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**West African monetary unification : the case for a common currency.**

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*Award date:*  
1986

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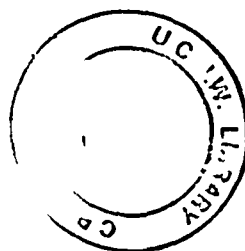
**WEST AFRICAN MONETARY UNIFICATION:  
THE CASE FOR A COMMON CURRENCY**

by

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BSc (Econ) USL; MA (Econ) Wales

A Thesis Presented in Fulfilment of the Requirements  
for the Degree of Doctor of Philosophy of the  
University of Wales



August 1986

To my parents, Ya Maikay, Alimamy Yillah,  
Sorsor and Wara, and to the memory of my  
grandmother, Ya Fatu and close friend and  
brother, Bockarie Kargbo.

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## ACKNOWLEDGEMENTS

It is difficult to acknowledge all persons and institutions from whom I have drawn help in pursuing this Study. It is obligatory, however, to record my very special debt and gratitude to Dr J S A Funna (Governor, Bank of Sierra Leone), and the Bank of Sierra Leone for providing the urge and financial sponsorship.

For the research itself I relied on the valuable experience, intellectual guidance and inspirational support of my supervisor, Mr Dudley J Peake. He painfully read through each line and page, provided much information and made countless corrections and modifications. Additionally, he enhanced my personal welfare and provided me with a very friendly research atmosphere.

Significantly, I never turned to feel or regret the temporary loss of all aspects of my family life, support and association throughout my research as these were more than sufficiently provided by Dr J L I Williams (Warden, Neuadd John Morris Jones), his wife, Irene Williams, their two children - Lowri and Robin - and several close associates to the family, especially Nain (Irene's mother), Hellen Parry-Williams, and the administrative and domestic staff of Neuadd John Morris Jones.

Special thanks also go to Kate Kumah (Financial Consultant, Kabel Halsey Group, UK), Dr Beulah Leitch (Midland Centre for Neurosurgery and Neurology, West Midlands), Dr Chris Ameyaw-Akunfi (Cape Coast University College, Ghana), and the staff of the Arts Library, the Department of Economics and the Institute of European Finance (UCNW) for variously supporting my research.

I am affectionately grateful to my family, especially Liz, Lucy, Samura and Gibril, and close friends at home and abroad, especially Messrs Brimah Conteh and James A Kamara both in the Bank of Sierra Leone, for their sympathetic support and understanding throughout my academic career.

Finally, my warm appreciation goes to Helen Treece of the Institute of European Finance, UCNW, for the excellent typing and setting of this thesis.

Any errors, of course, are my own.

## SUMMARY

In recent years, scholarly attention on the complementary role of monetary integration to further economic integration in developing countries has tended to emphasise the direct and indirect benefits of 'limited monetary integration' while neglecting considerations of those benefits likely to accrue from adopting a common currency or fixed rates of exchange between their national currencies. However, the decision by the Heads of State and Government of the 16 members of the Economic Community of West African States (ECOWAS) in May 1983 requesting a study of proposals leading to the creation of a single ECOWAS monetary zone has given a new scope and dimension of interest in the economics of common currencies.

The West African countries in their efforts to integrate and achieve higher growth and development are increasingly frustrated by a number of internal and external factors including their dependent, disintegrated and inefficient patterns of domestic production, trade and currency systems, in particular, the continuing weakness and increasing precariousness of their national currencies, and a succession of global monetary and financial crises. These constraints, together with the payments and adjustment problems they have occasioned, and the relative *unsuccessful* experiences in currency management, payments and exchange restrictions within the West African Clearing House (WACH) and the exclusively francophone West African Monetary Union (WAMU or UMOA), have created a need for extending and deepening the scope for monetary and economic co-operation in the region.

The Study advocates principally an all-embracing monetary union by means of a common currency as a strategic catalyst and timely element of realism that would create an impulse for national development and regional economic integration. Using basic propositions concerning aspects of monetary integration, stressing in particular the foundations of optimum currency areas, the Study tries to present a comprehensive and analytic discussion of the feasibility, processes, beneficial effects and constraints involved in achieving currency unification in the broader setting of West Africa's disparate economic and socio-political developments.

## LIST OF ABBREVIATIONS

AACB	Association of African Central Banks
ACMS	African Centre for Monetary Studies
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest
CEAO	Communaute Economique de l'Afrique de l'Ouest (West African Economic Community)
CFA Franc	Communaute Financiere Africaine (African Financial Co-operation) Franc
ECOWAS	Economic Community of West African States
MRU	Mano River Union
Senegambia	Senegal and The Gambia
WACH	West African Clearing House
WAMU	West African Monetary Union
WAUA	West African Unit of Account
UMOA	Union Monetaire l'Ouest Africaine (French acronym for WAMU)

**CHAPTER 1**  
**OBJECTIVE AND METHODOLOGY OF THE STUDY**

**1.1 RATIONAL, SCOPE AND HYPOTHESIS OF THE STUDY**

The sixteen countries which comprise the Economic Community of West African States (ECOWAS) represent a group which is diverse in terms of geo-physical conditions, natural resource endowment and overall economic performance. Amidst this diversity there are also a number of common socio-politico-economic elements: relatively low income levels; a relatively slow and in many cases declining rate of economic growth, especially in the seventies; desperate demographic trends; and sporadic instances of political instability - generally in the form of increased militarisation of political leadership. More specifically, the multiplicity of national currencies, the disparate levels of external and intra-regional inconvertibility between them, and the sporadic and unsettling speculative activities over changes in their international exchange values have ravaged the majority of West African countries, thus making financial and overall economic management as well as economic integration extremely difficult.

It is needless to point out that these adverse conditions have been accentuated by the collapse of the Bretton Woods system, the consequent protective floating of the major international currencies which are at the heart of the exchange rate mechanisms in West Africa, the volatility of the purchasing power of these currencies and the uncertainty about future developments towards a new and relatively more equitable international monetary system, as well as

by the 1973/74 and 1979/80 oil price crises and their concomitant effects on import and domestic prices.

The above factors have led to significant costs for West African countries resulting also from the high incidence of 'black market' and other illegal currency and commodity activities as well as from the transfer of seigniorage between countries and from the region as a whole. These in turn have involved substantial real economic costs associated with consequent unstable and rapidly expanding money supplies amid tighter exchange controls and payments restrictions, the continued weakness of many currencies and the erosion of even their internal (national) confidence, and the loss of overall financial resource mobilisation and utilisation efficiency.

In this perspective, the rationale of monetary integration among West African countries is with particular emphasis on its instrumentality for meaningful economic integration. The approach followed emphasises the politico-economic calculus of feasibility in a dynamic setting in contrast to the traditional approach of the literature on optimum currency areas. The various modalities of monetary integration are surveyed and a detailed discussion is offered of the major operational issues which arise in monetary unions.

Against the costs associated with the potential loss of national autonomy, especially the loss of the exchange rate as a basic policy instrument to deal with fundamental external disequilibria, participation in a currency union increases the role of a currency as a medium of exchange and as a store of value. The union should eliminate speculative capital and commodity flows among

participating countries and the costs associated with their control. It should increase capital mobility within the area and also reduce speculative flows between the area and the outside world. Intra-union trade is stimulated by reducing the risks involved.

Furthermore, a common currency improves monetary efficiency in the area through reserve saving, reduction in the cost of financial management, risk-pooling, intermediation, information saving and innovation (Mundell, 1973). It has been noted, however, that some of these potential benefits, and in particular reserve saving, are likely to be limited in the early stages of a monetary union when actual reserve-pooling is limited (Ishiyama, 1975). Some authors consider most important the potential benefits deriving from the effects of the establishment of a common currency area on government functions. In particular, it is believed that monetary integration is likely to be advantageous to the participating countries by accelerating fiscal integration (see Williamson, 1973; Ishiyama, 1975). On the other hand, the European experience so far seems to suggest that progress in fiscal integration can prove exceedingly difficult.

In this setting, monetary integration can be beneficial to West African countries. In particular, it will enhance regional convertibility and intra-West African trade by eliminating the costs associated with black market activities. It will facilitate the elimination of economic disparities among the member countries as well as the rationalisation of economic and financial dependence. Suffice it to say that where monetary union is formed between members more appreciable gains can be reaped. Monetary union in this case is characterised by two main elements:



- (a) the issuance of a single West African common currency, the flow of which is unrestricted among member countries, and
- (b) the establishment of a regional monetary authority which would pool foreign exchange reserves and enhance policy integration and regional monetary supranationality.

In recent years, West African countries, in common with several other regions among LDCs, have shown increased interest in the modalities and net benefits that might accrue from monetary integration. However, apart from the sub-regional common currency system within the institutional framework of the West African Monetary Union (WAMU), the scope of monetary integration in the region from a multilateral point of view has been restricted to the very rudimentary Clearing House arrangements. While the relevance of the WAMU for the ECOWAS as a whole has, however, to be critically qualified by the fact that France has fundamental participatory role in its operational framework and sustenance, the performance of the all-embracing West African Clearing House (WACH) is so far mixed and rather unsatisfactory. Intra-ECOWAS trade, regional currency convertibility and inter-state monetary and financial links which were meant to be enhanced under the Clearing House arrangements are still as low as before its creation and real progress in economic integration is hardly evident.

While there exists a considerable analytic literature on monetary unions, especially as they pertain to discussions regarding monetary integration among the developed industrial countries, there is still very little work at either the conceptual or empirical level on their likely impact on LDCs - notwithstanding the extent to

which the monetary and adjustment systems of many of these countries have been so adversely affected by the upheavals in the world economy and the international monetary system which culminated in the collapse of the Bretton Woods system. In particular, these discussions emerged during the 1960s in connection with the long-standing controversy about the pros and cons of fixed or flexible exchange rates, and were revived first, by the proposal for a common European currency as put forward in the Werner Report (1970) and, later with the creation of the European Monetary System (EMS) in 1979. It is here that the empiricism of the associated theory of optimum currency areas offers important considerations as to the conditions and constraints under which a country can join a currency group with positive net benefits and suggests how countries should be grouped into few and effective currency areas.

Monetary integration in this context is however relegated to the last (or at least a very late) step in economic and political integration as comprising two related bodies of theory: a stage theory of economic integration and a theory of monetary integration which also is now generally conceptualised into two distinct stages: partial (or limited) and complete (or full) monetary integration. Even where monetary integration is accepted in principle, there are still two generally unresolved issues. The first is whether monetary integration should precede, follow or develop alongside with economic integration. The second is whether the transition to monetary union should at the initial stage stress economic policy co-ordination and harmonisation before exchange rate rigidity (or currency unification) or vice versa (ie Economists versus Monetarists).

There is no doubt that these unresolved issues make the appreciation and choice of strategy for monetary integration more difficult for LDCs. Despite their having also shown increased interest in monetary integration in recent years, the experience of LDCs on this front appears rather limited, both in their understanding of the underlying concepts and of the choice of realistic options for them. The fact is that economic integration among LDCs is still basically of the conventional approach so that the achievement of a monetary union in particular is consistent with the stage process for attaining complete economic integration. Thus, while for them the recommended option is limited monetary integration as they are still at the rudimentary and early stages of economic integration, purely in terms of established currency area criteria also, LDCs do not possess the characteristics suitable for monetary union and therefore cannot adopt currency modification among them (Kafta, 1969 and 1973; Robson, 1983). It is further stressed that the idea of a payments union of the conventional type would not appear feasible, given their reluctance to expose themselves to the dangers of accumulating inconvertible balances in their reserves (Del Valle, 1978). By contrast, Mundell (1972) has argued that monetary integration should proceed from the 'top down, not from the grass roots up' and has therefore proposed a common currency for Africa as he has also done for Europe (1973).

It is, nonetheless, against the relatively unproven background of the inappropriateness of a monetary union for LDCs that this study attempts to reassess the critical role of monetary integration, in particular, currency unification, as a means to

revive the national economies of West Africa and further the process of economic and political integration within the region.

Up to date studies on West African monetary unification (eg Ijewere, 1976; Osagie, 1979; IMF, 1980; Cincin-Sain and Marshall, 1983; Frimpong-Ansah, 1983), virtually all of which have been undertaken at the instance of the ECOWAS Executive Secretariat, have generally ruled out monetary union as a shortrun or immediate option for the community. Limited monetary integration - ie a convertibility agreement for the exchange of national currencies in respect of all intra-regional transactions (IMF, 1980), the liberalisation of trade transactions first and then capital transactions (Cincin-Sain and Marshall, 1983) and/or the expansion of the Clearing House to incorporate trade credit and balance of payments support mechanisms (Frimpong-Ansah, 1983) - is still the most widely discussed and strongly recommended option for the member countries. More recently, however, the member countries have heightened the momentum of monetary integration among them by committing themselves towards the creation of an 'ECOWAS Monetary Zone' (undefined) and the Council of Ministers of the Community has been commissioned to 'supervise' its execution (resolution passed at the meeting of the Committee of Governors held in Arusha, Tanzania, August, 1983).

Economic arguments apart, monetary integration in any form must also be assessed significantly on geo-political and social considerations. All of these factors are closely related and, in addition to external developments, are variable and therefore obviously crucial in appreciating the choice, modalities and outlook of any strategy for any group of integrating countries. However, in

each of the previous studies on monetary integration in West Africa, there is little space and attention devoted to providing in one volume a comprehensive analysis of the economic background and non-economic constraints for economic development and integration. Besides, there is obviously little appreciation of the fact that, especially in the light of the changing international monetary environment, monetary integration in West Africa needs to be more positively approached and therefore deserves a new dimension in form and timing.

Deteriorating domestic economic performance and protectionism abroad (both in terms of trade and exchange rate management) should force this sudden change. The historic fragmentation of the West African socio-economic structures and, in particular, the growing disintegration in the infrastructure of monetary and financial arrangements and currency relationships constitute the major obstacle to economic rationalisation and regional integration. On a scale wider than that undertaken by any of the previous studies, this study makes analytic reflections on the major monetary and financial constraints to national development, evaluates the performance of ECOWAS and of both the West African Clearing House (WACH) and the West African Monetary Union (WAMU), and then defines a new role for monetary integration within the community's institutional framework, and in essence, proposes the institution of a single common currency as the short-run sine qua non of national development, regional convertibility and beneficial economic integration within the ECOWAS.

Finally, another important feature of this study is that it is timely and in many ways consistent with an outline of proposed background studies for the realisation of the 'ECOWAS Monetary Zone' (see Appendix I).

## 1.2 METHODOLOGY OF THE STUDY

The comparative analytic methodology adopted for the study is in three forms. Firstly, emphasis is placed on the structural differences, similarities and interaction of ECOWAS member countries with each other to reflect, in general, size, political and economic capacities. The collective nature of currency unification process becomes critical as the small and generally less prosperous member countries (eg Gambia, Cape Verde, Guinea-Bissau, Niger, Sierra Leone, Benin and Burkina) are taken to be of equal size and status in the union in relation to the large and economically and politically more advanced and powerful partners (ie Ivory Coast and Nigeria). The greater and more pronounced inter-member country differences are, the more critical are the implications of the associated polarization effects and the distribution of the costs and benefits of integration.

Secondly, the region is divided into three main groups, viz, countries within the WAMU, countries in the former sterling area, and a miscellaneous group that includes Liberia which, with the US dollar as national currency, has the most convertible currency and liberalised exchange transactions in the region.

Thirdly, comparative reference where relevant is made to other monetary and/or economic integration schemes. It is believed that any discussion of West African monetary integration would be greatly

enhanced by taking into account the integration experiences of other regions of the world as these experiences could be highly instructive by way of defining the major issues involved. As far as monetary integration is concerned, especially the available transition processes, the study has drawn substantially from discussions regarding monetary integration in Western Europe (notably the EEC).

As noted earlier, the case for monetary integration must reflect the existing and true structural characteristics of the member countries. In West Africa, many of these characteristics are deep-rooted and with a long historical perspective. However, the main statistical analysis is placed on developments since 1970 as the 1970s and early 1980s have represented the most critical years for the West African economies and the global economy. Of course, pre-1970 developments can also be taken into consideration where they are particularly relevant in shaping current trends and institutional arrangements (eg colonial influence on trade, banking and monetary policy structures).

Similarly, while theoretical considerations allow us to identify the important pre-conditions for beneficial monetary unification, it is important to recognise that they should not be regarded as preventing monetary unification in West Africa if they are not satisfied.

Throughout the study, sufficient emphasis is placed on providing a substantial critical, quantitative and qualitative discussion to enable us establish the nature and case for currency unification for West African monetary and economic integration and overall development.

### 1.3 DATA AND INFORMATION PROBLEMS

The severity of the problems of collecting and collating data and information for a study of this scale - involving sixteen developing countries with varied but generally low levels of development and with marked historical, political and socio-economic orientations - needs no further demonstration. Data and information in the majority of the LDCs are generally very scarce and even where available are hardly well documented, systematic and reliable. Of course, for the rather objective on-looker and/or especially for an objective study not initiated by them, national authorities are forced by political pressures and mistrust to regard all information and data as classified for security reasons.

At the regional level, however, the study has relied on four main sources for its background data and information: national central banks and fiscal authorities; the WACH Secretariat (Freetown, Sierra Leone); the ECOWAS Executive Secretariat (Lagos, Nigeria); and the African Centre for Monetary Studies - ACMS (Dakar, Senegal). The major difficulty with national data sources is updating. Because of the lack of adequate computer facilities, data in the Economic and Financial Review bulletins of most central banks are more than five years in arrears. Besides, differences in reporting languages as well as in the categorisation of data heads provide additional difficulties. In West Africa, the francophone countries are particularly more discrete with their published data and information than the anglophone states. Data and information from the WACH, ECOWAS and ACMS are obtained essentially from published and unpublished traditional reports and bulletins as well



as from reports and papers presented at organised seminars and conferences.

In this respect, the author was particularly fortunate to obtain substantial data and information through and from the Bank of Sierra Leone where he works and which is sponsoring this study. The frequent reference to developments in Sierra Leone is therefore understandable but this does not in any way bias the conclusions of the study.

Undoubtedly the most important sources of data and information, especially in terms of standardisation, reliability, originality and freshness are the IMF, World Bank, Commonwealth Secretariat and other related organs of the United Nations. Financial statistical data for example are obtained almost exclusively from the IMF's periodic specialised publications (eg International Financial Statistics - IFS; Government Finance Statistics - GFS; Balance of Payments; Article IV Consultations; and Country Reports).

These sources are also supplemented by such specialist periodic magazines and/or news bulletins on Africa (eg West Africa; Africa NOW; African Business; Africa Confidential) and South (the Third World magazine).

Throughout the discussion, efforts are made to ensure that supporting data and information are not only reliable but are also as current as possible.

#### 1.4 PLAN OF THE STUDY

The study is divided into 10 chapters. In Chapters 2 through 6, we analyse the socio-economic structural disposition of the West African economies. This background information is substantially policy-oriented and is deemed necessary to the understanding and appreciation of the scope and modalities of the currency unification proposal as a solution to the problems of development and economic integration in West Africa. To put it differently, these chapters together, carefully discuss the extent to which the member countries' structural and institutional characteristics have inhibited development and integration in general and/or can impair currency unification even when it is established.

Chapter 2 provides a brief survey of the region's geo-physical, economic and socio-political features and in particular discusses the disparate levels of resource endowment, industrial development, political instability and, income and growth.

Chapter 3 analyses the extent of economic co-operation in West Africa. It is hardly necessary to make a fresh case for West African economic co-operation or integration since, as will be shown in the chapter, there has been no lack of activity in recent years on this front. The need for economic co-operation and integration among LDCs in general is an assumption and does not need demonstration. Indeed, like most other developing countries, West Africa has emerged from the first and second UN development decades as the region registering some of the lowest rates of growth, and the indications are that many of the problems especially of the 1970s look like becoming larger and more difficult in the rest of the 1980s. The main emphasis in this chapter however is on the

reasons for the lack of real progress in economic integration in the context of the ECOWAS and the likely implications for monetary integration at the community level.

In Chapter 4 we analyse the present structure of West African trade. While trade between developed countries characteristically represents the major part of the total trade of these countries, that among LDCs in general amounts to only very small proportions of total trade. The bulk of LDC trade is with the developed countries. This pattern is characteristically true of West African trade. However, the intensity of the member countries' extra-regional and intra-regional trade structures and relations have varied significantly since the era of political independence. It is useful to identify these patterns and to try to understand the determining factors and mechanisms in order to perceive the scope and prospects of monetary integration, especially for intra-regional specialisation. Clarification of the monetary obstacles, in particular, for the expansion of intra-regional trade is stressed. This trade is basic to monetary and economic co-operation and integration and through its enhancement member countries are more likely to restructure their monetary, financial and overall economic structures and thus break the existing exclusively mutual structures of domestic consumption and production, a phenomenon that is the heart of the West African economic problem.

West Africa's overall external monetary and financial relations and the payments and adjustment problems they occasion, and which are emphasised in this study, create a need for extending and deepening the scope for monetary and economic co-operation among the member countries. In this perspective, the 'new' role required of

the region's money and banking system in its intermediation activity at the regional level goes beyond the characteristic need to enhance intra-regional trade which in itself provides little scope towards handling the region's payment problems in respect to total trade. In essence, West Africa's money and banking systems are required in their potential role to co-operate more closely in dealing with problems arising from deficiencies in international reserve assets and from the need to use the region's internal and external monetary resources more efficiently for national as well as regional stabilisation and growth. The fundamentals of such co-operation involve, first, the need for the money and banking institutions to improve in their rudimentary character and function and gear their operations more to West African needs; and second, the need for the institutions to enhance the process of the co-ordination and harmonisation of the institutional monetary and financial arrangements and policies of the member countries towards the achievement of currency unification.

To deal in part with these issues, Chapter 5 describes and analyses the money and banking system in West Africa in terms of its evolution, historic fragmentation and performance, as well as in relation to the disparate structure of monetary policy framework among the member countries.

In Chapter 6 we will examine West Africa's balance of payment problem and adjustment mechanisms. Manifestations of disintegration in exchange rate arrangements and other adjustment policies commonly adopted in the region are analysed, ie exchange controls and payments restrictions.

Chapter 7 provides a comprehensive survey of the different conceptualisations of 'monetary integration' and outlines its position as a roughly parallel theory to the stage theory of economic integration. Most of the discussion reviewed on this recognise there is a strong relationship between monetary integration and economic integration although the debate is whether the former should precede or follow the latter. To the extent that in practice monetary integration continues to be regarded as the ultimate stage of economic integration, ie completing the integration of trade and economic relations into a fully economic and political union, monetary integration among countries in the early stages of economic integration thus becomes an impracticable option. While the different monetary integration conceptualisations identify both the theoretical and empirical aspects of the transition towards monetary union, it is the hypothesis of the study that for West African monetary integration a less traditional analytic approach towards the currency unification objective is needed. Indeed, a clearer understanding however of the processes, modalities and potential net benefits and constraints associated with each conceptual route towards monetary unification is also a significant prerequisite for appreciating its achievements in West Africa.

Thus, the analytic review of the literature on optimum currency area theory in Chapter 8 is important as it provides specifically a basis for identifying those conditions and constraints that are considered necessary for a beneficial currency area formation between member countries. The empiricism of these conditions in relation to ECOWAS is tested although, as indicated earlier, the

failure of the ECOWAS to satisfy them should not be regarded as preventing currency unification among the member states.

Chapter 9 characterises the proposed West African monetary union and argues the case for a single common currency in West Africa in line with the analyses of the previous chapters. Available options for currency unification and the associated transitional problems are identified and discussed. The case for currency unification in the region is strengthened further as we critically assess the operational experiences of the WAMU and WACH and prove the inability of either scheme to improve the performance of the member economies or induce economic and/or monetary integration among them. Both institutions are examined in the study as practically the most important obstacle for realising the currency unification option for ECOWAS: WAMU, because it has existed for long more as a form of monetary convenience and source of socio-political unity among the francophones and between them and France, and the union is more or less in the process of expanding its membership to include new and former members of the CFA franc zone; WACH, because those member states which strictly regard their 'independent' monetary systems as the symbol of national sovereignty are distrustful of any new monetary integration ideas likely to threaten that sovereignty. In either case, the point, however, is that monetary sovereignty is already sufficiently threatened throughout the region. The relevant question therefore is simply whether this aspect of nationalism can be allowed to continue, albeit at the increasing expense of the member countries or whether the apparent loss of national sovereignty would not better serve

their interests and that of the West African region as a whole if sovereignty were restored to them in a concerted West African form.

Finally, it is argued in the chapter that an outright creation of a practically new currency for West Africa (by name and design) is much preferred to a system of variable exchange rate unification (ie with variable exchange margins) as this is by far less likely to insulate the member economies from the already rising incidence of illegal commodity and currency exchange practices that are strongly associated with foreign exchange shortage and the disparate levels of currency inconvertibility. Chapter 10 outlines the summary and conclusions of the study.

## CHAPTER 2

### SOCIO-ECONOMIC SETTING AND DEVELOPMENT PERSPECTIVES OF WEST AFRICA

#### 2.1 INTRODUCTION

A realistic appreciation of the opportunities, constraints and prospects of monetary and economic integration requires the initial systematic identification of participating countries in terms of relevant country/regional characteristics (eg geo-physical setting, economic structures, monetary and financial systems, socio-political systems, growth and development perspectives), the structure of interrelationships among them and the relative importance attached to each feature in determining a meaningful and workable integration strategy. The critical issue then is whether with respect to national and regional policy objectives, optimum or at least any viable integration should comprise countries which in terms of inherent characteristics are compatible because they are homogenous relative to those characteristics that need to be maximised; or because they are complementary; or because they are non-complementary but still believe they would best fulfil policy objectives, in a hierarchical system of functional independence which most countries would prefer. The initial problem is to choose from an almost infinite number of such integration characteristics to determine the path towards integration or identify those which constitute difficulties that are to be encountered after integration.

In essence, the basic features that characterise the West African countries are typical of most other LDCs and the rapid changes in them, especially since political independence, have



formed the basis for the rising interest in economic and monetary integration in recent years. In West Africa many of these developments are increasingly irreversible, thereby posing some of the most formidable problems of development and integration. As already indicated in Chapter 1, a clearer analytic understanding of these so-called structural realities and constraints is essential to fully appreciate the type of monetary integration that is advocated in the study as well as the urgency in the timing of such integration.

This chapter, as a first step, attempts to highlight the basic geographical, economic and socio-political setting of the West African region with a view to isolating some of the main background structural features that have immediate bearings on trade, monetary and financial patterns, and adjustment policies, all of which are at the heart of the integration process. We shall be concerned with trends over time as with developments currently or recently apparent. The areas stressed in the chapter include the geographical delimitation of West Africa - in particular, ECOWAS, its climate, vegetation and resource endowment, trends in production, income and growth, and recent political developments.

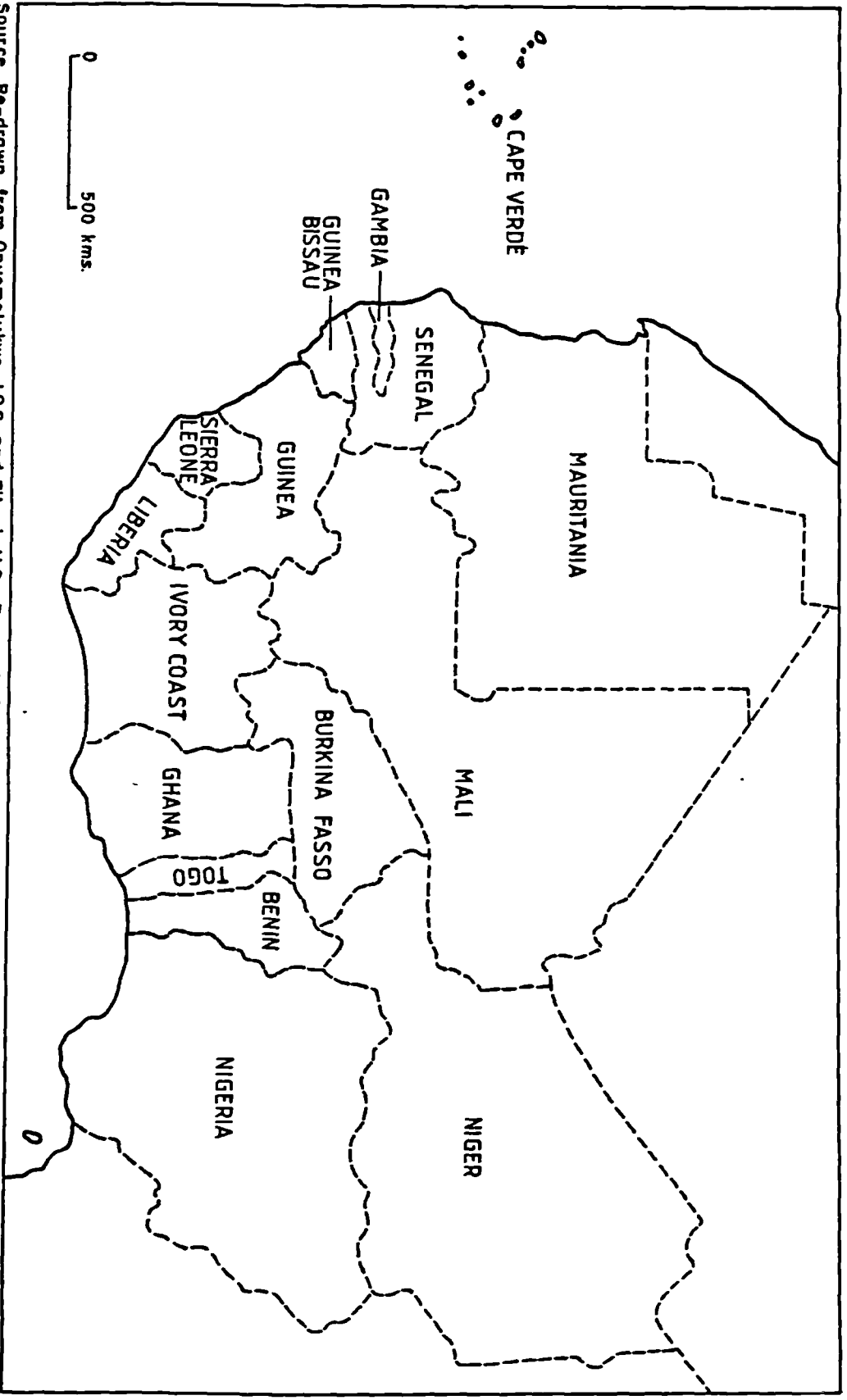
## **2.2 GEOGRAPHICAL DELIMITATION**

The geographical individuality of West Africa, in terms of the constituent countries, has been defined differently, depending mainly on grounds of historical, pure geo-physical, political and ethnographic backgrounds as well as on what the specific research intentions are on the region. As Plessez (1968) points out, West Africa is merely a geo-political expression and should not convey

the impression that it is already a single international region or market area.

Conventionally, West Africa is delimited as the area bounded by the Atlantic and lying south of the Sahara and west of the Cameroon. Geographically, this area is designated as stretching northwards from the Gulf of Guinea towards the southern margins of the Sahara and eastwards from the Atlantic coastlands towards central Africa. Alternative conceptions of West Africa have also reflected linguistic, cultural and botanical differences as well as relief.

Rimmer (1984, p 1) has observed however that many of these distinctions can be questioned and their significance appears uncertain. That West Africa as conventionally defined is more closely circumscribed owes more to diplomacy and administration than to geography or ethnography. In this respect, the major determining influence on the limitation of West Africa has been the colonial designation of the region into the Afrique Occidentale Francaise (AOF) or French West Africa and the British West Africa. This distinction clearly excludes the more southerly countries of equatorial Africa (ie Cameroon, Zaire, Chad, Gabon and the Central African Republic). Thus, except for Cape Verde (which comprises a horseshoe of ten volcanic islands about 450 kilometres west of Senegal and which became the sixteenth member of ECOWAS in 1977), all sixteen member states which make up the ECOWAS also compose the West Africa of conventional definition. The national boundaries of the community members are shown in Figure 2.1.



Source: Re-drawn from Onyemelukwe, J.O.C. and Filani, M.O., Economic Geography of West Africa, Longmans, 1983, pp. XII.

Fig. 2-1. Economic Community of West African States (ECOWAS): Member States.

Table 2A ECOMAS: Basic Indicators

	Area (000 sq km)	mid- 1981	1990	2000	Population		Growth (%)		Density 1981	GNP (market prices) \$m		% of total ECOMAS	Per Capita Average Annual Growth (%)	Purchasing power density (GNP/Area)		GDP Annual Growth (%)		
					Av Annual 1960 -70	1970 -81	1980 -2000	1981		1981	1981			1960-80	1960-80	1960-70	1970-81	
Benin	113	3.6	5	6	2.6	2.7	3.5	32	1,140	1.1	320	1.2	0.6	10,088	160	850	2.6	3.3
Burkina	274	6.3	7	9	2.0	2.0	2.9	23	1,490	1.4	240	1.6	1.1	5,438	200	1,080	3.0	3.6
Cape	4	0.3	-	-	-	-	-	75	113	0.1	340	5.5	-0.8	28,250	-	-	1.1	0.0 <sup>A</sup>
Gambia	11	0.6	-	-	-	-	-	55	220	0.2	370	3.1	2.58	20,000	20	211	5.4	2.8 <sup>A</sup>
Ghana	239	11.8	17	23	2.3	3.0	3.9	49	4,770	4.5	400	-2.6	-1.1	19,958	1,220	21,260	2.1	-0.2
Guinea	246	5.6	7	8	2.9	2.9	2.8	23	1,660	1.6	300	0.4	0.2	6,748	370	1,670	3.5	3.0
Guinea-Bissau	36	0.8	-	-	-	-	-	22	150	0.1	190	2.2	-	4,167	-	-	4.3	1.7 <sup>A</sup>
Ivory Coast	322	8.5	13	17	3.8	5.0	3.1	26	10,190	9.7	1,200	1.5	2.3	31,646	570	8,670	8.0	6.2
Liberia	111	1.9	3	3	3.2	3.5	3.5	17	1,010	1.0	520	-0.1	1.2	9,099	220	930	5.1	1.3
Mali	1,240	6.9	9	11	2.5	2.6	3.0	6	1,340	1.3	190	2.3	1.3	1,981	270	1,120	3.3	4.6
Mauritania	1,031	1.6	2	3	2.3	2.3	2.7	3	710	0.7	330	-1.0	-1.5	689	90	630	6.7	1.7
Niger	1,267	5.7	8	11	3.4	3.3	3.3	5	1,890	1.8	330	-0.8	-1.6	1,492	250	1,710	2.9	3.1
Nigeria	924	87.6	118	163	2.5	2.5	3.5	95	76,170	72.2	870	3.0	3.5	82,435	3,150	70,800	3.1	4.5
Senegal	196	5.9	8	10	2.3	2.7	3.0	30	2,530	2.4	430	-0.4	-0.3	12,908	610	2,330	2.5	2.0
Sierra Leone	72	3.6	4	5	2.3	2.6	2.9	50	1,140	1.1	320	-1.1	0.4	15,833	-	1,040	4.3	1.9
Togo	57	2.7	4	5	3.0	2.5	3.3	47	1,010	1.0	380	0.9	2.5	17,719	120	880	8.5	3.2
Total ECOMAS	6,143	153.4	205	274	2.7	3.3	3.2	35	105,533	100.2	685 <sup>C</sup>	0.98	1.01	17,179	7,250	113,181	4.2	2.7
Excl Nigeria	5,219	65.8	87	111	2.7	3.3	3.2	31	29,363	-	439 <sup>C</sup>	0.85	0.82	5,626	4,100	42,381	4.2	2.5

Sources: World Bank, World Development Report, 1983, 1984, 1985;  
 'Accelerated Development in Sub-Saharan Africa', 1981; and  
 World Bank Atlas, 1983, 1984, 1985;  
 Commonwealth Secretariat, 'Basic Statistical Data on Selected Countries', 1981

Notes: A 1970-79  
 B 1960-80  
 C Weighted average with population as weights

In terms of physical size, ECOWAS is a vast region and its sixteen member countries cover an area of some 6.1 million square kilometres (2.3 million square miles) or about 25 times the size of the United Kingdom, two-thirds the United States of America, about a fifth of the total area of Africa, smaller than Brazil but larger than Western Europe. Nearly half of this area is in the Sahara desert, enclosed within the borders of Mauritania, Mali and Niger. The remainder extends, on the mainland, roughly about 1300 kilometres (800 miles) between about 5° and 18°N and 3,200 kilometres (2000 miles) from west to east.

The contrasting sizes of the West African countries vary from 4 and 11 thousand square kilometres in Cape Verde and the Gambia respectively, to a huge land mass of 1267 thousand square kilometres in Niger. Niger, Mali (1240 thousand square kilometres), Mauritania (1031 thousand square kilometres), and Nigeria (924 thousand square kilometres) stand out as fourth, sixth, eighth and tenth largest countries in Sub-Saharan Africa respectively. The rest of the West African countries, with Cape Verde and The Gambia also being the smallest countries in Sub-Saharan Africa, have areas of much less than 500 thousand square kilometres per country. The three land-locked countries of Mali, Niger and Burkina together with Mauritania, account for over 62 per cent of the region's total area (see Table 2A).

### **2.3 DEMOGRAPHIC AND SOCIAL TRENDS**

Population statistics in West Africa, indeed, as in many other developing countries, are subject to rather wide margins of error, induced partly by administrative shortcomings, along with some

popular aversion to enumeration and, as much, by the different environments as well as by a desire to inflate population figures for political reasons rather than adapting them to some viable economic use. Moreover, in many LDCs, census enumerations are not only absent or few and far between, but even where they are carried out, they are often based on grossly inadequate maps which are generally indispensable for accurate and reliable delimitation of population areas.

However, in West Africa, population censuses have been an important feature of practically all countries, except Benin and Guinea. For instance, Ghana has held three census enumerations since World War II (1948, 1960 and 1970); the Gambia (1963 and 1973); Guinea-Bissau (1950, 1960, 1970 and 1979); Liberia (1962 and 1974); Sierra Leone (1963, 1974 and 1985); and Nigeria (1952, 1962/63 and 1973). The unreliability of census counts in Nigeria for instance resulted in the annulment of the second and last counts.

Despite the obvious misrepresentations of census enumerations, the rate of population growth that is evident in all member countries over the years is a highly important factor in any assessment of West Africa's economic trends, not only because it is rapid, but also because it is likely to remain relatively rapid in the immediate years and in cases compounded by considerable rates of urbanisation. The combined estimated population of the sixteen countries of the sub-region of about 205 million (mid-1983) represents about one-third of all Africa. It rose from about 153.4 million in 1981. Excluding Cape Verde, Guinea and Guinea-Bissau - for which data were not readily available, these combined population

estimates had risen by about one-third each decade from 76 million in 1960 to 100 million in 1970 and 134 million in 1980. World Bank estimates indicate that West Africa's total population would rise still to around 274 million by the year 2000.

As Table 2A further illustrates, there is as in size, a marked unevenness in population distribution, densities and general growth rates across the West African countries. Population sizes in the region in 1981 varied from over 87 million in Nigeria to under one-million each in Cape Verde, the Gambia and Guinea-Bissau. Estimates of annual rates of increase for the decade of the 1970s range between 0.9 per cent in Cape Verde to 5.1 per cent in the Ivory Coast (the highest in Africa). Except for Cape Verde where population estimates are seriously affected by recurrences of droughts and migration (about 6000 Cape Verdians are estimated to be emigrating annually since the 1973 drought) and Guinea-Bissau with population figures available only for 1970-78, virtually no country in West Africa has shown a population annual growth rate of below 2 per cent throughout the decade. No less than twelve countries, representing over 95 per cent of the region's total population, recorded rates in the range of 2.5-5.1 per cent during the decade. Rates of 3.5 per cent in Liberia, 3.3 per cent in Niger, 3 per cent in Ghana and 2.9 per cent in Guinea were some of the highest both in West Africa and in the whole of Africa. The high estimates for the Ivory Coast are affected by large scale immigration. The overall average for West Africa in the decade was 2.68 per cent and this almost equalled the African average of 2.72 per cent. While this rate compared favourably with the United Nation's estimates of 3 per cent annually for the region in the first half of the decade, it compared

unfavourably with corresponding rates of 0.1 per cent in the United Kingdom, 1.0 per cent in the United States, 2.1 per cent in India and Brazil and zero per cent in West Germany.

Population densities in the region have varied from less than two persons per square kilometre in Mauritania to over 90 in Nigeria in 1981. Cape Verde (75 persons), Gambia (54 persons) and Sierra Leone (50 persons) are the only other countries with densities of 50 persons and above. Mali, Mauritania and Niger, which together cover 57.6 per cent of West Africa's total land mass have an average population density of less than four persons. Their combined population of 14.2 million, represents 9.3 per cent of West Africa's total population. The average of 35 persons per square kilometre for West Africa in 1981 compares with 104 in China, 210 in India, 25 in the United States, 12 in the USSR and 228 in the United Kingdom.

At first sight, the dangers that are indicated by a high population growth may seem negated by the relatively low population densities in West Africa. Important as they are, population densities per se tell little about the so-called 'carrying capacity' of land, a concept which tries to relate a given area of arable and cropped land to that level of population which depends on it for welfare and development. The emerging index -the 'critical density of population' - denotes the 'human carrying capacity of an area in relation to a given land use system ...; it is the maximum population density which a system is capable of supporting permanently in that environment without damage to the land' (Allan, 1977). We have found this concept useful for West Africa in this Study since a fair assessment of the region's cultivable land area relative to its growing population is important not only because



this area is small relative to total land mass but also because in the immediate years, the area is more likely to remain constant in size or diminish through threatening desertic conditions while the corresponding rate of population growth remains relatively rapid.

**Table 2B ECOWAS:Critical Population Densities, 1980**

	Total land '000' ha	Arable and Cropped Land '000 ha	%	Population '000' mid-1980	Critical Density (Persons per 100 ha or per sq km of arable and cropped land)
Benin	11,262	1,795	15.9	3,479	194
Bourkina Fasso	27,420	2,563	9.3	6,161	240
Cape Verde	403	40	9.9	295	738
Gambia	1,130	270	23.9	574	213
Ghana	23,854	2,760	11.6	11,500	417
Guinea	24,586	1,570	6.4	5,425	346
Guinea- Bissau	3,612	285	7.9	773	271
Ivory Coast	32,246	3,880	12.0	8,262	213
Liberia	11,137	371	3.3	1,873	505
Mali	124,000	2,050	1.7	6,699	327
Mauritania	103,070	195	0.2	1,523	781
Niger	126,700	3,350	2.6	5,532	165
Nigeria	92,377	30,385	32.9	84,732	279
Senegal	19,619	5,225	26.6	5,703	109
Sierra Leone	7,174	1,766	24.6	3,474	197
Togo	5,679	1,420	25.0	2,578	182
ECOWAS	614,269	57,925	9.4	148,583	257

Sources: FAO Production Year Book, 1981  
World Bank Atlas, 1983

Thus Table 2B illustrates that out of a total land area of 614.3 million hectares in West Africa, only 57.9 million or 9.4 per cent was arable and cropped land in 1980. This means that more than 90 per cent of West Africa, though occupied by more than half the number of countries, is practically uncultivable or that to make any part of it arable would require huge land development expenditures which these countries cannot readily provide. The estimated critical population densities also indicate that West Africa's total population of more than 150 million is crowded in an area less than one-tenth of its total land mass. Compared with the 'nominal' population densities in Table 2A the critical densities more than clearly highlight the population problems faced by West African countries in an effort to feed their people.

