achieve the goal of convergence. Typically, the policy domain of the Central Bank is in the formulation and implementation of monetary and financial policy. Generally, as heads of organizations dedicated to the pursuit of monetary policy, the Director General of WAMI and the Governors of the Central Banks of the member states have common educational background, speak the same monetarist ‘lingo’ and share the same concern regarding the dangers of runaway inflation, exchange rate volatility and financial system instability which a bad monetary policy can impose on the economy. Consequently, these parties always reached a common policy framework which invariably focused on the pursuit of non- expansionary monetary policy especially, when the economy of a member country is over-heating. To that effect, Okwu Nnanna the former head of WAMI noted that “the biggest challenge he faced was convincing the fiscal authorities that no country has ever succeeded in spending itself to prosperity (growth and development) when the macro-economic fundamentals are wrong”. The fiscal authorities of some member states (especially, those experiencing social and political unrests), believed that the sole purpose of creating a central bank is for it to print money for the President of the respective countries and their ministers of finance to spend. Fiscal indiscipline still remains a major obstacle in the West African region and arguably is the bane to the successful creation of monetary union in West Africa.

6. The Role of the Director General

The role of the director general of WAMI can viewed as broker of deals amongst the member countries. Specifically, the appointment and responsibilities of the Director-General of WAMI are stated under Article 8 of the Statute as follows:

1. The Director-General shall be appointed by the Authority of Heads of State of Member Countries on the recommendation of the Council (comprising ministers of finance, justice, economic development and governors of central banks). The Director-General shall be selected from among persons of recognized standing and professional experience in monetary, financial or banking matters. Furthermore, only nationals of Member States may be appointed Director-General of the WAMI. The Director-General shall be appointed for a term of two years.
2. The Director-General shall be responsible for the day-to-day management of the WAMI. He/she shall prepare and chair the meetings of the Management Board of the WAMI. He/she shall present the views of the WAMI in the Zone and externally.

Overall, the statutory functions of the WAMI and its Director-General can be summarized in two words: monitoring and evaluating (M&E). In this regard, the Director-General and the institution can 'bark' but cannot 'bite' and this is typically a major limitation of the institution and its Director – General.

In an interview session with the former Director General (DG) Okwu Nnanna of WAMI, the DG emphasized utilizing a hands-on approach. In this regard, WAMI assisted the member countries to formulate sound fiscal and monetary policy programs which are consistent with the primary and secondary convergence criteria of the monetary union. However, the policies were not always implemented faithfully by the member states. In order to ensure that the country programs/annual budgets are faithfully implemented, the DG directed WAMI staff to conduct macro-economic surveillance missions to the member countries every six months even though the mission of the institute specifies annually. The DG opined a more proactive monitoring and evaluation stance would assist the member countries to avoid policy slippages and non- achievement of their performance targets. However this assumption turned out to be misplaced because the lack of political will and strong political leadership in the member states undermined the monetary union process. Very often, policy implementation in the member states can become muddled in the domestic politics, leading to the failure of country programs. And unfortunately neither the staff of WAMI nor the Director-General can do anything about it. Alas, when moral suasion failed to deliver the desired economic results, the DG adopted the strategy of: 'name and shame' and 'name and praise'. Accordingly, he authorized the publication of the results of the macro-economic surveillance missions in the hope that peer group pressure will influence positive behavioral change from the policy makers in the poor performing member countries. This policy of name and shame represented a radical departure from the past when the names of the member states were never disclosed in the annual performance score-card during the Convergence Council Meetings. As a result of the new leadership style, policy makers in the member countries were compelled to take the monetary union project more seriously. In no time, substantial achievement of the convergence criteria was recorded.

In the end, the monetary union process gradually came to a stand-still when Presidents Obasanjo of Nigeria and Kufour of Ghana completed their tenure in office and were succeeded by leaders who lacked their enthusiasm and political will to drive the monetary union process forward. The greatest challenge every DG has is the inability to persuade the Heads of State of the WAMZ to imbibe budgetary discipline. For a monetary union to succeed, the member countries must achieve and sustain fiscal consolidation.

7. Success and Failure of WAMI

According to the DG, one of the major achievements of WAMI was securing financial and technical grants from the African Development Bank which enabled some member states to finance the creation of a modern payments system infrastructure based on Real Time Gross Settlement System (RTGS), in order to facilitate intra- regional payments and settlements. Additionally, the DG convinced the member states to abandon the use of hard currencies for the settlement of their intra-regional trade transactions. Presently, most WAMZ member states use their domestic currencies for intra-regional trade settlement, instead of relying on the dollar or euro as units of account and medium of exchange. Finally,

trade liberalization was strengthened amongst the member states, thus leading to the increase of intra-regional trade from 10 per cent in 2006 to over 13 per cent in 2008.

The failure of political leadership and lack of political-will from the major member states of Nigeria and Ghana and pervasive fiscal pressures in the member states were the critical factors which frustrated the WAMZ monetary union between 2004 - 2008, despite the exceptional proactive monitoring and evaluation strategy of the WAMI which enabled two member countries to meet the four primary convergence criteria in two consecutive years (2006/2007), unlike in the past when no member country succeeded. During the interview the DG noted that he should have persuaded the convergence council to allow any pair or more countries that met the primary convergence criteria to kick-start the monetary union, without waiting for all to meet the convergence criteria for the commencement of the monetary union. Indeed a sequential approach to convergence is more rational than a big bang. After all, if this strategy were to be adopted, other countries can be allowed to join the monetary union at a later date when they have satisfied the primary convergence criteria, as was the case in Europe when Germany and France started the Euro monetary union.

Under the WAMZ Statute of 2000, WAMI was given the responsibility of driving the monetary union project without being granted the commensurate authority to sanction member states who failed to comply. The advisory and monitoring functions of the WAMI are prescribed in Articles 6 & 7 of the WAMZ Statute. Whereas, member states are required to consult the WAMI in the formulation of their monetary and fiscal policies, nevertheless, there is no penalty for non-compliance. The researcher contends, the major failure of the WAMI is its lack of power to enforce compliance. Alas, the organization is bereft of 'carrots' and 'sticks'.

Other than the WAMI and the various heads of states, the Governors of the member central banks were also victims of institutional weakness. As heads of central banks devoid of legal independence, they lacked the legal power to say 'NO' to their fiscal authorities (Mr. President and Minister of Finance), who regularly call on them to finance their annual budget deficits. It would be recalled that one of the pillars of convergence is the prohibition of central bank financing of government deficits. Consider this, if WAMI had the legal power to enforce compliance and the Governors of the member central banks also had the legal power to turn down demands for deficit financing, the achievement of the primary convergence criteria would not have been such a time consuming exercise as it were.

8. Concluding Remarks

The present crisis in the Euro-zone monetary union must not deter the WAMI from forging ahead with its monetary union project. Nevertheless, the WAMZ monetary union project must be pursued in tandem with the deepening of the political union. Without strong political-will and leadership, monetary union shall be prone to cyclical economic crisis. The researcher firmly believes that all aspects of the convergence project are connected. In other words, all countries and businesses stand to benefit from the monetary union. Ultimately, the rationale for convergence will create a common economic space which enhances the achievement of economies of scale and scope for countries and companies in the region. Furthermore, the union reduces transaction cost and eliminates exchange rate risks for companies buying and selling goods regionally, and finally it promotes capital accumulation and technological transfer. Indeed monetary unions have its problems. In fact, the recent Euro crisis illuminates the various burden member countries bare during and post convergence. In the final analysis the benefits still outweigh the risk.

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