FOREIGN AFFAIRS

Does West Africa Need a Single Currency?

The Region Should Heed the Lessons of the Eurozone

BY ESWAR PRASAD AND VERA SONGWE **August 18, 2021**

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Over a decade ago, the leaders of the Economic Community of West African States (ECOWAS), a regional trade bloc of 15 countries with a total population of roughly 400 million, committed to establishing a monetary and currency union by the end of 2020. In other words, they agreed to renounce monetary sovereignty and adopt a common currency managed by a single central bank. Eliminating multiple currencies, th believed, would dismantle barriers to the flow of goods, money, and

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people and lay the foundations for greater prosperity. Ultimately, they hoped their regional monetary organization might blaze a trail to an Africa-wide currency union that could unite the continent and expand its influence on the world stage.

But 2020 has come and gone, and the ECOWAS currency union has yet to break ground. Despite the initial rush of enthusiasm around the project, the goal of a currency union has slipped further and further out of reach in recent years. Prior to the 2020 deadline, virtually no ECOWAS country had attained the economic benchmarks the group had established as preconditions for the union. And then came the COVID-19 pandemic, which wreaked economic carnage in West Africa, as it did in much of the world, and sent member states into economic survival mode.

Although the pandemic has set back the goal of a West African currency union, it has also highlighted the need for greater economic integration that could better insulate African countries from the whims of international financial markets. Had ECOWAS had a robust monetary union in 2020, its members might have been able to pool their resources to better protect their currencies and to negotiate more favorable terms with foreign creditors when global markets crashed in March and April, and investors raced toward the safety of the U.S. dollar.

ECOWAS leaders have now set the more realistic goal of establishing a currency union by 2027, but the path there will not be easy. As the experience of the European Union and other currency zones has demonstrated, such projects necessitate difficult tradeoffs that have the potential to divide member states. West African leaders should heed the lessons of these monetary experiments and proceed toward a monetary

union of their own with caution—and only once they have built sufficiently strong economic and institutional foundations.

AN UPHILL BATTLE

The ECOWAS currency union faced considerable challenges from the get-go, not least being the very different stages of development of the bloc's member states. Six of its 15 members are middle-income states, with estimated annual incomes of at least $1,000 per capita. The other nine are low-income states, with per capita incomes falling below $600 in Liberia, Niger, and Sierra Leone. Countries at such divergent economic stages are unlikely to reach a consensus on short-term economic priorities even in the best of times, making it difficult to develop a uniform monetary policy for all of them.

Other economic disparities among ECOWAS states pose similar challenges to a regional currency zone. Nigeria, which is now the largest economy in Africa, accounts for about two-thirds of ECOWAS's total GDP. By contrast, the bloc's five smallest economies—Cape Verde, Gambia, Guinea-Bissau, Liberia, and Sierra Leone—together account for less than two percent of the group's GDP. The disparity in population among these countries is only slightly less stark. Two-thirds of ECOWAS residents live in just three of its member countries: Côte d'Ivoire, Ghana, and Nigeria. These discrepancies in size raise the possibility that large countries could dominate policymaking in a currency union, boxing out smaller member states that have little sway as it is.

Variations in economic structure add to the challenge of designing a currency union for such a heterogeneous region. Many ECOWAS economies are not well diversified and rely heavily on the sale of raw

materials and resources. The result is that commodity price fluctuations have very different effects across the region. Nigeria, for instance, is a major oil exporter, and the other ECOWAS members are net importers. So while an oil price increase might benefit Nigeria, it would likely hurt the rest of the region. GDP growth and inflation also vary widely across ECOWAS countries, adding to the difficulty of managing regional economic fluctuations under a uniform monetary policy.

Existing regional currency arrangements that would overlap with any potential ECOWAS currency zone present yet another challenge. Eight ECOWAS countries—Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo—are already members of a long-standing currency union: the West African Economic and Monetary Union, which in turn is part of the euro-pegged CFA franc zone. Another ECOWAS member, Cape Verde, also has a currency that is pegged to the euro. Although WAEMU countries have begun transitioning away from the euro and toward an independent currency, their economies need time to adapt to the loss of a credible external anchor before they adopt a new currency.