For instance, in Mauritania, instead of two persons per 'nominal' square kilometre about 782 people are now more likely to struggle for land survival within a comparable area of arable and cropped land. In Cape Verde, it is 738 instead of 75; 505 instead of 17 in Liberia; 417 instead of 49 in Ghana; 346 instead of 23 in Guinea; and 327 instead of 6 in Mali. For the region as a whole, the 'man pressure' on a square kilometre of land area has increased over seven times from a 'nominal' average of 24 persons to a 'critical' average of 257 persons. The relative scarcity of arable and cropped land in many of the countries has led to the existence of pockets of high density settlements in areas like the south-eastern part of Nigeria, the Mossi plateau in Burkina and in Senegal's groundnut basin.

The worst hit are countries of the drought-stricken Sahel Region, namely, Cape Verde, (Chad), the Gambia, Mali, Mauritania, Niger, Senegal and Burkina, whose combined land mass of 4023 thousand square kilometres or 65.5 per cent of total West Africa (excepting Chad) is reduced by 96.6 per cent to 136.9 thousand sq kms of arable and cropped land and serving a population of over 26 million or 18 per cent of total West African population. This means a widening of the Sahel's average population density from around seven persons per square kilometre (nominal) to over 193 persons per square kilometre (critical). Geographically, a greater part of Sahel countries comprises arid tracts whose inhospitable environment precludes normal economic development, thereby subjecting the countries to some of the most serious demographic pressures.

Relatively high fertility rates are the principal factor for the rising population growth rates in West Africa. In contrast with trends in a large segment of the developing world, where a decrease of 12-15 per cent in the crude birth rate has been recorded since 1960, a decline of about 2 per cent over 1965-83 is recorded in several West African countries (Ghana, Mauritania, Nigeria, Senegal, Sierra Leone and Togo). Increases of over 2 per cent, except in Benin where no change is recorded, have been registered in the rest of the region (eg Niger 8 per cent and Liberia 6 per cent). Crude birth rates range between 43 (Mauritania) and 52 (Niger) in 1983 compared with 44 (Ivory Coast) and 51 (Nigeria) in 1965.

Mortality rates have also been high in West Africa. Although crude death rates do appear to be declining in practically all countries - in line with the global decline - these declines in most countries are still low compared with the average registered through

the developing world as a whole. In 1965-83 the highest declines were registered in Ghana and Ivory Coast (35 per cent) compared with the lowest - 9.8 per cent - in Guinea. Life expectancy, infant mortality and child death rates have improved over the last two decades but are still among the worst in the world. For instance, life expectancy (male) has improved by 8-18 per cent in 1965-83 with the number of years in 1983 ranging between 37 (Sierra Leone) and 57 (Ghana). Infant mortality and child death rates have in general dropped substantially over the period by more than 20 and 30 per cent respectively (except in Sierra Leone where the decline is 14 and 22 per cent respectively).

Compounding the effects of rapid population growth is the high degree of urbanisation in recent years, particularly towards the mining areas and certain of the principal urban centres. With deterioration of ecological conditions in much of the region and falling trends in real incomes in the rural sector relative to the urban, the growth of urban centres has produced significant changes in the population distribution of these otherwise rural economies. The World Bank estimates that the ratio of urban to total population in West Africa in 1981 ranged between 11 per cent (Burkina) and 37 per cent (Ghana), compared with 5 per cent and 23 per cent in 1960 for both countries respectively. Urbanisation in West Africa has been induced by several factors including the search for relatively higher and stable wage incomes, recognisable political action and the exploitation of the 'extended family system', easily regarded as the developing countries' equivalent of the social security system in many developed industrial countries.

These demographic trends, continuing overall growth and urbanisation pose increasing pressure on West Africa's modest health and education facilities, and on the limited wage employment opportunities.

#### 2.4 POLITICAL CHANGE

By 1900 the 'partition of Africa' was complete. In West Africa, four countries (Gambia, Ghana, Nigeria and Sierra Leone) were under British colonial rule; nine (Benin, Burkina, Guinea, Ivory Coast, Mali, Mauritania, Niger, Senegal and Togo) were under French administration, while the two lusophones (Cape Verde and Guinea-Bissau) became Portuguese possession. In contrast, Liberia remains unique in that the country was created as long ago as 1847 as an independent state for the settlement of freed slaves, mainly from North America. Political independence in the rest of the member countries (except Cape Verde and Guinea-Bissau in 1975) was achieved between 1957 (Ghana) and 1965 (Gambia).

However, most countries, especially the francophones - except Guinea - are still politically and economically very closely related with the past colonial masters. Strong post-colonial links between France and several of the francophones are sustained within the WAMU and the so-called Conference of France and Africa (also known as the Franco-African Summit). On a collective basis, all West African countries are associated with the EEC - through the Yaounde and Lome Conventions - which further enhances the colonial historical relationships. To a large extent these relationships have continued to influence most of West Africa's external trade, monetary and

financial patterns and will undoubtedly influence the process of currency unification in the region.

Table 2C ECOWAS: Political Change

	Capital City	Year of Independence	Immediately Legal Status	Type of Current Government <sup>7</sup>
Benin <sup>1</sup>	Porto Novo	1960	Autonomous member French community	Military, 1972
Burkina <sup>2</sup>	Ouagadougou	1960	Autonomous member French community	Military, 1982
Cape Verde	Praia	1975	Overseas province of Portugal	Constitutional
Gambia	Banjul <sup>3</sup>	1965	British Colony & protectorate	Constitutional
Ghana <sup>4</sup>	Accra	1957	" "	Military, 1981
Guinea	Conakry	1958	French Overseas Territory	Military, 1984
Guinea-Bissau <sup>5</sup>	Bissau	1975	Overseas province of Portugal	Military, 1980*
Ivory Coast	Abidjan	1960	Autonomous member French community	Constitutional
Liberia	Monrovia	1847	Private Colony	Military, 1980
Mali	Bamako	1960	Member State, as Sudanese Republic of Fed of Mali	Military, 1979
Mauritania	Nouakchott	1960	Autonomous member French community	Military, 1984
Niger	Niamey	1960	Autonomous member French community	Military, 1974
Nigeria	Lagos	1960	British Colony & protectorate	Military, 1985
Senegal	Dakar	1960	Member state of Fed of Mali	Constitutional
Sierra Leone	Freetown <sup>6</sup>	1961	British Colony & protectorate	Constitutional, 1969
Togo	Lome	1960	French UN Trust Territory	Military, 1967*

- Notes:
- 1 Formerly Dahomey
  - 2 Formerly Upper Volta
  - 3 Formerly Bathurst
  - 4 Formerly Gold Coast
  - 5 Formerly Portuguese Guinea
  - 6 The name Freetown means - free settlement area for liberated slaves. the other was Libreville in Gabon
  - 7 Year indicates installation of current government
  - \* Military Head of State through some governments have introduced constitutional rule or elections.

The most important characteristic feature of West Africa's post-independence political scene is that it has been extremely volatile, complex and in cases, very violent. There are three major developments. The first is its militarisation. All but three of the indigenous governments which constitutionally replaced the colonial administrations (Gambia, Ivory Coast and Senegal) have been replaced through unconstitutional means - generally by military take-over. Including Togo, where Black Africa's first military take-over occurred in 1963, eleven of the sixteen West African governments are presently military. Among these, the worst affected are Nigeria where the latest coup in August 1985 marked the sixth (including the 'Biafra' Civil War, 1975) military take-over since independence in 1960, and Ghana where more than five successful and abortive military take-over attempts have taken place, beginning with the first successful coup in 1966. This changing pattern of West Africa's political scene is illustrated in Table 2C.

Secondly, even those few countries which have managed to sustain constitutional rule for longer years without fundamental changes have also had to contend with successive military/civil take-over attempts (as was the case in Sierra Leone in 1969 and 1974 although there were two different military governments in quick succession in 1967/68; and The Gambia in 1981), civil strife, political discontent and unrests, thereby making their political scene equally shaky and unstable. In Senegal, for instance, apart from the strong political opposition from the country's thirteen opposing parties, the main source of political tension for the ruling constitutional Parti Socialiste has been the threatened withdrawal of the southern province of Casamance in order to create

an independent state on its own. Such a new state would mean depriving Senegal of its most economically productive agricultural enclave. In addition, as in Nigeria during the Biafra War, the Casamance threat does provide an important source of irritation and friction between Senegal's major tribes.

In the Ivory Coast, apart from the frequently reported 'anti-government activities' which have included the unforgettable Gagnoa clash of 1970, the major source of political tension in the ruling constitutional government has always evolved out of the choice for a likely successor to the 'ageing' President Houphouet-Boigny who has been President of the Ivory Coast since independence in 1960.

The third significant development in West Africa's post-independence political scene is the long history of outstanding political disputes between several countries. These disputes, mainly over territorial boundaries, are sporadic and sometimes very serious and have resulted to protracted border closures and temporary suspensions of diplomatic relations. The most serious inter-state conflict in West Africa, however, is between two of the region's poorest countries - Mali and Burkina - and its cause has developed from a 25 years dispute over the mineral rich Agacher border zone. This conflict has not only brought the two states before the International Court of Justice at the Hague in 1983, it has also resulted into two 'wars' between the two countries, in 1975 and 1985. Other important disputes, though of relatively minor scale, have included conflicts between Ghana and Togo, and Sierra Leone and Liberia, mainly over the reported use or protection (though many a time unproven) of political dissidents to destabilise each other's government.



Furthermore, even some of the existing military governments have also reported frequent counter-coup attempts (eg Burkina 1983, Guinea 1985, Ghana 1985, Liberia 1986, Niger 1974, 1975 and 1976, and Nigeria 1985) since their installation.

This catalogue of political developments in post-independence West Africa has not only adversely affected national economic and political stability and performance, but at the regional level, it has also provided a major source of a high degree of suspicion and mistrust among the political leaders. In the first place, the pre-eminence of a high incidence of internal political fragility has in part prevented some of the most affected countries from identifying and/or fully implementing clearly defined political ideologies and economic framework. In most countries therefore, high priority is given to very shortterm, ad hoc and insufficiently appraised economic policies and development programmes. It has, in many instances (eg Sierra Leone), also triggered off large-scale displacement of productive population for purely military and political purposes and has induced a substantial diversion of financial resources from productive to the practically non-income generating defence spending. Even though declining, defence expenditure constitutes a significant proportion of central government spending in many countries (eg Nigeria, 17.9 per cent in 1978; Burkina, 17.1 per cent). In Liberia, the ratio actually increased from 2.7 to 13.5 per cent in 1978-82. In 1968-78, military expenditure has represented as much as 7.1 per cent of GNP in Guinea-Bissau and Mauritania, and 4.2 per cent in Nigeria (see Table 2D).

Table 2D ECOWAS: Central Government Defence Expenditure

	Defence expenditures as a % of total expenditure			Military expenditure as a % of GNP	
	1972	1978 <sup>1</sup>	1982	1968	1978
Benin	-	-	-	1.6	2.0
Burkina	-	21.8	17.1	1.2	3.4
Cape Verde	-	-	-	-	-
Gambia	-	0.0	-	-	-
Ghana	8.0	5.3	6.2	3.0	0.4
Guinea	-	-	-	3.3	-
Guinea-Bissau	-	24.0	-	-	7.1
Ivory Coast	-	7.2	-	1.3	2.2
Liberia	-	2.9	13.5	1.3	1.1
Mali	-	18.6	8.4	2.0	3.5
Mauritania	-	-	-	1.4	7.1
Niger	-	6.1	-	1.0	0.8
Nigeria	40.2	17.9	-	5.9	4.2
Senegal	-	10.7	9.1	1.9	2.2
Sierra Leone	-	7.8	-	0.7	1.0
Togo	-	9.6	7.1	1.2	2.8

Sources: World Bank, World Development Report, 1985; and Accelerated Development in Sub-Saharan Africa, 1981

Notes: 1 1977 for Burkina, Niger and Togo; 1979 for Liberia

Finally, there is no doubt that these political developments have serious implications for sustaining regional economic and monetary co-operation and integration. Already, in the WAMU, Burkina was prompted by its conflict with Mali to veto the latter's re-entry into the union in 1982. Sub-regional economic groupings like the Mano River Union (MRU) and the Communauté Economique de l'Afrique de l'Ouest (CEAO) are virtually in financial and political disarray, resulting mainly from the frequent occurrence of mistrust and suspicion among the member countries. Thus, political instability in West Africa is one important reason for looking at the future of regional co-operation and integration in a mood of apprehension than optimism.

## **2.5 CLIMATE, RESOURCES AND SECTORAL PERFORMANCE**

### **2.5.1 Climate, Vegetation and Resource Endowment**

West Africa's climatic and vegetational environment is pre-eminently tropical, constituting very broadly the coastal forests and the northern savannas further away from the equator. A more precise description of the region's topography is that as one journeys northwards from the coast, it is of sandy coastlands, followed immediately by a belt of tropical forests punctuated in the centre by wooded or tree savannas, immediately followed by an extension of another belt of undulating grasslands or dry savannas studded with trees, and finally by the Sahara desert.

Each vegetational zone runs parallel to the coast and each results from distinctive climatic conditions ranging from high temperatures, high rainfall (2000 mm or over per year) and high

humidity for most of the year in the forest area to a dry season increasing to five or more months and sparse rainfall (500-1000 mm a year) as one travels away from the coast into the landlocked countries on the edge of the Sahara.

Generally, most West African countries traverse these climatic and vegetational dimensions by stretching inland across the forests and tree savannas into the dry savannas and the desert. Significantly, nearly half of Mauritania and the most northern parts of Mali and Niger are embedded into the desert, while most of the coastal countries stretch inland across the forest zone and the savannas (eg Ivory Coast, Nigeria, Ghana and Sierra Leone). Liberia is the only West African country that is predominantly within the forest zone and without savannas, although here too, as in some other coastal countries, climatic conditions are distinctly of two seasons: a rainy season between May-October and a dry season between November-April. Rainfall in the drought-stricken landlocked (Burkina, Mali and Niger) and other Sahel countries (eg Cape Verde, Guinea-Bissau) is extremely scarce to the extent that in Cape Verde, for instance, it rains on average about twice a year.

The interaction of climate and topography in West Africa is such that most of the region's soils are depressingly delicate, substantially deficient in organic materials, and in general only moderately fertile. Countries with the heaviest rainfall (eg Liberia, Guinea and Sierra Leone) also experience the severest leaching of soils. In all countries, the dry season is partly characterised by an extended spell of gusty desertic conditions bringing with them the 'harmattan' - a cool, dry, droughty, vegetation - withering, and skin-cracking dusty winds. Furthermore,

the absence of frost in most parts adds to the acute problems of pest control, while the tropical nature of the climate itself exaggerates the problems of wide ranging bacterial, parasitic and endemic diseases (eg malaria, elephantiasis, schistosomiasis).

These contrasting climatic conditions and topography represent the most powerful explanations for the great diversities in population growth and distribution, resource base and economic opportunities and performance both within and between the West African countries. In terms of agricultural resources, the available arable land in the region is of varying fertility, ranging from the rich rain forest belt in the south to the poor and dry semi-desert in the north. Consequently, the primary agricultural activity ranges from the production of a wide range of tree and root crops (eg cocoa, coffee, palm trees, kola nuts, rubber) in the coastlands and rainforest areas to that of grains and mixed cereals (eg cotton, millet, sorghum, groundnuts, beans) and animal husbandry in savanna areas. Generally, the southwestern rains are more suited for rice and tree crop production although rice is grown in most countries in the region. Tree crops are generally perennials while grains and mixed crops are mostly annuals.

The endowment of West Africa in other natural resources is equally impressive. Vast reserves of fish resources and enormous potentials for hydro-electric power are available in many coastal countries. Most importantly, there are also extensive deposits of a very wide variety of mineral resources in most countries (eg diamonds, gold, bauxite, iron ore, rutile, manganese, coal, natural gas and petroleum).

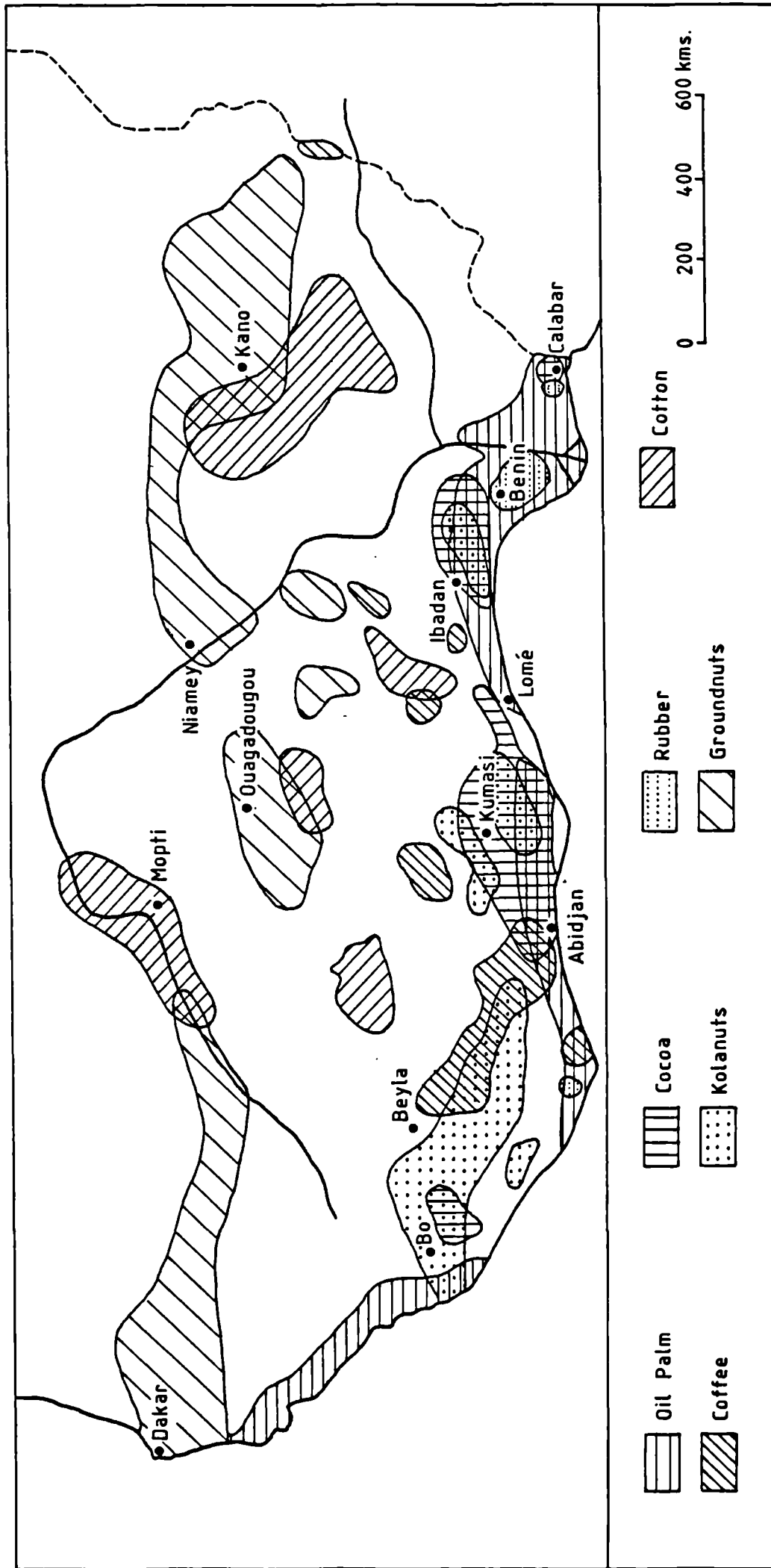
A basic distinctive feature of West Africa is that the exploitation of these primary resources is geared generally for export outside the region than for domestic consumption and the value-added pre-export levels are extremely low and rudimentary. Although on average each West African country is endowed at economically viable proportions with more than one or two types of agricultural and/or mineral products, performance on resource exploitation has substantially varied between them in recent years. In some countries (eg Nigeria, Ghana and Sierra Leone), production emphasis has drastically shifted from traditional agriculture to mining and this has affected sectoral and overall economic performance trends in recent years. The geographical distribution of West Africa's major agricultural and mineral products is shown in Figures 2.2 and 2.3 respectively.

## **2.5.2 Sectoral Performance**

Although this section is devoted to a critical review of the basic trends and problems of agriculture and mining, it will also highlight similar developments in the manufacturing, transport and communications sectors.

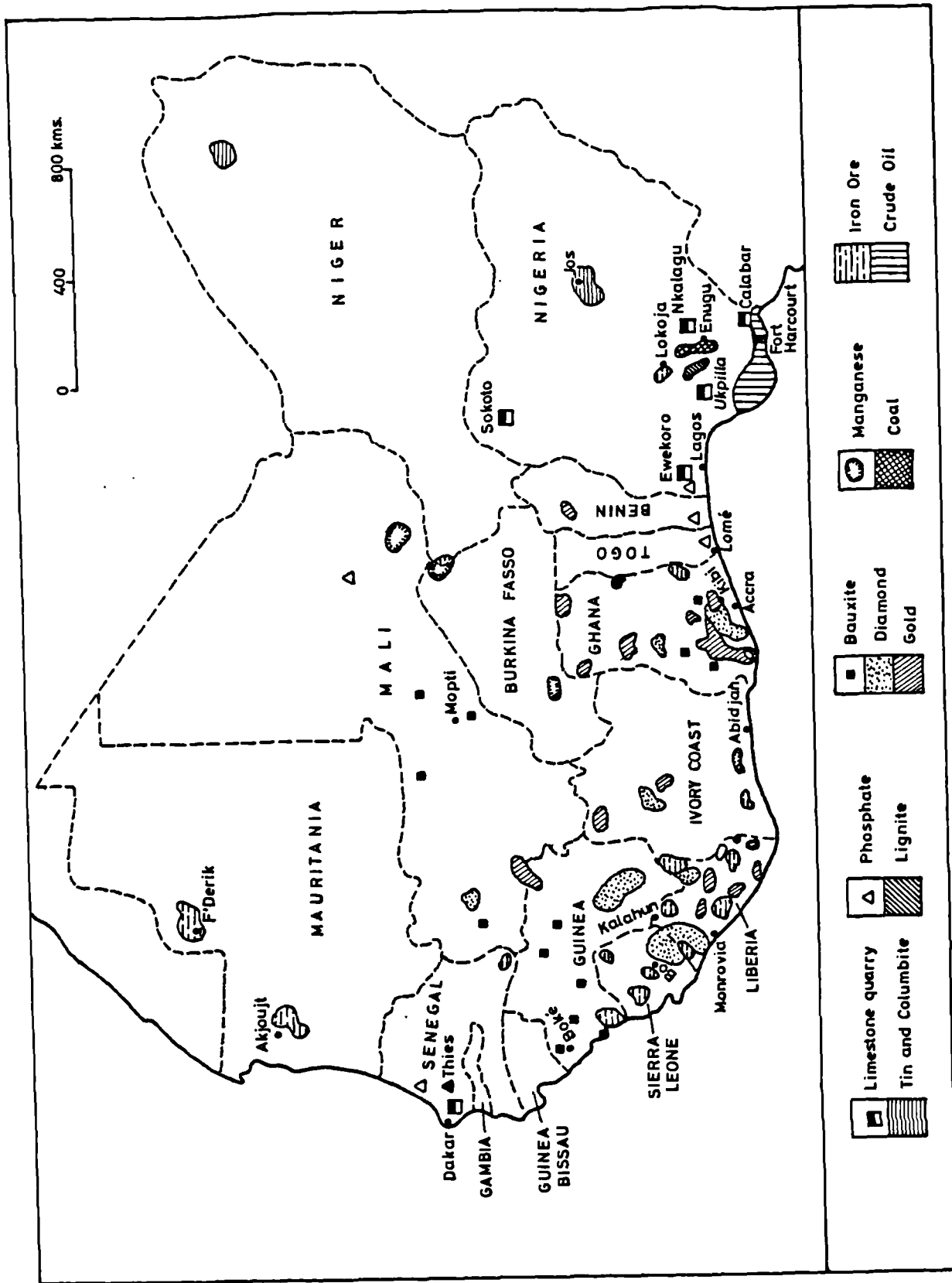
### **2.5.2.1 Agriculture**

The principal feature of the economic structure of West Africa, in common with the majority of LDCs, is that it is predominantly rural in character and in nearly all countries agriculture has remained the dominant source of livelihood, employing over three-quarters of the labour force. Three other important features of West African agriculture are worth mentioning. Firstly, there is a



Source: Redrawn from Onyemelukwe, J.O.C. and Filani, M.O., op. cit. pp 54.

Fig. 2-2. West Africa : Geographical distribution of major export crops.



Source : Redrawn from Onyemelukwe, J.O.C. and Filani, M.O. op. cit. pp. 64.

Fig. 2-3. West Africa : Geographical distribution of major mineral resources.



high incidence of overlapping in agricultural productivity between the West African countries in terms of the variety of crops cultivated, animal husbandry and fishing activities. This is explained essentially by the overlapping variations between countries in climatic conditions, vegetation, other topography, and cultural preferences.

The second feature relates to the dichotomy between non-monetised or subsistence and monetised sub-sectors. In most countries, the subsistence sector accounts on average for more than half of agricultural production and labour force, while the monetised sub-sector is generally smaller and is mainly oriented, directly or indirectly, towards exports. The emphasis on export crops through huge capital expenditure, bank financing, increased production incentives and marketing facilities is generally for the mobilisation of foreign exchange earnings. However, by encouraging a continuous drifting of population away from the food producing subsistence sector, this emphasis has also had the consequential effects of intensifying food shortages and thereby increasing the propensity for food imports. Despite the widely held objective of food self-sufficiency, food production per capita is still low in most countries, except the Ivory Coast and to a lesser extent Senegal, and in the last two years, Ghana. In many countries (eg Sierra Leone) the foreign exchange expenditure on food imports is by far greater than the corresponding revenue from agricultural exports.

Table 2E ECOWAS: Major Export Crop Performance, 1948-1981

	Annual Av 1948-52	1955	1960	1965	1970	1975	1980	1981
<b>Cacao</b>								
ECOWAS exports (million MT) <sup>a</sup>	.408	.391	.541	.954	.752	.694	.672	.695
(million dollars)	-	-	332.3	379.7	610.2	1034.1	2009.5	1211.8
% share of world	58.6	54.2	60.7	72.6	70.4	64.3	65.6	57.4
% share of Africa <sup>b</sup>	82.9	82.2	84.2	87.6	87.8	88.1	87.8	85.4
% share of ECOWAS merchandise exports	-	-	24.4	19.9	20.5	9.0	5.9	4.7
Principal exporter (% of ECOWAS)	Ghana 59.1	53.5	56.0	50.3	48.2	46.4	Ivory Coast 40.4	51.9
<b>Coffee</b>								
ECOWAS exports (million MT)	.065	.104	.168	.189	.244	.282	.239	.248
(million dollars)	-	-	9.3	11.4	186.1	315.7	759.8	568.5
% share of world	3.4	5.0	4.9	5.1	6.0	7.3	6.1	6.7
% share of Africa	23.1	23.9	26.1	21.7	22.8	24.2	27.0	26.5
% share of ECOWAS merchandise exports	-	-	0.7	0.6	6.3	2.7	2.2	2.2
Principal exporter (% of ECOWAS)	FWAC 91.6	81.4	Ivory Coast 81.0	92.3	83.5	90.9	86.2	87.2
<b>Cotton</b>								
ECOWAS exports (million MT)	.016	.034	.032	.030	.084	.059	.132	.102
(million dollars)	-	-	19.5	15.7	43.6	58.5	219.7	164.7
% share of world	0.7	1.4	0.8	0.7	1.8	1.3	2.8	2.2
% share of Africa	2.7	5.6	3.0	2.7	5.6	6.1	18.6	15.6
% share of ECOWAS merchandise exports	-	-	1.4	0.8	1.5	0.5	0.6	0.6
Principal exporter (% of ECOWAS)	Nigeria 79.7	100.0	89.3	58.6	22.0	Mali 31.3	38.4	36.7
<b>Groundnuts (shelled)</b>								
ECOWAS exports (million MT)	.502	.618	.714	.916	.562	.113	.057	.021
(million dollars)	-	-	146.1	171.2	103.5	54.7	25.1	15.7
% share of world	64.0	68.6	72.0	62.4	53.5	11.4	4.8	1.8
% share of Africa	87.3	83.6	86.2	78.4	73.6	27.0	23.9	8.5
% share of ECOWAS merchandise exports	-	-	10.7	9.0	3.5	0.5	0.1	0.1
Principal exporter (% of ECOWAS)	Nigeria 54.3	65.3	43.8	61.8	58.8	Gambia 49.8	71.4	51.7
<b>Groundnut Oil</b>								
ECOWAS exports (million MT)	.062	.121	.167	.253	.265	.221	.086	.037
(million dollars)	-	-	59.6	87.0	88.5	166.5	71.6	38.4
% share of world	33.7	32.2	54.9	62.5	60.5	52.0	19.5	11.8
% share of Africa	82.3	83.2	88.4	91.7	89.7	59.3	71.6	50.6
% share of ECOWAS merchandise exports	-	-	4.4	4.6	3.0	1.4	0.2	0.1
Principal exporter (% of ECOWAS)	FWA 93.7	71.8	Senegal 72.1	61.2	52.8	87.3	85.3	54.3
<b>Palm Kernels and Nuts</b>								
ECOWAS exports (million MT)	.568	.626	.626	.556	.342	.250	.137	.103
(million dollars)	-	-	101.9	94.6	53.0	44.9	37.2	25.9
% share of world	74.4	79.2	86.7	87.3	76.8	75.8	68.1	77.1
% share of Africa	79.8	85.6	94.2	94.3	90.6	91.3	94.0	96.6
% share of ECOWAS merchandise exports	-	-	7.5	5.0	1.8	0.4	0.1	0.1
Principal exporter (% of ECOWAS)	Nigeria 65.6	70.3	71.6	78.5	57.4	66.9	72.5	54.1
<b>Palm Oil</b>								
ECOWAS exports (million MT)	.180	.204	.205	.167	.035	.152	.097	.077
(million dollars)	-	-	43.0	41.4	7.8	57.8	54.7	39.3
% share of world	37.8	36.6	34.8	31.6	3.9	6.2	2.7	2.2
% share of Africa	55.3	55.5	54.9	67.7	19.1	63.9	81.1	86.2
% share of ECOWAS merchandise exports	-	-	3.2	2.2	0.3	0.5	0.2	0.2
Principal exporter (% of ECOWAS)	Nigeria 90.2	90.7	91.1	91.9	Benin 42.5	Ivory Coast 84.6	83.3	58.5
<b>Rubber</b>								
ECOWAS exports (million MT)	.046	.070	.107	.121	.159	.144	.110	.112
(million dollars)	-	-	7.9	5.7	67.3	72.0	147.1	124.2
% share of world	2.1	3.2	4.4	4.6	6.0	4.4	3.4	3.7
% share of Africa	77.1	70.3	73.3	81.2	78.9	76.7	83.5	80.7
% share of ECOWAS merchandise exports	-	-	0.6	0.3	2.3	0.6	0.4	0.5
Principal exporter (% of ECOWAS)	Liberia 68.8	56.0	Nigeria 50.4	53.6	Liberia 53.8	64.2	69.5	69.8

Source: FAO 'Trade Year Book', various issues

Notes: a MT = metric tonnes  
b Sub-Saharan Africa excluding South Africa  
c French West Africa  
- not available

A further general feature of agriculture in West Africa relates to some archaeological and ethnological evidence that not only is agriculture itself alien to Africa as a whole but many of the crops which represent the continent's agricultural mainstay are considered 'exotic', ie they are introduced from abroad, mainly from Asia and South America (see Hopkins, 1973, p 29). Some of these crops include cocoa, coconuts, cotton, cassava, groundnuts, plantains, bananas, sugar-cane, citrus fruits, sweet potatoes, maize, mangoes, peas and beans. While this piece of evidence (though controversial) is worth noting, its empirical significance for West Africa is perhaps little in that agriculture in the region has developed into a pervasive and long-established activity that almost intuitively all West Africans have come to accept its existence as an important part of their livelihood.

The performance of the agricultural sector in West Africa has not only dominated the course of most member economies in the past but holds major implications for their prospects in the near future. However, growth in the sector has been variable and in many countries slower in recent years. While in some countries (eg Ghana) the decline has merely reflected the downward performance of the domestic economy and, demand conditions in the global markets, in others (eg Nigeria and Sierra Leone) the decline reflects the drastic shift from agriculture to mining especially in the 1970s. The great drought in the Sahel has been a principal factor for the slow growth of agriculture in those countries.

The overall impact of these developments on West African agriculture is illustrated in Table 2E, which measures three types of performance trends: the combined share of West African countries

in the export of each crop in relation to African and world production levels; the share of each crop in relation to the region's total world exports; and the share of West Africa's principal exporter in relation to the total regional export of each crop.

West Africa contributes about 57 per cent of the cocoa and over 77 per cent of the volume of palm kernels and nuts entering world markets. The region's share in groundnut oil and palm oil has fallen drastically over the years. In relation, however, to the volume of export products entering world markets from Africa, West Africa contributes about 85 per cent of cocoa, over 50 per cent of groundnut oil, 75 per cent of palm kernels, 80 per cent of palm oil and 80 per cent of rubber. By 1980 Ivory Coast had replaced Ghana as major regional cocoa exporter. Similarly, Nigeria's position as the largest West African exporter of cotton, groundnuts and palm kernel oil has, since the mid-1970s been held by Mali, Gambia and Ivory Coast respectively.

In the majority of cases, the average share of agriculture, including livestock, forestry and fishing, in the GDP has declined very significantly since 1960. As shown in Table 2F, the most severe contractions have been registered in Ivory Coast where the ratio has fallen from 43 per cent in 1960 to 27 per cent in 1981; Niger, 69 to 30 per cent; Nigeria, 63 to 23 per cent; and Togo, 55 to 24 per cent. Of the thirteen countries for which comparative estimates were available, Cape Verde and Ghana have had substantial improvements in agriculture as a proportion of the GDP. The regional weighted average dropped from 48 per cent in 1960 to 31 per cent in 1981.

Table 2F ECOWAS: Distribution of Gross Domestic Product and Sectoral Growth (Per Cent)

	AGRICULTURE			INDUSTRY			MANUFACTURING			SERVICES				
	Share in GDP 1960	Annual Average Growth rate		Share in GDP 1960	Annual Average Growth Rate		Share in GDP 1960	Annual Average Growth Rate		Share in GDP 1960	Annual Average Growth Rate			
		1981	1960-70		1970-81	1981		1960-70	1970-81		1981	1960-70	1970-81	1981
Benin <sup>a</sup>	55	44	4.9	-0.3	8	13	9.9	9.8	3	7	37	43	-	6.0
Burkina Faso	55	41	-	1.4	16	16	-	2.9	9	12	29	43	-	5.8
Cape Verde	13	21 <sup>b</sup>	-4.4	6.7	2	2 <sup>b</sup>	9.6	0.6	-	-	85	77 <sup>b</sup>	-	-
Gambia	43	46	4.6	7.0	18	9	2.1	3.3	-	-	40	46	6.6	-0.5
Ghana	41	60	-	0.0	10	12	-	-2.2	-	7	49	28	-	0.4
Guinea	-	37	2.1	3.0	33	33	2.3	14.1	-	4	30	30	7.2	0.7
Guinea-Bissau <sup>a</sup>	51	54 <sup>c</sup>	-2.4	1.4	0	9 <sup>c</sup>	-	-	-	-	49	34 <sup>c</sup>	-	-
Ivory Coast	43	27	4.2	4.7	14	23	11.5	9.3	7	12	43	50	9.7	5.8
Liberia	-	36	-	4.0	-	27	-	-0.7	-	8	-	37	-	1.4
Mali	55	42	-	4.0	10	11	-	2.4	5	6	35	47	-	5.9
Mauritania	44	28	1.4	3.1	21	24	14.1	-4.0	3	7	35	48	7.4	5.2
Niger	69	30	3.3	-3.0	9	32	13.9	11.4	4	8	22	38	-	6.9
Nigeria	63	23	-0.4	-0.4	11	37	14.7	6.0	5	6	26	40	2.3	7.4
Senegal	24	22	2.9	2.6	17	26	4.4	4.4	12	15	59	52	1.7	0.9
Sierra Leone	-	31	-	2.4	-	20	-	-3.6	-	6	-	49	-	4.5
Togo	55	24	-	1.5	16	27	-	6.2	8	7	29	49	-	3.2
Total Xa	47	35	1.6	2.4	12	20	9.2	4.0	6	8	41	44	5.8	3.8
ECOWAS Xw	48	31	-	-	11	30	-	-	3	7	33	39	-	-

Source: World Bank, World Development Report, 1983;

'Atlas', 1983

'Accelerated Development in Sub-Saharan Africa', 1981, c/w Secretariat

'Basic statistical data on selected countries', 1981

Notes: a first period reported is for 1961-70 and second period is for 1970-76

b 1978

c 1979

d first period reported is for 1961-70 and second period is for 1970-78

Xa arithmetic average

Xw weighted average with GDP values as weights

- not available

In terms of growth, high rates were experienced in Cape Verde, from -4.4 per cent in the 1960s to 6.7 per cent in 1970-80; Gambia, 4.6 to 7 per cent; Guinea-Bissau, -2.4 to 1.4 per cent; and Mauritania, 1.4 to 3.1 per cent. Marked contractions were experienced in Benin, from 4.9 to -0.3 per cent; and Niger, 3.3 to -3.0 per cent over the same periods, while in Nigeria, agricultural growth remained constant at -0.4 per cent.

With respect to cash crops, again the Ivory Coast has achieved sustained growth throughout the 1970s, due largely to diversification into products such as palm oil and rubber while maintaining its more traditional products, coffee and cocoa.

Clearly, agricultural performance in West Africa is heavily influenced by climatic conditions, vegetation and other ecological factors as well as by many tropical crops and human diseases. But while these factors are important, they do not fully explain the varying performance in agriculture observed among many West African countries in the more recent years. Other factors are chiefly the product of both the increased politicisation of the rural population and government policy. Principal among these are the rising rate of urbanisation, induced by the more obvious shortrun political gains, military and security service requirements, as well as sheer neglect as in Nigeria and the lack of adequate price incentives and extension facilities. In countries where the exchange rate has been adjusted downwards to induced increased export production, inadequate price incentives for producers are reflected in the unwillingness by governments to pass on directly to producers substantial proportions of corresponding currency gains. In this respect perhaps we may argue for a review of the use of the so-

called agricultural price stabilisation funds maintained in countries like Sierra Leone and Ghana.

Policies to improve agricultural production, apart from exchange rate adjustment, have included the provision of subsidised agricultural extension services, substantial financial investments through government, banking and other financial institutions, and agricultural diversification programmes. In a number of countries, agricultural resuscitation attempts are taking place through the World Bank Integrated Agricultural Development Projects (IADPs) which stress the combined improvement of rural life and agricultural production (mainly subsistence). The basic criticism of these programmes, however, relates to the amount of investment funds that go towards actual crop production which is relatively small compared with that on infrastructural facilities, ie housing, offices, wages and salaries, etc. Funna (1982) has argued that by concentrating essentially on effecting qualitative improvements in subsistence production, combined with somewhat low production targets, the impact of the IADPs even in food production is bound to be limited. Despite these individual national attempts, there are clear indications that the experience of the seventies and early eighties should lead to a wider appreciation and more concerted rationalisation of existing West African agricultural programmes and policies.

#### 2.5.2.2 Mining

Although the West African economic structure is predominantly agricultural, the wide variety of mineral resources traversing the different countries have equally played an increasing role in

national development. Geographically, as in agriculture, many West African countries have immense potentials to exploit more than one or two types of minerals at economically viable volumes. Like agriculture, West African mining has had a long historical perspective with the exploitation of such minerals as gold, salt, iron ore, bauxite and diamonds in full swing several years before the colonial era and its commercialisation is also substantially for export. It is worth noting however that commercialisation of agricultural production in West Africa is more a reflection of the general colonial trade policy, especially with the introduction of 'staple exports' which replaced slave exports. Here, the main features of the 'new' West African economy after the abolition of the external slave trade in the 19th century were analysed by making use of 'staple theory', developed specifically to explain the particular type of growth stemming from diversification around a well-defined export base (see, for instance, Watkins, 1963, pp 141-58). In West Africa, however, staple theory was applied to solve the problem of developing alternative exports to slave exports.

Also, in contrast with agriculture, mining activity in West Africa has generally involved large and active participation of foreign capital and control especially because of the extensive exploration pursuits and large-scale mining which have characterised the post-independence years. This changing pattern of mining has increased the role of minerals in West Africa and has transformed some economies away from their traditional agricultural structures (eg iron ore in Mauritania; phosphates in Senegal and Togo; uranium in Niger; and petroleum in Nigeria). This transformation is, of course, more predominant in Nigeria where, following the initial



more than sevenfold oil price increase in 1973/74, the oil industry has completely overshadowed agriculture as the backbone of the economy and is currently accounting for well over 90 per cent of national exports. Table 2G provides a list of some of the expatriate enterprises that have dominated the West African mining scene over the years. It is noted however that in Ghana and Sierra Leone, small-scale indigenous alluvial mining accounts for over 30 per cent of total diamonds produced in both countries and around 40 per cent in the Ivory Coast.

Table 2H shows trends in the changing performance, over the years, of West African mining in terms of volume and the combined regional share in world mine production of each of the region's major minerals. The principal regional producer country for each mineral is also indicated in terms of its share in regional production. The period 1970-81 is taken mainly because of data accessibility.

During the period, most of West Africa's minerals suffered erratic fluctuations (mainly downwards) in relation to world production quantities. However, as in agriculture, West Africa contributes the bulk of world production of minerals derived from Africa, eg gold, diamonds and manganese. Significantly, West Africa's share in world production of bauxite and uranium in 1970-81 increased from 5.8 per cent to 15.1 per cent and 0.25-9.9 per cent respectively, while its corresponding share in the production of most of the other minerals has either stagnated at comparatively very low levels, or has dropped sharply, eg diamonds from 14.1 to 3.9 per cent; and tin ore, from 3.9 to 1 per cent.

Table 26 ECOWAS: Expatriate Interests in Mine Operations

Country	Company	Mineral
Guinea	FRIA - an international consortium of US, French, British and Swedish interest	Bauxite
Ghana	Ghana Consolidated Diamond Mining Company	Industrial diamonds
	Lonrho - took over from the Ashanti Gold-fields Corporation which had been mining gold since 1897	Gold
Ivory Coast	A private consortium of Mitsubishi and Sumitomo (Japan), British Steel, Usinor (France) Hoesh Hoogovens (Netherlands) Bong - a German-Italian mining company, , 1965	Iron Ore
Liberia	LAMCO - Liberian-American-Swedish Minerals a consortium of six Swedish firms, US Bethlehem Steel Corporation, 1963	Iron Ore
Niger	SOMAIR --- Societe des Mines de l'Air (French)	Uranium
	COMINAK --- A consortium of Japanese and French interests	-
Nigeria	SAFRAP; Shell-BP; AGIP-Phillips; Gulf; Mobil; Texaco (exploration and production) Royal Dutch Shell Group - owners of Shell Nigeria Limited (marketing)	Crude Petroleum
Senegal	MIFERSO	Iron Ore
Sierra Leone	CAST - Consolidated African Selection Trust	Diamonds
	Sherbro Minerals - a consortium of British and American interests - ceased operations in 1971	Rutile
	Sierra Rutile - a consortium of Bethlehem Steel and Nord Resources (USA), 1972	Rutile
	Austro-Minerals (Austrian), 1980 - replaced Sierra Leone Development Company (DELCO) which closed in 1975 after over 40 years operations	Iron Ore
	SIEROMCO - A subsidiary of Swiss Aluminium Company (Alusuisse)	Bauxite
Togo	CTMB - Compagnie Togolaise des Mines du Benin (French), 1961	Phosphate Rocks

Sources: Onyemelukwe and Filani, *ibid*  
West Africa, various issues

Table 2H ECOWAS: Mine Production of Minerals and Metals

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
<b>Bauxite</b>												
Total ECOWAS ('000' Tonnes)	3391	2923	3077	4709	7096	9436	12234	11944	12783	15450	14326	13623
% share of World	5.8	4.7	4.6	6.3	8.6	12.3	15.2	14.1	15.2	16.9	15.0	15.1
Principal producer (% of ECOWAS)	Guinea 76.7	68.8	66.6	78.6	86.0	89.1	92.5	91.0	91.1	94.8	93.7	94.2
<b>Diamonds</b>												
Total ECOWAS ('000' Tonnes)	5711	5645	5373	4042	4646	3995	3422	3139	2652	2516	2078	1516
% share of World	14.1	13.7	12.3	9.6	10.4	9.7	8.9	8.0	6.7	6.4	4.9	3.9
Principal producer (% of ECOWAS)	Ghana 44.6	45.4	49.5	57.1	55.4	58.3	66.7	62.0	53.7	48.7	55.3	55.2
<b>Coal</b>												
Total ECOWAS ('000' Tonnes)	60	158	341	355	312	285	280	238	400	172	193	116
% share of World	.002	.01	.01	.01	.01	.01	.01	.01	.01	.005	.005	.003
Principal producer (% of ECOWAS)	Nigeria 100	100	100	100	100	100	100	100	100	100	100	100
<b>Copper</b>												
Total ECOWAS ('000' Tonnes)	1.95	4.74	15.05	21.28	20.08	6.58	10.00	7.64	1.77	-	-	-
% share of World	.03	.07	.22	.28	.26	.09	.13	.10	.02	-	-	-
Principal producer (% of ECOWAS)	Mauritania 100	100	100	100	100	100	100	100	100	-	-	-
<b>Gold</b>												
Total ECOWAS ('000' Tonnes)	22.4	21.9	22.7	24.5	20.9	17.8	17.4	15.9	12.8	10.2	11.0	10.6
% share of World	1.4	1.4	1.4	1.6	1.5	1.5	1.5	1.3	1.0	0.8	0.9	0.9
Principal producer (% of ECOWAS)	Ghana 99.3	99.1	99.2	92.5	91.4	91.7	95.2	94.1	97.7	99.5	99.4	100
<b>Iron Ore</b>												
Total ECOWAS ('000' Tonnes)	33.8	35.6	34.6	36.2	39.4	28.4	30.2	27.2	27.7	29.3	26.0	28.4
% share of World	4.4	4.5	4.4	4.3	4.4	3.2	3.3	3.2	3.2	3.2	2.9	3.3
Principal producer (% of ECOWAS)	Liberia 66.0	69.0	66.4	65.0	65.2	64.8	68.8	63.9	75.1	67.9	66.8	69.4
<b>Manganese Ore</b>												
Total ECOWAS ('000' Tonnes)	399	467	509	290	252	409	312	292	317	254	250	233
% share of World	2.0	2.2	2.4	1.3	1.1	1.6	1.2	1.2	1.4	1.0	0.9	1.0
Principal producer (% of ECOWAS)	Ghana 100	100	100	100	100	100	100	100	100	100	100	100
<b>Crude Petroleum</b>												
Total ECOWAS ('000' Tonnes)	52.8	74.1	89.8	100.9	110.0	95.8	102.3	103.4	93.4	113.7	100.3	69.9
% share of World	2.3	3.1	3.5	3.5	3.9	3.6	3.5	3.4	3.0	3.6	3.3	2.5
Principal producer (% of ECOWAS)	Nigeria 100	100	100	100	100	100	100	100	100	100	100	100
<b>Phosphates</b>												
Total ECOWAS ('000' Tonnes)	2.6	3.3	3.3	4.0	4.4	3.5	3.9	4.9	4.6	4.8	4.3	4.2
% share of World	3.1	3.8	3.5	3.3	3.6	3.2	3.6	4.2	3.7	3.6	3.1	3.0
Principal producer (% of ECOWAS)	Togo 58.0	52.0	58.4	56.8	58.0	Senegal 51.5	Togo 53.0	58.3	61.5	60.8	68.1	52.7
<b>Rutile</b>												
Total ECOWAS ('000' Tonnes)	44.1	11.9	-	-	-	-	-	-	-	7.5	45.4	50.8
% share of World	10.5	3.0	-	-	-	-	-	-	-	2.1	10.4	14.0
Principal producer (% of ECOWAS)	Sierra Leone 100	100	-	-	-	-	-	-	-	100	100	100
<b>Salt</b>												
Total ECOWAS ('000' Tonnes)	151	196	222	210	237	210	213	216	219	195	195	195
% share of World	0.11	0.14	0.15	0.14	0.14	0.13	0.13	0.13	0.13	0.11	0.12	0.12
Principal producer (% of ECOWAS)	Senegal 77.9	59.2	60.9	57.9	63.3	63.3	66.7	60.0	67.3	71.8	71.8	71.8
<b>Tin Ore</b>												
Total ECOWAS ('000' Tonnes)	8.0	7.4	6.8	5.9	5.5	4.7	3.8	3.3	3.1	2.9	2.7	2.4
% share of World	3.9	3.6	3.2	2.9	2.7	2.1	1.7	1.6	1.4	1.3	1.2	1.0
Principal producer (% of ECOWAS)	Nigeria 99.5	99.0	99.0	98.8	99.2	99.0	97.6	99.0	95.8	96.6	95.7	95.8
<b>Uranium</b>												
Total ECOWAS ('000' Tonnes)	46	431	3077	2623	2712	1305	1460	1441	2062	3616	4129	4366
% share of World	.25	2.3	15.7	13.2	14.2	6.4	6.2	5.1	6.1	9.6	9.5	9.9
Principal producer (% of ECOWAS)	Niger 100	100	100	100	100	100	100	100	100	100	100	100

Source: Institute of Geological Sciences, World Mineral Statistics, various issues

- Notes: 1 Tonnes expressed in metric units, each unit approximately 7 barrels on average for crude petroleum  
2 Coal constitutes sub-bituminous only  
3 Phosphates constitute both rock and aluminium phosphates  
- No production, negligible or not available

Crude petroleum increased marginally from 2.3 to 2.5 per cent after reaching a peak of 3.9 per cent in 1974. Oil exploration and seismic research is actively being pursued in most of the coastal countries especially Ivory Coast, which is already producing small quantities of crude, Guinea-Bissau, Ghana and Sierra Leone. Some of the major producers of West Africa's minerals, include Nigeria (petroleum, coal and tin); Guinea (bauxite); Ghana (diamonds, gold); Liberia (iron ore); Niger (uranium); Togo (phosphates) and Sierra Leone (rutile).

As a share of the GDP, mining (industry) has improved from 11 to 30 per cent in 1960-81 for West Africa as a whole (Table 2F). As the table shows these percentages vary between countries. By 1981 mining had represented over 30 per cent of the GDP in Nigeria, Guinea and Niger, and less than 20 per cent in most countries. Between the last two decades, mining has shown substantial growth only in Guinea (from 2.3 to 14.1 per cent). It has declined very sharply in most other countries, especially Mauritania (from 14.1 to -4.0 per cent) and Nigeria (14.7 to 6 per cent). Negative growth rates of -2.2 per cent and -3.6 per cent were registered in Ghana and Sierra Leone respectively for 1970-81.

Rapid depletion and the insufficiency of investment capital have largely accounted for the declining performance of the mining sector in most of the affected countries. In some countries like Sierra Leone, Ghana and Liberia where the smaller and more valuable minerals (gold and diamonds) are mined, smuggling is also a major factor. In Sierra Leone in particular, Funna (1982 and 1983) has also stressed the lack of meaningful contribution from the expatriate mining companies and has therefore argued for

'institutionalising' the capacity of government in its contractual mine negotiations with these companies. As in agriculture, the basic constraints for the mining sector are the product of government policy which now requires rationalising on a regional basis. Clearly, in Sierra Leone, the increased government participation in mining activity (ie through nationalisation; partial or majority equity participation; and joint ventures) has not improved the performance of the mining sector in recent years.

#### 2.5.2.3 Industry and Manufacturing

Another important characteristic of the West African economies is the weakness and rudimentary nature of industrial and manufacturing processes. Historically, West African manufacturing depended largely on the small household unit and concentrated on such activities as black-smithing, gold-smithing and pottery with little import-input content. Production was essentially for domestic consumption although several finished products most of which now form part of the region's imports were traded in border markets. These manufacturing processes were severely constrained by the indifferent and biased colonial policies as well as by the conservatism of expatriate enterprises most of which were merely agents of colonial administration (see for instance, Hopkins, 1973).

Few new manufacturing processes and opportunities have developed in West Africa since the introduction, during the colonial period, of the so-called 'first stage processing' which in essence was conceptualised into the 'import-substitution' industrial strategy. Historically, this form of industrialisation had always started off with the processing of agricultural raw materials and

simple manufactures essentially to replace imports, but quite often with a margin for exports.

Modern manufacturing in West African is still a first stage processing activity that is heavily biased towards the processing of agricultural raw materials. A few minerals have been added to the list (see Table 2I). It is dominated by low technology and light industries and consists mainly of the production of consumer goods and simple manufactures. Food, beverages and tobacco, textiles, clothing and footwear constitute the main manufacturing components. A few countries like Nigeria, Ivory Coast, Ghana and Senegal have relatively advanced and diversified their manufacturing industries to include much heavier assembly industries for the production of more durable and capital goods, eg tiles, cement, building materials, vehicles and cars.

With the notable exception of Senegal, the share of the manufacturing sector in total production of West African countries is generally below 15 per cent (see Table 2F). There is evidently a considerable variation in the share of this sector in the GDP among individual countries. There are a few countries like Benin, Burkina, Ivory Coast, Mauritania and Niger whose manufacturing sectors have performed relatively better between 1960-81 in relation to the GDP. In Ghana and Togo, the manufacturing sector has deteriorated badly (in growth terms) over the last two decades. Nigeria has probably one of the most advanced manufacturing sectors in the region (the other being Ivory Coast), but the ratio of manufacturing output to GDP has been diminished by dominance of the oil sector. In growth terms, the manufacturing sector has slowed down in virtually all countries between the sixties and the

seventies, except notably Nigeria where it grew marginally from 9.1 to 12.4 per cent.

**Table 2I ECOWAS: First-Stage Processing of Selected Primary Products**

Raw Material	Processing Activity	Processed Product
Palm kernel fruit	Nut-cracking and oil-milling	Palm kernel and palm oil
Cotton Seed	Ginning	Cotton lint
Rubber latex	Crepe making	Crepe
Cocoa pod	Extraction and sun drying	Cocoa beans
Coconut	Kernel extraction and drying	Copra
Groundnut	Shelling and oil milling	Groundnut oil
Cassava	Peeling, grating and roasting	Gari
Paddy rice	Hulling	Rice
Coffee	Extraction and drying	Coffee
Logs	Saw-milling	Sawn timber and plywood
Raffia	Fibre extraction and drying	Coir
Hides and skin	Tanning	Leather
Tin ore	Cassiterite separation/smelting	Tin
Bauxite	Dressing/smelting	Bauxite/aluminium
Diamonds	Dressing	Diamonds
Gold	Smelting	Gold

Source: Onyemelukwe and Filani, op cit, p 77

The basic problem of the manufacturing sector in West Africa is the extent to which the inherent import-substitution strategy can be rationalised to reduce the import-input content and/or improve upon existing value-added levels of exports. No doubt, the existing structure of manufacturing production reflects the relatively low level of economic development in the region, as well as the undiversified nature of most economies. Conceivably, backward and forward linkages of manufacturing processes either within the sector or in relation to the other sectors of the economies are severely limited and national markets are relatively small. Given the importance of market size as a pre-requisite for meaningful rationalisation and fuller realisation of the linkage effects of manufacturing activities, there is no doubt that meaningful inter-member country industrial linkages are required and can only be achieved through concerted planning within the framework of regional co-operation.

#### 2.5.2.4 Transport and Communications

The development of basic infrastructures in an economy - power, transport and communication - has to anticipate and precede growth in the rest of the economy. Their adequacy and efficiency must be analysed therefore not only in terms of the physical availability of such facilities in fixing the size of the market in geographical terms, but also, in relation to the underlying costs in defining the depth of the market in social, political and economic terms. Indeed, in all three respects, the marked deficiencies and sparse pattern of West Africa's infrastructural facilities are apparent in all member countries.



In power supply for instance, there is a great dependence on petroleum imports and rising cost of these in recent years has increased the incidence of power black-outs and exaggerated the heavily skewed rural-urban power distribution pattern across the region. The cost of rural-urban transportation facilities has increased correspondingly and this has had serious implications for the flow of goods and services between these two areas. Of course, in nearly all countries, infrastructural facilities are concentrated mainly in the principal cities as against the rural areas.

An equally important feature of West Africa's infrastructural system is the notable lack of meaningful intra-regional linkages. Air and shipping facilities between West African countries are limited either by the lack of indigenous ownership and/or control in them or because they are concentrated mainly on overseas routes. Intra-regional inland road links are poor and generally impaired by frequent border closures which are basically the product of badly managed customs/immigration procedures and inter-state conflict. Moreover, the problem of the inadequacy of intra-regional telecommunications links is such that telex, cable and telephone messages necessarily have to be channelled through overseas transit centres, notably Britain and France.

These infrastructural deficiencies in West Africa have obviously been recognised by the UN Economic Commission for Africa (ECA) in its 1978-88 Transport and Communications Decade, as well as by the Organisation of African Unity's (OAU) Lagos Plan of Action (1980). Consequently, the ECA's Global Strategy has recommended in particular, the improvement of inter-country transport through the simplification of border-crossings, adoption of bilateral reciprocal

arrangements on vehicle movements, harmonisation of transport-oriented financial arrangements, standardisation of travelling documentation, and further experimentation with 'appropriate technology' in solving West Africa's transport problems. It cannot be denied that even where the need to improve their infrastructural facilities is sufficiently recognised, the efforts of most West African countries are severely impeded by the huge capital expenditures and executive capacity involved. Although geophysical obstacles have often made intra-West African transport development for instance prohibitively expensive, the logic of economic integration in the sub-region demands a balanced transport and communications network. While high intra-regional transport costs may give 'natural protection' to a number of small-sized enterprises which outweighs the benefits of economies of scale, by the same token, poor communications, involving time-consuming procedures and insufficient information sharing, can only retard economic growth and regional co-operation. The absence of a satisfactory integrated transport and communications system in West Africa represents another important constraint for the expansion of intra-regional trade and industry.

## **2.6 INCOME AND GROWTH**

Although there are serious conceptual and empirical differences and problems regarding the definitions, computations and comparisons of GNP and GDP estimates, especially as they pertain to the LDCs (see for instance, Rimmer 1984, pp 19-62), the fact remains that in West Africa not only are the absolute levels of income low, but the rate of economic growth in nearly all economies in the seventies has

been slow relative to that in many other developing countries. Moreover, in many West African economies, growth rates have generally been slower in the seventies than those registered by the same countries in the preceding decade and the evidence of the levels of economic performance achieved so far in the early eighties points to a worsening future unless of course the crucial role of domestic policies and regional co-operation and integration is more fully appreciated.

As shown in Table 2A, eleven of the sixteen West African countries fall within the World Bank's conception of 'low-income' countries in 1981 (GNP per capita of less than \$410), all of which, except Ghana, are further classified into the World Bank's conception of 'least developed' countries. The five remaining countries fall within the 'middle income' range (GNP per capita of \$410 or more). Those five countries (Ivory Coast, Nigeria, Liberia, Mauritania and Senegal) account together for 68.8 per cent of total West African population and for 85.9 per cent of total GNPs. For Nigeria alone these proportions are 57.1 and 72.2 per cent respectively.

The disparity in per capita incomes between the West African countries is such that the highest of \$1,200 (Ivory Coast) is more than six times the lowest of \$190 (Guinea-Bissau and Mali). There are only three countries (Ivory Coast, Nigeria and Liberia) with a per capita income of more than \$500. The West African average of \$685 may be compared with estimates for the same year of \$12,820 in the United States, \$9,110 in the United Kingdom, \$2,140 in Brazil and \$5,670 in Trinidad and Tobago. In three countries (Ghana, Niger and Senegal) the average annual growth rate in per capita income in

1960-80 was negative, while for the rest of the countries (except Gambia, Ivory Coast, Nigeria and Togo) the rate fell well below 2 per cent.

Another important feature of West Africa's income patterns is the high level of interpersonal inequality. Estimates of Gini coefficients of income equality for five countries - Benin, 1959; Ivory Coast, 1959 and 1970; Nigeria, 1960 and 1967; Senegal, 1960; and Sierra Leone, 1968 - range between 0.45 and 0.60 (0.34 in Niger). A coefficient of between 0.7 and 0.8 was estimated for Nigeria in the mid-1970s. The share in total income of the lowest 40 per cent is estimated at 10 per cent or less in the Ivory Coast, Nigeria, Senegal and Sierra Leone (Rimmer, 1984, p 47). In Sierra Leone (1967-68) the 'lowest 20 per cent' receive only 5.6 per cent of total income compared with a share of 52.5 per cent by the 'highest 20 per cent'. These estimates may be compared with 4.5 and 42.8 per cent in the United States (1972) and 7.3 and 39.2 per cent in the United Kingdom (1979) (World Bank, World Development Report, 1983). What greater income inequality signifies to those countries experiencing it may be debatable. Certainly for West Africa, greater inequality points to marked differences in earnings between rural and urban population and between the different sectors of the economies, as well as to serious lapses in government fiscal and monetary policies, all of which help to further explain the existing production and consumption patterns in the region as a whole.

Growth rates in West Africa have deteriorated from a range of 1.1 per cent (Cape Verde) and 8.5 per cent (Togo) in 1960-70 to -0.2 per cent (Ghana) and 6.2 per cent (Ivory Coast) in 1970-81. Growth has been particularly weak in Cape Verde, Ghana, Guinea-Bissau,

Liberia, Mauritania and Sierra Leone, all of which recorded growth rates of less than 3.0 per cent in the seventies. Only three countries - Ivory Coast (6.2 per cent), Mali (4.6 per cent), and Nigeria (4.5 per cent) - have recorded through the seventies rates of over 4.0 per cent.

The generally slow and in many cases declining rates of growth described above can be explained differently. Notably, the impressive growth rate in the Ivory Coast was achieved chiefly on the strength of its agricultural sector, while that in Nigeria is not surprisingly a result of the boom in its oil industry. Many of the slow growth countries have been plagued by drought of increasing frequency and severity. In other countries such as Liberia and Sierra Leone, growth has been inhibited by declining or stagnating production of the principal export commodities - iron ore, rubber and diamonds. This is also true for Ghana, once the world's largest cocoa producer. In yet many other countries, growth has been severely disrupted by continuing internal conflict and political instability.

Furthermore, West Africa's recorded slow rates of growth are of even greater concern as account is taken of the relatively rapid growth of population. Again only the four countries with the highest growth rates have registered rates significantly higher than the rate of population growth. In the rest of the countries, population has either grown much faster than economic growth or both rates are marginally the same (see Table 2A).

Given these trends in West Africa's overall economic performance, certainly the structure, appropriateness and timing of economic management policies could not have remained neutral. In

practice it is the nature and application of these policies in most countries, especially in respect of resource management, that have also accounted for the varying growth rates among them. In general, however, the slow and declining growth rates in the region can also be explained first, by the apparent failure of the import-substitution industrialisation strategy through which there has been little foreign exchange savings; second, by the superficiality of economic plans most of which have lacked feasible projects, supporting economic surveys, adequate inducements for private sector investment, implementation discipline and sufficient financing; and third, by sheer neglect of the traditional agricultural sector.

## 2.7 CONCLUSIONS

In general, the level of development of any region is largely a function of the structure of its economy. And the level of development itself is reflected in the structure of the economy. West Africa, in the socio-economic sense, is typical of an underdeveloped area, exhibiting the common characteristics of underdevelopment. This chapter has highlighted the extent of diversity and similarity that exist between West African countries in these basic structural socio-economic characteristics in terms of geo-physical conditions, natural resource endowment, political conditions and economic performance.

These features, as already indicated, are fundamental in explaining and understanding the need and scope for integration in West Africa as well as the issues affecting its effectiveness. Indeed, for the individual West African micro-state, economic integration is now a sine qua non for improving resource

exploitation, sectoral performance, the predominantly subsistence economy, international relations and bargaining conditions and, hence, for enhancing growth and development. The highly undeveloped character of input-output relations and the evidently lacking socio-economic complementarity within and among West African economies provide even stronger reasons for striving towards effective economic integration within the region.

There has, of course, been no lack of efforts or continued interest in economic co-operation or integration among West African countries especially after achieving political independence in the late fifties and early sixties. In general, however, many of the schemes are either defunct, not functioning or barely surviving. Many of the reasons for this can be traced from the foregoing discussion of the main structural dispositions of the member countries. There are two other important factors that are also applicable to LDC economic integration in general. The first is the fact that often the short-run effects of integration are not favourable and the expected gains from integration may not accrue for a long time, and in any case, these gains are generally uncertain, difficult to quantify and sometimes less tangible than the potential costs of integration. The second reason for the slow progress and apparent failures of LDC economic integration is attributed largely to the outright adoption of the conventional integration framework, ie customs union formation. The discussion in the next chapter illustrates and discusses these points in relation to West African economic integration. In essence, the chapter outlines the potential benefits of economic integration, re-enforces the need for more effective integration among the member

countries and, at the same time, analyses the major factors that have severely impeded effective integration within the institutional framework of the ECOWAS.



## CHAPTER 3

### ECONOMIC INTEGRATION IN WEST AFRICA: PROBLEMS AND PERSPECTIVES

#### 3.1 INTRODUCTION

The discussion in this chapter is divided into two broad parts. The first section looks briefly at developments in the traditional theory of economic integration and outlines the fundamental reasons extended for the limited practical relevance of the theory for economic integration among developing countries. The discussions on this issue have more recently stressed the relevance of the 'dynamic' rather than 'static' effects of economic integration in analysing the need and potential gains of economic integration among LDCs.

In the second section, we will firstly survey the progress of economic integration in West Africa in relation to its institutional build-up up to the Senegambia (1981) which represents the latest integration grouping in the region. Secondly, and more importantly, attention will be focussed on the progress of economic integration within the institutional framework of ECOWAS which, agreeably, has been very slow and substantially ineffective in realising its objectives. The key factors that are responsible for this and which also have immediate bearings on the future perspectives of economic integration in the region as a whole are analysed. In this respect, the factors stressed are the economic disparities among the ECOWAS member states and the polarization tendencies, the high incidence of political fragility and ambivalence, financial constraints as they affect the members' budgetary contributions to ECOWAS, the question whether ECOWAS can and should coexist with the three relatively more

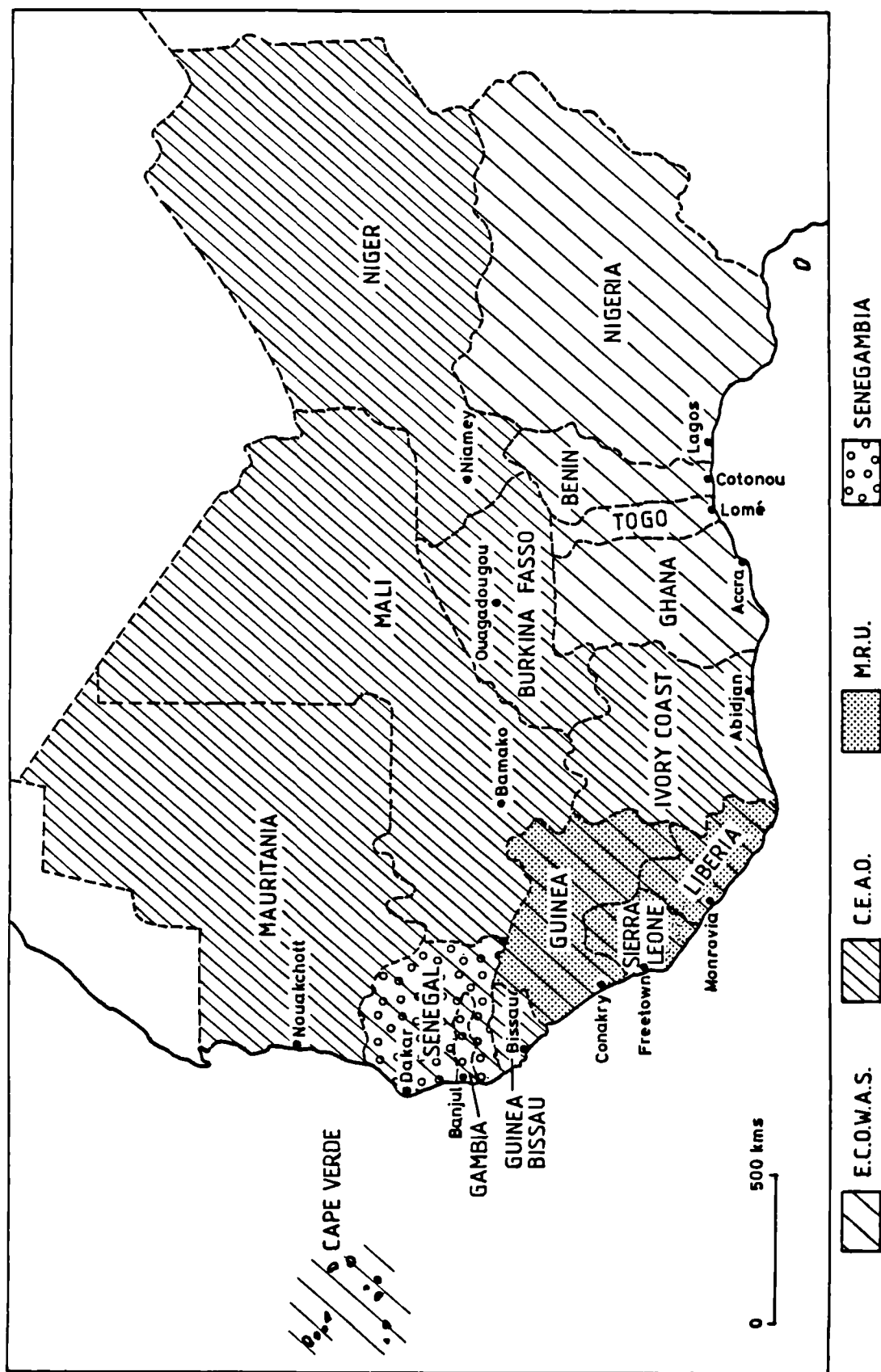
active sub-regional economic groupings - the CEA0, MRU and Senegambia (see Figure 3.1) - and external influences.

In so far as the future of ECOWAS is concerned, the study emphasises that this can not be improved without instituting meaningful and realistic monetary relations among West African countries. In dealing with this hypothesis, the discussion in this chapter is important in two respects. Firstly, it demonstrates in part the apparent limitations of theoretical pre-conditions in dealing with those empirical issues requiring effective integration in West Africa. Secondly, the factors identified as the main constraints for economic integration are basically those factors that have also reflected the narrow scope and equally slow progress in monetary integration in the region and on which further developments in monetary integration in West Africa also depend. The problem of the co-existence between ECOWAS and other sub-regional economic groupings, in particular the CEA0, is specifically significant for realising the proposed institution of a single common currency to embrace the whole of ECOWAS. This is because within the CEA0, which comprises half of ECOWAS membership, there already exists a common currency arrangement - the CFA franc - that has lasted long among all its members but one - Mauritania.

## **3.2 THE TRADITIONAL THEORY OF ECONOMIC INTEGRATION AND DEVELOPING COUNTRIES**

### **3.2.1 Static Effects of Economic Integration**

The post-war years have been characterised by widespread enthusiasm for the formation of economic co-operation and integration schemes both among the developed and the developing



Source : Redrawn from Robson, P (1983), Integration, Development and Equity: Economic Integration in West Africa (London: George Allen & Unwin).

Fig. 3-1. Economic Communities in West Africa.

countries. This enthusiasm is derived from a complex of motives and sentiments. In Western Europe, it began with the search for permanent peace and world order and was later transformed into the need for the so-called 'market-integration'. This concept in itself is considered wide and complex but the main emphasis as is derived from the Treaty of Rome has been the establishment of supranational organisations for the creation of a common market within the European Economic Community (EEC). Integration according to this broad objective distinguishes five consecutive stages - the free trade area (FTA), the customs union (CU), the common market (CM), economic union (EU) and total economic integration (TEI) (Balassa, 1976).

In the Eastern bloc, the formation of the CMEA (Council for Mutual Economic Assistance) in 1949, within which 'socialist integration' is conceptualised, was not in the beginning considered as a process of economic integration. As Simai and Garam (1977) have observed, the CMEA in its initial objectives served as an instrument for promoting economic co-operation among its members but purely as a defence function against trade embargo policies existing at the time. The formation of the CMEA, instead, came mainly as a reaction of the East European countries to the Marshall Plan and to the policies of the United States at the time, thus stressing political elements in CMEA integration. However, since the late sixties and early seventies (the period when the word integration was began to be used in official CMEA documents) socialist integration has set itself the aim of 'achieving rapid economic, scientific and technical progress in all members and of raising the material and cultural standards of their peoples through deep

structural changes in the economy in accordance with the objective requirements of scientific and technical progress' (Ezenwe, 1983, p 42).

In LDCs also, historic, socio-political and economic considerations have combined to explain the enthusiasm for economic integration among them, designed initially in the hope of achieving satisfactory and lasting solutions to their trade problems. Thus, in the early postwar period, economic integration among developing countries was considered primarily as a way of extending the policy of import-substitution on a regional scale. In more recent years, the urge for a broader conceptualisation of 'development integration' for LDCs has been strengthened by the serious limitations of the import-substitution policy itself and the multi-dimensional pattern of the development constraints in LDCs. Consequently, economic integration among LDCs is considered as one of the policy options available to them and as part of an overall strategy for economic development.

Politics, economic folklore and misconceptions account for some of the rising enthusiasm for integration (Robson, 1971, p 9). Nevertheless, it is generally agreed that a properly conceived economic integration scheme provides a number of potential beneficial consequences, which are discussed in the literature under two headings: static effects and dynamic effects. Static effects refer to the welfare gains or losses from a marginal reallocation of production and consumption patterns, under given assumptions - eg economies of scale are disregarded; the terms of trade are constant; prices adequately reflect opportunity costs; and trade is balanced. On the other hand, dynamic effects refer to the various possible

ways in which integration affects the rate of growth of GNP of participating countries. A comparative schema of both types of considerations is presented in Table 3A.

The primary concern of the traditional theory of economic integration has been to evaluate the desirability of customs unions from the world's welfare viewpoint and using static effects as criteria (Yu-Min Chou, 1967, p 19).

Under given assumptions, the normative implications of the pioneer work of Viner (1950) distinguish between two effects of a customs union: trade creation and trade diversion. In this limiting case, Viner uses the term trade creation to describe a shift of production from the dearer to a cheaper source, whereas trade diversion involves a shift from the lower cost producer outside the union to a higher cost source to supply within it. He points out that trade creation raises the home country's welfare, while trade diversion lowers it so that if on balance the trade creation effect is predominant, there is an increase in efficiency in the sense that through the geographical reallocation of production, more can be produced from given resources. In other words, as Spraos (1964) interprets the concepts, trade creation means that the same world output of a community can be obtained for a smaller sacrifice of alternatives whereas in trade diversion the same output can only be obtained at the cost of a longer sacrifice of alternatives. Viner suggests that a customs union formation should be judged to have a 'good welfare effect' or 'bad welfare effect' according to which effect is predominant and concludes that a predominantly trade creating customs union benefits at least one member country and the

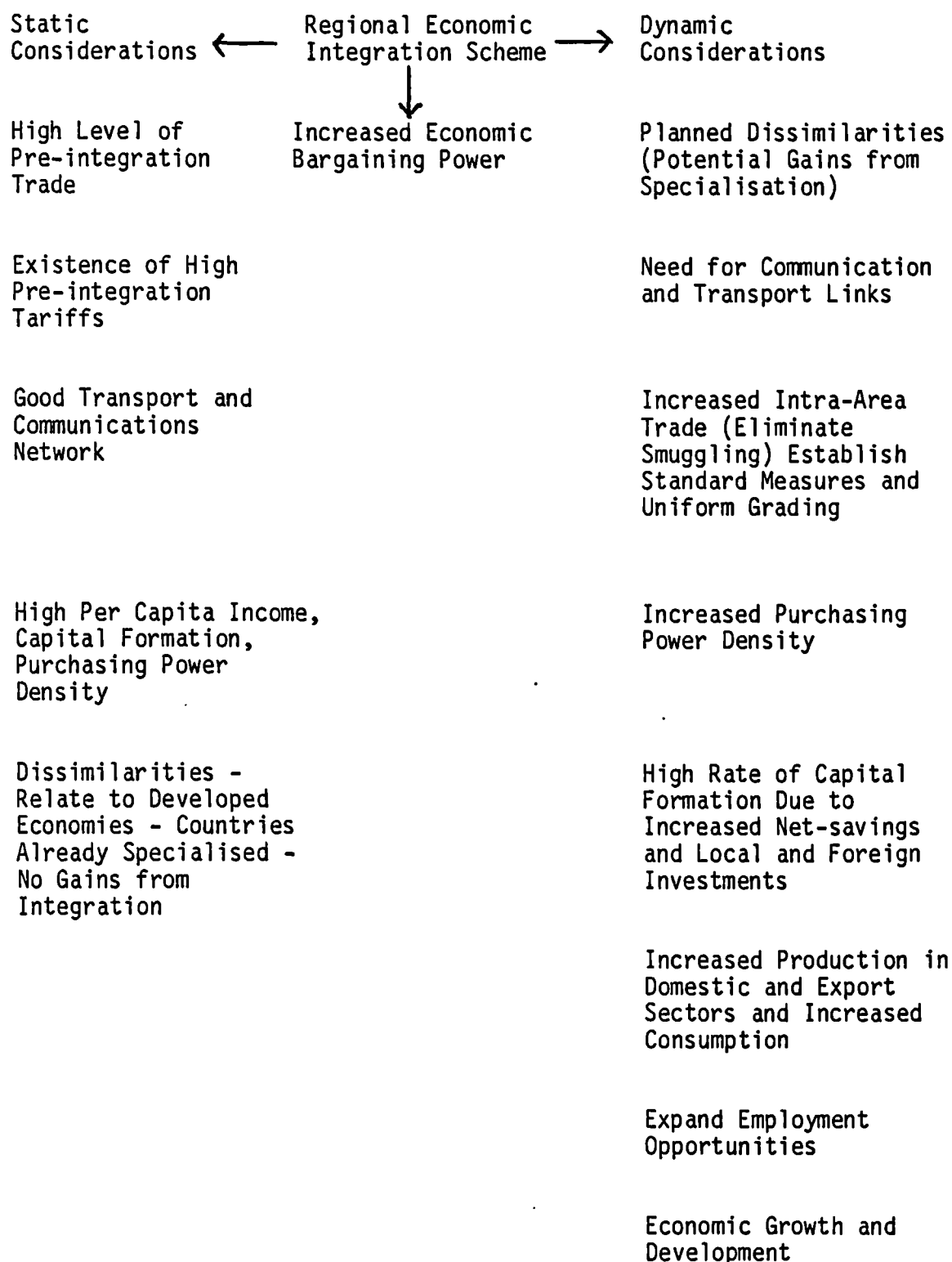
world as a whole, while a trade diverting union injures at least one member country and the world at large.

Thus in its simplest form the Vinerian analysis leads to the important conclusion that a customs union raises the world's welfare if its trade creation effect outweighs its trade diversion effect. Therefore to predict the welfare effects of a customs union, it is necessary to determine the relative strengths of the forces influencing trade creation and trade diversion. The analysis further implies that trade creation, from the point of view of free trade, is a move in the right direction whilst trade diversion is a move in the wrong direction. The former occurs when the constituent economies are competitive in products, rather than complementary, prior to the formation of a customs union.

Viner's basic conclusions have been commented on by later writers. Meade (1956) suggested that the trade creation and trade diversion effects should not be measured in terms of the size of trade diverted only. A better method, according to Meade, would be to compare the product of trade diverted multiplied by the rise in its cost, and the product of trade created multiplied by the fall in its cost.

Viner's confinement to production effects - assuming demand curves of zero elasticity and supply curves of infinite elasticity - was commented on by Gehrels (1956). He introduced the consumption effects of a customs union as 'the response of consumers to the drop in import prices caused by the tariff removal (p 61). Gehrels conceived of positive consumption effects only which should be added to trade creation effects in evaluating the gains or losses of a customs union.

**Table 3A Schema of Static and Dynamic Considerations for Economic Integration**



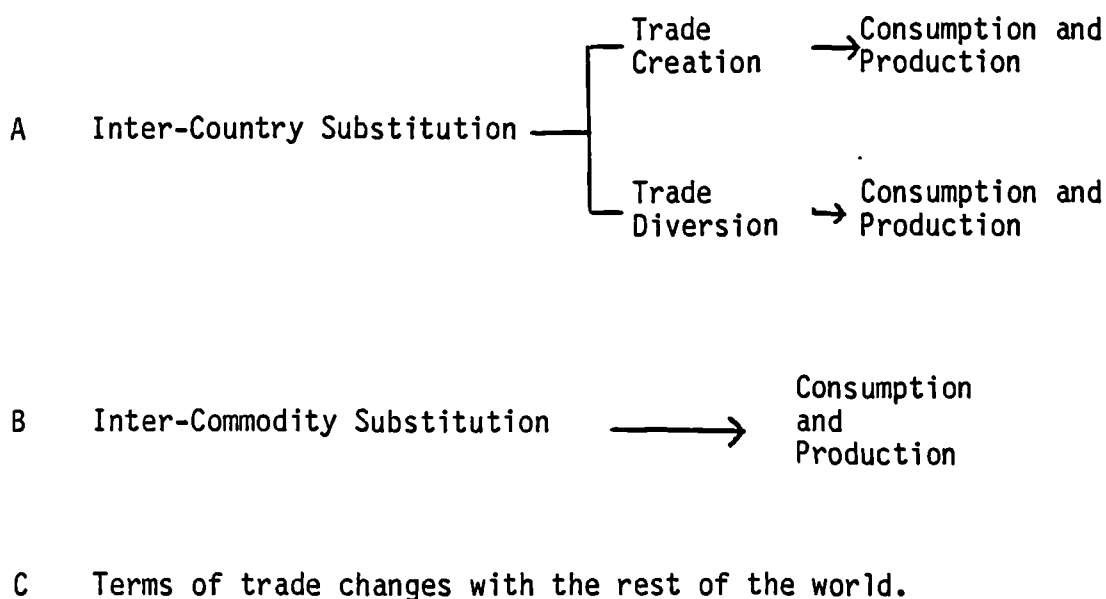
Source: Kanu, S M B, 'Economic Integration and Development in West Africa', unpublished PhD dissertation, University of Reading, 1976, p 36



Lipsey's (1956, p 211) basic criticism of the Vinerian analysis also stressed the important omission of the consumption effect but, unlike Gehrels, he suggested that 'in general, the consumption effect, like the production effect, can work either to raise or to lower welfare'. Lipsey (1957 and 1960) demonstrated further that national and even world welfare may be improved by a trade diverting customs union if a favourable consumption effect outweighs an unfavourable production effect. He argues that this criticism of Viner is valid not only because union members are going to increase the total consumption of intra-union goods through mutual trade while reducing their consumption of extra-union goods but, also, because Viner's analysis assumes that commodities are consumed in some fixed proportions without reference to changes in relative prices. Since a customs union changes relative prices, this should lead to some substitution between commodities that would tend to increase the volume of intra-union imports and diminish both the volume of imports obtained from third countries and the consumption of an individual member country's home produced commodities.

Scitovsky (1958) on the other hand considered such effects as increased competition, economies of scale, change in the volume and location of investment, and terms of trade.

The full schema of static effects which emerge from these elaborations of the traditional integration theory is as follows:



The justification for this schema is argued on the basis that consumption effects will themselves cause changes in production. In general, either of these effects (inter-country and inter-commodity substitution) will cause shifts in both consumption and production.

The emphasis on the static effects in the traditional theory of economic integration is considered inevitable on two counts. The first is that it is consistent with the static approach in international trade theory whereby economic integration is conceived as 'that branch of tariff theory that deals with the effects of geographically discriminatory changes in trade barriers' (Lipsey, 1960, p 261). Secondly, and more significant, it is consistent with the relative importance of adjustments likely to occur once a group of developed countries decide to integrate. Furthermore, as Balassa (1965, p 16) explains, the theoretical literature of economic integration has dealt almost exclusively with customs unions of industrial economies, where the problem has not primarily been one

of economic development but of relatively marginal adjustments in production and consumption patterns. However, in view of the structural characteristics of LDCs as were outlined earlier in the case of West Africa, their patterns of production and consumption are such that substantial adjustments and rationalisations are required in them for the furthering of development and regional integration. It is basically in this respect that the traditional theory is rendered less relevant for LDC economic integration.

### **3.2.2 Dynamic Effects of Economic Integration**

Most of the writers who have considered the problems of development in LDCs and therefore the potential role of economic integration in solving these problems have strongly indicated the limited relevance of the traditional theory on this front (see for instance Meir, 1960; Allen, 1961; Seers, 1965; Cooper and Massell, 1965; Myint, 1965; Balassa, 1965 and Jaber, 1971). They have pointed out several arguments in support of this view and which Jaber (1971, p 256) has summarised as follows:

First, economic integration in the case of LDCs should be treated as an approach to economic development rather than as a tariff issue. Accordingly, it combines various aspects which could improve the international trade position as well as the level of economic development of LDCs.

Second, the emphasis should be put on dynamic rather than static effects in evaluating the desirability of economic integration among LDCs. The present economic structure is not acceptable and each LDC is trying individually to introduce positive changes. These changes are not marginal but structural. Their net

effect will not be felt over a short period of time. Accordingly, any evaluation of economic integration schemes should concentrate on potential or dynamic effects, such as:

- (a) the economies of scale brought about by the enlargement of the market size;
- (b) the external economies which reduce costs;
- (c) the polarisation effect which refers to the cumulative worsening of the economic position of a member state of some regions in the integrated area due to concentrated trade creation or attractiveness of production factors;
- (d) the effect on investment allocation; and
- (e) the effect on economic efficiency and smoothness of trade transactions due to the changes in the degree of competition and in uncertainty and unilaterality of trade policies of member states.

There are understandably minor variations among the writers on the extent to which these arguments can be carried through in support of LDC integration without worsening world welfare. However, the general reformulation and extension which they have suggested for the standard theory for LDCs rests on three strands of thought: first, that customs union theory should contribute to a more equitable distribution of income; second, that trade diversion might be inevitable in a developing country; and third, that the standard theory must incorporate dynamic aspects.