THINKING OUTSIDE THE BOX

Given the array of serious obstacles to an ECOWAS monetary union, West African leaders would do well to look to the successes and failures of other monetary and trade configurations for insight. The fate of the eurozone, for instance, is a cautionary tale in moving hastily toward a single currency. The union's lack of mechanisms to effectively prevent macroeconomic imbalances, combined with low borrowing costs and the undisciplined budgetary policies of some member states, precipitated the eurozone debt crisis that began in 2009. Poor enforcement of rules meant

to bring member states' monetary policies in line with their commitments to the zone and the subsequently harsh castigation of countries in fiscal and economic distress have likewise fostered economic and political tensions among eurozone countries. These challenges suggest that the eurozone could be fortified by a broader economic union, including a banking union, a unified financial regulatory system, and harmonized institutions underpinning the functioning of labor and product markets. These are certainly long-term considerations for ECOWAS leaders but important ones on their path toward economic integration.

The eurozone does have one critical advantage: it is anchored by Germany and several other relatively wealthy and well-managed states, including Austria, France, and the Netherlands. These economies underpin the credibility of the zone, and their resources effectively provide insurance to other member states when the economic tide is ebbing. An ECOWAS currency union would presumably be anchored by Nigeria. But although Nigeria is wealthier than other countries in the region, it faces profound economic challenges, including dependence on volatile oil prices, high inflation, political instability, and weak public governance. A currency union anchored by an economically unreliable Nigeria would likely face credibility problems from the outset, defeating its very purpose.

One alternative to a monetary union—or a steppingstone to one—that could spur growth and accelerate regional integration without the added political complications of a common currency can be found in Asia. The ten members of the Association of Southeast Asian Nations have established an extensive network of financial and trade arrangements but

retained monetary policy autonomy. This has allowed them to foster economic integration and to speak with a more unified voice on important economic and geopolitical issues while avoiding any tensions that might arise from trying to coordinate their monetary and fiscal policies. Should they continue to pursue a currency zone, ECOWAS leaders might consider starting with similar small steps toward trade and financial integration as precursors to a more durable monetary union.

Some such efforts are already slowly underway. The African Continental Free Trade Area, which the African Union brokered in 2018 with the aim of creating the largest free-trade area in the world, promises to substantially reduce barriers to the free movement of commodities, goods, and services across the continent. It will also give Africa the opportunity to speak with a common voice on global trade policy issues in which it has a large stake. In addition, ECOWAS itself has moved to dismantle trade barriers among its member countries—by adopting a common external tariff, for instance. These initiatives have so far had only a limited impact, in part because of lingering disharmony between domestic and regional policies, but they represent important steps toward greater economic collaboration—and they do not preclude the possibility of an ECOWAS monetary union in the future.

Indeed, ECOWAS members could reap enormous rewards from a resilient and carefully crafted currency zone. Done right, such a zone could improve trade and investment flows in the region and shore up member states' defenses against external shocks. With a strong central bank at its center, a currency union could also serve as an anchor for inflation expectations within the zone. It could impose discipline on fiscal policies, since states would face pressure from other members to avoid

reckless government spending that could result in large government budget deficits. And a currency union could facilitate important labor and market reforms by forcing member states to find ways to respond to domestic and external shocks without looking to the exchange rate.

But setting up a currency union is no simple matter. Especially given the range of disparities among member states, the loss of an independent currency and monetary policy as an economic adjustment mechanism could lead to short-term economic pain in some member countries—necessitating initial wage reductions and fiscal belt tightening, for instance. ECOWAS countries should therefore focus on getting their own economic houses in order and putting in place institutional mechanisms to ensure widespread fiscal discipline and accountability before considering a currency union.

An ECOWAS currency zone promises considerable potential payoffs. But it also entails significant costs, operational challenges, and transitional risks that ECOWAS leaders must consider carefully before moving too quickly—or they risk making their currency union an economic straitjacket rather than a foundation for jobs, growth, and prosperity.

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