The necessity of these conclusions is explained in several ways. Firstly, Viner considers trade diversion a negative production effect which necessarily reduces welfare. The limitations of this effect appear once the existing economic structure of LDCs is considered and in a dynamic setting.

In the first place many writers have argued that trade diversion is basically taking place in LDCs through the import-substitution industrialisation strategy. The choice then is between trade diversion in favour of the domestic producer at any cost and trade diversion in favour of the most efficient producer in the region. In general, however, there seems little doubt that a pattern of industrialisation that is based on greater specialisation within the region will be more economically rewarding than one based on production by each country for its own domestic market, especially for the smaller countries (Mikesell, 1963).

Another version of this argument is that the rate of growth of domestic demand for small LDCs individually does not readily assume optimum capacity of output or, indeed, allow for a large volume of quantity demanded which would enable domestic firms to achieve real cost reductions over a reasonable time period. Thus economic integration among LDCs would therefore make this process of trade diversion more efficient in terms of reducing real costs over a shorter period (Bhambri, 1962, p 245).

Secondly, in most LDCs there exists a situation of generally low productivity, and in some sectors marginal productivity might approach zero. Also, unemployment is not uncommon. If trade diversion moves labour from low productivity to more productive activities, it will bring about a welfare gain. The evaluation of

integration among LDCs should not therefore be confined to production and consumption effects; income and unemployment effects are equally important.

Thirdly, when imports of most LDCs are disaggregated, trade diversion appears to occur only in non-durable, and to a less extent in durable, manufactured consumer goods. In a static situation, no trade diversion or creation is likely to occur in their imports of capital goods which in most cases represent a very significant proportion of total imports. In a dynamic situation, it is argued that a higher rate of growth conceived by an economic integration scheme would require a larger investment. Since a large portion of this investment is imported as capital goods, the level of imports of integrated LDCs might then increase. In any case, the long run impact of a regional trading arrangement is not to decrease trade with the rest of the world at any cost but rather to rationalise and change its pattern and then enlarge it.

However, some writers (see for example Bhambri, 1962, and Linder, 1967, p 127) have argued more specifically that economic integration among LDCs should aim at trade diversion from the developed countries. Hence, the effectiveness of such economic integration then is to be indicated by the success of such trade diversion process.

Finally, trade creation, like trade diversion, should be looked at in dynamic terms. The dynamic trade-creating effect results from the increase in income of the integrated area and through the foreign trade multiplier. It is argued that this effect would be large enough to outweigh the dynamic trade diversion effect of economic integration among LDCs. Kitamura (1966, p 53) states,

'The income effects, so far as trade with the outside world is concerned, will clearly tend to increase considerably the scope for beneficial exchange of goods with third countries, and this secondary trade expansion may very well more than offset the possible initial reduction of this particular type of trade'.

While recognising the limited relevance of the traditional theory to LDCs, it has also been argued that the theory has made some generalisations, albeit in judging the desirability of economic integration in developed countries, which can apply to LDCs as well (see for instance Allen, 1961). Viner, for instance, has raised the issue of competitiveness and complementarity in product markets and has suggested that the more the partners are competitive (complementary) in the sense of producing similar (dissimilar) products, the more (less) favourable economic integration would be. Makower and Morton (1953, p 35) added that with larger cost differences among partners the gain from economic integration would also be larger.

The traditional theory has also held that, in general, the larger the size of the customs union, the larger the gains in welfare; inadequate transport facilities tend to limit the gain from economic integration among LDCs; the higher the initial tariff rates and the lower the common external tariff, the larger the welfare gain of economic integration; a customs union is more likely to raise welfare the higher is the proportion of intra-union trade and the lower the proportion of extra-union trade; and a customs union

is more likely to raise welfare the lower is the volume of foreign trade as a percentage of GNP of member countries.

As in the case of the production effects, the relative validity or reality of these generalisations for LDCs has also been discussed in the light of the existing economic features of LDCs. For example, being specialised in primary products, LDCs tend to be more competitive in the Vinerian sense. Nevertheless, this general state of competitiveness, on balance, limits the welfare gain of economic integration among them. The fact is that most LDC primary products are export-oriented, consequently economic integration among them, in these circumstances, would not bring about a sizeable expansion of their intra-group trade. Clearly the criterion of competitiveness and complementarity can not particularly be relevant to LDCs unless it is given a different conception as in the case of the trade diversion effect. Moreover, where GNP is taken as a measure of the size of a union to determine the size of the welfare gain, the implication is that the gain from integration among LDCs is small or even negligible. Such gain depends not only on the given size of the union but also on the rate at which it increases. There is sufficient empirical evidence to show that mutual trade among LDCs is small and rarely growing. The obvious implication is that welfare gains from static effects will be small in their economic integration process. While the implications of some of these generalisations may appear plausible in the static case, some may not be accepted at face value. Perhaps the more critical implication of these generalisations is that the 'possibility of a universal theory of customs unions and economic development is automatically ruled out' (Linder, 1967, p 32). Consequently some



writers have suggested a specific approach to deal with economic integration of LDCs which, in essence, accepts industrialisation as a legitimate policy goal and considers how membership in a customs union may enable a developing country to achieve more economically the ends served by protection (see for example Cooper and Massell, 1965, p 462).

Robson (1983) has observed that there is also no automatic case for economic integration among a purely random group of LDCs nor is there a generalised path or concept of the type of integration process these countries must follow. Nevertheless, the general conclusion is that integration among LDCs must integrate both the static and dynamic considerations if it is to address itself to the multidimensional problems of the member countries' development efforts. Both these considerations and problems are better understood only if full recognition is taken of the several and varied issues and structural features which characterise the integrating countries and which also pose the most serious constraint to the progress of co-operation and integration among them.

To the extent that the problems of integration are related more to their causality than their symptoms, the principal issues that become more apparent in evaluating its progress among LDCs therefore include the following:

- (a) the incompatibility of political systems with integration in general or with the machinery selected for implementing integration;

- (b) problems of political relations between integrating countries, frequently with territorial implications (ie geopolitical problems);
- (c) differences among member countries in the level of industrial development achieved and in their potentials or capacity for such development - the main expression of which is the dissatisfaction of some members with the distribution of benefits and costs of integration;
- (d) other differences in economic structures which affect the machinery and therefore the objectives of integration;
- (e) the difficulty in determining an appropriate scope and direction of regional trade, development and specialisation in operational terms;
- (f) the lack of a clear vision of the implications for integration of the growth and operations of foreign enterprises on the pattern of regional trade and productivity.

Accordingly, some writers like Andic, Andic and Dosser (1971), for example, have added a new composite evaluation criterion - development creation - and significantly generalise the minimum structure of standard stages of economic integration into a multiplicity of different arrangements involving preferential tariffs product by product or country by country both within the grouping and towards outside countries.

While the combination of static and dynamic considerations may have provided the urge and setting for the formation of general economic groupings among LDCs, in practice the experiences of most

of the major groupings that have emerged (see Table 3B) have been very disappointing. The constraints are generally common to all although in some instances the relative importance of each constraint has varied between groupings. For example, the reasons for the final collapse of the East African Community in 1977 were mainly the product of polarisation effects as Tanzania and Uganda equally resented the skewed distribution of trade, industrialisation, services and other integration benefits in favour of Kenya, the most developed and industrialised member of the Community. The experiences of the Andea, CARICOM, CACM and LAFTA have indicated the critical importance of such issues as incomprehensiveness and the lack of clarity and precision in legal provisions dealing with aspects of community justice, defence, supranationality, infrastructures, distribution of gains and costs as well as the problem of trying to sustain enthusiasm for integration. In the Andean, these issues precipitated the 1974/76 crisis and also led to Chile's withdrawal from the grouping in 1976 (Vargas-Hidalgo, 1979).

After ten years of its existence, many of these and other obstacles that have tended to impede the progress of economic integration in other Third World groupings have already begun to surface in the ECOWAS. No doubt, important lessons can be drawn from the experiences of these groupings. For the rest of this chapter we will examine the performance and problems of economic integration in West Africa.

**Table 3B Major Economic Groupings Among Developing Countries**

Year of Formation	Grouping	Membership
1959	West African Customs Union (UDEAO) replaced in 1972 by the West African Economic Community (CEAO) under the Treaty of Abidjan Equatorial African Customs Union (replaced in 1964 by the Central African Customs and Economic Union UDEAC)	Benin, Ivory Coast, Mali, Mauritania, Niger, Senegal, Burkina  People's Republic of Congo, Cameroon, Gabon, Central African Republic, Equatorial Guinea (1983) (Chad withdrew in 1968 but was readmitted in 1983)
1960	Latin American Free Trade Association (LAFTA) - established under the Treaty of Montevideo)  Central American Common Market (CACM-established under the Managua Treaty)	Argentina, Brazil, Chile, Mexico, Paraguay, Bolivia Uruguay, Columbia, Peru, Ecuador, Venezuela, Guatemala, Honduras, Costa Rica, Nicaragua, El Salvador
1964	Arab Common Market - established under the Council of Arab Economic Unity (CAEU)	Iraq, Jordan, Syria, United Arab Republic
1967	East African Community (EAC - created under the Treaty for East African Co-operation but was dissolved in July 1977) Association of South-East Asian Nations (ASEAN)	Kenya, Tanzania, Uganda  Singapore, Malaysia, the Philippines, Indonesia, Thailand
1968	Caribbean Free Trade Association (CARIFTA - became the Caribbean Community (CARICOM) in 1973)	Jamaica, Trinidad and Tobago, Guyana, Barbados, Belize, St Lucia, St Vincent, Grenada, St Kitts-Nevis, Dominica, Antingua, Montserrat
1969	Andean Common Market or Andean Group (set under the Andean Pact; also known as the Cartagena Agreement)	Chile, Columbia, Peru, Venezuela, Ecuador, Bolivia

**Table 3B continued Major Economic Groupings Among Developing Countries**

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1975	Economic Community of West African States (ECOWAS - established under The Treaty of Lagos)	Benin, Cape Verde, Sierra Leone, The Gambia, Ghana, Guinea-Bissau, Senegal, Guinea, Mauritania, Mali, Niger, Nigeria, Burkina, Togo, Ivory Coast, Liberia
1983	Economic Community of the States of Central Africa (ECSCA)	Angla, Burundi, Cameroon Central African Republic, Chad, Congo, Equatorial Guinea, Rwanda, Sao Tome, and Principe, and Zaire

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### 3.3 THE EMERGENCE OF ECONOMIC GROUPINGS IN WEST AFRICA

#### 3.3.1 Sub-regional Groupings

As already noted, several efforts have been made on economic co-operation in West Africa during the post-independence years, especially by the francophone countries (see Table 3C). However, apart from the ECOWAS and its Clearing House (WACH), the Mano River Union, Senegambia, and the exclusively francophone CEA0, most of the schemes that have emerged are either defunct or barely functioning. Also, excluding the above schemes, the rest of those that are marginally operating either reflect simple primary commodity arrangements or are based on the implementation of specified projects and cannot therefore be strictly defined as economic integration arrangements. Besides, other groupings like the CPA (Cocoa Producers Alliance), APC (African Groundnut (Peanut) Council), and the IACO (Inter-African Coffee Council) are extra-regional in that membership in them by West African countries is shared with outside countries, especially in Africa.

The most significant feature of West African economic integration (critically the most important threat to ECOWAS) is that much of the efforts towards integration have come from among the francophone countries. Of the fifteen groupings listed in Table 3C, combined francophone and anglophone membership is in no more than seven (three of which are project-related and are also in a state of paralysis), the rest are exclusively francophones. Although some of these all-francophone schemes have ceased operating, eg the UDAO and UDEAO, or are hardly operational, eg Entente, the evidence is that francophone West Africa has advanced much faster in economic integration than anglophone West Africa.

Table 3C Economic Organisations in West Africa

	ECOWAS	UDAO	UDEAO	CEAO <sup>a</sup>	Entente	RNC	CBC	OERS	OMVS	OMVG	MRU	Senegam	OCCAM	UMOA	MACH
Dates of formation	1975	1959-66	1966-72	1972	1959	1963	1964	1968-71	1972	1978	1973	1981	1962	1962	1975
Benin	X	X	X	X	X	X							X	X	X
Burkina Faso	X		X	X	X	X							X	X	X
Cape Verde	X		X	X	X	X									X
Gambia	X									X					X
Ghana	X														X
Guinea	X					X		X			X				X
Guinea-Bissau	X									X					X
Ivory Coast	X		X	X	X	X					X		X	X	X
Liberia	X										X				X
Mali	X	X	X	X		X		X	X				X	X	X
Mauritania	X	X	X	X		X		X	X				X	X	X
Niger	X	X	X	X	X	X		X	X				X	X	X
Nigeria	X					X		X							X
Senegal	X	X	X	X				X	X		X	X	X	X	X
Sierra Leone	X										X				X
Togo	X			X	X										X

Notes: a Benin and Togo have observer status only

Key: ECOWAS Economic Community of West African States (Communauté Economique des Etats de l'Afrique l'Ouest - CEDEAO)  
 UDAO West African Customs Union (Union Douanière de l'Afrique de l'Ouest)  
 UDEAO Customs and Economic Union of West Africa (Union Douanière et Economique de l'Afrique l'Ouest)  
 CEAO Economic Community of West Africa (Communauté Economique de l'Afrique l'Ouest)  
 Entente The Entente Council (Conseil de l'Entente)  
 RNC River Niger Commission  
 CBC (Lake) Chad Basin Commission  
 OERS Organisation of Senegal River States (Organisation des Etats Riverains du Senegal)  
 OMVS Senegal River Development Organisation (Organisation pour la Mise en Valeur du Fleuve Senegal)  
 OMVG Gambia River Development Organisation (Organisation de Mise en Valeur de Fleuve Gambia)  
 MRU Mano River Union  
 Senegam Senegambian Confederation  
 OCCAM Organisation Commune Africaine et Malagache  
 UMOA West African Monetary Union (Union Monétaire Ouest - Africaine)  
 MACH West African Clearing House (Chambre de Compensation de l'Afrique de l'Ouest)

This skewed pattern of economic integration in West Africa has been historically explained on two grounds. It was partly because the francophones, unlike the anglophones, had the advantage of geographical contiguity (see Figure 2.1). But a more important explanation has been that the French Union, of which French West Africa was a part, was (and still is) more closely knit politically and economically than the British empire to which the British West African countries belonged. Indeed both the French West Africa (AOF) and British West Africa (BWA) had similar institutional arrangements commonly shared among the respective colonies - eg common currency, transport, trade, production, defence and other services - but not in the method of political administration by and over the constituent colonies.

Significantly, the AOF had a 'government-general' that was based in Senegal to administer over the territories and its common currency and customs arrangements have survived. Moreover, it is generally believed that most of the francophone economic integration efforts even after independence have been largely at the instance of France's continued interest in strengthening the French Union. By contrast, after independence, the common institutional arrangements among the BWA countries - eg the West African pound, West African Airways Corporation and West Africa Cocoa Research Institute - were dissolved and each country established its own institutions. Certainly for these countries, political and/or economic integration has been overshadowed by the stronger urge to maintain and sustain national sovereignty at all cost.



Of course, some writers have however argued strongly that unity (or integration) under such colonial groupings as the AOF and BWA was illusory and therefore operationally disintegrating for West Africa, so that strong foundations were not laid for the enhancement of a deeper need and sense of economic integration in West Africa after independence. Hazlewood (1967, p 3) argues that the unity under these institutions was for 'the administrative convenience of the colonial power - a unity of Europe in Africa, reflecting the hegemony of the metropolitan country over its various colonies. It was not to be expected that, with the removal of Europe from the scene, the unity would necessarily continue'. Ezenwe (1983, p 6) on the other hand, maintains that even in the case of French West Africa, the sequence of measures introduced by France long before independence to support the French Union - eg the Assemblies (1952), the loi-cadre (1956); territorial distribution of power (1956) and the alternative choices open to the colonies in the 1958 French Constitution - complete independence, independence within the French Community or absorption as a 'Department of France' (1958) - had a destructive effect on the integration that had been established between the French colonies.

This factor apart, West Africa as a geopolitical expression presents a formidable challenge to received integration theory and practice. Despite the dynamic conceptualisation of economic integration, free-trade-area, customs-union and common-market objectives have characterised both the sub-regional groupings and the ECOWAS, and it is in the areas of implementation of these objectives that little success has been achieved.

The first customs union of West African states (Union Douaniere de l'Afrique de l'Ouest (UDAO) failed because of over-ambitious goals, inflexible provisions and a complex and dilatory machinery, especially in the system of revenue collection and fiscal harmonisation. Similarly, the failure of the second West African customs union (Union Douaniere des Etats de l'Afrique de l'Ouest or UDEAO) which replaced the UDAO in 1966 was attributed largely to the lack of compliance by the member countries (faced for the most part with serious budgetary problems) with the so-called three principles of the Union - free exchange of goods and persons between member states, the establishment of a common external customs tariff, and the sharing of customs receipts amongst all member states (see for instance, Ezenwe, 1983 and African Research Bulletin, 2347A). In the CEA0, the replacement for the defunct UDEAO in June 1972, the establishment of a common external tariff intended for 1985 is still to be achieved, while in the MRU, there has been little progress in implementing the union's two phased customs union programmes.

In the CEA0, however, there has been mutual agreement to simplify and harmonise the structure of customs duties and other indirect taxes. Fiscal compensation in the CEA0 is payable to member states in respect of the revenue losses deemed to be incurred as a result of the provision of intra-CEAO preferences under the regional co-operation tax (Taxe de Cooperation Regionale - TCR) for traded manufacturers of 'local origin' (the expression 'goods of local origin' is interpreted variously but with emphasis on the source of the traded commodity as well as on the proportionate share of domestic/indigenous input content on its manufacture. For a more detailed description, see for example, Mano River Union Commission

on Industry and Trade, July 1976). These losses are defined as the difference between the duties that would be imposed on a product imported from a third country not subject to the droit de douane and the duties imposed under the TCR regime. The driot de douane is a relatively small component - presently 5 per cent - of the aggregate fiscal import duties charged by the CEA0 member states. The required interbudgetary transfers are affected through the Community Development Fund (FCD). But the common industrial policy, intended to have been established within three years of the CEA0's creation, is also yet to be realised.

During its first ten years of existence, the MRU, in contrast to the CEA0, has nonetheless taken more significant strides in infrastructural build-up between its member states. These include; in the transport and communications - the Union Bridge between Liberia and Sierra Leone was commissioned in 1976; in trade - the adoption of harmonised customs and excise legislation, administration and procedures in 1981; in project and industrial development - the implementation of feasibility studies for a Union Basin Development Project and for the establishment of an industrial development unit; and in manpower training - the establishment of Union training institutions on maritime, telecommunications and postal services, customs, forestry, excise and trade statistics.

Unlike the CEA0, the MRU does not possess a common monetary system as each member country operates its currency and monetary arrangements without sub-regional co-ordination. The CEA0 on the other hand has had the advantage of entrenching the already existing CFA franc common currency system within its operations although this

system also has hardly enhanced the process of economic integration among its members.

More specifically, progress of integration within the MRU and the CEA0 has been constrained by issues of disparate political and socio-economic positions as well as by the suspected unfair distribution of integration costs and benefits, especially in terms of the flow of mutual trade.

In most cases, suppressed socio-political differences and the increasing level of disparate national economic development and interests between member states, as their respective domestic economic social, and political problems escalate, have given rise to open inter-state conflicts. In the MRU, this situation has resulted to frequent border closures and, in one instance, to the temporary suspension (ie immediately after the military take-over in Liberia in 1980) of Union activities. With military regimes (still relatively unsettled) in Guinea and Liberia and a constitutional government in Sierra Leone, the political life of the MRU depends essentially on the level of co-existence, balance and understanding between the ideologies and operational framework of these different leadership structures. The recurring political discord, especially between Sierra Leone and Liberia, has severely strained the ratification and implementation of MRU Protocols and Decisions, while budgetary contributions to the Union Secretariat are increasingly short and have lagged far behind the due dates. For instance, by the end of 1985, budgetary arrears in the MRU had stood at around \$7.25 million (ie Guinea, \$4 million; Sierra Leone, \$2 million; and Liberia, \$1.25 million).

In the CEA0, despite its intentions to promote economic co-operation and development among its member states on a rather more cautious, equitable and balanced basis (Treaty of Abidjan, 1973) than its preceding groupings, integration efforts are more seriously impaired by the inherent conflict of interests between its relatively more developed coastal countries (ie Senegal and Ivory Coast) and the less developed, semi-desert landlocked members. As is illustrated elsewhere in the study, trade between these two groups of countries is evidently skewed, with the smaller states resenting Ivory Coast and Senegal's political and economic dominance. In the defunct UDEAO, for instance, Ivory Coast was accused of exporting predominantly manufactures to the smaller states while importing mainly raw materials and animal products from them, thereby making its industrial and manufacturing base much stronger at the expense of the other members.

Integration efforts between The Gambia and Senegal were urged as far back as the 1960s mainly on the grounds that geographically The Gambia, wholly surrounded by Senegal, except on its seaward margin, cuts an 'irrational intrusion' in Senegalese territory, which provides a significant outlet for a high incidence of smuggling and other illegal exchange and trade practices. It was argued further that for both countries, the geographical intrusion had meant the inability to exploit more fully the agricultural, port and ancillary facilities of the Gambia River. Before the Confederation in 1981, (which recreated what was Senegambia, 1765-83), several co-operation agreements had been signed between the two countries following a UN Report in 1964. These included a Defence Pact (1964), Cultural Agreement (1967), a trade agreement (1970),

and a Convention (1976) on which the Gambia River Development Organisation (OMVG) was established in 1978.

However, unlike other West African economic groupings, the Senegambia was created purely on military rather than economic expediency, following Senegal's military intervention in the take-over attempt in The Gambia. Consequently, the economic conceptualisation of the Senegambia is still undefined as both member countries have indicated different forms of economic integration for Senegambia. The Gambia supports a confederation without loss of any form of sovereignty, while Senegal has opted for a move towards an integrated state and a new country - Senegambia (West Africa, 24 August 1981). For now, the smouldering fear is that once the dust (ie military expediency) finally settles, The Gambia may wish to reassert its political sovereignty, thereby bringing the grouping to a premature end.

As far as the monetary integration aspect of Senegambia is concerned, there is still an element of uncertainty as to the adoption of the proposed monetary union. Meanwhile three alternatives are available. Firstly, The Gambia could maintain the dalasi freely convertible into the CFA franc (which circulates widely in The Gambia already) at an irrevocably fixed rate. Secondly, Senegal may withdraw from the CFA zone and then re-enter, together with Gambia, as Senegambia. In the process, the dalasi would be replaced by the CFA franc or a new Senegambia currency. Thirdly, The Gambia would enter the CFA franc zone as a full member. The adoption of either options has implications for The Gambia in respect of its sterling relationship, while for Senegal, the implications are for its membership in the CFA franc zone.

Certainly the infusion of the dalasi into the CFA franc system by any means seems more logical and practical, although where this is achieved, it will further strengthen the influence of the francophones in determining the course of monetary unification for ECOWAS. In the event the two states continue to exist autonomously within Senegambia, it is apparent that Senegal's relatively more developed and export-oriented industrial sector would threaten the sustenance of the confederation through marked polarization effects.

Although the achievements of these three sub-regional economic groupings from the point of view of their stated objectives may not have been encouraging, yet their continued existence as rival integration schemes, poses the biggest potential danger facing ECOWAS and therefore needs priority attention.

### **3.3.2 The Economic Community of West African States (ECOWAS)**

#### **3.3.2.1 The Lagos Treaty and Aims of ECOWAS**

The inception of the Economic Community of West African States (ECOWAS) on 28 May 1975 in Lagos, Nigeria, came after many years of hesitation, vacillation and politicking that lasted over a decade (see Table 3D). Despite continued support from the United Nations Economic Commission for Africa (ECA) - through Resolutions 132 (8) and 145 (7) passed at the Seventh Session, Nairobi, 1965, and thereafter, a series of organised research and conferences on economic integration in West Africa - the transition towards ECOWAS was marred firstly, by the 'great Francophone-Anglophone divide' in West Africa; and secondly, by a long impasse (1968-72) which resulted from a series of internal political unrests in some of the

more active countries, especially Nigeria (see Chapter 2, especially Section 2.4).

Finally, a 'shuttle diplomacy' by Nigeria and Togo and the adoption of the Nigeria-Togo WAEC (West African Economic Community) proposals in 1973 by the first ministerial meeting to comprise all but one (Cape Verde) of the sixteen West African countries led to the birth of ECOWAS in 1975. A draft ECOWAS Treaty in line with the WAEC objectives was drawn in 1974, adopted by a Ministerial Council in January 1975, and was signed and ratified by a Lagos Summit (May 1975) represented by eleven countries. By the end of 1975, the Treaty was ratified by fifteen member countries, and Cape Verde adhered soon after.

In broad terms, the Lagos Treaty committed the sixteen ECOWAS member states to the gradual elimination of customs duties and, quantitative and administrative restrictions on trade; the establishment of common customs tariff, free movement of persons, labour and capital; and the harmonisation of agricultural, industrial, fiscal, monetary and overall economic policies.

Specifically in Article 2(i) of the Treaty the member states aspire:

'... to promote co-operation and development in all fields of economic activity, particularly in all fields of industry, transport, telecommunications, energy, agriculture, natural sciences, commerce, monetary and financial questions and in social and cultural matters for the purpose of raising the standard of living of its peoples, of increasing and maintaining economic stability, of fostering closer relations among its



members and of contributing to progress and development of the African continent.'

To this end the Treaty further provides that the Community shall, by stages ensure:

- (a) the elimination as between the member states of customs duties and other charges of equivalent effect in respect of the importation and exportation of goods;
- (b) the abolition of quantitative and administrative restrictions on trade among member states;
- (c) the establishment of a common customs tariff and a common commercial policy towards third countries;
- (d) the abolition as between member states of the obstacles to the free movement of persons, services and capital;
- (e) the harmonisation of the agricultural policies and the promotion of common project in the member states, notably in the fields of marketing, research and agro-industrial enterprise;
- (f) the implementation of schemes for the joint development of transport, communication, energy and other infrastructural facilities as well as the evolution of a common policy in these fields;
- (g) the harmonisation of the economic and industrial policies of the member states and the elimination of disparities in the level of development of member states;
- (h) the harmonisation, required for the proper functioning of the Community, of the monetary policies of the member states;

**Table 3D Genesis of the Economic Community of West African States (ECOWAS)**

Date	Meeting	Main Features of Meeting
November 1963	Lagos Conference on Industrial Co-ordination in West Africa	-
January 1964	Inaugural Speech by President William Tubman, Liberia	Introduced idea of Free Trade Area in West Africa
August 1964	Meeting between Ivory Coast, Sierra Leone and Liberia in Monrovia	Issued Communique supporting President Tubman's proposals
October 1964	Bamako Conference on Co-ordination of Industry	ECA/FAO sponsored meeting on regional industrial location. Proposed the establishment of a multilateral Iron and Steel industry
February 1965	Interim Committee of Ministers	Agreement for creation of an interim organisation for Economic Co-operation; signed in Freetown in May, Interim Secretariat established in Monrovia in Sept; Mr Donald George (Sierra Leone) as Admin Sec
August 1965	Interim Committee of Experts	Discussion of issues relating to co-ordination of industries
October 1966	ECA/West African states meeting in Niger	Discussion on regional economic integration; first anglophone-francophone meeting comprising all West African states except Cape Verde and Guinea-Bissau; recommended multinational programme for development of power supplies

**Table 3D Genesis of the Economic Community of West African States (ECOWAS) continued**

Date	Meeting	Main Features of Meeting
April-May 1967	2nd ECA/West Africa meeting in Ghana	Articles of Association or co-ordination and harmonisation of macro-economic policies and on intra-regional trade expansion drawn; Interim Council of Ministers established with temporary secretariat in Ghana
November 1967	1st meeting of Interim Council of Ministers in Senegal	Preference expressed for a West African Common Market rather than free trade over a customs union
April 1968	Monrovia Conference of West African Heads	Attended by 9 of the 14 states, (Gambia, Ghana, Mali, Guinea, Liberia, Mauritania, Nigeria, Senegal, Burkina Fasso); adopted protocol establishing a West African regional grouping; commissioned preparation of draft treaty (Liberia and Senegal) and list of priority studies (Nigeria and Guinea)
April 1972	Nigeria-Togo Heads of State meeting	Revived discussions on details of a WAEC
December 1973	First Ministerial meeting in Lome, Togo	Attended by all West African except Cape Verde. Adoption of the Nigeria-Togo proposals <ol style="list-style-type: none"> <li>1 Community institutions</li> <li>2 States in co-operation on trade, customs, immigration, monetary and financial arrangements               <ol style="list-style-type: none"> <li>a A preparatory stage - 2yrs</li> <li>b elimination of tariff and fiscal charges - next 8yrs</li> <li>c Setting up a CET - next 5yrs</li> </ol> </li> </ol>

Table 3D Genesis of the Economic Community of West African States (ECOWAS) continued

Date	Meeting	Main Features of Meeting
		3 Industrial harmonisation 4 Natural resources 5 Intra-West African payments arrangements 6 Infra-structural links - transport and communications 7 Mechanism for settlement of disputes
February 1974	Accra Meeting of Experts and Jurists	Draft Treaty of ECOWAS drawn
January 1975	Second Ministerial meeting in Monrovia Liberia	Adoption of Draft Treaty
May 1975	Lagos Summit of Heads of State and Government	Treaty was signed and ECOWAS launched; by December all 15 signatures had ratified the Treaty and Cape Verde adhered in 1977
November 1976	Lome Heads of State Summit	Five protocols signed; Nigeria chosen as ECOWAS Secretariat; Ivorian as 1st Secretary General; Niger chosen as Secretariat for ECOWAS Fund for Co-operation, Development and Compensation

Note: For more details please see Onwuka (1977); Africa Research Bulletin and West Africa, (various issues, 1966-77)

- (i) the establishment of a Fund for Co-operation, Compensation and Development; and
- (j) such other activities calculated to further the aims of the Community as the member states may from time to time undertake in common; (Article 2(2)).

In Article 12, the priority concern of the Community is a customs union, to be established in the course of a transitional period of fifteen years from the definitive entry into force of the Treaty. Within this customs union, the Treaty provides that customs duties or other charges with equivalent effect on imports shall be eliminated; quota, quantitative or like restrictions or prohibitions and administrative obstacles to trade among the member countries shall also be removed; and the common customs tariff in respect of all goods imported into the member-states from third countries shall be established and maintained.

Accordingly, in Article 13, the implementation of the essentials of a customs union - the elimination of all tariff and non-tariff barriers to trade - is timetabled into three stages:

- (a) a period of two years (to 1981) within which member states are not required to reduce or eliminate import duties;
- (b) a period of eight years (to 1989) over which member states must adjust and ultimately eliminate their import duties on intra-community trade; and
- (c) a period of five years (to 1994) over which the common external tariff is to be established.

The Treat also stipulates a timescale for the implementation of those other aspects that are closely related to trade liberalisation and customs union.

Significantly, however, apart from providing for general 'co-operation in monetary ..... matters' (Article 36), and the creation of a Committee of West African Central Banks to oversee the payments system within the Community (Article 38), the Lagos Treaty, unlike the Senegambia Confederation Pact, does not commit the ECOWAS signatories to monetary union.

On the Community's organisational structure, the Treaty establishes five institutions: the Authority of Heads of States and Government; the Council of Ministers; the Executive Secretariat; the Tribunal of the Community; the Technical and Special Commissions. Other important Treaty provisions include the appointment of an External Auditor of the Community's accounts; and the establishment of a fund for co-operation, compensation and development as a mechanism for the equitable distribution of the benefits and costs of integration. The Fund is to be financed from members' contributions, income from community enterprises, external receipts, and subsidies and contributions from all other sources (Articles 4-11, 38 and 50).

#### 3.3.2.2 Benefits and Progress of ECOWAS

The economic case for the establishment of the ECOWAS, in common with other LDC economic groupings, hinges on the assumption that the size of the market is of paramount importance for large scale production. Through the concepts of trade creation and trade diversion, the ECOWAS member states, especially the smaller and relatively less economically developed and diversified countries like Cape Verde, The Gambia, Guinea-Bissau, Liberia, Sierra Leone

and Togo, should be able to stimulate their production capacities in a relatively more efficient manner. Concurrently, ECOWAS should create a single potential market of over 150 million consumers, covering an area of 6,143,000 square kilometres (see Table 2A) for each producing country. Through the economies of scale, this vast market area should create opportunities for specialisation, efficiency, expansion, employment and growth.

In addition, ECOWAS should, within the context of positive rather than negative integration, be capable of evolving and implementing a concerted development framework that would improve upon a wide range of monetary, fiscal and general economic activities such as transport and communications, industrial capacities, food production for domestic consumption, trade, solutions for climatic, social and demographic obstacles, etc. Effective co-operation on industrial location and competition, for instance, would reduce the level of non-complementarity in production processes, while that on trade would expand the currently low level of intra-regional trade, averaging less than 10 per cent of total foreign trade. It should also reduce the high incidence of smuggling and other illegal trade practices which have constituted an effective source of foreign exchange leakages in many countries. An integrated transport and communications network on the other hand should reduce the extremely high international transactions costs and help to bring member countries much closer than as present. Presently, over 75 per cent of airline, shipping and telecommunications services in West Africa are directly or indirectly under expatriate influences with hardly any directional or beneficial control by West African countries. In general, an

effective ECOWAS should be able to reduce the general economic disparities among the member states and also generate closer political co-operation between them, a sine quo non for the achievement of full economic integration.

Because of its multidimensional context, involving, through traditional and dynamic effects, various changes in the political, legal, ideological, general economic and socio-political superstructures, it has been quite difficult to derive a generally acceptable method or quantitative indicators in determining the degree or progress of regional economic integration among a group of countries. This situation is acknowledged by a number of eminent integration analysts including Verdoorn and Von Bochore (1972), Beyarslan (1977), Shishkov (1977) and Ivo Fabric (1977).

Following the pioneering work of Balassa (1967), empirical studies aimed at measuring the Vinerian production effects of integration conclude positive integration if a significant trade creation effect is found. Beyarslan in particular, criticises this approach on two counts. The first is that the approach is confined only to the foreign trade sector ( $X - M$ ) in the income-expenditure model of:

$$Y = C + I + G + X - M,$$

where the variables represent income, consumption, investment, government, exports and imports respectively.

This method, Beyarslan analyses, tries to show that it leaves no room for the analysis of monetary and income policies which converge towards the expanded four sector Keynesian system. Since economic integration is sought in labour, money, bond and commodity markets, its gross effect should be seen in a diminishing of the price, wage, interest rate and bond yield differential between the



integrating countries. This wide conception also takes care of Beyarslan's second objection that the above approach does not provide for a direct measure of integration because it takes no account of 'merging' labour, commodity, money and capital markets.

Shishkov advises that attempts at measuring the degree of regional economic integration must be preceded by a clear conception of what integration is. Once this is clear, its progress can then be determined by the degree of unity in all aspects of its reproduction framework as well as by indirect indices such as synchronization of individual synthesizing economic processes and the alignment of levels of certain structural indices of economic development. The fuller the integration of the member economies, the freer the movement of commodities, capital and manpower of the integrated area and more conditions are present for the alignment of economic development levels.

The ECOWAS Treaty does make provision for the realisation of a high level of integration between the West African countries especially in the areas of commodity and labour markets. The money and capital markets in the region as are discussed elsewhere in the study, are still rudimentary. After only a few years of existence, it may be obviously inappropriate to attempt any quantitative measure of the progress of ECOWAS in line with the above approaches. The first eight years of the grouping (1975-83) have only witnessed gradual progress in institutional-building which has only meant 'putting flesh on the bones of the Treaty' (Robson, 1983). In this connection, the Community has adopted several important protocols and decisions on a number of community issues relating to compensation, rules of origin, free movement of persons, privileges

and immunities and on non-aggression, yet significant progress has still to be made in providing operational content to these as well as to some of the more general provisions of the Treaty. In particular, there has already been a substantial delay in bringing into operation the second stage for trade liberalisation, which involves the reduction of tariff and non-tariff barriers. This implies a corresponding delay in establishing a community CET and, hence, in realising the overall objective of creating a West African Common Market.

In the meantime, however, most of the ECOWAS economies have, irrespective of integration, continued to stagnate or deteriorate, while intra-community trade has also remained relatively low and stagnating in relation to overall external trade. A very pertinent question at this point is to ask what the problems of ECOWAS are regarding its performance and future survival. The more serious these problems are, the more critical are the implications for monetary unification within the institutional framework of the ECOWAS.

#### 3.3.2.3 Outlook and Problem Areas for ECOWAS

Despite the evident potential advantages of economic integration in West Africa there are many issues needing urgent but very cautious treatment if these advantages are to be realised. Like integration itself, these issues are complex and multidimensional, ranging from the more general technical and administrative difficulties, which are common to all forms of integration, to the more structural constraints that are peculiar to Third World integration groupings in general and to West Africa

in particular. As in several other regional economic groupings, the ECOWAS is equally vulnerable to the critical issues of political and ideological differences among the member states, their ethnic and cultural diversity, their different levels of development, the incompatibility of their economic structures, the low level of trade among them relative to overall foreign trade, poor information, transport and communications facilities within and between them and so forth. For ECOWAS in particular many of these problems are already posing increasing difficulties for its continued existence. However, in the brief discussion that follows, we regroup these problems in order to enable us to isolate those that are considered most crucial in determining the Community's future development.

#### 3.3.2.3.1 Economic disparities and polarisation tendency

In the previous chapter, we outlined some of the most salient characteristics and structural deficiencies of the West African economies. While many of these are common to all the member economies, we also observed that between them there are marked disparities. In an integration scheme that is without a mechanism to critically identify these disparities and then design a policy of agreed convergence, there is the obvious likelihood that the gains from integration will be polarised in a few partners. This tendency has several debilitating consequences for the integration process. First, it could lead to stagnation in the small and less prosperous member states. In other words, as in the case of the East African Community, growth in these partners is less likely to improve while that in the more prosperous members will tend to expand as integration progresses. This is because as the skewed distribution

of gains and losses, and the patterns of trade and development levels persist, the originally less developed and less fortunate member states will continue to remain net losers as a result of their inability to attract the positive effects of integration, notably, rising investment opportunities and expanded trade. The ultimate result is gross dissatisfaction, and rising mistrust and suspicion among member countries, and eventually, the collapse of the grouping.

With the relatively sharp divergencies in the levels of development in the West African scene, especially as between the more developed and open coastal economies and the less developed landlocked Sahel economies, the polarization tendency is quite conspicuous in the region. In particular, the polarization effect would tend to widen the development gap between countries such as Nigeria, Ivory Coast, Senegal, Ghana and to a less extent, Liberia on the one hand, and the rest of the region on the other.

Certainly, the most critical aspect of the polarisation effect within ECOWAS is the extent to which Nigeria (representing about 57 per cent and 62.6 per cent of total GNP and GDP respectively; 75.9 per cent and 67.5 per cent of total exports and imports respectively; and 40.5 per cent of intra-Community exports but less than 10 per cent of corresponding imports) would be willing and able to 'spread out' in favour of the community as a whole.

Furthermore, with the likelihood that some lowly placed ECOWAS member states or more importantly, the francophone group, could both do better from outside the Community, the high degree of commitment that is required of each member state to the Community may disappear very rapidly unless the polarization tendency is carefully and

critically analysed and then solved within the context of an equitable distribution of the integration benefits and costs.

#### 3.3.2.3.2 Political fragility and ambivalence

Apart from the member countries' conspicuously differing political background and ideologies, the long chain of fresh and recurring socio-political internal unrests and inter-state conflicts (mainly border disputes) combine with the rising degree of militarization to pose a very serious threat to the future of ECOWAS. Political instability is now more of an endemic feature of all the member states of the Community. In retrospect, political instability in the ECOWAS members had already had its historical impact during the evolution of the Community. For instance, the inability by Mali and Niger to host ministerial conferences, Sierra Leone's absence in the 1968 Heads of State Summit and the 1968-72 impasse were a spill-over effect of the political unrest in those countries at the time. Furthermore, the Community experienced a long period of inactivity immediately after its inception following the overthrow in 1975 of one of its main architects, General Gowon (Nigeria).

While the frequent occurrence of internal political unrest continues to militate against the progress of ECOWAS, there is also the ambivalent attitude of political leadership when it comes to transforming into action their verbal and/or written commitments towards Community decisions. This 'feet-dragging' syndrome is already manifesting itself in the slow process of ratification and implementation of the protocols.

As of 1981, only one out of six Protocols signed since 1978 has been fully ratified; three have been ratified by only four governments (still needing three to make them operational); one by five and one by no government. In the case of the fully ratified and therefore operational protocol on the free mobility of persons, a number of countries, eg Sierra Leone, Liberia and Nigeria, are still to implement it. This may be understandable since, in the absence of strict observance of the immigration laws and regulations in force in the various countries and, given the under-development of West Africa, serious political, social and economic difficulties in any one country may force or cause massive migration from that affected country to a neighbouring or more prosperous state. Such uncontrolled mass movement is bound to provoke hostilities against the immigrants, especially at times of economic adversity in the immigrant country. It can also result into forceful repatriations or expulsions of immigrants, thereby further accentuating interstate hostilities (eg Nigeria's mass expulsion of Ghanaians in 1982-84). By 1985 only two out of eleven protocols have been ratified by the minimum of seven member states required to make each protocol effective.

#### 3.3.2.3.3 Budgetary arrears

An initial success story to the credit of ECOWAS members was the agreement to the method of financing the Community - members' contributions to ECOWAS' operational budget were worked out on the basis of members' economic strength, with the richer members of the Community paying more. Financial contributions have however been most irregular with the majority of member states still owing

substantial proportions of their allocated commitments. The extent of debt commitments by each member country as on the 10th anniversary of ECOWAS (May 1985) is shown in Table 3E.

The increase in total arrears of more than 117 times from WAUA 123,000 to WAUA 14.5 million by the end of May 1985 corresponded with a rapid rise in the number of owing countries, from one (Liberia) for 1978 to all the 16 members for 1985. Only three countries - Guinea, Ivory Coast and Nigeria - were fully paid-up as of May 1984. Annual budgetary arrears for Liberia, Guinea-Bissau and Burkina have accumulated each year from 1978, 1979 and 1980 respectively, while for most of the other countries, the growth in arrears became more consistent since 1982.

Financial difficulties apart (scarcity of foreign exchange), the consistent growth of arrears in budgetary contributions to ECOWAS both in terms of value and in the number of debtor members also raises vital questions about the perception of member countries regarding the beneficial role of ECOWAS, about the willingness to meet the transition costs towards the realisation of the Treaty objectives, and about their interest in the community and enthusiasm for integration in general. But more recently, however, the ECOWAS Secretariat has also been accused of financial mis-management as well as of an indulgence in exceptionally high Secretariat expenditures, estimated at more than two-thirds of its annual budget (West Africa, 3 December 1984, p 3449). While answers to these reasons cannot be found unless there is a resurgence in the ECOWAS spirit, it is noteworthy that the pattern of growth in budgetary arrears over the years has not suggested any anglophone/francophone divide.

Table 3E ECOMAS: Statement of Accounts as at 31 May 1985 Showing Amounts Owed by Member States  
(In ECOMAS units of account<sup>1</sup>)

	1978	1979	1980	1981	1982	1983	1984	1985	Total	%
Benin	-	-	-	-	-	192,551	193,080	176,730	562,361	3.9
Burkina	-	-	143,885	167,881	188,201	166,877	167,336	153,166	987,346	6.8
Cape Verde	-	-	-	-	3,416	64,184	64,360	58,910	190,870	1.3
Gambia	-	-	-	-	180,463	166,877	167,336	153,166	667,842	4.6
Ghana	-	-	-	-	-	715,011	830,244	759,939	2,305,194	15.9
Guinea	-	-	-	-	-	-	-	170,839	170,839	1.2
Guinea-Bissau	-	12,525	102,703	96,854	108,577	96,275	96,540	88,365	601,839	4.2
Ivory Coast	-	-	-	-	-	-	-	765,830	765,830	5.3
Liberia	122,576	312,150	453,736	432,617	484,979	430,029	431,212	394,697	3,061,996	21.2
Mali	-	-	-	-	-	13,460	122,284	111,929	247,673	1.7
Mauritania	-	-	-	196,709	260,586	231,061	231,696	212,076	1,132,128	7.8
Niger	-	-	-	-	-	-	4,189	123,711	127,900	0.9
Nigeria	-	-	-	-	-	-	-	1,440,692	1,040,692	10.0
Senegal	-	-	-	-	-	90,702	347,544	318,114	756,360	5.2
Sierra Leone	-	-	-	85,412	318,494	282,407	283,184	259,204	1,228,701	8.5
Togo	-	-	-	-	-	-	3,998	212,076	216,074	1.5
TOTAL	122,576	324,675	700,324	979,473	1,544,716	2,449,434	2,943,003	5,399,444	14,463,645	100.0

Source: ECOMAS Secretariat

Notes: 1 One ECOMAS unit of Account (MAUA) = SDR 1.0



#### 3.3.2.3.4 Co-existence

The rather slow progress of ECOWAS has also been attributed to the existence of integration schemes within the Community. As indicated earlier, the objectives and integration strategies of these inter-governmental organisations vary widely, sometimes tending to highlight the historical differences between groups of countries. In the absence of any effort to ensure that they work in harmony, they undoubtedly represent a considerable dissipation of energy and an escalation of budgetary strains.

The critical question for ECOWAS is whether it should or could co-exist with these sub-regional economic groupings or whether there can be a continuing role for them if ECOWAS is successful. These questions relate more to the relationship between ECOWAS on the one hand, and the CEA0, MRU and Senegambia, on the other. For these sub-regional groupings, the concern is whether they in turn should harmonise and then merge their objectives and programmes within the wider context of ECOWAS or continue to operate independently of ECOWAS but with the assurance not to encroach on the respective commitment to ECOWAS of their member states. Obviously, the most logical approach would be for the sub-regional groupings to dissolve and then allow the member countries to concentrate on the ECOWAS objectives and aspirations. This option appears more difficult for the CEA0 - mainly because of the entrenched historical and monetary relationships between its members as well as between the Union and France - than it is for the relatively less integrated MRU and Senegambia both politically and economically.

Arguments against co-existence are based strongly on grounds of economic rationality for eliminating institutional overlaps and conflicts of integration objectives. Assiduously over the years, the ECA, for instance, has pursued the formation of regional economic groupings on the sound principle that it is only through collective action and the welding of small units of tenuous viability into larger, more operational entities that Africa can hope to survive in the modern world. Within ECOWAS, the merging of the CEAO, MRU and Senegambia was firmly supported by Guinea, Nigeria and the Council of Ministers during the Sixth ECOWAS Summit held in Conakry, Guinea in 1983. The most conspicuous dissenting country at the meeting was Liberia whose President Doe argued that 'we must realise that a small group of countries can promote economic co-operation and integration more rapidly than a larger group ... Countries that are more or less at the same level of development when grouped together will find it easier to agree on specific projects which would be impossible if there were wide differences between these countries'.

There are arguably a number of pragmatic considerations that would tend to favour the co-existence between ECOWAS and the smaller sub-regional groupings. Firstly, it is perfectly possible for a smaller economic grouping to exist within a larger unit as is manifested in the BENELUX and EFTA/EEC relationship. It is noted however that these two organisations, especially EFTA which is basically a trade grouping, do not possess any of the supranational features of the EEC. In contrast, the three most important economic sub-regional groupings in West Africa do to a large extent possess the same supranational features as ECOWAS except that the CEAO

operates within a central common monetary system for its members, while in the Senegambia, the initial initiative is for economic and monetary integration.

A second reason is based on the argument that it may not be advisable to do away with organisations that are already functioning, as long as those belonging to them wish them to continue. One important advantage is that it gives the members a stronger bargaining position with the politically and economically stronger member of the larger grouping, than they might have individually. Undoubtedly, there can be stronger cohesiveness within a smaller than a larger grouping.

The position of the ECOWAS Treaty on this issue is more cautious than definite. In Article 59(1) the Treaty states that:

'... member states are permitted to be members of other regional or sub-regional associations, either with other member states or non-member states, provided that their membership of such associations does not derogate from the provisions of this Treaty';

and (Article 59(2) and (3)):

'... to the extent that pre-ECOWAS sub-regional agreements, which can claim immunity against the Treaty provisions are not compatible with the Treaty, the member states concerned should take steps to eliminate the incompatibilities'.

During this period of lack of meaningful political cohesiveness in ECOWAS, the smaller groupings cannot be expected to favour a weakening of their own special arrangements. A merger is economically and politically sound but until ECOWAS shows concrete signs of developing effectual measures for monetary, fiscal and industrial harmonisation, there can be no positive strides towards this end.

#### 3.3.2.3.5 External influences

As a corollary to the coexistence problem, the future of ECOWAS is also dependent on its external relations with governments, international organisations and multinationals, all of which have tremendous influence on activities within the ECOWAS economies. The impact of international organisations, especially the UN and its organs, has been felt mainly in the agricultural sector and in the institution of structural adjustment policies, while for the multinationals, their operations, for the most part, are in mining, industry and general commerce. Much of the external influence has been expressed in terms of financial assistance and actual investment.

If the assumption that a regional grouping has potential to represent a stronger economic bargaining power for its members is accepted, it is likely therefore that West African countries, especially the smaller and less economically and politically powerful, may stand to gain more if international aid donors and investment agencies are approached within the wider context of ECOWAS. The significant presumption here is that these international institutions may, out of experience, be more ready and

willing to assist clearly defined integrated projects. Here also, ECOWAS has had the problem of competing with both its member governments as well as with sub-regional groupings. The critical point is the extent to which ECOWAS, national governments and sub-regional groupings can reconcile between that form of external assistance that is required to promote more ECOWAS integration efforts and that which is needed for the more immediate national development projects or sub-regional integration. The intention in this case must be the rationalisation of external aid, debts and investments with a view to avoiding unremunerative duplication while increasing efficiency in their utilisation, thereby increasing the positive effects of integration.

### **3.4 CONCLUSIONS**

In this chapter, we have tried to outline the traditional theory of economic integration and the extent to which its conceptualisations appear inadequate in formulating the type of economic integration that could be more appropriate to LDCs relative to their development problems. Three major reasons have been advanced: first, the traditional theory is based purely on static assumptions and analysis that are associated with integration in developed economies; second, integration in LDCs is conceptualised as a strategy for development rather than a customs union issue; and finally, the standard theory fails to recognise or give adequate attention to the role of protection and policy harmonisation which is significantly crucial to the economic integration of LDCs. Consequently, the reshaping of the standard theory in line with the requirements of economic integration for LDCs has stressed a variety

of 'dynamic' factors which should encourage the adoption of comprehensive socio-political and macroeconomic and structural policies geared to promoting growth and structural change.

Admittedly, economic integration in West Africa has been even more a question of trying to realise standard theory objectives; ie free trade areas, customs union, and common markets. In essence, problems of development - eg balance of payments adjustment, economic planning, agricultural and industrial rationalisation, socio-political instability, overall monetary and financial instability, and the establishment of close intra-regional economic relationships - are not adequately addressed in the Lagos Treaty. That the Treaty has no institutional provision for monetary unification per se within the context of ECOWAS is understandable. Little progress has been made in the monetary analysis of integration possibilities either through incorporation of monetary mechanisms into customs union theory or into the extensions to integration in LDCs. Yet the role of monetary unification in realising this objective cannot be ignored as it underwrites the integration of trade relations and, product and factor markets, and expands the domain for better exploitation of internal and external scale economies.

The problems of West African economic integration as outlined in this chapter relate more to supranationality, political instability and changing perceptions. The survival and future success of ECOWAS depend on these factors as well as on its relationship with the CEA0, MRU and Senegambia. For ECOWAS to be effective, these issues are of critical importance.

Meanwhile, as the expansion of intra-regional trade is a prime concern for West African economic integration, the next chapter describes and analyses the patterns of West African trade with two major objectives in mind: first, as another test for the performance and effectiveness of West African economic integration, since economic integration is perceived to lower the ratio of foreign trade to total intra-regional trade; second, to identify the main problems of trade, especially intra-regional trade, with a view to clarify more particularly those that are monetary in nature. As noted above trade unification and monetary integration are closely interdependent and the greater the extent to which this relationship is developed and improved among the West African countries, the better it is for each country and for regional economic integration.

## CHAPTER 4

### DIMENSIONS OF WEST AFRICAN TRADE

#### 4.1 INTRODUCTION

The basic feature of West African trade relations is that they have remained more outward- than inward-oriented, which represents one of the major obstacles to the West African development efforts. Indeed the historical foundation of this flow pattern can be drawn from the structure of the three earliest forms of West Africa's trading contacts with the rest of the world, namely, the trans-Saharan trade, which began as early as the year 1000 BC; the generally 'triangular' Atlantic slave trade, which flourished up to the mid-19th century; and 'legitimate' commerce, which was designed (through the Staple Theory) to fill the trade vacuum that was created as a result of the official abolition of the slave trade (see for example, Hopkins, 1973).

In essence, this feature of West African trade has reflected two relatively mutually exclusive patterns of trade demand in each West African economy: a domestic market demand that is exclusively dependent on foreign imports of goods, services and capital, and a foreign market demand that is decreasingly dependent on West African primary raw material exports. In particular, the consequent northward orientation of West African trade flows reflects the large and critical dependence on trade with the developed industrial countries and as a result, trade among West African countries has remained generally small and stagnating in relation to total trade.



As recent trends have clearly shown, there exists no automatic means by which these two demand forces which, for West Africa, determine the pressure for production and export as well as for providing consumer, intermediate and capital goods in the region as a whole, can be brought into balance with the forces determining the needs in industrialised countries for imports from the region or indeed those influencing their supply of exports to the region. In both instances, there are, in other words, 'limits' especially to the capacity of industrialised countries as a whole to absorb the West African exports, irrespective of whether they are exported in an unprocessed or a fully processed state or export to the region at meaningful preferential commercial basis.

Two other striking developments in West Africa's trade relations are first, the declining but relative persistence of trade with traditional export markets (that is, with former colonial powers) and second, trade between some countries is justified in most part by colonial and linguistic links. In most cases, these features characterise more noticeably the trade patterns of the francophone countries.

The patterns and problems of West Africa's trade as a whole are by and large a direct reflection of the member countries' basic geopolitical and socio-economic structures reviewed in Chapter 2. This however raises two important questions: first, whether these structural characteristics, especially in so far as their influence on intra-regional trade is concerned, provide obstacles that are wholly 'natural' or 'artificial'; and second, whether any policy measures could or should be adopted to change the existing trade orientation with a view to improving the regional position.

The obvious failure of ECOWAS so far is the inability of the Community to influence and/or expand intra-regional trade, or, to influence the external orientation of the members' trade relations or, indeed, to enhance the generative impact of trade on the members' economic development process. Thus, while extra-regional trade has developed on very large scale and has been the economic nerve centre of each West African country, corresponding trade among them has remained on a relatively small scale, representing on average less than 5 per cent of both total exports and imports.

Within this structural disposition of West African trade, there are nonetheless a number of pertinent fundamental implications for the pursuit of monetary unification in the region. The main focus of this chapter therefore is to describe and analyse these inherent features. Section 4.2 examines the patterns in total trade; Section 4.3 analyses the structure and growth of intra-regional trade while the problems affecting this trade are discussed in Section 4.4; and Section 4.5 analyses the relationship between trade and economic development in West Africa, ie in terms of foreign trade/GDP or GNP ratios. Section 4.6 provides the conclusions to the chapter.

## **4.2 PATTERNS OF EXTRA-REGIONAL TRADE**

### **4.2.1 Growth and Distribution**

The last 10 years of colonial administration marked the beginning of the rapid rise in West Africa's external trade, as both merchandise exports and imports doubled, in value terms, from less than one billion dollars at the beginning of the decade to more than a billion dollars by 1960. This rising trend continued each year during the next two decades (though with marginal fluctuations

between years) to the extent that by 1980, exports had increased to US \$34.17 billion, compared with \$26.24 billion for imports. Between decades, the value of exports rose by 74.4 per cent, from \$0.78 billion to \$1.36 billion in 1950-60; by 118.4 per cent in 1960-70; and by over eleven times, from \$2.97 billion to \$34.17 billion between 1970 and 1980. The corresponding import bills increased from \$0.67 billion in 1950 to \$1.58 billion in 1960, \$2.80 billion in 1970, and \$26.24 billion in 1980, representing percentage increases of 135.8, 77.2 and 837.1 respectively. Significantly, both exports and imports have shown a declining trend in the early eighties but the illustrations in Table 4A and Figure 4.1 indicate how the relationship between the two trends became increasingly less tenuous especially during the last decade as import values exceeded export values by considerable margins.

In growth terms, the total value of West Africa's merchandise exports in 1950-80 grew by an average annual rate of around 6.1 per cent in the fifties, 8.5 per cent in the sixties and 31.7 per cent in the seventies, while corresponding rates for imports were 9.3 per cent, 6.4 per cent and 26.5 per cent in the three decades respectively. In volume terms, the average annual growth rate for exports was around 7.5 per cent in the 1960s and 6.2 per cent in the 1970s, compared with 5 per cent and 7.8 per cent for imports over the two periods respectively.

These West African trade trends may be compared with corresponding trends in the world's overall trade. The value of world exports increased by 7.1 per cent (5.8 per cent in volume) in 1965-60 and 9.4 per cent (7.9 per cent in volume) per year during the 1950s and 1960s respectively, and further by 20.7 per cent (5.5

per cent in volume) a year in the 1970s. The corresponding value of world imports grew by 7.4 per cent (6.4 per cent in volume), 9.4 per cent (8.4 per cent in volume), and 20.5 per cent (5.4 per cent in volume) over the three decades respectively.

They also compare with trade trends by non-oil African countries (excluding South Africa) whose combined export values grew at an average annual rate of 6 per cent (6.3 per cent in volume), 5.8 per cent (3.5 per cent in volume) and 17.8 per cent (6.0 per cent in volume) respectively. The corresponding import value grew at 6.3 per cent (4.7 per cent in volume), 7.5 per cent (6.4 per cent in volume) and 17.2 per cent (2.0 per cent in volume) during the same period.

It is important to note however that West Africa's external trade trends, especially since the early 1970s, were substantially influenced by Nigeria's trade which had by 1980 increased several-fold since 1973 because of oil, and by 1983 accounted for 69 per cent and 50 per cent of the region's total exports and imports respectively (see Table 4B). The effect of this extraordinary growth in Nigerian trade has the tendency of downplaying the deteriorating performance of the region's export sector and the consequent widening of the import-export gap between 1970 and 1980. In general, as also shown in Table 4A and Figure 4.1, though still showing rising tendencies throughout the reviewing period, the absolute value of the rest of West Africa's merchandise trade was reduced drastically, thereby depicting much higher trade deficits as well as much lower and declining trends in the region's share of world and non-oil African (excluding South Africa) trade.

Table 4A ECOMAS: Trends in Merchandise Trade (Exports, fob; Imports, CIF), 1950-1983  
(Billion US Dollars)

	Including Nigeria		Excluding Nigeria		ECOMAS Trade as Percent of				
	Exports	Imports	Net	Exports	Imports	World	Africa	Imports	
1950	0.78	0.67	+0.11	0.53	0.50	1.35	1.13	35.2	32.4
1955	1.06	1.13	-0.07	0.69	0.75	1.24	1.26	30.8	31.4
1960	1.36	1.58	-0.22	0.89	0.97	1.18	1.30	33.6	41.4
1965	1.91	2.14	-0.23	1.17	1.36	1.14	1.20	38.3	39.6
1970	2.97	2.80	+0.17	1.73	1.74	1.04	0.94	40.6	37.5
1975	11.49	10.37	+1.12	3.71	4.33	1.43	1.27	78.0	54.6
1980	34.17	26.24	+7.93	7.33	9.86	1.83	1.36	116.5	73.1
1981	26.04	27.38	-1.34	6.27	8.82	1.42	1.43	98.5	74.6
1982	23.85	24.06	-0.21	6.34	10.08	-	-	-	-
1983	20.76	17.54	+3.22	6.48	8.96	-	-	-	-

Source: IMF Supplement on Trade Statistics, 1982  
World Bank, Direction of Trade

Notes: 1 Non-oil Africa excluding South Africa  
- Not available

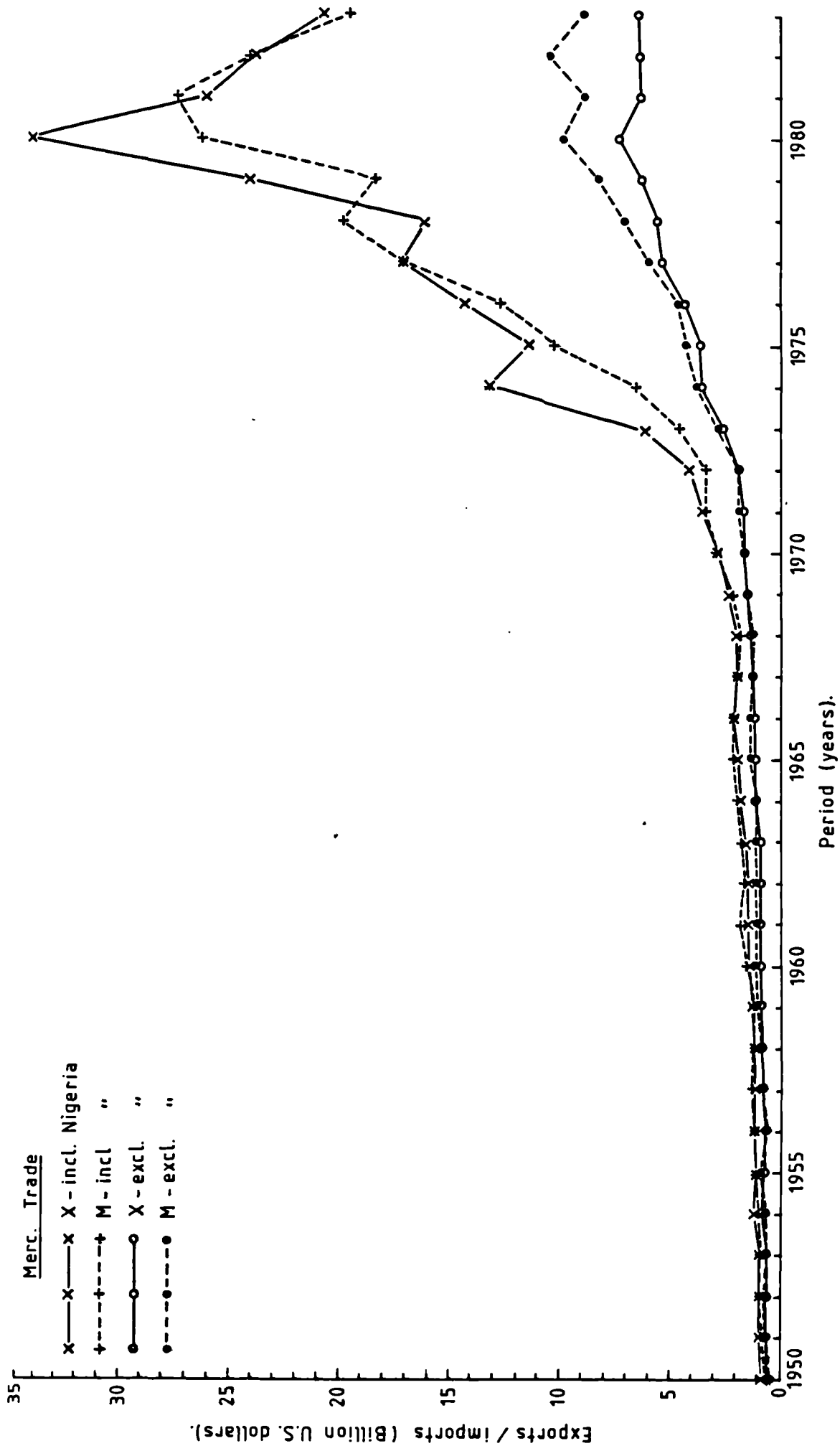


Fig. 4-1. ECOWAS : Merchandise Trade (Export, fob ; Import, cif) 1950 - 1983.

Table 4B ECOWAS: Distribution of Merchandise Trade

	Exports (millions of dollars)					Per Cent					Imports (millions of dollars)					Per Cent				
	1950	1960	1970	1980	1983	1950	1960	1970	1980	1983	1950	1960	1970	1980	1983	1950	1960	1970	1980	1983
Benin	13	18	33	69	85	1.7	1.3	1.1	0.2	0.4	12	31	64	775	523	1.8	2.0	2.3	2.9	3.0
Burkina Faso	-	4	18	90	99	-	0.3	0.6	0.3	0.5	-	11	49	359	250	-	0.7	1.8	1.4	1.4
Cape Verde	8	11	2	3	1.7	1.0	0.8	0.1	-	-	9	12	16	99	84	1.3	0.8	0.6	0.4	0.5
Gambia	6	8	17	32	46	0.8	0.6	0.6	1.0	0.2	8	9	18	164	108	1.2	0.6	0.6	0.6	0.6
Ghana	217	325	458	1154	895	27.8	23.9	15.4	3.4	4.3	135	363	411	1154	719	20.1	23.0	14.7	4.4	4.1
Guinea	-	51	56	417	391	-	3.8	1.9	1.2	1.9	-	50	78	360	279	-	3.2	2.8	1.4	1.6
Guinea-Bissau	-	4	4	11	12	-	0.3	0.1	-	0.1	4	11	27	55	59	0.6	0.7	1.0	0.2	0.3
Ivory Coast	79	157	469	2971	2421	10.1	11.5	15.8	8.7	11.7	61	131	388	3014	1878	9.1	8.3	13.9	11.5	10.7
Liberia	-	83	214	589	841	-	6.1	7.2	1.7	4.1	-	69	150	534	2170	-	4.4	5.4	2.0	12.4
Mali	-	-	33	205	106	-	-	1.1	0.6	0.5	-	-	47	439	343	-	-	1.7	1.7	2.0
Mauritania	-	-	89	194	246	-	-	3.0	0.6	1.2	-	-	47	286	498	-	-	1.9	1.1	2.8
Niger	3	13	32	566	311	0.4	1.0	1.1	1.7	1.5	4	13	58	594	361	0.6	0.8	2.1	2.3	2.1
Nigeria	253	475	1240	26841	14272	32.4	34.9	41.7	78.6	68.8	173	604	1059	16374	8583	25.8	38.3	37.9	62.4	49.9
Senegal	174	113	152	477	585	22.3	8.3	5.1	1.4	2.8	237	172	193	1052	984	35.3	10.9	6.9	4.0	5.6
Sierra Leone	19	83	100	215	202	2.4	6.1	3.4	0.6	1.0	19	74	116	426	139	2.8	4.7	4.2	1.6	0.8
Togo	9	15	55	335	242	1.2	1.1	1.9	1.0	1.2	9	26	65	550	566	1.3	1.7	2.3	2.1	3.2

Source: See Table 4A

Note: - Not available or negligible

Excluding Nigeria, West Africa's share in world trade declined steadily from 0.91 per cent in 1950 to 0.34 per cent by 1980 for exports, and from 0.84 per cent in 1950 to 0.46 per cent for imports. These percentages compare with an overall average of over 1 per cent as a share of world trade and between 30 and 117 per cent as a share of non-oil African trade when Nigeria's trade is included. The table shows that total trade in West Africa has stagnated at less than 2 per cent of the world's overall trade.

Table 4A also shows rising regional net trade surpluses between 1970 and 1980 which merely reflected the rising oil revenues from Nigeria, and to a less extent, the marginal rise in coffee export revenues following the relative improvement in international coffee prices during this period. But the exclusion of Nigeria's exports reduces this net surplus position to a worsening net deficit position. Trade performances by Ghana, Ivory Coast and Senegal have also influenced the trends in West Africa's world trade. The importance of these four most developed and economically the largest countries - Nigeria, Ivory Coast, Ghana and Senegal - is such that their combined share of the region's total trade is over 90 per cent of both exports and imports. Of the remaining 12 countries, only Liberia and Togo have shown some improvement in their respective regional trade shares (see Table 4B).

As in absolute trade values, the proportion of West Africa's merchandise trade in world trade compared with combined shares held by the non-oil developing African countries as well as with those of other regional economic groupings in LDCs, all of which, as in West Africa, have remained equally low. The share of non-oil developing Africa in fact fell from 3.8 per cent in 1950 to 3.5 per cent in



1960, 2.6 per cent in 1970 and 1.6 per cent in 1980 for exports, while the corresponding shares in import trade also dropped from 3.5 per cent in 1950 to 3.2 per cent, 2.5 per cent and 1.9 per cent in 1960, 1970 and 1980 respectively. Except for the ANDEAN, whose combined share in world trade was much higher, ranging between 1.63-3.84 per cent in 1950-80, comparative shares by such other groupings as the defunct EAC, CACM, CARICOM and the UDEAC all stagnated at much below one per cent during the same period (see Table 4C).

Finally, the downward trend in West Africa's import payments in the early 1980s has largely reflected the imposition of tighter monetary and fiscal restrictions on imports by many countries, especially the anglophones - Ghana, Nigeria and Sierra Leone.

#### **4.2.2 Changing Composition and Direction**

Export production in West African countries as we have indicated already, has been concentrated on a narrow range of primary commodities, generally between one and three, with little or no meaningful domestic value-added. This narrow range has in sum accounted for over 50 per cent of total export earnings in the majority of countries in the region. For a number of countries, especially those without mineral resources, the enclave of the so-called 'staple' export commodities introduced as part of 'legitimate' commerce has continued to preponderate in their principal exports such that in many, the composition of exports has in general, changed very little over the last three decades. However, in countries where minerals have been exploited extensively, their importance in relation to total export earnings has outpaced that of traditional agricultural products. Table 4D

indicates the major products exported by each West African country since 1970 relative to the country's total exports.

In particular, Gambia and Ivory Coast depend almost entirely on agricultural products, whereas in Nigeria, Niger, Guinea, Senegal and Togo, increased mineral exploitation and export has substantially depleted the agricultural export base. As was illustrated earlier (see Tables 2E and 2G), in some of these countries, notably Nigeria, leading positions in agricultural production has been lost to other countries. This remarkable decline in agriculture has caused the combined value share of West Africa's eight principal agricultural export commodities in total exports to drop from 52.9 per cent in 1960 to 15.6 per cent in 1975 and 9.7 per cent in 1980 (Table 4E). By contrast, the combined proportionate share of mineral exports in total export value has increased by more than forty times, from less than 2 per cent in 1960 to over 70 per cent in 1980. Consequently, the index of fluctuations in West Africa's export earnings tend to be much higher in mineral exporting countries than those with substantial export dependence on agricultural products (see Table 4D).

It can be noted also that a limited number of West African countries, notably Ivory Coast and Nigeria, have in more recent years added a few manufactured or semi-manufactured goods in their export base. Examples are cotton textile goods from Ivory Coast and fuel oils from Nigeria. In each of the countries where such expansion has taken place, the list of commodities is also usually very short; this is, in part, a reflection of the problems of competitive industrial production among West African countries.

Table 4C ECOWAS: Share in World Trade Compared with that of Other Regional Groupings  
(Per Cent)

	ECOWAS		EAC <sup>1</sup>		ANDEAN <sup>2</sup>		CACM <sup>3</sup>		CARICOM <sup>4</sup>		UDEAC <sup>5</sup>	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
1950	1.35	1.13	.36	.35	3.58	1.51	.51	.40	.34	.39	.07	.13
1955	1.24	1.26	.35	.46	3.84	2.74	.49	.47	.41	.46	.09	.12
1960	1.18	1.30	.34	.33	3.37	2.31	.38	.41	.49	.58	.07	.10
1965	1.14	1.20	.38	.36	2.71	1.97	.45	.50	.47	.57	.19	.18
1970	1.04	0.94	.29	.31	2.13	1.57	.40	.41	.37	.49	.15	.14
1975	1.43	1.27	.16	.24	1.82	1.60	.29	.36	.40	.42	.20	.16
1980	1.83	1.36	.11	.20	1.63	1.15	.26	.31	.32	.30	.23	.14

Source: IMF and World Bank, *Ibid*

- Notes: 1 East African Community (Kenya, Tanzania and Uganda); created in 1967; dissolved in 1977  
 2 Andean Group (Colombia, Venezuela, Ecuador, Peru, Bolivia and Chile); established in 1960; Chile withdrew in 1976; 1980 figures exclude Chile  
 3 Central American Common Market (Guatemala, Honduras, Costa Rica, Nicaragua and El Salvador); established in 1960  
 4 Caribbean Community (Antigua, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts-Nevis-Anguilla, St Lucia, St Vincent, and Trinidad and Tobago); created in 1973  
 5 Central African Customs and Economic Union (Central African Republic, Congo, Gabon and Cameroon); established in 1966

Table 40 ECOWAS: Export Commodity Concentration and Index of Fluctuations in Export Values

	Principal Exports	Export Values			Percentage Share of Principal Exports in Total Exports			Index of Export Fluctuations <sup>f</sup>	
		1970	1975	1980	1970	1975	1980	1955-65	1965-79
Benin	Cotton	15.4	22.7	15.1					
	Palm products <sup>a</sup>	35.1	19.3	8.0					
	Cacao	16.6	9.5	20.6	67.1	51.5	43.7	10.1	20.6
Burkina	Cotton	25.7	16.3	43.9	25.7	16.3	43.9	27.3	19.7
Cape Verde	Fish	-	-	36	-	-	36	-	17.0 <sup>d</sup>
Gambia	Groundnut products	95.1	84.3	54.2	95.1	84.3	54.2	17.6	19.3
Ghana	Cacao	64.3	59.3	60.7					
	Wood <sup>a</sup>	7.9	8.3	5.1	72.2	67.6	65.8	5.5	6.3
Guinea	Coffee	11.6	2.1	2.3					
	Palm products	5.4	1.7	0.9					
	Bauxite	2.8	67.8	69.7	19.8	71.6	72.9	17.1	15.9
Guinea-Bissau	Palm products	13.6	9.1	17.6					
	Groundnuts & oil	54.0	57.4	25.7	67.6	66.5	43.3	17.3	15.4
Ivory Coast	Coffee	33.2	24.2	22.0					
	Cacap	20.5	18.7	27.3					
	Wood <sup>b</sup>	18.0	13.7	12.6	71.7	56.6	61.9	10.5	8.1
Liberia	Iron Ore	70.1	74.5	52.7					
	Rubber	16.9	11.7	17.4					
	Diamonds	13.0	4.7	5.7	100.0	90.9	75.8	13.3	10.4
Mali	Coton	21.0	33.9	48.2					
	Groundnuts	14.4	15.2	2.3	35.4	49.1	50.5	13.9	14.6
Mauritania	Iron Ore	84.8	82.3	77.8					
	Fish	8.2	9.2	22.0	93.0	91.5	99.8	73.2	59.3
Niger	Uranium	18.5 <sup>e</sup>	60.8	76.3	18.5	60.8	76.3	73.2	59.3
Nigeria	Crude Petroleum	57.5	95.8	95.3					
	Cacao	15.0	3.7	0.9	72.5	99.5	96.2	77.5	84.3
Senegal	Groundnuts & Oil	37.1	32.6	13.3					
	Phosphates	7.8	22.4	16.3					
	Petroleum products	3.1	7.0	18.8					
	Fish & Shell fish	1.2	3.7	-	49.1	65.7	48.4	8.9	7.4
Sierra Leone	Diamonds	62.6	56.8	53.3					
	Cacao	4.0	6.0	10.6					
	Coffee	5.2	5.9	16.8	71.8	68.7	80.7	14.2	13.5
Togo	Phosphates	24.5	64.6	39.6					
	Cacao	41.8	17.4	11.8					
	Coffee	17.5	6.5	7.9	83.8	88.5	59.3	18.3	10.1

Source: IMF and World Bank Trade statistics, *ibid*  
 FAO Trade statistics, *ibid*  
 Commonwealth secretariat, *ibid*  
 Institute of Geological Sciences, *ibid*

Notes: a 3rd year is 1978  
 b 3rd year is 1979  
 c 1975  
 d 1965-77  
 e 1971  
 f Index provides an indication of the relative magnitude of fluctuations in total merchandise export values and have been calculated like coefficients of variation  
 - Not available

**Table 4E ECOWAS: Share of Principal Agricultural Export Commodities in Total Community Export Earnings**

(Per Cent)

	Including Petroleum					Excluding Petroleum				
	1960	1965	1970	1975	1980	1960	1965	1970	1975	1980
Cocoa	24.4	19.9	20.5	9.0	5.9	24.6	20.9	27.0	25.6	23.4
Coffee	0.7	0.6	6.3	2.7	2.2	0.7	0.6	8.2	7.8	8.8
Cotton	1.4	0.8	1.5	0.5	0.6	1.4	0.9	1.9	1.4	2.6
Groundnuts	10.7	9.0	3.5	0.5	0.1	10.8	9.4	4.6	1.4	0.3
Groundnut Oil	4.4	4.6	3.0	1.4	0.2	4.4	4.8	3.9	4.1	0.8
Palm Kernels	7.5	5.0	1.8	0.4	0.1	7.5	5.2	2.3	1.1	0.4
Palm Oil	3.2	2.2	0.3	0.5	0.2	3.2	2.3	0.3	1.4	0.6
Rubber	0.6	0.3	2.3	0.6	0.4	0.6	0.3	3.0	1.8	1.7
<b>Total</b>	<b>52.9</b>	<b>42.4</b>	<b>39.4</b>	<b>15.6</b>	<b>9.7</b>	<b>53.2</b>	<b>44.4</b>	<b>51.2</b>	<b>44.6</b>	<b>38.6</b>
Petroleum <sup>1</sup>	1.8 <sup>2</sup>	5.0	24.0	64.8	74.9	-	-	-	-	-

Source: See Table 4D

Notes: 1 Based on Nigerian exports  
2 1962

Table 4f ECOWAS: Structure of Merchandise Trade (Percentage Share of Merchandise Exports and Imports)

	EXPORTS						IMPORTS								
	Food, Beverages and Tobacco	Raw Materials	Manufactured goods	Fuels	Food, Beverages and Tobacco	Raw Materials	Manufactured Goods	Fuels	Food, Beverages and Tobacco	Raw Materials	Manufactured Goods	Fuels			
	1970	1975	1980	1970	1975	1980	1970	1975	1980	1970	1975	1980	1970	1975	1980
Burkina Faso	29.7	35.3	25.8	59.6	57.5	63.2	0.2	0.2	2.0	10.6	13.5	9.0	17.6	17.7	15.0
Burkina Faso	40.8	42.9	34.7	54.7	50.6	52.3	-	-	0.6	4.5	6.5	12.4	19.4	19.6	19.5
Cape Verde	80.6	68.3	-	12.9	17.0	-	-	-	6.5	14.7	-	42.2	55.6	-	-
Gambia	14.6	11.1	19.4	83.9	87.0	77.3	-	0.7	0.6	0.5	0.7	2.7	31.6	24.0	26.1
Ghana	76.4	76.5	75.6	14.1	14.1	10.5	0.2	2.8	0.6	7.9	5.4	12.1	19.9	12.3	9.9
Guinea	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Guinea-Bissau	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ivory Coast	66.1	57.4	66.1	26.8	24.9	20.8	0.6	5.7	4.5	6.4	11.3	8.0	15.3	14.4	14.8
Liberia	2.9	3.0	7.6	94.4	95.0	87.9	-	-	-	2.1	1.2	2.3	16.4	13.5	17.6
Mali	50.9	31.6	21.1	38.6	56.7	77.7	0.1	-	0.1	9.6	11.7	1.1	28.6	21.2	12.7
Mauritania	8.2	8.0	-	90.9	90.0	-	0.1	0.7	-	0.8	2.3	-	22.4	29.3	-
Nigeria	27.5	24.7	21.0	68.7	66.5	76.5	-	-	-	2.7	8.4	12.5	13.2	11.7	10.0
Nigeria	19.1	4.4	3.2	17.7	1.4	1.0	58.1	93.2	94.9	-	0.6	0.6	8.2	9.3	15.5
Senegal	28.4	18.9	34.1	49.2	59.0	34.2	2.9	7.0	17.5	19.3	15.0	14.1	28.0	23.6	22.7
Sierra Leone	27.9	17.9	19.7	7.9	21.1	27.4	2.6	6.8	-	61.6	53.5	53.3	25.5	19.9	21.0
Togo	60.1	25.3	29.7	34.2	68.9	49.6	-	-	11.3	5.7	5.8	9.4	22.7	14.1	13.4
ECOWAS Xa	38.1	30.4	27.5	46.7	50.3	48.2	4.6	8.4	11.0	9.9	10.8	11.5	22.2	20.4	15.4
Xw	35.4	16.8	15.9	30.0	20.8	8.8	25.1	62.2	72.0	6.0	3.6	3.0	17.4	12.5	15.6

Source: IMF Trade statistics, *ibid*

World Bank, 'Accelerated Development in Sub-Saharan Africa', 1981

Commonwealth secretariat, 'Base statistical data on selected countries', 1981

Notes: a 3rd year reported for 1978

b 3rd year reported for 1977

c 3rd year reported for 1979

Xa arithmetic average

Xw weighted average with country exports/imports as weights

- None or not available

As already noted, the import component of West African countries' external trade has one common characteristic, namely, the almost equal importance of capital and consumer goods. This feature reflects the continued dependence on imports for domestic consumption, production and capital formation, although the degree of dependence in terms of these import uses differs between countries in relation to their level of industrial development. That is, consumer goods usually account for the greater part of total imports by the less industrially developed (eg Cape Verde, Gambia and Burkina), while capital goods (as industrial inputs) form a good part of imports in the more industrially progressive - eg Ivory Coast, Nigeria, Ghana and Senegal. Some of the most prominent imported inputs include raw materials for the brewing of beer and spirits and intermediate goods for paper, chemicals, textiles, confectionary, building and construction, and allied industries. The varied importance of imports (and exports) in terms of IMF/World Bank groupings is shown in Table 4F.

The most important change in the import structure of the majority of West African countries, especially since 1974/75, is the rising level of fuel imports (in terms of import value). As expected, fuel imports are lowest in Nigeria, and have, as a proportion of total imports dropped from 3.2 per cent in 1970 to 2.3 per cent in 1980. In virtually all other countries, notably, Benin, Liberia, Niger, Senegal, Sierra Leone and Togo, the share of fuel imports to total imports has more than trippled over the same period to the extent that, excluding Cape Verde, Guinea and Guinea-Bissau for which complete data was not available, fuel imports have by 1980 accounted for an average 13.2 per cent of total import value

compared with 5.6 per cent in 1970. In Sierra Leone, for instance, the actual percentage cost of crude petroleum and platformate to total import value rose from 7.2 per cent in 1971 to 16 per cent and 43.5 per cent in 1980 and 1983 respectively.

On a regional basis, imports of manufactured goods have accounted for nearly two-thirds of total imports (10.8 per cent for exports) in 1980, while imports of foodstuffs averaged around 15 per cent (28 per cent for exports). Imports of raw materials and intermediate products have shown little expansion in relative terms since 1970; this is a reflection of the generally slow technological industrial progress in the majority of countries.

Geographically, the direction of West Africa's external trade, as already noted, is still largely towards the Western industrial markets both directly and indirectly through multinational firms. The share of trade with the more traditional markets (France and the United Kingdom), though having declined or fluctuated widely especially in the case of regional imports during the last decade, is still relatively significant (in terms of non-oil trade), while corresponding trade with non-traditional markets like Japan, West Germany and the United States has increased substantially.

Together, the group of twenty industrialised developed countries (see World Bank Direction of Trade classification) has regularly accounted for around 70 per cent and 85 per cent of West Africa's exports and imports respectively (Table 4G). The table also shows that within this group, the share of imports to the more traditional EEC markets has remained relatively stable, averaging around 50 per cent of total imports, while the proportion of exports taken by them has almost halved, falling from 63.9 per cent in 1970



Trade 46 ECOWAS: Direction of Trade - Share of Regions in Total Community Trade<sup>1</sup>  
(Per Cent)

	Industrial countries		EEC		Oil-exporting countries		Non-oil Developing Countries		USSR, Eastern Europe, etc			
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports		
1970	82.8	77.6	63.9	56.7	0.7	1.8	3.0	3.6	1.3	4.7	3.0	4.7
1971	80.8	78.3	59.4	55.8	0.6	1.8	4.2	3.2	0.6	4.1	2.8	4.4
1972	84.5	78.2	60.7	57.2	0.7	2.0	3.9	3.5	1.2	4.9	2.7	3.7
1973	80.3	74.9	54.6	54.9	0.7	2.4	4.9	4.5	0.2	4.2	2.4	4.1
1974	79.2	83.4	51.8	56.9	0.4	5.6	3.7	4.4	0.2	4.4	2.0	4.5
1975	82.1	81.0	50.5	56.8	0.5	4.0	4.4	3.5	0.3	4.2	2.4	2.0
1976	79.8	82.4	45.9	58.0	0.6	2.6	3.7	2.5	0.3	4.8	1.5	1.4
1977	77.1	82.2	42.0	57.2	0.4	2.6	4.2	2.7	0.5	5.4	1.3	1.7
1978	80.4	82.5	45.8	57.3	0.4	2.4	4.4	2.6	0.4	6.0	1.7	1.4
1979	83.9	72.8	43.1	52.4	0.5	4.0	3.5	3.0	0.5	8.9	0.9	2.0
1980	80.1	77.0	41.2	54.5	0.5	3.7	3.2	2.8	0.5	9.0	0.5	1.6
1981	80.3	81.4	34.9	53.8	0.7	3.3	4.0	2.6	1.0	10.8	0.7	1.6

Source: World Bank, Direction of Trade Statistics

Note: <sup>1</sup> Region is as defined in the World Bank, Direction of Trade Statistics, 1984

Table 4H ECOWAS: Direction of Trade - Share of Major Trading Countries in Total Community Trade  
(Per Cent)

	EXPORTS					IMPORTS					NET TRADE (million dollars)				
	UK	France	Germany West	USA	Japan	UK	France	Germany West	USA	Japan	UK	France	Germany West	USA	Japan
1970	19.9	14.4	8.0	12.8	2.5	18.2	17.5	10.0	12.3	5.2	+88	-57	-33	+33	-57
1971	16.6	16.5	7.3	15.0	3.0	20.1	16.2	9.7	12.3	6.6	-89	+36	-69	+118	-115
1972	16.4	17.2	7.0	15.0	4.2	16.7	20.0	10.3	10.1	6.5	+98	+15	-69	+301	-54
1973	15.1	14.6	6.0	17.8	4.5	14.7	20.0	10.4	10.4	5.9	+241	-35	-115	+623	-
1974	14.2	12.5	7.6	21.2	3.8	13.9	16.8	13.1	10.7	6.0	+962	+550	+136	+2107	+108
1975	12.6	14.3	7.3	23.2	3.6	16.5	16.1	11.3	10.8	7.3	-274	-30	-334	+1543	-350
1976	10.2	12.8	7.6	29.2	1.4	17.5	14.5	13.0	10.7	5.9	-797	-17	-584	+2834	-558
1977	8.0	11.6	6.4	30.6	1.1	16.5	14.1	12.8	10.6	8.7	-1459	-404	-1092	+3452	-1242
1978	6.4	12.5	8.2	30.2	0.9	16.8	14.7	12.5	9.6	8.7	-2302	-909	-1167	+2987	-1594
1979	3.7	11.1	11.1	36.2	1.0	11.8	16.9	9.7	7.0	6.6	-1176	-431	+888	+7467	-979
1980	2.6	12.5	10.4	32.8	1.0	14.5	16.1	9.7	7.4	7.7	-2935	+39	+995	+9268	-1667
1981	2.5	9.9	7.9	36.7	3.2	14.6	15.0	10.8	8.7	9.9	-3341	-1539	-885	+7165	-1864
1982	3.6	11.8	9.3	32.6	0.9	11.9	14.9	9.0	8.3	6.8	-1952	-755	+61	+5536	-1422
1983	4.0	14.0	10.6	20.6	1.2	9.7	16.5	7.0	8.2	4.9	-876	+5	+978	+2838	-606

Source: World Bank, Direction of Trade Statistics

to 34.9 per cent in 1981, although it experienced a more than sevenfold increase in value terms. As the table indicates, this shift, especially in the case of exports, is by and large a reflection of Nigeria's petroleum exports which are mainly directed to the United States (and the Carribbean) for refining and distribution purposes. In 1980 for instance around 60 per cent of Nigerian crude went to the United States compared with 30 per cent to three European countries combined - France, West Germany and the Netherlands.

On the other hand, West Africa's trade with Asian, centrally planned, and other African countries, as also illustrated in Table 4G, is generally low, standing at less than 10 per cent for each group of countries. The share of imports from Asian countries, especially China and India, has however risen to 10.8 per cent in 1981 from 4.7 per cent in 1970. It can of course be argued that the sluggish trade relations between West African countries and other LDCs, in particular, the non-oil developing African countries, reflects more directly the close similarities in production and industrial capacities, although the lack of patriotic demand for each other's manufactured goods as well as infrastructural problems have also played a significant part.

Another very important trend in West Africa's external trade relations is the continued decline in the proportion of trade held by the two most important former colonial 'masters' - France and the United Kingdom. In particular, noticeable shifts have occurred since the second half of the 1970s as illustrated in Table 4H. The share of exports to the United Kingdom has dropped drastically from 12.6 per cent in 1975 (19.9 per cent in 1970) to 4.0 per cent in

1983, reflecting mainly the spectacular drop in Nigeria's exports to the United Kingdom from 28.3 per cent in 1970 to less than 2 per cent by the end of the seventies. It must be noted that the decline in Nigerian exports to the UK is mainly because both countries are oil producing (extracting the same type of crude) and also because Nigeria's more traditional exports to the United Kingdom (ie agricultural products) have shrunk following the general decline in Nigerian agriculture since oil extraction was stepped up. In addition, Ghana's exports to the United Kingdom have also fallen in the last decade. By contrast, the drop in the share of imports from the United Kingdom both at the regional and country (Nigeria and Ghana) levels as shown in Tables 4H and 4I is not as spectacular as that for exports.

Table 4I Ghana and Nigeria: Trade with the UK

	GHANA				NIGERIA			
	Exports \$m	%	Imports \$m	%	Exports \$m	%	Imports \$m	%
1970	107	23.4	97	23.6	351	28.3	325	30.7
1975	117	14.5	119	15.0	1130	14.5	1389	23.0
1980	221	19.2	226	19.6	320	1.2	3079	18.8

Source: Table 4H

It must be recognised also that by the second half of the seventies the United Kingdom's other traditional trading countries in West Africa - Gambia and Sierra Leone - had commenced looking elsewhere for alternative trading markets, while the conspicuous lack of preference by the francophones for the UK market is also worth noting.

By contrast, France has generally had stable trading relations with West Africa in terms of proportions held in total exports and imports. As is also illustrated in Table 4H, both export and import shares have stabilised at around 14 per cent and 16 per cent per annum respectively. This is due mainly to France's consistent trade relations with the francophones, especially trade with Ivory Coast and Senegal.

As in trade between the UK and Ghana and Nigeria, France's share of trade with these two major francophone countries in the region has increased in value terms but declined in relative ratios. In 1960s, France provided 70 per cent of Ivory Coast's imports and took 53 per cent of exports. In Senegal in the same year, 69 per cent of the imports came from France and 82 per cent of the exports went to that destination. Between 1970 and 1980, as shown in Table 4J, the share of both countries' exports to and imports from France dropped considerably. In the Ivory Coast, exports to France declined to 32.6 per cent in 1970, 27.3 per cent in 1975 and 24 per cent in 1980, while imports from France dropped from 46.1 per cent in 1970 to 39.3 per cent and 41.5 per cent in 1975 and 1980 respectively. Similarly, in Senegal, the share of exports to France fell from 54.6 per cent in 1970 to 32.1 per cent in 1980 while that of imports from France declined from 51.3 per cent in 1970 to 33.7 per cent in 1980. The proportions for Senegal remained higher than the Ivory Coast's but still below the 1960 level. The main factor could be the general drop in export revenues from the two countries, as well as the greater level of economic diversification that has taken place in Ivory Coast.

Table 4J Ivory Coast and Senegal: Trade with France

	SENEGAL				IVORY COAST			
	Exports \$m	%	Imports \$m	%	Exports \$m	%	Imports \$m	%
1970	83	54.6	99	51.3	153	32.6	179	46.1
1975	223	48.4	241	41.3	323	27.3	443	39.3
1980	153	32.1	355	33.7	714	24.0	1251	41.5

Source: Table 4H

Unlike the UK, the share of France's trade with West Africa as a whole, though declining, has remained comparatively much higher, especially in the amount of exports to the French market. From Table 4H, it is observed that exports to France dropped from 14.4 per cent in 1970 to 9.9 per cent in 1981, while the corresponding level of imports from the French market fell only marginally from 17.5 per cent in 1970 to 15 per cent in 1981. Comparatively, both France and the UK have managed to sustain their import trade ties with West Africa at about the same levels.

The higher ratio of West African trade with France is also accounted for by the increasing trade with Nigeria whose (oil) exports to France in 1970-80 rose more than twenty-five times to \$2728 million, while imports from France also increased by more than fortyfold from \$35.4 million to \$1483 million over the same period. The improved trading relations with Nigeria, Ivory Coast and Guinea have in particular caused West Africa's exports to the United States to rise from 12.8 per cent of total exports in 1970 to 36.7 per cent in 1981, although the share of imports has fallen marginally to 8.7

per cent from 12.3 per cent. Nigeria accounts for 93.3 per cent and 64.9 per cent of these US export and import shares respectively. The share of West Germany's trade in West Africa has generally stabilised at around 10 per cent a year for both exports and imports, while Japan's share in imports has increased mainly because of the rising volume of imports of motor vehicles.

#### **4.2.3 Factors Affecting Extra-Regional Trade**

The analysis both in Chapter 2 and in this chapter so far has clearly demonstrated West Africa's substantial resource potential in agricultural as well as in mineral products. It is true however that since independence many countries in the region have depleted their resources to the extent that this has largely accounted for the remarkable drop in export earnings. In the Sahel countries, export performance has generally been affected by severe drought and other climatic conditions. Factors like the high incidence of political instability and inadequate information and communications infrastructures also combine with restrictive trade policies by the developed industrialised markets to impair the expansion of West Africa's export market which is structurally restricted to raw material products. But even for some of those countries where export performance has improved, the full realisation of export potential has been severely affected by a combination of deteriorating terms of trade and the adoption of restrictive domestic monetary and financial policies. Indeed, against the background of an increasingly difficult foreign exchange situation over the last few years, imports have (through artificial measures) decline steadily in most countries.

It must be noted however that in general, movements in West Africa's raw material export prices, and hence, in the terms of trade have been rather selective. Table 4K indicates that apart from the sharp increases in crude oil prices (1973/74 and 1978/79) which favoured Nigeria's terms of trade, there were also substantial improvements in the prices of other major export commodities like coffee, cocoa and phosphates. This latter movement thus also favoured the terms of trade of major producers like Ghana, Ivory Coast and Togo, whereas the long slide in mineral prices (primarily copper and iron ore) worsened the terms of trade for countries like Liberia and Mauritania. The deteriorating terms of trade for such countries as Gambia, Senegal and Sierra Leone could also be explained by the drop in market prices for groundnut products and palm products.

**Table 4K ECOWAS: Principal Export Commodity Price Trends**

	Average Annual Growth Rate (Per Cent)	
	1960-70	1970-80
Cocoa	3.5	7.5
Coffee	0.8	3.9
Cotton	0.1	-2.2
Groundnuts	0.1	-3.5
Groundnut Oil	-0.1	-3.1
Palm Oil	-1.7	-2.4
Rubber	-6.0	1.3
Timber (Sapelli)	1.0	0.4
Bauxite	5.6	2.2
Iron Ore	-3.9	-13.0
Petroleum	-2.2	18.2

Source: World Bank, 'Accelerated Development in Sub-Saharan Africa: An Agenda for Action' (1981).



The income terms of trade on the other hand improved more substantially in the 1960s than in the 1970s for virtually all countries in the West African region. Especially for countries like Niger and Nigeria, the income terms of trade improved markedly even in the 1970s but deteriorated very significantly for Benin, Liberia, Mauritania, Sierra Leone, Togo and Burkina. Since income terms of trade are related to export volumes, their deterioration in these countries was apparent as growth in export volume dropped significantly during the seventies. The only notable exception was Nigeria, where despite the substantial decline in the annual average rate of growth of export volume, from 6.5 per cent in the 1960s to 0.5 per cent in the 1970s, the corresponding escalation of oil prices caused the income terms of trade to improve from 7 per cent to 16.9 per cent over the two decades. Thus, while the substantial increase in Nigeria's net barter terms of trade accounted for the improvement in the income terms of trade, in most countries, it was their deterioration which also worsened the income terms of trade. Eventhough net barter terms may not have had quite a substantial influence on West Africa's overall export performance, there is nonetheless an increasing worry that this situation may worsen in the near future, particularly when reference is made to the World Bank's expectations for an acute drop in world prices for many of the region's major export products by 1990 (see World Bank, 'Sub-Saharan Africa: Progress Report on Development Prospects and Progress', Report No 4630, 6 July 1983). It is also true that a substantial decline in the corresponding prices of oil would dampen this effect considerably.

It is a fact that in general, import values in West Africa, in common with the rest of the world, have gone up not so much as a result of increased import demand but mainly as a spillover effect of oil price increases. This has induced massive increases in import unit costs. For example in most West African countries, as already discussed, the proportion of national expenditures on petroleum imports in relation to total imports has more than doubled since 1973/74, although the actual amount of petroleum consumed in volume terms may have been reduced or has remained relatively constant. In Sierra Leone, for instance, the country's absolute minimum energy requirements of crude petroleum and platformate at 288,170 long tons cost \$5.99 million in 1971. By 1975, a reduced quantity of 214,738 tons cost \$20.18 million, representing an increase of over 236 per cent in value terms. In 1981 the cost of a lesser quantity of 203,726 tons was over \$70 million. Consequently, in most countries, the diversification in the choice of external trading partners has been influenced by the search for new sources of comparatively more favourable commercial opportunities especially for the supply of cheaper oil and consumer imports. But on the whole these efforts in the search for additional markets outside the traditional areas are still subject to serious geographical and commodity constraints that need more critical attention.

The regional pattern of West Africa's international trade is thus institutionalised in two ways. The first, through the Treaty of Rome and the Conventions of Yaounde and Lome, provides for special trading arrangements between the West African countries as part of the Africa, Caribbean and Pacific (ACP) group and the EEC. The EEC/ACP arrangements are intended to increase the exposure of

the ACP countries to additional financial, trade and investment linkages with the EEC bloc, thereby giving them increased opportunities for accessibility to international trade financing credits to help offset part of their trade losses. The arrangements are also meant to diversify ACP trade among Western European countries. For West Africa in particular, the EEC/ACP arrangements should also help to further sustain the traditional francophone and anglophone trading links. Anglophone links are further enhanced through the Export Credits Guarantee Department (ECGD) arrangements.

The second form of institutionalised regional trading relations between West Africa and the outside world is through inter-governmental technical co-operation agreements with countries like the USSR and the People's Republic of China. However, these arrangements featured only in the 1960s and early 1970s, and they required in essence the recipient West African countries to barter part of their commodity exports in exchange for economic and other technical assistance from each donor country. The intention, as in the import-substitution strategy, ironically, was to provide foreign exchange savings in settlement of the corresponding repayment obligations.

Between 1961 and 1972, the Republic of China, for instance, had signed trade-linked technical co-operation agreements with more than half of the sixteen West African countries under study: Gambia in 1966 and 1968; Ghana in 1968 and 1971; Ivory Coast in 1962 and 1967; Liberia in 1961, 1965 and 1967; Niger in 1962, 1963, 1966 and 1972; Senegal in 1963 and 1969; Togo in 1964 and 1970; and Burkina in 1964-66, 1970 and 1972. It was essentially the termination and/or abrupt abandonment of these arrangements - as repayment

arrears began to mount in respect of both commodity, local currency and eventually foreign convertible currency obligations - that accounted for the sharp slow down in West Africa's overall trade with the USSR and China after 1975 (see Table 4G).

For instance, during the period of these technical co-operation agreements, the share of Ghana's trade to the centrally planned countries rose from 5 per cent to 24 per cent between 1960 and 1965. Exports dropped from 12.8 per cent in 1975 to 7.4 per cent in 1980, while the corresponding level of imports from them only ranged between 2.2 per cent in 1975 to 3.0 per cent by 1980. Similarly, Nigeria's exports to these countries has fallen to 0.1 per cent by 1980, as imports dropped to around 1.4 per cent. Gambia's imports from the centrally planned countries declined from 17.2 per cent to 6.1 per cent over the review period. The overall share of West African trade by centrally planned countries in 1975-81 dropped from 2.4 per cent for exports (2.0 per cent for imports) to 0.7 per cent (1.6 per cent).

### **4.3 PATTERNS OF INTRA-REGIONAL TRADE**

#### **4.3.1 Growth and Distribution**

As noted in the last chapter, the ECOWAS Treaty has envisaged the establishment of a customs union within the Community. This implies that all customs duties and other charges in imports from member countries should be eliminated and a common tariff against third countries is adopted. It also implies, in line with standard economic integration theory, that achieving a customs union would enhance trade among the member states. But, as already noted, scarcely any meaningful progress has been made in dismantling

tariffs within the Community as well as in concertedly attacking some of the more structural factors which have adversely affected the expansion of intra-regional trade. Negotiations in this direction have largely been unproductive, partly for genuine reasons, such as the potential loss of customs revenues, especially for countries largely dependent on customs duties, but also for less genuine reasons that have to do more with the desire to protect national sovereignty. The result is that ten years after the signing of the ECOWAS Treaty, trade regulations within the Community have remained virtually unchanged from what they were before the Treaty. In the event, the existence of the organisation has hardly provided any significant impetus to intra-regional trade promotion. The magnitude of this trade as a corollary of the substantially entrenched extra-regional trade has remained strikingly low and is still substantially rudimentary in structure. Based upon past trends, there are hardly any visible tendencies for its improvement without any meaningful monetary and economic integration.

In terms of magnitudes, the level of intra-ECOWAS exports and imports has increased individually by more than sevenfold, from less than \$100 million in 1970 to between \$700-\$800 million by the end of 1983. Exports have risen from \$86 million in 1970 to \$870.9 million in 1983, while the corresponding level of intra-Community imports has risen from \$76 million to \$756.8 million. However, if estimates for Nigeria are excluded on account of over 90 per cent of the country's exports being crude oil, intra-ECOWAS exports are lower but rising rather more steadily over the fourteen year period; from \$79 million in 1970 to \$589.9 million in 1983. In contrast, because of Nigeria's low level of intra-Community imports, its

effect on the trend of total intra-Community import trade is disproportionate. The level of intra-ECOWAS imports (excluding Nigeria) has risen by more than nine times in 1970-83 (7.5 times for exports) from \$72 million to \$654.8 million.

Table 4L shows that the level of intra-ECOWAS trade has been consistently below 5 per cent of overall trade for either exports or imports.

When the Community began in 1975, its member states sold on average 4.1 per cent of their total exports to other member states. That ratio has only risen marginally to 4.2 per cent by 1983 after dipping a little between 2.9-3.7 per cent in the intermittent years. There is a similar situation on the import side. If one also excludes estimates for Nigeria, total intra-ECOWAS exports rose to 9.1 per cent of total exports or 0.67 per cent of Community GDP (includes GNP estimates for Cape Verde, Gambia and Guinea-Bissau). Total intra-ECOWAS exports, including Nigeria, is 0.99 per cent of Community GDP. The Community's merchandise exports to the rest of the world amounted to 22.6 per cent of GDP in 1983. Among the 16 member states there are no signs of a levelling off in the fraction of GDP devoted to intra-Community trade. Only Senegal has devoted more than 5 per cent of GDP to intra-Community export trade. The ratio in 1983 for each member state is shown below (per cent):

Benin	0.95	Gambia	3.6	Guinea	0.02
Burkina	3.0	Ghana	0.2	Guinea-Bissau	0.4
Liberia	1.0	Nigeria	0.4	Ivory Coast	4.2
Niger	4.4	Senegal	5.3	Sierra Leone	0.1
Togo	4.2				

Table 4L ECOWAS: Intra-Community Trade as a Proportion of Overall Trade, 1970-1983

	EXPORTS TO COMMUNITY													
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Benin	17.2	9.8	11.9	12.7	14.0	32.3	13.6	14.7	12.5	7.8	7.9	15.1	23.8	10.5
Burkina	48.8	53.6	59.5	52.2	47.6	50.4	21.2	36.9	48.6	48.0	61.1	74.4	30.0	27.3
Cape Verde	-	-	-	-	-	-	5.0	10.0	-	6.7	13.3	-	-	-
Gambia	1.5	4.6	2.2	1.6	1.4	3.4	4.9	6.0	5.5	8.9	21.7	25.7	20.4	16.0
Ghana	0.4	0.9	1.1	2.2	0.7	2.0	1.6	1.4	0.8	0.9	1.4	1.9	0.6	0.9
Guinea	0.5	0.5	0.5	0.7	0.4	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Guinea-Bissau	2.5	5.0	3.3	-	1.0	13.4	14.5	9.5	9.1	9.5	11.5	12.4	4.9	5.0
Ivory Coast	4.7	4.7	6.6	7.6	9.4	12.7	7.8	7.4	6.5	8.7	8.8	10.3	10.9	12.2
Liberia	1.2	1.1	1.5	1.0	1.1	1.2	1.0	0.8	1.2	-	1.8	2.0	1.9	1.1
Mali	65.8	62.2	56.6	40.9	32.4	32.5	23.4	18.7	7.6	9.1	8.1	10.7	5.0	4.9
Mauritania	2.4	2.8	-	0.1	0.2	0.2	4.2	-	-	-	-	-	-	-
Niger	32.1	33.9	33.6	33.2	33.5	22.2	26.0	18.6	0.9	0.8	0.9	1.7	21.4	18.8
Nigeria	0.6	1.8	1.4	1.5	1.7	2.0	1.9	2.2	2.5	1.8	1.6	1.9	1.8	2.0
Senegal	1.0	23.0	0.7	24.9	17.3	15.2	11.4	17.9	21.4	16.2	27.8	28.8	23.8	23.4
Sierra Leone	1.1	1.3	1.3	1.2	2.0	2.3	1.0	1.1	-	-	-	-	0.9	0.8
Togo	2.1	2.7	2.8	3.9	2.2	5.6	6.2	3.9	9.3	11.8	19.0	18.5	12.3	12.5
ECOWAS	2.9	4.0	3.3	4.1	3.2	4.1	3.3	3.7	3.6	3.0	2.9	3.6	3.6	4.2
Excl Nigeria	4.6	6.2	5.4	7.5	7.3	8.7	6.6	7.0	5.6	6.4	7.9	9.0	8.7	9.1
	IMPORTS FROM COMMUNITY													
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Benin	9.5	10.1	8.7	10.2	11.9	6.6	5.1	4.4	3.3	4.6	4.8	4.2	2.5	3.9
Burkina	22.7	20.6	22.7	19.8	20.0	22.0	19.5	16.4	15.0	21.7	26.8	28.4	30.0	28.4
Cape Verde	-	-	-	-	-	0.5	1.3	1.1	0.6	0.4	0.9	0.3	0.1	0.1
Gambia	3.3	5.4	6.3	6.2	5.5	5.8	3.1	3.7	5.5	3.4	5.3	7.1	6.1	6.4
Ghana	2.8	3.5	5.5	6.3	9.8	8.6	11.6	11.7	11.3	13.0	17.0	15.2	16.8	15.0
Guinea	1.4	3.9	1.8	1.3	1.7	0.8	0.6	0.9	1.0	0.6	2.6	2.6	4.3	4.3
Guinea-Bissau	0.4	0.3	0.6	-	0.3	2.0	2.9	2.2	1.3	3.7	5.3	7.5	3.6	3.2
Ivory Coast	2.9	3.6	4.9	3.9	7.2	7.2	4.6	5.3	4.8	4.4	4.6	5.5	6.2	6.5
Liberia	1.5	1.5	1.2	1.7	3.1	0.8	0.9	2.6	2.0	2.3	1.5	1.7	0.3	0.3
Mali	16.5	19.9	20.1	18.2	15.5	26.6	24.2	27.3	28.7	28.6	29.7	35.8	37.5	32.4
Mauritania	5.9	5.8	2.0	22.2	19.2	19.1	11.6	17.2	9.5	14.1	11.5	12.4	6.3	6.6
Niger	13.2	10.9	13.6	12.4	16.1	3.0	14.5	21.2	16.4	10.4	8.4	10.8	20.0	25.3
Nigeria	0.4	0.3	0.2	0.2	0.2	0.4	0.6	0.6	0.4	0.6	0.6	0.5	0.8	1.2
Senegal	-	2.1	1.7	8.0	9.5	8.6	6.1	7.2	6.4	6.8	10.2	9.8	5.1	5.1
Sierra Leone	4.0	6.4	8.9	4.9	10.3	25.3	14.7	27.7	10.2	-	0.5	1.0	2.2	2.9
Togo	7.0	6.1	5.1	5.1	5.9	4.7	3.4	2.7	2.8	14.5	19.1	16.1	3.4	2.9
ECOWAS	2.7	2.8	3.4	4.3	5.4	4.0	3.0	3.5	2.9	4.0	3.9	3.6	3.5	4.3
Excl Nigeria	4.1	5.0	5.8	7.0	9.1	9.0	7.3	8.7	7.4	8.2	9.4	10.1	6.9	7.3

Source: World Bank, Direction of Trade Statistics

Notes: - Not available, nil or negligible

Table 4M EUUWA's Share of Member States in Intra-Community Trade (Per Cent)

	EXPORTS TO COMMUNITY													
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Benin	6.6	3.0	3.2	2.2	1.4	2.2	1.1	0.9	0.7	0.6	0.5	0.6	1.0	1.0
Burkina Faso	10.2	6.1	8.8	5.2	4.1	4.6	2.3	3.1	3.5	5.1	5.5	5.8	2.8	3.1
Cape Verde	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gambia	0.3	0.4	0.3	0.1	0.1	0.3	0.4	0.4	0.4	0.7	0.7	0.7	0.8	0.8
Ghana	2.1	3.0	3.6	5.7	1.3	3.4	2.7	2.3	1.5	1.3	1.6	1.7	0.9	1.0
Guinea	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	-	-	-	0.1
Guinea-Bissau	0.1	0.1	0.1	-	-	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Ivory Coast	25.5	15.3	26.9	25.9	27.1	31.6	26.2	24.7	26.0	30.3	26.1	27.1	31.5	33.9
Liberia	2.9	1.7	2.7	1.3	1.0	1.0	1.0	0.6	1.0	-	1.1	1.1	1.1	1.1
Mali	25.1	12.8	14.3	8.7	4.9	3.6	4.1	3.6	1.5	1.9	1.7	1.7	0.5	0.6
Mauritania	2.4	1.9	-	-	0.1	0.1	1.5	-	-	-	-	-	-	-
Niger	11.9	9.4	13.4	8.2	4.2	4.2	7.2	4.7	0.4	0.5	0.5	0.5	7.4	6.7
Nigeria	8.1	23.7	23.1	21.6	38.1	31.9	40.3	40.8	45.2	43.8	42.5	40.5	36.0	32.3
Senegal	1.8	20.5	1.2	19.3	15.9	14.7	11.4	17.4	15.6	12.0	13.2	12.7	14.4	15.7
Sierra Leone	1.3	0.9	1.2	0.6	0.7	0.6	0.2	0.2	-	-	-	-	0.2	0.2
Togo	1.4	1.0	1.0	0.9	1.0	1.5	1.3	1.0	3.9	3.5	6.4	6.7	3.3	3.5

IMPORTS FROM COMMUNITY

	IMPORTS FROM COMMUNITY													
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Benin	8.0	8.1	6.8	5.7	4.9	3.1	2.7	2.0	1.8	3.3	3.7	3.8	2.7	2.7
Burkina Faso	14.6	12.0	13.3	9.8	8.0	8.0	7.1	5.8	5.9	8.9	9.4	9.8	9.4	9.4
Cape Verde	-	-	-	-	-	-	0.1	0.1	0.1	-	-	-	-	-
Gambia	0.8	1.2	1.3	1.0	0.7	0.8	0.6	0.5	0.9	0.6	0.8	0.9	0.8	0.3
Ghana	15.2	15.9	13.8	14.4	22.4	16.4	24.7	22.5	19.2	19.1	19.2	18.4	14.3	14.3
Guinea	1.4	3.3	1.6	1.2	0.8	0.4	0.5	0.4	0.5	0.2	0.9	0.9	1.6	1.6
Guinea-Bissau	0.1	0.1	0.2	-	-	0.2	0.3	0.1	0.1	0.3	0.3	0.4	0.3	0.3
Ivory Coast	14.7	14.9	19.1	13.9	19.2	19.5	15.1	15.6	19.3	15.0	13.6	13.5	16.1	16.1
Liberia	3.0	2.4	1.9	1.6	2.5	0.6	0.9	2.0	1.6	1.6	0.8	0.8	0.9	1.0
Mali	10.2	11.6	13.5	9.8	7.7	11.2	9.2	7.3	14.1	14.0	12.8	13.4	14.7	14.7
Mauritania	4.4	3.4	1.2	14.3	6.4	7.4	5.3	6.0	2.9	3.4	3.2	3.4	4.4	4.4
Niger	10.0	6.1	7.6	5.4	4.3	0.7	4.7	7.0	8.6	6.5	4.9	5.0	12.1	12.1
Nigeria	5.4	4.1	2.8	1.9	1.7	6.2	11.7	11.8	9.6	8.2	9.2	9.2	13.2	13.5
Senegal	0.1	4.7	4.1	14.5	13.1	12.1	9.8	9.3	8.3	8.7	10.5	10.4	6.6	6.6
Sierra Leone	6.1	7.7	9.0	3.9	6.3	11.3	5.7	8.4	4.9	-	0.2	0.2	0.5	0.5
Togo	6.0	4.5	3.7	2.6	1.9	2.0	1.6	1.3	2.2	10.2	10.3	9.8	2.2	2.2

Source: World Bank, Direction of Trade Statistics

Notes: - Not available, n.f.l. or negligible



Table 4L also shows that the relative importance of the various ECOWAS member countries to overall regional trade varies widely. In relation to overall trade, by far the largest exporter and importer in the region is Burkina Fasso. Exports from Burkina to the Community have represented over 70 per cent (1981) of the country's total exports. Both imports to and exports from Burkina almost levelled off at 28 per cent of total trade in 1983. Benin, Ivory Coast, Senegal and Togo are the next largest exporters to the Community, while Mali, Ghana and Niger are the next largest importers in intra-Community trade. While these countries have increased their level of intra-ECOWAS trade in relation to overall trade since 1975, in some member states, shifts which occurred in the commodity composition of their trade in the 1970s, coupled with the effects of deteriorating climatic, political and economic conditions accounted for the substantial drop in intra-Community trade. Ghana, Guinea, Liberia, Nigeria and Sierra Leone are among those countries that have devoted the lowest percentage of overall trade to intra-ECOWAS trade. In terms of total national imports, percentages in Nigeria and Liberia are also among the least in the region, averaging far less than 2 per cent of total imports.

However in value terms, the distribution of intra-ECOWAS trade shown in Table 4M singles out Nigeria, Ivory Coast and Senegal as major exporters, and Ghana, Ivory Coast, mali and Senegal as principal importers. Nigeria is by far the largest exporter, having on average accounted for over 40 per cent of total intra-Community exports since the commencement of ECOWAS. Exports from Ivory Coast have ranged between 15 - 34 per cent of total exports. On the import side, Ghana is the largest importer and takes on average,

over 14 per cent of total intra-regional imports. By contrast, Cape Verde is the least exporter and importer, having accounted for around 0.1 per cent of both total exports and imports. Between these variations, most countries in the region have shown intra-regional export and import shares that range between 1 and 3 per cent of total trade.

A vital feature in the pattern of distribution of intra-ECOWAS trade, as also observed from Table 4M, is the relative importance of the francophone countries in terms of the degree of dependable participation. This feature is significant as these countries (except Mauritania and Guinea) belong to the West African Monetary Union (WAMU), a grouping which, as already noted, is characterised by the use of a single common currency and a common central bank among member states. Besides, it will be discovered in the next section that much of the francophones' intra-Community trade is between themselves with each country having generally less trade relations with the rest of the ECOWAS member states. Together, the nine francophone states have accounted for over 50 per cent of total intra-regional trade. In 1983, their share in total exports was 64.6 per cent (or 95.4 per cent excluding Nigeria) and 69.7 per cent (or 80.5 per cent excluding Nigeria) in total imports. The principal participants amongst them, undoubtedly, are the more developed states, Ivory Coast and Senegal. By contrast, the share of the two lusophone member states in both exports and imports has remained rather negligible, ranging between 0.07 per cent for exports to 0.26 per cent for imports in 1983. While the combined share of intra-Community trade (exports plus imports) by the seven WAMU member states has risen from 7 to 12 per cent of their overall

foreign trade in 1970-81, for the remaining nine ECOWAS member countries, it has remained particularly small. This is the case especially for Cape Verde, Guinea, Liberia and Nigeria, whose combined intra-ECOWAS trade has accounted, on average, for less than 2 per cent of overall exports and imports. Trade among the anglophones, except for import of Nigerian petroleum, is also strikingly low.

#### **4.3.2 Intra-Regional Trade Matrices**

The direction of intra-ECOWAS trade flows and the resulting inter-country net trade balances are illustrated in three trade matrices: Table 4N for 1970-75 (the pre-ECOWAS period), and Tables 4O and 4P for the periods 1976-80 and 1983 (showing trade trends since the establishment of ECOWAS). A number of pertinent observations can be made which characterise both country and sub-regional trade positions.

The first which, like the rest, derives largely from the divergent historical and geo-political orientations of the member states as well as from the relatively wide disparities in economic development levels between them, relates essentially to the continued dominance of the more advanced member countries - Ghana, Ivory Coast, Nigeria, Senegal and to a lesser extent, Liberia. The conspicuously skewed direction of trade as the Tables show is that of the 16 member states only Nigeria, Ivory Coast, Senegal and, to some extent Liberia are predominantly net exporters while the rest of the Community, especially Ghana, are net importers with widening trade deficits throughout the 14 year period.

Table 4N ECOWAS: Intra-Community Trade Matrix, 1970-75

(million dollars)

	Exports to Imports from	Benin	Burkina Faso	Cape Verde	Gambia	Ghana	Guinea	Guinea- Bissau	Ivory Coast	Liberia	Mali	Mauri- tania	Niger	Nigeria	Senegal	Sierra Leone	Togo	Total
Benin	Exports Imports Balance	.13 -10 +.03	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	36.12
Burkina Faso	Exports Imports Balance	.17 .01 +.16	1.93 +.31 9.89	-	-	-	-	-	-	-	-	-	-	-	-	-	-	63.73
Cape Verde	Exports Imports Balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-20
Gambia	Exports Imports Balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3.90
Ghana	Exports Imports Balance	.33 2.84 -2.51	1.39 14.39 -13.00	.80	1.07 .58 +.49	2.24 1.99 +.22	-.38 -.38 -.10	-	-	-	-	-	-	-	-	-	-	8.29
Guinea	Exports Imports Balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	12.86
Guinea- Bissau	Exports Imports Balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.30
Ivory Coast	Exports Imports Balance	17.80 .50 +17.30	98.20 4.00 +94.20	-	.20	16.70 1.60 +15.10	-.50 -.50 +.50	-	-	-	-	-	-	-	-	-	-	409.90
Liberia	Exports Imports Balance	.20	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	21.70
Mali	Exports Imports Balance	.20	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	118.67
Mauri- tania	Exports Imports Balance	.08 .09 -.01	3.79 2.63 +1.16	-	.02	11.18 1.33 +9.85	1.70 1.31 +.97	-	-	-	-	-	-	-	-	-	-	5.68
Niger	Exports Imports Balance	6.16 2.80 +3.36	2.42 2.38 +.04	-	-	11.85 -11.09 -11.09	-	-	-	-	-	-	-	-	-	-	-	84.83
Nigeria	Exports Imports Balance	11.30 -7.00 15.57	-	-	-	7.80 1.58 +4.60	-.30 +.30 +.15	-	-	-	-	-	-	-	-	-	-	439.00
Senegal	Exports Imports Balance	4.90 10.67 +10.67	2.45 -.03 +2.42	.48 -.11 +.37	7.22 +.26 +6.96	1.58 1.58 +1.58	4.60 +.60 +4.45	-	-	-	-	-	-	-	-	-	-	391.80
Sierra Leone	Exports Imports Balance	-	-	-	-	1.25 1.25 +1.25	1.47 1.47 +1.47	-	-	-	-	-	-	-	-	-	-	100.11
Togo	Exports Imports Balance	3.50 4.92 -1.42	1.21 1.45 -.24	-	2.48 +.05 +2.48	2.02 10.03 -8.01	-.01 +.01 +.01	-	-	-	-	-	-	-	-	-	-	17.52

Table 40 ECOWAS: Intra-Community Trade Matrix 1976-1980

(million dollars)

	Exports to Imports from	Benin	Burkina Faso	Cape Verde	Gambia	Ghana	Guinea	Guinea- Bissau	Ivory Coast	Liberia	Mali	Mauritania	Niger	Nigeria	Senegal	Sierra Leone	Togo	Total	
Benin	Exports Imports Balance	.76 .25 .51	-	-	.28 -12.63 -11.98	13.03 4.38 9.32	-	-	-	-	-	-	-	-	-	-	-	7.52 17.07 -7.59	
Burkina Faso	Exports Imports Balance	.24 .86 -.62	-	-	-	-4.94	-	-	-	-	-	-	-	-	-	-	-	4.85 5.39 -5.39	
Cape Verde	Exports Imports Balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gambia	Exports Imports Balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ghana	Exports Imports Balance	1.50 .90 .60	7.80 8.70 -.90	-	4.20 9.00 -4.80	-	-	-	-	-	-	-	-	-	-	-	-	2.90 2.80 .10	
Guinea	Exports Imports Balance	-	-	.09 -1.89 -1.59	1.89 -1.89 .39	.03 .02	.93	.30	-	-	-	-	-	-	-	-	-	.46 .46 .46	
Guinea- Bissau	Exports Imports Balance	-	-	1.13 -.98 -.59	.98 -.59	-	.63	-.04	-	-	-	-	-	-	-	-	-	.46 -.46 -.46	
Ivory Coast	Exports Imports Balance	46.80 .40 46.40	258.90 3.10 255.80	-	-	-	-	-	-	-	-	-	-	-	-	-	-	109.40 2.20 107.20	
Liberia	Exports Imports Balance	-	-	-	.80 10.10 -7.90	2.20 1.30 6.10	-	-	-	-	-	-	-	-	-	-	-	7.30 12.10 -4.80	
Mali	Exports Imports Balance	-	-	-	.33 3.36 -3.03	.78 .55 .23	.01	.01	.03	58.97 263.22 -204.25	.43	5.85	-	-	-	-	-	3.08 2.65 .43	
Mauritania	Exports Imports Balance	-	-	-	1.11 -.01 -1.11	.01	-	-	-	10.09 -10.01 3.96	1.19	-	-	-	-	-	-	.46 -.46 -.46	
Niger	Exports Imports Balance	1.61 7.13 -5.52	1.89 5.35 -3.46	-	3.49 3.44 .05	-	-	-	-	115.45 -111.49 296.00	2.71	-	-	-	-	-	-	61.81 51.50 10.31	
Nigeria	Exports Imports Balance	20.00 -18.00 13.48	5.00 5.00 10.68	-	40.00 678.00 638.00	-	-	-	-	4.00 203.00 126.54	4.00	-	-	-	-	-	-	34.00 10.00 20.85	
Senegal	Exports Imports Balance	11.32 2.16 13.48	10.58 .10 10.68	.97	16.98 .47	5.25	17.26	-	-	1.19 -1.19 -1.19	108.29	-	-	-	-	-	-	20.83 37.11 173.49	
Sierra Leone	Exports Imports Balance	-	-	-	.93 1.05 -.03	.47	-	-	-	3.69 -2.86	-	-	-	-	-	-	-	.20 .02 -.02	
Togo	Exports Imports Balance	5.32 2.50 2.82	13.84 3.55 10.29	-	-1.02 8.83 .43	-.32	-	-	-	9.47	-	-	-	-	-	-	-	5.54 1.94 3.60	
																		24.52 95.09 -70.57	
																		143.89 258.04 -114.15	
																		103.41 -101.01 124.43	
																		206.49 -82.06	

Table 4P ECOWAS: Intra-Community Trade Matrix, 1983

(million dollars)

	Exports to Imports from	Benin	Burkina Faso	Cape Verde	Gambia	Ghana	Guinea	Guinea- Bissau	Ivory Coast	Liberia	Mali	Mauritania	Niger	Nigeria	Senegal	Sierra Leone	Togo	Total
Benin	Exports Imports Balance	.14 .22 -.08	.05 +.05 -.39															8.91 20.34 -11.43
Burkina Faso	Exports Imports Balance	.24 .13 +.11																8.91 20.34 -11.43
Cape Verde	Exports Imports Balance																	8.91 20.34 -11.43
Gambia	Exports Imports Balance																	8.91 20.34 -11.43
Ghana	Exports Imports Balance																	8.91 20.34 -11.43
Guinea	Exports Imports Balance																	8.91 20.34 -11.43
Guinea- Bissau	Exports Imports Balance																	8.91 20.34 -11.43
Ivory Coast	Exports Imports Balance																	8.91 20.34 -11.43
Liberia	Exports Imports Balance																	8.91 20.34 -11.43
Mali	Exports Imports Balance																	8.91 20.34 -11.43
Mauritania	Exports Imports Balance																	8.91 20.34 -11.43
Niger	Exports Imports Balance																	8.91 20.34 -11.43
Nigeria	Exports Imports Balance																	8.91 20.34 -11.43
Senegal	Exports Imports Balance																	8.91 20.34 -11.43
Sierra Leone	Exports Imports Balance																	8.91 20.34 -11.43
Togo	Exports Imports Balance																	8.91 20.34 -11.43

Source: World Bank, Direction of Trade Statistics

Notes: - Not available; n/a or negligible

In the review period, which also coincides with the rising importance of oil, Nigeria's intra-regional trade surplus rose from a cumulative total of \$390.90 million in 1970-75 to a similar total of \$1136.60 million for the period 1976-80, representing a percentage increase of 190.8 per cent. Corresponding surpluses for Ivory Coast and Senegal rose by 120 per cent and 100 per cent respectively over the two periods. Over 50 per cent of Nigeria's surpluses (and of Ghana's corresponding deficits) arose from trade with Ghana, while the bulk of Ivory Coast and Senegal's trade has essentially been in respect of their trade links with other francophone member countries, notably Benin, Burkina, Mali and Niger. The main difference between the three net exporters however is that trade between Ivory Coast and Senegal and the rest of the region is more diversified, both in the variety of traded goods and in the number of member trading partners than that between Nigeria and the rest of the region which has depended more generally on oil exports, with Ghana being the major taker.

While there is a reasonable flow of trade between countries bordering each other, the matrices also indicate the relative dependence of the landlocked member states (ie Niger and Mali) on the coastal states. More importantly, the matrices do stress the dominance of the francophones in intra-ECOWAS trade. They illustrate that trade between this group of countries is consistently higher than that between them and the other members of ECOWAS, except to some extent trade with Nigeria.

Table 4Q ECOWAS: Performance of Sub-Regional Groupings in Intra-ECOWAS Trade

CEAO		Exports		Imports	
		1974	1983	1974	1983
1	Share in Intra-ECOWAS trade (\$m)	248.5	562.0	237.1	515.2
2	Share in Intra-ECOWAS trade (%)	60.2	64.5	72.4	68.1
3	Intra-CEAO trade (\$m)	197.6	356.22	146.8	358.68
4	3 as a percentage of 1	79.5	63.4	61.9	69.6

MRU		Exports		Imports	
		1974	1983	1974	1983
1	Share in Intra-ECOWAS trade (\$m)	5.18	11.49	13.45	23.28
2	Share in Intra-ECOWAS trade (%)	2.1	1.3	7.6	3.1
3	Intra-MRU trade (\$m)	1.57	7.26	2.07	9.29
4	3 as a percentage of 1	30.3	63.2	15.4	39.9

SENEGAMBIA		Exports		Imports	
		1974	1983	1974	1983
1	Share in Intra-ECOWAS trade (\$m)	126.88	144.36	110.02	56.37
2	Share in Intra-ECOWAS trade (%)	13.4	16.6	11.3	7.4
3	Intra-Senegambia trade (\$m)	5.41	5.35	5.95	4.82
4	3 as a percentage of 1	4.3	3.7	5.4	8.6

Source: As in Tables 4N, 4O and 4P

On a sub-regional basis each of the three economic groupings discussed in the last chapter (ie CEAO, MRU and Senegambia) has since its inception shown (in value terms) some improvement in its share of intra-ECOWAS trade, although it can be argued that as in the ECOWAS community at large such performance could not have been inspired purely by membership to either group. Table 4Q shows that the value share of the CEAO and MRU in total intra-ECOWAS trade as



well as the proportion of the respective intra-union trade have both more than doubled between 1974 and 1983. In percentage terms however, the share of intra-union trade in the CEA0's total ECOWAS export trade dropped from 79.5 per cent in 1974 to 63.4 per cent in 1983 while that of the MRU more than doubled. The CEA0's declining trend can be attributed to the rising cost of Nigerian oil exports. On the other hand, intra-Senegambia export trade, dominated largely by Senegal, has also declined as a proportion of the confederation's combined exports in total intra-ECOWAS exports. In the Lusophone group, Cape Verde has depended more exclusively on trade with Guinea-Bissau, while that of Guinea-Bissau appears relatively more diversified, involving trade links with Gambia, Guinea, Liberia and Senegal.

#### **4.3.3 Commodity Composition**

A great deal of intra-ECOWAS trade is concerned with farm crops, particularly foodstuffs and re-exports of imports from outside the region, although in more recent years, oil from Nigeria and simple manufactures, especially from Ivory Coast and Senegal, have also shown increasing importance. As discussed in Chapter 2, ecological variations in most of the countries have resulted in some broad specialisations and therefore in the promotion of interdependence through intra-regional trade. This is particularly the case with such countries as Nigeria, Ivory Coast, Ghana, Guinea and Sierra Leone. The smaller countries like Benin and Togo, which also span several latitudes of forest zone and grassland, also produce a wide variety of staple foods according to the range of ecological zones they traverse. A contrasting situation occurs in

the more arid countries - Niger, Mali, Mauritania, Senegal and Burkina Fasso - devoid of humid tropical environments characterised by root-crop and tree-crop economies. There is therefore greater intra-regional trade flows involving a greater variety of food staples in the first group of countries than in the second. The arid countries have however traded such commodities as livestock products, grains and dried and smoked fish in exchange for coastal consumer products, including simple manufactures.

In recent years, the rapid disappearance of many of these traditional exchange commodities among West African countries has been increasingly replaced (apart from oil) by re-exports of foodstuffs and such commodities as textiles and light consumer durables, the bulk of which tend to be traded in the more convertible regional and extra-regional currencies, especially in the border market centres. This high incidence of re-export trade has more serious foreign exchange implications for several countries in the region, especially the less convertible countries. This is also true for trade even in the simple manufactures - eg cotton cloth, soap, tobacco, matches, plastics, and confectionaries - which, as already noted, have a high import-input content. On the whole, with extra-regional trade so deeply entrenched within the industrial and agricultural production and consumption demands of the West African countries, it is expected that the range of indigenous goods that enter intra-regional trade has to be extremely narrow. On the whole, this range (including even re-exports and simple manufactures) is almost exactly the same for all countries. The flows of agricultural foodstuffs have been affected during the last few years, especially that of rice, by the weakened

agricultural positions of the grassland countries. At the same time, the establishment of similar industries almost everywhere aggravates competition and is liable to further reduce intra-regional trade flows in future. Although modest in absolute terms, these flows are important and extremely vital for several infant industries as is shown by the partial use of their actual production capacities.

#### **4.4 FACTORS AFFECTING INTRA-REGIONAL TRADE**

##### **4.4.1 Non-Monetary Factors**

At the beginning of this chapter the question was posed whether the common tendency of West African trade being more outward- than internal-oriented, or, indeed, whether the consequent small and stagnating proportion of intra-regional trade is structural, political, economic, financial or monetary, or, just 'natural' or 'artificial'. Some of these important considerations have already been highlighted in this chapter as well as discussed in the preceding chapters. They undoubtedly constitute the major constraints not only for the expansion of intra-regional trade but also for the overall development process.

It is thus recognised by now that the problems of trade and economic relations with developing regions and countries and those of intra-regional West African trade are not dissimilar: the low level of economic development, the need for changes in production and consumption structures, the paucity of information, transport and communications network, inadequate and limited competence in trade promotion, the large and dominant foreign cleavage in import and export trade, historic ties, border closures, road blocks and

other non-tariff barriers, and negative attitudes of nationalism. These factors broadly represent the so-called non-monetary obstacles which, in combination with the monetary and financial constraints, inhibit the expansion of intra-regional trade. Special concrete efforts are therefore necessary to fully appreciate them to identify possibilities for co-operation in trade, finance, industry and agriculture. This will require a degree of economic co-operation not yet, perhaps, sufficiently recognised or accepted by West African states.

Hopkins (1973) has stressed that the low level of intra-West African trade should be attributed to the achievement of political independence which as he puts it, 'led to the erection of barriers to the internal flow of goods and services, the claims of territorial sovereignty providing in this instance more than a match for the ideals of pan-Africanism'. One very important implication deriving out of this tendency is the lack of enthusiasm for countries to make their economic and production structures relatively complementary to one another. Most of the trade policies pursued in the region do not discriminate in favour of intra-regional trade and many countries have simply acquiesced to the status quo in which foreign trade is the most important consideration and therefore the most favoured in national policy making, no matter its costs.

Perhaps one would have expected a number of socio-economic factors to have a positive influence on intra-West African trade. These include the socio-cultural inter-country linkages which resulted from the division of ethnic groups following the colonial frontier demarcations of the region (eg the Fullahs between Sierra

Leone and Guinea; the Ewe between Ghana and Togo; the Vi, Mende and Kissi between Liberia and Sierra Leone; the Gambia and Senegal, though two different countries with different political backgrounds, are ethnically the same); those associated with the large-scale intra-regional migration; and the range of ecological variations. This expectation is built on the assumption that at least the flow of local products would be encouraged as migrants and ethnic settlements would have a tendency to retain their eating habits, traditional values and life style no matter where they are; thereby enabling major immigrant countries like Nigeria (until the recent mass repatriations of 1981-84), Ivory Coast, Sierra Leone and Senegal to gain through trade in huge quantities of foodstuffs and other delicacies. While this logical sequence holds, it should also be expected that its realisation in practice, at least in West Africa, is dampened by the close similarity that exists in the consumption patterns of the countries and therefore in the domestic production of staple (or very close substitutes) food items.

It also needs to be recognised that while the close trading relations which exist among the francophone states may be justified by their close colonial and linguistic links, the likelihood exists that this pattern could change towards greater intra-regional diversification once a common currency operates throughout West Africa. In fact, as will be discussed later in the study, intra-WAMU trade is excluded from the West African Clearing House arrangements. The direct implication is that more than half of total intra-regional trade is automatically excluded from the existing all-embracing monetary integration scheme.

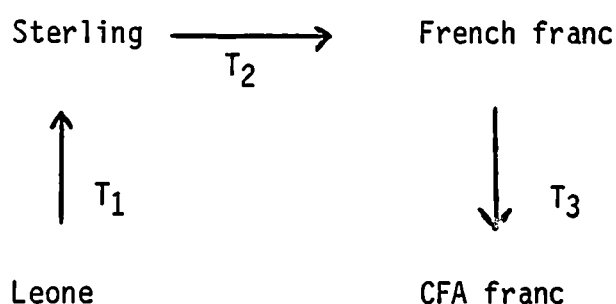
#### 4.4.2 Monetary and Financial Factors

The analysis of West Africa's financial system in a later chapter will try to divulge in some detail the nature and structural foundations of this second set of factors which have in many respects deterred the extent of mutual trade in the region. The IMF (1980) reckons that these are factors that must of necessity assume increasing importance of a deterrent to intra-West African trade once the first subset of obstacles discussed above are alleviated. But to the extent that the complete elimination of these non-monetary barriers, many of which are structural in design, as a first step, is seemingly cumbersome and practically difficult and, because they are in many ways closely related to the monetary and financial obstacles, it is argued that the alleviation of both sets of obstacles should be considered simultaneously. The distinction between monetary and non-monetary restrictions may be somewhat arbitrary if only because impediments to the flow of finance ultimately influence the flow of trade. But the means by which currency arrangements can affect the channels of trade are of immediate relevance to this study. The deficiency of these arrangements among West African countries has substantially led to various forms of illegal exchange of goods and currencies.

In general, monetary and financial obstacles inhibiting intra-West African trade are to be found not only in the fact that there are a considerable number of national currencies, but, more importantly, in the fact that there are differing degrees of monetary control and financial practices. The widespread adoption of foreign exchange control and other import restrictions, especially among the former sterling area countries, has permitted

the currencies of these countries to remain overpriced, 'which cancels out significant cases of comparative advantage' (Balassa, 1965, p 31). Furthermore, all West African currencies, except the Liberian dollar (which is the same as the US dollar) and to a lesser extent, the CFA franc, are grossly inconvertible, which makes them always in large supply on the parallel market. Some of the most inconvertible currencies like the Ghanaian cedi, the leone and the Guinean Syli command lower prices vis-a-vis the official rates for the more convertible currencies. However to the extent that virtually all West African currencies are overvalued even vis-a-vis each other, the expansion of intra-regional trade along the lines of fully liberalising it, adopting a common trade policy, and/or common tariffs with respect to goods of overseas origin would also imply substantial downward adjustment of each currency if persistent payments problems are to be avoided.

The implications for intra-West African trade of the lack of convertibility between currencies is illustrated as follows. Let us consider Sierra Leone's currency, the leone, which is convertible into a 'master' currency, say sterling, after a delay of time,  $T_1$ ; and suppose that sterling has to be reconverted into another master currency, say the French franc, after another delay,  $T_2$ ; and that the French franc is convertible into another sub-currency, the CFA franc, after a delay,  $T_3$ ; then the aggregate waiting time to convert the leone into the CFA franc is the time it takes to go through the exchange transactions route,  $T_1 + T_2 + T_3$ , which is graphically represented:



Each of these delays involves costs and profit margins that are expressed in real costs and rents accruing to the banking systems and passed on through currency margin differentials to the transactor and ultimately, the trader. This exchange problem is compounded by the inadequacy of formal banking and currency market facilities to enhance the execution of intra-regional currency transfers without having to go through extra-regional currency and institutional transit facilities.

As already indicated, the nature and deleterious effects of these monetary and financial factors on the domestic economies as well as on the West African region as a whole will be analysed later on. Meanwhile the inhibiting effects of the West African Monetary Union on the expansion of intra-West African trade can be related further to, firstly, the limit set on any meaningful monetary co-operation (eg exchange rate adjustment and/or realignment) between the union and those outside it; and second, the limit set on the ability of members of the union to pursue independent monetary, financial and development strategies which would be a pre-requisite to any meaningful development of complementarities to promote intra-West African trade.



Also, while in the anglophones trade is largely distorted through the adoption of very tight exchange controls and payment restrictions, a different bias distorts trade relations in the WAMU. The ready availability of the French franc, in contrast with other currencies, makes it natural to conserve drawings on the common pool of scarcer currencies for more urgent requirements, where the cost differentials between France and other countries are greatest. The discrimination is implicit but it may have a great impact on the pattern of trade.

#### **4.4.3 Unrecorded Trade**

Another significant aspect of the pattern of intra-ECOWAS trade is that much of it is 'underground', taking the form of illegal trading and smuggling and is therefore unrecorded. There are no precise figures for its level but most estimates agree that this trade is substantial and may be several times bigger than the recorded trade.

The items of unrecorded trade are wide ranging. Apart from the more obvious local foodstuffs found in the markets physically convenient to sellers but technically on different national territory from their own (this trade is only an incidental extension of local commerce across frontiers), it also involves the smuggling of some of the most valuable export products (eg diamonds and gold) and an assortment of durable and non-durable consumer goods manufactured both in the region and outside it.

Perhaps the most obvious explanation for the continued existence of unrecorded trade in West Africa as well as for its expansion in recent times can be found in the wide disparities in

trade and exchange rate policies among the member countries. Because of the concomitant effects of the divergent practices on domestic prices, customs duties, the convertibility of national currencies and the supply of basic commodities, there has been a tendency to take across borders goods from countries with highly restrictive trade and monetary practices for goods from those countries with more liberal trade and monetary systems.

In this respect, the most adversely affected are the anglophone member states which also are the ones maintaining tighter trade restrictions even with their ECOWAS neighbours and non-convertible currencies. Typified by Ghana's experience, these countries have also experienced the most frequent and widest fluctuations (generally downward) of their national exchange rates as well as a rising shortage of international liquidity. Consequently, unrecorded trade has usually involved smuggling out the products of the more affected countries in exchange for either the convertible CFA francs or Liberian dollars, with which the 'underground' traders would buy goods the importation of which is prohibited or severely restricted in their own country. Alternatively, since trade is generally transacted in relatively convertible regional currencies, the foreign exchange earnings are also smuggled into the more restrictive countries to finance the black market activities which further disequilibrates the official exchange rate and steps up the incidence of smuggling.

It is generally acknowledged that on this course of events, the francophone countries are more generally the major beneficiaries. For example, it is common knowledge that a significant part of Togo and Benin's imports of wines and spirits, cigarettes and embroidery

ultimately end up in Nigeria, while Niger has made no secret of the fact that its economy depends heavily on imports from Nigeria (since Niger is the nearest landlocked country to Nigeria), almost all of them through the underground market.

In general, the underground economy in West Africa has had its adverse impact on the incentives for the member countries of ECOWAS to implement trade promotion aspects of the Treaty. The fact is that even though the movement of national products is not approved of officially, in almost all cases these products are to be found in most national markets. Yet, the large size of the underground trade cannot be reasonably blamed for the lack of impact by ECOWAS on intra-Community trade. No plausible allowance for the existence of unrecorded or smuggled exports would remove the impression that production for export of many of the major commodities discussed earlier has strongly declined in Nigeria, Ghana, Senegal and Sierra Leone and strongly grown in the Ivory Coast. Strong and meaningful concerted policies are needed to control the incidence of smuggling. It is thus in its ability to remove or minimise the existing incentives for participation in the underground or black market currency and commodity activities as well as the monetary and non-monetary obstacles of intra-ECOWAS trade that the new role of monetary integration in West Africa is further appreciated in this study.

#### **4.5 TRADE AND ECONOMIC DEVELOPMENT IN WEST AFRICA**

The very low proportions of intra-West African trade in terms of the GDP/GNP (see Section 4.3) are by implication the direct result of correspondingly high and rising foreign trade/GDP (or GNP)

ratios; which further demonstrates, statistically, the strategic role of foreign trade in West Africa's development process. These ratios also provide another measure for testing the success of economic integration as well as the degree of openness of the West African economies.

Indeed for a fairly large number of LDCs foreign trade/GDP ratios have risen quite substantially during the last three decades both in terms of exports and imports and a large part of this upward trend especially since the 1970s, can be attributed to upward shifts in oil prices.

IMF estimates (see: IMF, Supplement on Trade Statistics, 1982) have shown that the median export/GDP ratio for the non-oil developing countries increased slightly to 16.8 per cent (29.6 per cent for imports) in 1970 from 16.0 per cent in 1960 (21.8 per cent for imports) but then showed a significant increase to 20.4 per cent (32.0 per cent for imports) in 1980.

The observed ratios in Table 4R illustrate the rising exposure of West African economies to external trade influences since the end of colonial rule. The marked inter-country variance in the ratios between 1960 and 1981 largely relates to the divergencies between countries in their commercial policies and the fortunes of their exports as well as to changes in per capita incomes.

The ratios of exports to the GDP show that on average production for exports has typically made up no less than 10 per cent of the GDP in the majority of the West African countries. In the major iron ore producing countries - Liberia and Mauritania in particular - export production has represented over 40 per cent of total domestic production. The very low domestic demand for export

products, together with exceptionally huge export surpluses have in part also accounted for rising ratios in other mineral exporting countries like Nigeria, Togo, Niger and Guinea. For the region as a whole, the export/GDP ratios have tended to rise more rapidly in the 1970s than the decades before. The percentage number of countries where this ratio exceeded 20 per cent has increased from 25 per cent in 1960 to 44 per cent by 1981.

For imports, the changes in the ratios have been more pronounced. Traditional import propensities (ratio of imports to GDP) and import coefficients (ratio of imports to GNE) have been very high, indicating further that output is specialised for export sales and also that imports in West African countries have accounted for an equally large share of aggregate national expenditures. Between 1960 and 1981 the number of countries with import/GDP ratios greater than 20 per cent increased from 38 per cent in 1960 to 69 per cent in 1970 and 81 per cent in 1981. Exceptionally high ratios of over 50 per cent were experienced in Benin, The Gambia, Liberia and Togo in 1981. In the same year also, all countries in the region had import/GNE ratios of over 20 per cent, with countries like Benin, Cape Verde, The Gambia, Liberia and Togo experiencing ratios of above 50 per cent.

The inadequacy of exports to provide sufficient cover for corresponding levels of imports is also illustrated in the Table by the declining export/import ratios in most countries. The Table indicates that only two countries - Liberia and Ivory Coast - have managed to show ratios of 100 per cent and above from 1960 through 1981. Nigeria could only maintain such a situation after 1970 following the huge oil revenues. The worst deterioration was in

Table 4R ECOWAS: Merchandise Trade and Domestic Production (Per Cent)

	Exports to GDP			Exports to Imports			Imports to GDP			Imports to GNE <sup>a</sup>			Total Trade to GDP							
	1960	1970	1975	1960	1970	1975	1960	1970	1975	1960	1970	1975	1960	1970	1975	1981				
Benin	11.3	13.0	6.0	4.2	58.1	51.0	16.0	4.1	19.4	25.3	37.2	104.2	-	25.6	37.2	77.7	30.7	38.3	43.2	108.4
Burkina Faso	2.0	5.1	6.4	6.9	36.4	37.0	29.0	22.0	5.5	13.9	22.3	31.3	-	-	40.1	22.7	7.5	19.0	28.7	38.2
Cape Verde	-	-	-	-	91.7	10.0	6.0	5.3	-	-	-	-	-	-	-	66.4	-	-	-	-
Gambia	40.0	42.6	48.8	12.3	88.9	93.0	81.0	22.0	45.0	45.7	62.4	58.1	-	-	-	56.8	85.0	88.3	111.2	70.4
Ghana	26.6	20.7	17.6	4.1	89.5	112.0	102.0	74.2	29.8	18.5	17.2	5.6	-	24.4	18.6	24.8	56.4	39.2	34.8	9.7
Guinea	13.8	-	-	25.6	102.0	72.0	74.0	121.9	13.5	-	-	21.0	-	-	-	21.1	27.3	-	-	46.6
Guinea-Bissau	-	-	-	-	36.4	14.0	19.0	22.0	-	-	-	-	-	-	-	33.3	-	-	-	-
Ivory Coast	27.5	31.4	30.5	29.2	119.8	121.0	105.0	106.0	23.0	26.0	28.9	27.5	-	35.0	40.4	23.4	50.5	57.4	59.4	56.7
Liberia	37.7	60.8	64.6	63.2	120.3	143.0	118.0	111.0	31.4	42.6	54.5	56.7	-	66.7	76.4	74.4	69.1	103.4	119.1	119.9
Mali	-	12.6	8.9	13.8	-	70.0	30.0	42.0	-	17.2	29.1	32.6	-	-	-	27.2	-	29.8	38.0	46.4
Mauritania	-	44.0	39.3	41.1	-	159.0	109.0	98.0	-	27.7	36.2	42.1	-	-	-	37.3	-	71.7	75.5	83.2
Niger	5.2	7.9	14.0	17.4	100.0	54.0	90.0	66.1	5.2	14.6	15.7	26.3	-	-	-	23.8	10.4	22.5	29.7	43.7
Nigeria	15.1	15.8	23.5	27.9	78.6	117.0	129.0	106.0	19.2	13.5	18.2	25.9	-	18.3	24.9	24.4	34.3	29.3	41.7	53.8
Senegal	18.5	17.6	24.4	17.9	65.7	79.0	79.0	66.1	28.2	22.4	30.7	44.4	-	-	-	40.9	46.7	40.0	55.1	62.3
Sierra Leone	-	23.5	19.6	26.6	112.2	86.0	68.0	116.4	-	27.4	29.3	22.9	-	30.6	37.4	20.9	-	50.9	48.9	49.5
Togo	12.5	20.6	21.0	39.1	57.7	85.0	72.0	59.4	21.7	24.3	29.0	67.8	-	31.1	-	59.1	34.2	44.9	50.0	106.9
ECOWAS (X <sub>m</sub> ) <sup>b</sup>	15.1	20.6	21.0	17.9	89.2	82.0	76.5	66.1	21.7	24.3	29.1	32.0	-	30.6	37.4	30.3	34.3	40.0	48.9	55.3

Source: IMF and World Bank Trade Statistics

Notes: a Gross National Expenditure = GNP

b X<sub>m</sub> represents median average  
- Not available

Benin and Cape Verde where the ratios fell from above 50 per cent in 1960 to below 10 per cent in 1981 as well as in The Gambia where it dropped to 22 per cent in 1981 from over 80 per cent between 1960 and 1975. The ratio has exceptionally remained low in Guinea-Bissau.

Finally, the median ratio of West Africa's total foreign trade (imports plus exports) to the GDP increased from 34.3 per cent in 1960 to 40 per cent in 1970 and 55.3 per cent in 1981. While the median export/GDP ratio rose only marginally to 17.9 per cent in 1981, from 15.1 per cent in 1960, that for imports was more distinct, rising from 21.7 per cent in 1960 to 32 per cent in 1981. The adequacy of export value in covering import bills has declined from an export/import ratio of 89.2 per cent in 1960 to 66.1 per cent in 1981, indicating also the faster growth in import bills.

#### **4.6 CONCLUSIONS**

The discussion in this chapter on the dimensions of West Africa's trade relations may be summarised as follows. Firstly, West African export performance in recent years is judged by reference to the composition of export commodities (which are wholly primary raw material inputs), and changes in their relative prices, as well as to trends in volumes. While export composition in some countries has changed only marginally, in others it has been greatly altered - especially in Nigeria, because of the emergence of mineral oil as the predominant export. In a number of countries, mineral exports had by the end of the 1970s contributed more than the traditional agricultural exports.

Secondly, the composition of West African imports has altered because of changes in the structures of domestic production and expenditure and changes in import costs, particularly the cost of imported fuel.

Although both export and import values have been falling during the early 1980s, the import-export gap is still wide enough to impose serious problems for development and growth. Geographically Nigerian oil has made West African export links as much transatlantic as with Western Europe. Import ties are however still more largely with the European Community. On the whole, there has been considerable diversification of West African trade connections to the extent that in virtually every country, the trading predominance of the former metropolitan power, though still relatively significant to influence national trading and financial policies, has reduced since the achievement of political independence.

Another, and generally the most important feature of West African trade from the point of view of economic integration, is that intra-West Africa is still relatively insubstantial; only for two countries - Burkina and Niger - has it really (in terms of both intra-regional exports and imports) consistently exceeded 15 per cent of total exports or imports throughout the review period, 1970-83. Its pattern however reflects the general importance of the francophones compared with the rest of the countries, especially the anglophones. Our discussion of West Africa's intra-regional trade has carefully stressed the monetary and non-monetary obstacles for its expansion, including of course the fact that much of it is still 'underground' and therefore unrecorded. Among the major



constraints emphasised included the relative inconvertibility of the national currencies and foreign exchange control and other trade and financial restrictions which have also given rise to overvalued currencies.

The pattern of West African resource endowment and trading relations have combined to ultimately determine the divergent evolution of the various West African economies. The most critical case for treatment is that of countries suffering increasingly from falling export revenues and rising import bills. For improving West African trade performance as a whole, adjustment means cutting and/or rationalising imports to stress only 'essential' commodities and services and expanding production and exports, which could also mean the search for other exploitable natural resources suitable for export and reducing import demand, especially of foodstuffs and intermediate technology. Equally important for the West African economies, most of which are continuously weakening, is the need for a redistribution of world effective demand in their favour. This in effect would be accomplished more meaningful through preferential or relatively sustained prices for raw material exports and capital imports, through increased financial assistance without resorting to further accumulation of high debt-service commitments, and through increased local processing before export to markets that should also include industrial countries.

In the context of the 'dynamic' approach to economic integration, the corollary follows that the removal of the constraints to intra-West African trade and its expansion through an increase in effective intra-regional demand would enhance the realisation of the benefits of integration - in particular trade

creation and trade diversion effects in industrial and agricultural processes, as well as in carefully and meaningfully conceived internal and external tariff policies. Thus, the adjustment process of intra-West African trade requires the formation of a regional machinery that would reorient and exert a massive influence on existing consumption and production patterns, ease the information, transport and communications problems to make feasible both the movements of goods and persons among the member countries, and, above all, facilitate intra-regional currency exchange and enable an improvement in regional convertibility.

We therefore need to emphasise that in line with the main hypothesis of this study, the role of monetary integration for West Africa is defined in terms of its capacity to significantly influence and facilitate these two adjustment processes against which effective economic integration in the region must be tested. The need to develop intra-West African trade is fully recognised but so also is the fact that West Africa's overall trade and financial relations and the payments and adjustment problems they occasion create a need to extend and deepen the scope of monetary and economic co-operation among member countries. In this context, the role of West Africa's monetary and banking arrangements and relationships are equally crucial, especially as they are generally disintegrated, rudimentary and dependent in operational structure and performance. This feature of the West African economy is described and analysed in the next chapter.

**CHAPTER 5**  
**MONEY AND THE BANKING SYSTEM IN WEST AFRICA**

**5.1 INTRODUCTION**

The comparative description and analysis of the structure, instruments, processes and performance of the West African monetary and banking systems in this chapter is concerned with the implications of its findings for efforts to achieving effective monetary and economic integration in the region. In particular, the interrelated aspects of the monetary integration strategy that is argued in this study include the very close co-ordination or harmonisation of domestic monetary policies and banking practices. This emphasises not only the relevance of the differences in central banking arrangements in monetary and credit techniques but, even more important, also stresses the critical importance of the commercial banking system in the integration process.

The monetary, financial and banking development that has taken place in West Africa, like the structures already discussed, has strong historical perspectives, to the extent that seven of the francophone West African states have retained a common currency arrangement that goes as far back as 1948. Even in those countries where some major institutional changes have taken place in their monetary systems since independence, eg replacement of colonial monies with national currencies and the indigenisation of banking institutions, the structural and operational features of these systems broadly reflect their colonial foundations. In general however, West Africa's domestic monetary systems are commonly dependent, characterised by close links with those of the developed

industrialised countries, in most cases France, Britain and the United States.

In broad terms, the West African monetary system has two major differences in its framework within which monetary integration is to be achieved among member countries. Firstly, Liberia and seven francophone countries - WAMU - are tied closely to the US and French monetary systems respectively, given the need for external support for their national currencies. In this instance external support for the national currency creates confidence in its value and stability, while free movement of capital allows access to a highly diverse foreign capital market so that a large volume of banking operations is possible. The development of financial institutions in these countries has sometimes been retarded, as the availability of foreign capital reduces the pressure that could be exerted with the adaptation and establishment of financial and banking institutions capable of making maximum use of domestic capital for development purposes. In many cases, the national banking system depends on subsidiaries or branches of foreign banks, and it is sometimes necessary to modify traditional monetary policies in order to avoid excess liquidity in the banks or in the branches of foreign banks, which would flow out of the country. Accordingly, interest rates in these countries must be brought into line with those prevailing in world financial markets, and there is not only the absence of independent monetary policies - especially exchange rate management, there is also a certain reluctance to invest in domestic securities, which would contribute to the development of markets.

In the second group of countries, especially three of the former sterling area countries (Ghana, Nigeria and Sierra Leone), monetary independence has been achieved, even at the cost of unrealistic exchange rate policies and inflation rates high enough to cause uncontrollable distortions in the financial system as a whole. In this instance the operations of savers and investors as well as the development of the commercial banks and the effectiveness of monetary and financial policies are severely distorted, making it difficult for the entire financial structure to perform its desired function.

Under monetary unification (implying a fixed exchange rate or common currency system), forces operating through a country's balance of payments constitute a significant challenge to the effectiveness of domestic monetary policies and financial practices. Increasing economic and monetary interdependence among countries sharpens the issues in the choice of means available to national authorities to cope with this challenge. Hence, in West Africa, the possible responses of each national monetary system to the problems of monetary and economic interdependence are fundamental to achieving realistic integration for the region as a whole.

The chapter is divided into five main sections. Section 5.2 describes the evolution of national currencies and banking institutions and outlines the major structural changes introduced in these institutions since the achievement of political independence. Section 5.3 examines monetary policy objectives, formulation and management, while in Section 5.4, the relative performances of the banking systems are evaluated in terms of the efficiency of

financial intermediation and the role of monetary policy through statistical ratios. The conclusions are provided in Section 5.5.

## 5.2 THE EVOLUTION OF MONEY AND BANKING

### 5.2.1 Coinage and Currency

Historically, a reasonable proportion of the commercial transactions which entered West Africa's pre-colonial exchange markets were traded by barter, but barter itself was not the dominant means of effecting exchange. Ethnological and historical findings have revealed that in the past centuries West African economies, like most other African economies, had moved from barter trading to the use of commodity monies (eg cattle, gold dust, salt, tobacco) which had intrinsic value through the use of money standards (eg cowry shells, manilla) with little intrinsic value, even before the introduction of colonial token money (coins and currency notes) which still form the substantial part of total money supply (see for instance, Onoh, 1982; Hopkins, 1973; Mundel, 1972; Latham, 1971; Johnson, 1970; Dalton, 1965; Mladek, 1964; Einzig, 1951).

There was a great similarity in the indigenous currencies used in the pre-colonial communities of West Africa; reflecting the relative similarities and cross-frontier intercourse between ethnic and economic communities. However, the comparative importance of each 'early money' also reflected the geo-physical features of the communities. For instance, gold dust was a more dominant currency in Ghana, while in Gambia, Guinea and Senegal, the main commodity moneys were kola nuts, rice, corn and cattle. The cowry shell was probably the most important and widely used money in the region.

Slaves provided transport and currency especially as between the coastal and hinterland communities.

In the wake of the Arab conquest came Arab culture and money. By the 10th century, Arab influence had introduced gold dinars and silver dihrems in West African communities. The cloth merchants of Ghana obtained gold from more primitive communities to the south through the 'silent trade' or 'dumb barter' - a system in which the two parties would leave their respective merchandise and then depart, while the other party would accept and exchange or add to the price until a bargain was struck. The coming of the European traders and explorers by the 15th century introduced such commodity moneys as the Spanish doubloon, the American eagle, Portuguese manilla and Mexican dollar. In the 17th and 18th centuries, the English African Company for instance, minted a 'guinea' with an elephant and castle and soon to be imitated by the crown. The first issues of the gold ACKEY and silver TAKOE were made; one ounce of gold was divided into 16 AKEIES and 8 TAKOES = 1 AKEY.

Significantly the pattern of colonial exploration and administration was typically followed by monetisation. Initially this was in the private hands of a banking monopoly, later taken over by the government. The colonial power generally introduced local currencies. Currency boards, or their equivalent, were set up and the colony became a monetary satellite of the metropolitan country. By 1912 the UK silver had become the most important single means of payment throughout British West Africa and the issuance of West African currency notes through the West African Currency Board (West African pound at par with a pound sterling) afterwards achieved a uniform currency from subsidised coinage to sterling

currency notes. Monetisation proceeded fairly rapidly in the 1920s through official demonisation proclamations against the use of indigenous commodity moneys. Currency systems changed with independence.

Both the newly created Ghanaian pound (1959) and the Nigeria pound (1963) were linked to sterling at par, but Nigeria did not follow the sterling devaluation of 1967. During the Civil War (1966-72) the Nigerian pound was redesigned to make currency notes held by the Biafrans valueless. In 1973 the Nigerian pound was replaced by the 'naira' whose shape was also redesigned in 1979 and the highest denomination - the twenty naira note - was introduced. The third and largest currency change in Nigeria was in 1984 when, as in Ghana's redesignation of currency denominations in 1981, the obvious change was merely a colour swap between the old and the new naira notes. In July 1965, the Ghanaian pound gave way to a new decimal currency unit, the 'cedi', also linked to sterling. This unit was later (1967) replaced by the 'new cedi', now renamed the 'cedi'.

In Sierra Leone, a new decimal currency, the 'leone' (also linked to sterling until 1978) replaced the WACB pound in 1963 and was devalued with sterling in 1967.

In The Gambia, the transition from colonial to post independence currency system was based initially on a choice between two alternatives: one, to create an independent system and the other, to join a common system with Senegal (hence an adoption of the French franc system) in the event of political association. However with the creation of the Gambian Currency Board in 1964 in replacement of the WACB, a new currency, the Gambian pound, at par



with sterling, was introduced, and followed sterling's 1967 devaluation. In 1971, the Gambian pound gave way to a new decimal currency, the 'dalasi', also linked to sterling.

In Liberia, the currency in circulation up to 1950 consisted of the coins and notes of the WACB. That year, despite the law of 1935 creating the 'Liberian dollar', the WACB currency ceased to be legal tender and was replaced by the US dollar, an action that was later (1956) confirmed by legislation. The indigenous Liberian dollar has been restricted to coin only.

The currency change-over in the francophones especially during and after the colonial era has not been as varied, chaotic, complex and political as that in British West Africa. In 1945, the wide range of commodity currencies in the francophones were replaced by a 'colonies francaises d'Afrique' (CFA), which like the WACB pound sterling relationship, was initially at par with the French franc and moved with the latter's subsequent devaluations. Upon independence, the CFA's original name was changed (but the initials preserved) to the franc of the 'Communaute Financiere Africaine'.

The CFA franc, issued by a common central bank for the 'francophones', the Banque Centrale des etats de l'Afrique de l'Ouest (BCEAO), is legal tender in all the member states. Serial markings make it possible to identify the state where the notes have been issued, and notes issued in one member state that are intercepted by the bank of issue or governmental agencies in other states are returned to the branch of BCEAO which originated them. The amount of notes thus returned are recorded in the credits and debits between the states concerned. By opting out of the CFA franc area, Guinea (1962), Mali (1967), and Mauritania (1972) introduced

their national currencies: the Guinean franc and in 1972, the 'syli'; the Malian 'franc'; and the Mauritanian 'ouguiya' respectively.

In the lusophone states, the national escudo in each county was at par with the Portuguese escudo. The new Cape Verde escudo and the Guinea-Bissau 'peso' are currently not tied to the Portuguese escudo.

### **5.2.2 Central Banks**

It was the rapid decline of West Africa's indigenous commodity currencies, and the increasing circulation of European currencies in their place as well as the aspirations of colonial administrations to consolidate their commercial interests in their territories that led to the introduction of modern banking institutions in the region. During the colonial period these developments were aided by the adoption of policies which speeded the demonetisation of the transitional currencies and were replaced by colonial currency exchange media. Apart from the deliberate ban on the import and use of transitional currencies, the colonial masters also encouraged the adoption of modern money by paying the expanding colonial labour force in colonial currency and by insisting on receiving taxes and other payments to the colonial treasuries in such currency. An urgent need was thus created for the establishment of central monetary control institutions to manage the supply and circulation of the colonial currencies.

In the former British African Territories, Currency Boards were the precursors of the Central Banks. Three Currency Boards were established, namely, the West African Currency Board (1912), the

East African Currency Board (1919) and the Southern Rhodesia Currency Board (1939 and, after 1954, the Central African Currency Board). Except for very minor differences, these Boards operated on similar lines.

In general, currency exchanges through the Board were closely related to the amount of export earnings while additional revenues were provided to the colonial treasury through profits from seigniorage and asset investments. The WACB operated from London while currency distribution centres were the capital cities of the four colonies and was administered on the Board's behalf by British Bank of West Africa Ltd.

The prescribed objectives of the WACB were threefold:

- (a) the initiation of West African issue of currency;
- (b) the assurance of convertibility of local currency into sterling at a known rate of exchange; and
- (c) the provision of revenue to the governments through sharing in the profit of issue.

The WACB's responsibility was outlined as 'to provide for and to control the supply of currency to the British West African colonies and protectorates; to ensure that the currency is maintained in a satisfactory condition and generally to watch over the interests of the constituent territories so far as currency is concerned' (Loynes, 1962, p 41). Through this the Board arrangement was characterised by fixed parity of local currency with sterling, automatic issues and 100 per cent sterling coverage.

There was no doubt that the Currency Board System played a significant role in the monetisation of the barter economies of the dependent colonies and provided the needed financing for export

trade. It might be argued also that the excessive inflationary self-financing that now characterises the monetary operations of the majority of the former British colonies in West Africa and Africa as a whole might not have been possible under the currency board system. Although it never per se integrated the domestic monetary systems, the Board system can in some degree be looked upon as having provided some foundation for monetary co-operation among the member countries.

However, it was long before the Board's weaknesses were realised. The Board system has generally been criticised on the following grounds:

- (a) it was operationally rigid and institutionally limited, in that the currency it issued depended only on sterling earned through export trade;
- (b) it was more of a money changing and accounting institution;
- (c) it could not exercise an independent monetary policy;
- (d) it had no refinancing programme for the indigenous banks which experienced financial problems during the early period of the banking system in the colonies;
- (e) it left money supply to be determined largely automatically by the state of the balance of payments, and, with its external balance invested mainly in sterling assets overseas, it deprived the colonies of scarce resources.

As described by Nwankwo (1980), 'the Board System was essentially no more than an expatriate sterling, a dependent currency, in all but name and form the British pound. Besides, the West African currency

was too rigid to the British pound. Indeed whatever its virtues the WACB had no room for monetary management'. Other eminent critics of the Board system include Onoh, 1982; Mohammed, 1980 and Newlyn, 1967.

Undoubtedly, these criticisms coupled with the aspirations of the newly independent states to express their national sovereignty in political and economic management triggered the vigorous agitation for the establishment of national central banks. However these developments were not without a lengthy controversy among British experts, many of whom argued forcefully against the establishment of the central bank mainly on the lack of developed money and capital market which was perceived to be the pre-requisite for central banking. The Central Bank of Ghana was established in 1957, followed by the Central Bank of Nigeria in 1958 and the Bank of Sierra Leone in 1963. The operations of the WACB were finally phased out upon the establishment of the Central Bank of Gambia in 1971. The central banks immediately assumed the responsibility of issuing their respective national currencies that replaced the WACB pounds. However, for a considerable period of time these national currency issues were pegged to the pound sterling and the Bank's foreign reserves held in sterling securities. Presently, only the Gambian dalasi is still pegged to sterling (see, for instance, Taylor, 1980, for a survey of discussion of the controversy preceding the establishment of West African central banks).

Among the francophone states, the Banque Central des Etats de l'Afrique de l'Ouest (BCEAO) was established in 1962 as common central bank for the members of the Union Monetaire Ouest Africaine (UMOA). However before independence, currency arrangements evolved

by France for these countries were entrusted to seven different private banks established exclusively to issue franc notes for circulation in all the French overseas territories. The Bank of West Africa (Banque de l'Afrique l'Ouest), which was later reformed into the BCEAO, was established in 1901. It absorbed the Bank of Senegal which was established in 1856 with the head office in Paris and branch offices around the West African territories. The BCEAO is linked to the French Treasury by an Operations Account and the four monetary criteria which originally governed its operations are:

- (a) the common currency - the CFA franc - issued by the BCEAO is mutually convertible with the French franc without restriction, ie freedom of financial transfers within the system;
- (b) convertibility rests on fixed parities among member countries and the French franc;
- (c) member countries apply uniform exchange controls; and
- (d) the BCEAO holds its pooled foreign currency holdings in the 'Operations Account' - a currency account exchange reserve fund at the French Treasury.

The BCEAO had three early setbacks: the withdrawal of Guinea (1958); then Mali (1962) and later Mauritania (1972). Mali was readmitted into the system in June 1984. Both Guinea (1958) and Mauritania (1973) established their national central banks. Structurally each member country in the BCEAO has a local monetary committee to control domestic currency in circulation and the use of its foreign exchange.

Among the rest of the West African countries, Liberia began effective central banking in 1974 following the establishment in that year of the National Bank of Liberia. Hitherto, minimal central banking facilities were provided by the Bank of Monrovia, a subsidiary of the First National City Bank of New York. Before the establishment of their national central banks in 1980/81, both Cape Verde and Guinea-Bissau had relied on the Lisbon-based Banco Nacional Ultramarino (established in 1864) for the issue of local currencies.

### **5.2.3 Commercial Banks and Other Financial Institutions**

Commercial banking began in British West Africa in 1891 following the establishment in Nigeria of a branch by the South African based African Banking Corporation mainly for the purpose of handling the import of British silver coins into the territories. It continued this role until the creation of the West African Currency Board in 1912. Persistent complaints to the Colonial Office by African traders for discriminatory treatment by the bank led to the incorporation of a joint stock bank, the Bank of British West Africa, (BBWA) (see Okigbo, 1982, p 85) which expanded so rapidly that by 1910 it had established branches in the four British colonies and also in Liberia. With the attainment of independence by the colonies, BBWA was renamed Bank of West Africa (BWA) in 1957 and Standard Bank of West Africa (SBWA), after the merger with Chase Manhattan Bank and Standard Bank of South Africa. On local incorporation, SBWA became the Standard Bank Nigeria Ltd (1969) and later the First Bank of Nigeria in 1979. In Ghana and Sierra Leone,

SBWA became the Standard Bank (Ghana) and the Standard Bank Sierra Leone Ltd.

The second expatriate bank which has dominated British West Africa's commercial banking scene is Barclays which commenced banking activities under the name Barclays, Dominion Colonial and Overseas Bank formed in 1926 with branches in the four colonies. Barclays (DCO) was an offshoot of Barclays Bank, and it emerged from an amalgamation of the Colonial Bank, first established in West Africa in 1917, the National Bank of South Africa and the Anglo-Egyptian Bank. In Nigeria the name of the bank changed to Union Bank in 1979.

Commercial banking began a little much earlier in the French colonies with the establishment of the Banque du Senegal in 1853. Its successor, the Banque de l'Afrique Occidentale (BAO) remained the largest and important bank in French West Africa until 1924 when Banque Commercial Africaine was created. A combination of new issue, commercial banking activities and banker to the French colonial government placed the BAO in an advantageous position to expand its banking business more effectively than other joint banks in francophone West Africa. Other commercial banks later established in the francophone colonies were the BNCI in 1939, and the societe Generale and Credit Lyonnais in 1941.

In the last two decades several other commercial banks, expatriate and indigenou, have sprang up in many countries, especially in the former British colonies. In Nigeria, the total number of commercial banks now stands at around 28, about 12 in Ghana, and 5 in Sierra Leone. By the end of 1978, commercial banks had established about 585 branches in Nigeria; around 240 branches



in Ghana in 1980; and 46 branches in Sierra Leone in 1983. While Gambia's economy and population have been rather too small to support the spread of many banks (the Bank of West Africa has dominated commercial banking activities), in Liberia, the country's open-door economic policy and the totally dependent monetary system have mainly been responsible for the mushrooming of foreign banks mainly of US origin. The origin of the oldest and largest commercial bank in Liberia, the 100 per cent American-financed Bank of Monrovia, goes back to the early operations of the Firestone (Rubber) Company and in 1955, it became affiliated to the First National City Bank of New York. Nearly 10 commercial banks operate in Liberia, and as in the other anglophone countries, almost all of these are largely foreign in ownership and operational phenomenon.

In contrast to the situation in British West Africa and Liberia, the development of commercial banks in French West Africa has not been as spectacular. French colonial banks were not able to expand their banking businesses as rapidly as the British banks in anglophone Africa. Bank branches were few and far between, and the French colonial governments did not patronise them with deposits as they did with the BAO. Money transfers through the Post Office were cheaper than bank transfers, resulting in lower transfer commission income for the banks. Lending rates were low but the commercial banks failed to extend much lending because of restrictive credit policies by the Banque du France which, in supervising the monetary co-operation agreement between France and its overseas territories, still exercises substantial control on the operations of banks in these countries. Deposits also stagnated as deposit rates were similarly low (Onoh, 1982, p 51). Apart from the BAO, no French

bank was able to establish branches in all the French West African colonies. The British banks, by contrast, enjoyed high commissions through bank transfers as transfers through the Post Office were limited only to small amounts. They, unlike their French counterparts, charged high lending rates and more heavily patronised by governments, the marketing boards and large expatriate commercial enterprises, mainly in the import and export trade. While the French banks depended largely on the discounting of bills, British banks relied more on credit extension.

The growth of central and commercial banks in West Africa has been followed closely by the establishment, in some countries, notably Nigeria and Ivory Coast, of a number of other more specialised banking institutions - ie development banks, rural and agricultural banks, merchant banks, co-operative and other credit institutions. These institutions, some of which are central bank sponsored, are at the moment more relatively rudimentary than the commercial banks and their operation is relatively lacking in competition with the commercial banks, particularly in savings mobilisation. As in the commercial banks, the operations of some of these institutions are largely supra-national. As expected, their lending operations are more longer-term than the commercial banks. Other fast developing financial institutions are insurance and mortgage companies. Post Office Savings Banks and the Treasury Deposit Systems (mainly in the francophones) are also important banking institutions in West Africa. For instance, by May 1982, over forty insurance companies - mainly indigenous, had been established in Nigeria.

Two other important developments in the evolution of monetary and banking institutions in West Africa include first, the establishment of two stock exchange markets - the Lagos Stock Exchange (1960) and the Abidjan Stock Exchange (1976) in Nigeria and the Ivory Coast respectively; and second, the increasing importance of the traditional money lenders, thrift societies and co-operatives whose intermediation activities, though in controversy, are appreciated in their provision of small-scale financing, especially for food production and housing within the rural communities. The growing popularity of traditional lenders, in particular, is argued on the basis that unlike the formal banking institutions, their lending is often without collateral and credibility tests; negotiations with them are relatively short, direct and more personal as they are conducted on a person to person basis and without formal documentation.

#### **5.2.4 The Emergence of Indigenous Banks**

The most significant characteristic of the West African banking system is its supra-national orientation both in its organisational structure and operational patterns. This, in general, represents the formal extension of the functions, methods and traditions of the colonial banking systems. The monetary and banking developments that have taken place during the last decade or so have therefore broadly reflected attempts at breaking this foreign monopoly with a view to making the banking systems more responsive to the general problems of development. This new challenge fully recognises the importance of the banking sector in the development process. Financial repression, rather than bringing about a better

distribution of income, aggravates disparities and hinders the mobilisation of financial resources (Shaw, 1973).

More specifically, changes in the West African banking systems in recent years have largely reflected the pressures of economic and political nationalism, the desire for economic autonomy, inflationary financing and the integration of the large subsistence rural economy and the modern urban sector. The inadequacy of the supra-national commercial banking system in West Africa is explained by its insistence upon the traditional concept of the commercial bank as protection against risk of insolvency, liquidity crisis and monetary depression. Expatriate commercial banks are thus forced to concentrate their operational roles - the creation of money and means of payment in the economy, financial intermediation and service agents - on import-export financing while at the same time retaining a large part of their reserves and liquidity on foreign investment both overseas and in their countries of operation in West Africa. This further implies the concentration of their branch network and operations in urban centres and/or high productive areas (mainly in mining localities), thereby exaggerating economic dualism in their countries of operation (the dual system comprises a barter (subsistence) economy involving the bulk of small household and peasant population, indigenous production of staple foodstuffs and cash crops; and a modern sector or foreign sector that is almost entirely dependent on external relations).

Some countries, especially the anglophones, were either overwhelmed by colonial banking or other company legislation which made it practically difficult for indigenes to establish banks, or their economies were criticised of providing an insufficient base

for additional and more competitive banking. In Ghana, for example, the Company Act of 1906 prevented the establishment of any local company to carry out any form of banking operations. It was not until the 1950s that the Act was amended (Onoh, 1982, p 95). In Nigeria, nationalists strongly condemned foreign banks on grounds of discriminatory practices against indigenous businessmen by imposing high and punitive interest rates and commissions (Okigbo, 1982, pp 84-86). In the francophones, the French zeal for centralisation did not permit the development of indigenous banks.

Until very recently, many of the banks in West Africa, by being wholly branches of overseas banking institutions, had their policies, management structures, operational procedures, lending criteria, business volume, interest rate and commissions procedures and investment preferences guided largely by conditions and practices prevailing in their countries of origin. Where they operated locally beyond the basic function of accepting and re-issuing deposits, the banks' credit and other intermediation activities concentrated largely on the financing of foreign trade and providing working capital for expatriate enterprises.

One obvious result has been excess liquidity in the net positions of the banking systems in several countries. The orientation of the commercial banks in these countries has been blamed for this biased lending pattern on the grounds that indigenous operators could not provide the types of collateral required by the banks; that the banks are not prepared to venture in unfamiliar areas of financing; and on the associated issue of creditworthiness. The banks for their part have, in defence, also

complained about the paucity of bankable projects submitted for their consideration by indigenous enterprises.

As the West African economies expanded and became more open and therefore more vulnerable to external and internal socio-economic developments, government dissatisfaction with the domestic banking system became increasingly extended to the operations of central banks. The perennial complaint has been that the central bank functions have also tended to reflect the strong influence of foreign financial and banking practices, especially in the formulation and implementation of monetary policy. In other words, central banks in West African countries, as indeed in several LDCs, have in recent years been criticised for lacking selective and innovative use of traditional monetary policy instruments; firstly to help the commercial banks and other financial institutions to play a more significant role in terms of national economic development priorities; and secondly, for the central banks themselves to initiate various forms of development assistance.

In this regard, monetary policy should be co-ordinated with financial policy. For example, legal reserve requirements for the commercial banks can serve as a means of influencing the structure of bank lending, in terms of the maturity structure, the conditions on which loans are made, and the economic sectors to which they are directed. The aims of this policy would be to increase the proportion of lending to the basic productive sectors, with longer maturity periods, and to serve agriculture, industry, and other sectors not offering a high rate of return but have generative development capacity.

While in most countries, many of these criticisms of the banking system do hold, it has to be recognised that where a country suffers from political instability, lack of concrete and consistent development policy objectives, inflation, an overvalued exchange rate, artificial interest rates and prices, or if it is burdened by inflexible legal, political and social structures, fundamental problems can arise for the introduction of financial reforms to expand and improve the functioning of the banking system. Political and administrative pressures by governments, especially as regards the availability of credit from the banking system, have substantially worsened central bank's position in West Africa and have also tended to negate the banks' nominal autonomy, which for them is perceived as the pre-requisite for efficient functioning. In such conditions, and especially where central banks have also complained of receiving wrong and inconsistent signals from the Treasury, central banking measures cannot have more than modest impact in promoting the wider objectives of economic growth, income distribution, exchange rate stability and financial infrastructural development.

The changing pattern of the West African banking system - which for some countries (eg Nigeria, Ghana) had begun since its initial formalisation during the colonial era, while for others, in the post-independence years - can be viewed in two main perspectives: first, in its organisational and management structures and second, in the objectives, structures and formulation of monetary policy. The second aspect is discussed in the next section. Meanwhile, the major step in transforming the organisation, management and operations of national banking systems

in West Africa has been the growth of indigenous banks which can also be viewed in two perspectives: the establishment of new wholly indigenous banks to break the monopoly of foreign banks, and the nationalisation (wholly or partly) of foreign banks.

Effectively, indigenisation of the West African system began with the establishment of the wholly-indigenous central banks and the direct and relatively automatic replacement of the colonial central banking arrangements. Except the BCEAO which still has direct representation by France in its Board of Directors, management profiles in most central banks are wholly indigene and equity capital is entirely local. In most cases this development has been followed by the creation of wholly indigenous commercial banks, development banks, rural banks and a variety of savings institutions. However, the growth of indigenous commercial banks has been generally slow in all countries, except in Nigeria where more than 100 indigenous banks were established in the 1940s and 1950s (Onoh, 1982, p 96), although this rapid expansion during this period was also accompanied by a high failure rate - eg in 1954, 16 out of 25 indigenous banks collapsed due mainly to poor management, inadequate capital, depressive economic and regulative (legal) conditions (Agu, 1984, p 71). By 1978, indigenous banks in Nigeria had represented 46 per cent of the total number of commercial bank branches, although this reflected a marginal drop from 49.5 per cent in 1972, as well as around 29 per cent of the commercial banking sector's total assets/liabilities (Okigbo, 1981, p 113).

In Ghana, the Ghana Commercial Bank established in 1953, and in Sierra Leone, the Sierra Leone Commercial Bank formed in 1972, represented practically the only wholly indigenous banks. The



emergence of indigenous banks in the francophones as already indicated has been severely restricted by restrictive controls by France. In Liberia, commercial banks are generally wholly expatriate while in Cape Verde, the financial system consists of one monetary financial institution, the Bank of Cape Verde (and one non-monetary financial institution, the Caixa Economica Postal), which performs the roles of central, commercial and development banks.

Other approaches towards indigenisation have generally comprised the complete nationalisation of expatriate banks (Benin, Guinea and Guinea-Bissau), or the acquisition of large percentages of their equity either by government or by the general public. In most countries equity participation by governments has ranged between 40-60 per cent of share capital. In Nigeria and Sierra Leone, for instance, in spite of minority (Nigeria) or zero (Sierra Leone) equity participation in the alien dominated banks, both national governments have taken and exercised the right to appoint nationals to head the Boards of Directors of such banks. Moreover, by local incorporation, alien-dominated banks - eg Barclays and Standard - have been forced to transfer their Head Offices from their parent banks overseas to their country of operation. In Nigeria, the indigenisation process has also resulted in bank mergers as well as in change of names of foreign banks. For instance, Standard Chartered Bank only holds 38-40 per cent interest in First Bank of Nigeria, while Barclays Bank International has around 20 per cent stake in Union Bank of Nigeria. Banque Nationale de Paris (BNP) holds about 25 per cent interest in Union Bank for Africa. In several other countries, many foreign banks have retained their original names even after indigenisation. In 1973

the BCEAO transferred its head office from Paris to Dakar in Senegal.

### **5.3 OBJECTIVES, FORMULATION AND INSTRUMENTS OF MONETARY POLICY**

Two major divergencies are investigated in this section: those divergencies in the objectives and formulation of monetary policy, and divergencies related to the choice and use of monetary policy instruments. These distinctions are most germane to the problems and limitations of managing national monetary systems in West Africa.

#### **5.3.1 Objectives and Design of Monetary Policy**

In West Africa, the role of monetary policy has been extended alongside the more conventional objectives of maintaining monetary (price and exchange rate) stability, full employment and economic growth to incorporate the newly perceived 'development and promotional phenomena'. These phenomena suggest the importance of pursuing monetary stability, not only as an end of economic policy, but also as a means to an end - the acceleration of financial development. Monetary policy in West Africa has therefore assumed the broader responsibilities of enhancing the monetisation and monetary integration of the economy through direct or indirect promotion, mobilisation and allocation of domestic savings; through the development and maintenance of financial institutions and instruments; and through the design and conduct of balance of payments adjustment policies.

These objectives of monetary policy are usually implicit or explicit in the central banking legislation and are usually broadly defined as:

- (a) price stability
- (b) high rate of employment
- (c) rapid economic growth
- (d) balance of payments equilibrium and stabilisation of financial system.

However in practice, some countries have either emphasised these objectives differently or they have more explicitly added other objectives. In Ghana, for instance, the stated objectives of monetary policy in 1975 were to improve the allocation of financial resources, to strengthen the balance of payments, and to mitigate domestic inflation. In Nigeria, part of the stated objectives constitutes the regulation of commercial banks credit to the private sector while in the BCEAO, monetary policy objectives, especially after 1975, have stressed the adjustment of global liquidity of the member economy in relation to the evolution of the monetary situation of each state and of the union, and in relation to development needs; and to ensure a better use of member countries' resources within the union (Ouattara, 1978).

Against this broad interpretation of monetary policy, modern central banking legislations in West Africa are virtually similar (with the exception of the National Bank of Liberia which does not issue currency) in specifying the traditional as well as the broad developmental and promotional roles of the central banks. In most instances, the inclusion of the developmental functions has required

a series of amendments to the legislations initially enacted for the establishment of the central banks. To the extent that the twin roles of monetary policy - monetary stability and economic development - are not mutually exclusive (although in practice, some conflict appears to have emerged), the central banks in their newly perceived functions have concentrated on one or more of the following: the mobilisation of domestic financial resources, contribution to sectoral development, encouragement of productive agricultural and industrial investment, regulation of the money supply to maintain the relative value of the currency, contribution to the balance of payments, and financial adviser to the government.

In time, some of the amendments which followed on the central banking legislation, in particular, in Ghana, Nigeria and Sierra Leone were influenced largely by:

- (a) the increasing difficulties in economic management as the economies grew and the money supply and inflationary tendencies expanded correspondingly,
- (b) the growth in international trade and its attendant complexities, eg foreign exchange shortage,
- (c) the increasing burden of public debt management as central banks became more active underwriters of both domestic and external government debt instruments,
- (d) the need to control, supervise and guide an expanding bank and non-bank financial sector towards the broad development objectives.

Consequently, one of the principal tasks of monetary policy in these countries in the more recent years has been exchange rate and foreign exchange management.

There is no clearly apparent line of demarcation in most central banking legislations on the question of who has responsibility for monetary policy formulation between the bank and the government, except in the case of some banks - BCEAO, The Gambia and Nigeria. Within the framework of the UMOA (WAMU) Treaty and the BCEAO statutes, the responsibility of defining the monetary and credit policy to be pursued by the union is entrusted with the Council of Ministers in the monetary union. The BCEAO as the Issuing Institute is entrusted with the implementation of monetary and credit policy. In the context of the policy adopted by the Council of Ministers as well as of the rules of intervention established by the BCEAO, the adjustment of the Bank's assistance to the programmes and special needs of the member states of the union is affected in each member state through autonomous national bodies akin to the National Credit Council in France. These statutory measures are meant to allow a decentralisation of the decision process as well as to facilitate the diversification of interventions according to the needs of each member state. There also exists a Banking Control Commission which supervises the operations of commercial banks, a function which is undertaken mostly by central banks in other countries.

In Nigeria, the central bank legislation makes the Federal Executive Council the final arbitrator on a conflict of opinion between the Bank and the Ministry of Finance in respect of the pursuance of monetary and credit policy, and specifically entrusts the responsibility of policy formulation upon the Bank. In the Gambia, however, the government is empowered by the central bank

legislation to prescribe, through the Ministry of Finance, the monetary policy to be adopted by the Bank.

However, in spite of the provisions of the legislations, the practices still differ. Traditionally, monetary and credit policy formulation is expected to be the prerogative of the central banks and the extent to which banks are given a free hand to discharge this important responsibility determines the degree of autonomy enjoyed by them vis-a-vis the government. In all cases nonetheless, it is supremacy of the government which has remained inviolable both in the formulation of monetary policy and in the apparent use of monetary policy instruments. The Treasury plays an important role in the short-term credit market in the BCEAO countries mainly in discounting custom's bills to the public. This practice is not common in the rest of the sub-region.

### **5.3.2. The Choice and Application of Monetary Policy Instruments**

A great variety of emphasis exists within West African states regarding the assignment and relative use of monetary policy instruments. It is obvious however that traditional monetary policy instruments, viz, variable interest rates, open market operations, variable deposit requirements, credit controls and moral suasion are still relied on to a large extent. Although there appears to be no rule of thumb as to which policy instrument to apply, the relevance, appropriateness or the degree of importance attached to each instrument tends to vary directly with the peculiar characteristics of the economy concerned as well as the prevailing economic problems. More specifically, differences in the overall approach to economic policy (ie economic planning philosophy) tend to manifest

themselves more noticeably in the differing use and reliance on monetary policy instruments.

Generally, it can be said that countries with a substantially less-market-oriented approach to economic planning tend to rely fully on the use of more formalised and comprehensive quantitative control mechanisms such as overall and selective credit ceilings. Consequently, a relatively greater degree of official (government) intervention is required because of the allocative function of these instruments. By contrast, pricing mechanisms in monetary policy such as the use of variable deposit ratios and frequent adjustments in the cost of credit are very rarely employed in these countries but correspondingly more in the relatively more market-oriented planning countries. Charges, commissions and several other bank control mechanisms are more often fixed or guided by the monetary authorities than the government.

This broad dichotomy is relatively apparent in West Africa as the general approach to overall economic planning has varied between completely comprehensive planning procedures in non-market oriented countries such as Cape Verde, Guinea, Guinea-Bissau and to a less extent, Ghana, and a type of planning in such countries as Gambia, Liberia, Nigeria and Sierra Leone, that relies quite frequently on the working of market forces and private initiative, although this does not exclude some degree of public ownership and private monopoly participation in selected enterprises. In between these two categories are the WAMU member states for which planning in many respects mirrors the French system of 'planification'. These countries, together with Mauritania, confine themselves to

macroeconomic planning in which only strategic enterprises are partly or fully state-owned.

Against this background, and from the divergent stress on the more specific objectives of monetary policy, West African states have tended to differ somehow on the emphatic use of monetary policy instruments. More specifically, perhaps, for countries such as Gambia, Liberia, Nigeria and Sierra Leone, the heavy reliance on the more conventional instruments (even in terms of functional definition) has been influenced, strongly, by the desire to control the overall supply of money (even where such target is proven misguided) rather than to perform specific allocative function. Generally, while these traditional instruments are available and have been variously applied in the region, some countries have relied primarily on rediscount ceilings (WAMU states), on quantitative/overall and sectoral credit ceilings (Ghana and Nigeria), reserve requirements and/or discount and advances policies (The Gambia and Liberia) or liquidity ratios (Sierra Leone). Moral suasion and interest rate policies have also featured in the region, but mainly in Liberia (moral suasion) and the former sterling area countries. From this varied choice, the four main general instruments of monetary policy employed by most central banks in West Africa are:

- (a) the discount rate
- (b) liquidity reserve requirements
- (c) direct/selective credit controls
- (d) moral suasion.



In Guinea, monetary expansion is largely influenced by fiscal controls, as the government, because of its over-riding share in overall economic activity, generates large surpluses which are then deposited at the central bank. A special credit committee operating under the auspices of the central bank is set up with responsibility to review requests submitted by the specialised banks for credit from the central bank to ensure that they conform with the overall economic policies and priorities set by the Government. There is no statutory limit on the central bank credit to specialised banks which are neither subject to reserve requirements and liquidity ratios, nor are interest rates used to influence the volume and allocation of credit.

However, because in the majority of West African states the public sector is the major employer and therefore the major borrower, monetary policies have in general been accommodating and have only become relatively more restrictive under the emerging pressures from external imbalances and inflationary tendencies which have required stabilisation programmes in several countries. In these programmes (notably the IMF programmes), one of the major policy stresses is to restrict domestic lending as well as to correspondingly stimulate domestic saving. But as is often the case, the consequent concern for the control of money supply poses an important problem in the sense that the traditional tendency for over-liquidity of the banking system must also be taken into account as should the cash holdings from households and enterprises both of which constitute a decisive factor in the growth of money supply (in particular, currency in circulation).

Although as already mentioned evidence of utilisation of the traditional instruments of monetary policy is observable in all West African central banks (except in Guinea), there are a number of constraints that have severely restricted their efficiency not only in West Africa, but among LDCs in general. These limitations are exhaustively covered in the literature (see for instance Aschheim, 1961; Newlyn, 1967; Bain, 1970; Eshag, 1971; Cramp, 1971, Fisher, 1976; Furness, 1978; and Ghatak, 1981).

In general, the scope and effectiveness of monetary policy and its instruments are severally circumscribed in circumstances where:

- (a) the money and capital market (or financial infrastructure) is very narrow, under-developed or rudimentary; ie the number of financial intermediaries is limited and both the volume of traded securities and the number of potential transactors are very restricted;
- (b) the commercial banking system, in particular, is excessively liquid and currency in circulation is of comparable magnitude with bank deposits;
- (c) the general private sector demand for bank credit is not interest elastic;
- (d) there is a large unorganised money market;
- (e) there is hardly any prior careful assessment of prevailing economic conditions within the economy; ie there is no in depth, reliable and objective national economic surveys relating to such economic indicators as unemployment, price fluctuations, payments imbalances, structural distortions, growth and overall economic performance, all

of which are individually responsive to changes in monetary policy;

- (f) the application of monetary policy is inappropriately timed, or excessively directed to day-to-day/very short-term issues, or is specially tailored to favour very personal uneconomic ventures; and
- (g) there is visible tension and unhealthy co-ordination between fiscal and monetary authorities in their design and implementation.

It is particularly emphasised that while open market operations is constrained under conditions of limited financial markets and traded securities, the discount rate and liquidity reserve ratios (ie cash ratio and/or (less liquid) reserve ratio) are both more directly restricted by the excess liquidity of the commercial banks. Moral suasion (also known as jawboning) is effective only where there is perfect understanding, mutual respect, co-operation and professional discipline between the central bank and the other banks. Ghatak (1981) stressed that the prescription of quantitative limits on bank credit (the chief form of direct monetary controls) could only be effective if used as an integral policy package deal programme aimed at ensuring a fairer mobilisation and distribution of financial resources, adequate protection for depositors and the banks, and effective control of the base of the banks. These conditions characterise the West African banking system and in essence make it generally underdeveloped and rudimentary.

In the wake of the renewal of the WAMU monetary co-operation agreement with France (which existed since 1962), BCEAO's means of

action in the application of its monetary policy underwent considerable change in 1975. However, the rediscount facility still predominantly dominates the monetary policy instruments of the BCEAO. Changes in the modes of BCEAO intervention through rediscounting have nonetheless included the abolition of rediscount ceilings and quotas previously available to the banks and businesses, although rediscounting for the banks is still restricted to a variable maximum credit limit (presently 45 per cent) on the ratio of a bank's total credit. Annual limits on central bank financing are fixed for each member state (ie country rediscount ceilings) depending on each state's production, price, liquidity, balance of payments, external reserve balance and the ability for debt repayment as well as on the total external reserves of the union as a whole. Reserve requirements in respect of the liquidity ratio were also abolished in 1975, although the possibility exists should the need arise, for the BCEAO to compel the commercial banks to maintain required reserves expressed as a percentage of either total deposits or of total credit extended by them.

Furthermore, to carry out qualitative control, in addition to priority refinancing or refinancing loans at preferential rates (agricultural credits, credits to small and medium-sized enterprises) the BCEAO may require banks to observe liability ratios (coefficient de tresorerie) or to allocate a specific portion of their liabilities to financing national enterprise needs (coefficient de division des risques). Control over credit distribution operates through the 'prior authorisation' required before extending any credit which would increase the volume of outstanding credits awarded an enterprise beyond the ceiling set for

each country. Credit limits as of 1982 stood at CFA 100 million for Ivory Coast and Senegal, and CFA 30 million for the other member states.

As in all West African countries, interest rate policy has not been an active instrument of monetary policy in the BCEAO countries despite the legal authorisation given to the Governor of the BCEAO to vary interest rates; taking into account both the domestic and international money market conditions. Nonetheless, similar to other West African countries, the BCEAO group prescribes interest rates for bank lending and borrowing. Lending, savings, and discount rates are identical among the member countries of the BCEAO. The discount rate currently stands at 10.5 per cent. Interest rates have remained relatively low and stable and have been adjusted only three times since 1960 (1973, 1975 and 1980). As in the rest of the West African region, these rates have remained generally negative in real terms following the corresponding higher rates of inflation. In 1980, for instance, the real discount rate was -4.1 per cent in the Ivory Coast but 1.7 per cent in Senegal; the real savings rate was -7.1 per cent in the Ivory Coast and -1.3 per cent in Senegal; and the real lending rate was -1.6 per cent in the Ivory Coast but 6.7 per cent in Senegal. Until very recently (1985/86), commercial banks in the WAMU states were allowed to pay interest on current accounts. The interest on time and savings deposits in these countries is currently 12 per cent.

In contrast to the BCEAO countries, the anglophone states, in particular, the four former sterling area countries (FSA) have adopted a much wider range of monetary policy instruments, although in practice the effectiveness of many of these has been found

seriously wanting in each country. The most important reason is that commercial banks in non-BCEAO countries normally have excess liquidity and therefore rarely need central bank support.

Selective credit control has taken different forms including the imposition of priority credit ceilings as between the government and the private sector on one hand, and between the different economic sectors. In Ghana and Sierra Leone, selective credit ceilings have been mainly at the instance of the IMF conditionality requirements which accompanied their stabilisation programmes. With minor differences in terms of broad categorisation, the most favoured priority sectors are agriculture, export trade, manufacturing and transport and communications as against the less favoured sectors of general commerce (import trade). In 1980 credit to agriculture represented 53.1 per cent of total bank credit in The Gambia, and in Ghana, credit to the agriculture and export trade was 60 per cent of total credit.

Sectoral credit allocation in the FSA countries has also been in the form of special credit guarantee schemes initiated by the central banks. These schemes are generally aimed at steering credit to support indigenous small-scale businesses outside the import sector. The risk exposure of the commercial banks in providing such credit is minimised through specific indemnity guarantees by the central banks in the event of default by the borrowing enterprises; eg 66.6 per cent in Sierra Leone and 75 per cent in Ghana and Nigeria. Other special credit control measures have included ceilings on loans and advances (overdraft facilities) and advanced (or special) deposit requirements. Mandatory cash margins against imports (up to 100 per cent of total import value) are required in

Ghana and Nigeria. In Ghana, a commercial bank's credit hold in government debt instruments is required to be, at least, equivalent to 25 per cent of total deposit liabilities, while in Nigeria, the banks are required to buy stabilisation securities from the central bank with 50 per cent of the excess of individual savings account of 20,000 naira. In Sierra Leone, special deposits have taken the form of 'sterilised' local currency equivalent of private sector import or external debt payment arrears held in banks while awaiting foreign exchange availability.

Liquidity restraint measures have included the imposition of minimum liquidity and cash reserve ratios, although the latter is usually employed as supportive and temporary instrument depending on the extent of the commercial banks' excess liquidity position. The ratios are generally based on the deposit liabilities of banks. However, the basket of assets and liabilities allowed for the purpose of satisfying the ratios has varied between countries. The liquidity ratio is usually defined to include the variety of government securities (eg treasury bills, negotiable certificates of deposit and any other first class bills held by the commercial banks). In Ghana this ratio has also included sectoral lending. The cash ratio typically relates the bank cash holdings to total deposits. In some cases differential percentages are prescribed for different categories of deposit as well as the volume held, while the composition of the assets for the reserve ratio, which are being held by the central bank are usually in the form of cash and government debt instruments.

The range of the liquidity ratio is from 25 per cent in Ghana and Nigeria (1980/81) to 40 per cent in Sierra Leone (1984), while that of the cash ratio is from 6 per cent in Liberia on demand deposits, 5 per cent on time and savings deposits to 40 per cent in Ghana. In general, however, these ratios have in practice fallen well below the actual ratios. In Sierra Leone for instance, the actual liquidity ratio has ranged between 66 and 85 per cent in 1978/79 compared with a 40 per cent legal minimum requirement.

Additional liquidity restraint mechanism similar to the liquidity ratio has been introduced in Nigeria where commercial banks' credit held in government debt securities must be over 25 per cent or equal to 10 per cent between adjusted capital funds and their loans and advances. Dividend squeeze is imposed until this condition is fulfilled.

Similarity of interest rate philosophy prevails among West African countries in that the central banks prescribe both the loan and deposit rates rather than leaving them to be determined by market forces. The rates seldom change except in Liberia, and all countries (except Liberia) peg their rates on given percentage points above the standard discount rate, which stands at 6 per cent in The Gambia and Nigeria, 19.5 per cent in Ghana, and 12 per cent in Sierra Leone (1983). Interest rates in West Africa are generally lower than the rate of inflation, giving rise to negative rates of return in real terms.

In Sierra Leone, major adjustments of interest rates in general have only occurred three times (1975, 1977 and 1979), twice in Ghana (1975 and 1980) and Nigeria (1975 and 1979), and once in The Gambia (1980) since 1970. In Liberia, lending rates tend to move



in tandem with New York rates. In Ghana where the rise in the rate of inflation is highest in the whole region (eg rising from 2.9 per cent in 1970 to 123 per cent in 1983) the real discount, savings and lending rates were all negative in 1980 at -36.6 per cent, -38.1 per cent and -31.6 per cent respectively. These compare with real rates of -0.7 per cent, -1.8 per cent and 4.8 per cent respectively in The Gambia in the same year. The real discount and savings rates in Sierra Leone in 1980 were 0.9 per cent and -1.1 per cent respectively, whereas in Liberia and Nigeria, the real savings rates were -5.8 per cent and -1.2 per cent respectively in the same year.

All West African countries have rudiments of open market operations, although these also have not constituted an effective instrument of monetary control because of the absence of developed financial markets as well as the marked absence of variation in interest-sensitive debt instruments to encourage brisk open market operations. Nonetheless, in Ghana, for example, the Bank of Ghana Act, 1963, permits open market operations in treasury bills and medium- and long-term government securities. By mid 1985, the number of traded securities in the Lagos Stock Exchange had risen to 181 from 4 and 168 in 1961 and 1982 respectively (West Africa, 9 December 1985, p 2582).

Central banks in West Africa, notably the FSA countries and Liberia, have also relied substantially on moral suasion. But the rapid expansion in the banking system of most countries as well as the increasing threats of politicisation and inflation have compelled most central banks to rely more on stronger direct controls. The current practice however is to supplement this instrument by resorting to punitive measures for non-compliance. In

Ghana, for instance, defaulting commercial banks have been forced to place special reserve deposits (equal to twice the amount by which the commercial bank's lending exceeds the credit guideline) with the central bank. These deposits are not interest-bearing and are also not eligible to form part of the cash reserve requirement. Nigeria imposes, first a 'strong warning', and then a 'levy' of one eighth of one per cent on the excess credit with the same increase every month of violation up to the maximum of 1 per cent. In Sierra Leone, non-conformity with submission of periodic 'schedules' by the commercial banks in 1982 resulted to the temporary withdrawal of interest payment on interest-bearing deposits ('excess deposits') held by the central bank for the Sierra Leone Commercial Bank, and this represented a loss of revenue amounting to over Le 1.0 million that year to the commercial bank.

Credit controls are also important in Cape Verde. Interest rates have changed only once in Mali (1977) and Guinea (1978), whereas in Cape Verde and Guinea-Bissau, no interest rate adjustment has taken place since independence.

As in the case of its objectives, many of these instruments of monetary policy are prescribed in the central bank legislation of most countries. This procedure is frequently supplemented by the issue of monetary policy circulars, usually annually, in which quantitative and qualitative guidelines are prescribed. Policy circulars have featured more prominently in Ghana and Nigeria.

## 5.4 EVALUATING THE PERFORMANCE OF THE WEST AFRICAN BANKING SYSTEM

### 5.4.1 Financial Development and Economic Growth

As indicated at the beginning of this chapter, the structural changes that have taken place or which are urged in the West African banking system since the achievement of political independence, have, in common with other LDCs, emphasised the need for both central and commercial banking institutions to be expansive, selective and innovative in their respective functions and practices with a view to enhance the development efforts of the member economies.

Recent literature on economic development, together with numerous empirical studies on the basic theoretical conclusions, have focussed considerable attention on the process of financial intermediation and its impact on economic growth, and the general hypothesis is that financial institutions in general are a necessary adjunct or catalyst to the general development process (see for instance Bhatia and Khatkhate, 1975; Shaw, 1973; Goldsmith, 1969; Gurley and Shaw, 1967, 1956 and 1955). Improvement in financial intermediation in this context denotes the development of credit and capital markets and of domestic financial institutions as well as a substantial improvement in the monetisation of the economy through a rise in the proportion not only of money but also of the total of all financial assets relative to gross national product (GNP). However, this basic conclusion regarding the role of financial institutions in economic growth and development is not without recognisable conceptual controversies: 'monetarist' versus 'Keynesian' (see for instance, Friedman, 1983; Auerbach and Rutner, 1975; and Sims, 1972); 'demand-following' and 'supply-leading'

(Patrick, 1966); and in the savings-investment process - 'financial repression hypothesis' (Shaw, 1973; McKinnon, 1973; and Cameron, 1972) and the 'structuralist hypothesis' (Gerschenkron, 1962).

Purely from the point of view of developing countries, the importance of financial institutions or more specifically, the 'financial superstructure' (ie the set of financial institutions, intermediaries and instruments) is appreciated broadly in terms of the extent to which it can influence the elimination of the major constraints of development, ie, balance of payments, savings and absorptive capacities. The nature of these constraints and the manner in which they interact in relation to given investment/capital inflows relationships are formally discussed within the framework of the 'dual-gap' or 'multi-gap' formulations developed and elaborated during the sixties (see for instance McKinnon, 1964; Bruton, 1969; Chenery, 1969; Taylor, 1971). This financial intermediation, Goldsmith (1966) observes, is manifested in facilitating the 'migration' of funds by the financial superstructure to the best users; ie, to the place in the economic system where the funds will yield the highest social return. This process will accelerate economic growth and hence, improve overall economic performance.

The acute shortage of domestic savings and foreign exchange, together with low absorptive capacity, have been recurring problems for many developing countries, especially since the seventies. By definition, the significance of savings as an upper bound on investment, given an amount of foreign capital inflows, is acknowledged, both in the modern capital-oriented growth models and in the dual-gap analysis. Many of these models, which adopt a

variation of the Harrod-Domar framework do assume that the marginal savings ratio must be higher than the average savings ratio if per capita output is to grow. Thus a savings gap appears when the domestic savings rate falls below the level necessary to permit the investment required to achieve a target rate of growth while imports are adequate. Hence, if the maximum possible domestic savings are limited by the marginal savings rate ( $S_m$ ),

$$\text{Savings (t)} = S_0 + S_m Y_t$$

then investment can be undertaken up to the limit imposed by the sum of savings plus foreign capital inflows (F):

$$C_s = I_t - F_t - S_m Y_t = 0$$

where  $S_0$  is the amount of savings at the initial year;  $I_t$ ,  $F_t$  and  $Y_t$  represent investment, foreign capital and national income in time (t) respectively. The savings constraint,  $C_s$ , is therefore a function of the general level of investment capital formation, the amount of foreign capital inflows and the marginal propensity to save.

On the assumption of fixed input-output coefficients and limited possibilities for export expansion, a foreign exchange shortage on the other hand becomes an almost absolute constraint on growth in that even if domestic savings were available in sufficient amounts to allow an increase in investment, the absence of the required complementary foreign exchange makes such an increase impossible (the neoclassical answer to this 'structuralist' view has always been to stress the role of relative prices and, in particular, exchange rate adjustment as a means of overcoming any

foreign exchange shortage. See for instance, Findlay, 1973 and Diamond, 1978). With imports (M) expressed as:

$$M_t = M_0 + MY_t + MI_t$$

where M is the marginal import coefficient, the foreign exchange constraint (C) is defined as a function of total import requirements and total capital inflows ( $F_t + X_t$ ) where  $X_t$  represents the level of exports:

$$C_f = M_0 + MI_t + MY_t - F_t - X_t = 0$$

Recognising partly the practical limitations of the 'two-gap' or 'multi-gap' formulations and then the complexity of the development process in general, Taylor (1971) demonstrates that with forward timeflow, an economy passes through three phases of development constraints. The first is when constraints such as foreign aid shortage and insufficient absorptive capacity ( $C_a = I_0 - aY_0 = 0$ ; where  $C_a$  = absorptive capacity constraint;  $a$  = marginal absorptive coefficient) and the savings limit are binding. The second phase is when both the savings and the overall balance of payments constraints are binding, and in the final phase, when the economy would coast into terminal conditions with only the balance of payments and investment floor constraints become binding.

However, the experience of developing countries indicates that several variants on this sequence are possible. For instance, an initial phase can exist, with absorptive capacity and balance of payments binding or there can be the omission of both the second and/or final phases with all the constraints interacting at almost the same time. Nonetheless, if domestic savings were large enough

to finance any otherwise feasible investment, the major constraint on investment expenditure would be the balance of payments restriction. Plentiful savings early in the development period may imply that the balance of payments and absorptive capacity constraints or foreign aid limit would bind. If savings were initially binding, but then become more plentiful afterwards, the sequence:

$$(C_s, C_a) = (C_f, C_a) = (C_f, C_i) \text{ and} \\ (C_s, C_a) = (C_f, C_i)$$

where  $C_i$  is the lowest bound on investment, would be possible. The probable movement of these constraints over time is graphically illustrated by the arrows in Figure 5.1.

The role of the banks in tackling these development obstacles is obviously difficult and complex. There are serious practical conflicts in their operational desires; first to support national development and second, to sustain themselves by acquiring and protecting adequate liquidity and profitability positions amid relatively more restrictive and protected financial markets. There are even more complicated problems where the achievement of monetary integration within a group of countries require substantial coordination and/or harmonisation in the banks' operations.

There is no single optimum method of evaluating the extent of financial development that is required for real development. However, on the elimination of the development constraints the role of financial institutions lies not only in their ability and willingness to manage the structures of their assets and liabilities in a manner that will provide appropriate and adequate financing to generate foreign exchange, but also, to support and facilitate the

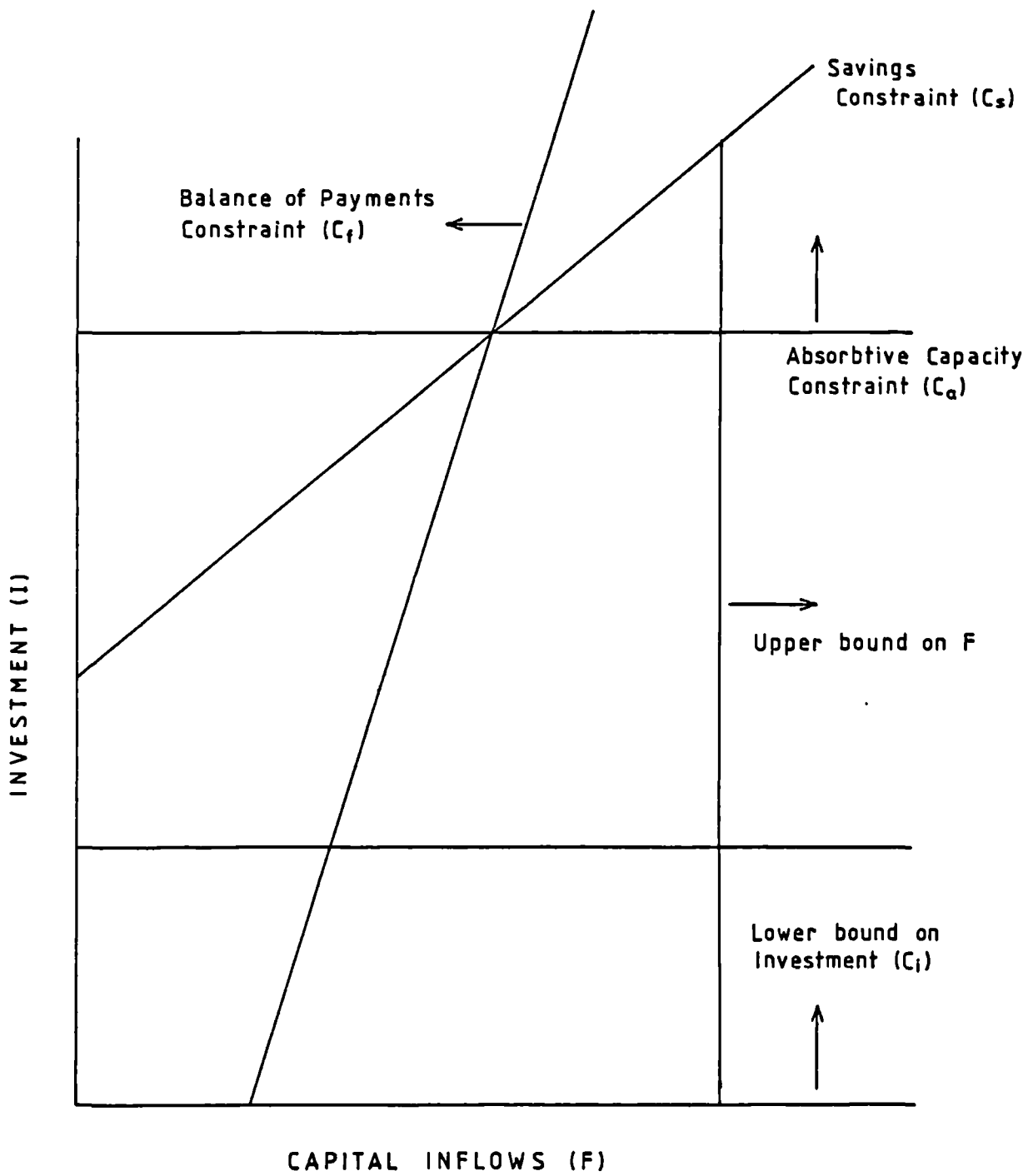


Fig. 5-1. Problem constraints on economic development.



creation of money and the payments mechanism that could minimise foreign exchange transaction costs, and hence, boost domestic and foreign trade relationships. On the savings-investment process, financial intermediation must raise the level of savings and at the same time induce investment programmes. Consequently, the higher the ratio of total financial assets in relation to real assets (ie financial inter-relations-ratio - FIR) the more significant the importance of financial institutions and instruments in the economy (see for instance, Goldsmith, 1966, 1969; Revell, 1973). Goldsmith (1966) has observed the FIR to range between 1-1.5 in developed markets or mixed economies, and between 0.66-1 for developing economies. He has further observed that first, the ratio increases with expanding industrialisation up to a certain level and then remains fairly stable; second, the influence of financial institutions in the financing process is similarly linked to the development of an economy; and third, among financial institutions, the share of commercial banks falls after the early stages of industrialisation. These results, Goldsmith concludes, demonstrate the occurrence of a direct and visible relationship between financial development and real development.

Clearly, one fundamental problem in attempting a comparative application of the FIR concept to different economies is the composition of the 'financial superstructure' and 'financial infrastructure' (see Revell, 1973, p 9). In the context of West Africa, the extent of this problem is initially in the classification of financial institutions and in some cases the composition of financial assets and liabilities. There are different types of banks and non-bank financial institutions

operating in the region ranging from all purpose banks to specialised institutions. These institutions could be classified in four main categories, viz, commercial, merchant, development banks and non-bank financial institutions. However, for the purpose of classification, BCEAO has only two categories, namely, banks and non-bank financial institutions, but in particular, the latter does not include insurance companies, trust and pension funds. Apart from Nigeria, merchant banks are not a common feature of the West African financial system although their functions are variously performed by the development banks and non-bank institutions.

Financial underdevelopment in West Africa is largely manifested by the smallness and thinness of credit and capital markets, especially medium-term and long-term markets. This tendency is made more worrisome by the fact that where these exist, their operational activities are dominated by the government, a situation which has also affected the rate at which domestic savings are mobilised. Significantly, one result of financial underdevelopment is the tendency for most governments, government entities and private enterprises to borrow in foreign capital markets where they can obtain medium-term and long-term credit - credit that is unavailable or prohibitively expensive at home. A second consequence is perhaps most immediately relevant to the day-to-day conduct of monetary policy because it increases the risk and cost of deficit financing by the public sector. This relates to the huge budget deficits run by the government and the bulk of which is bank credit. The implications of these issues for the balance of payments are particularly significant in small developing countries where budget deficits are generally monetised.

## 5.4.2 The Extent of Financial Intermediation

### 5.4.2.1 Bank Per Capita

As already indicated, the expansion of the West African banking system in terms of both the number of commercial banks, their branch network and their operations has been influenced in part by the wave of indigenisation as well as by the rising demand for their services, especially the public sector. In most countries, in particular, the FSA countries for which data was more readily available, the number of established commercial banks has more than doubled since the end of the colonial system. This has been accompanied by a substantial rise in the branch network.

For instance, in Nigeria before independence in 1961, there were only five commercial banks. By 1972, this number had more than trippled to 16. It reached 19 in 1975 and by August 1985, it had increased further to 28. The number of corresponding branches has risen from 367 (including 9 agency offices) in 1972 to 436 in 1975; 585 in 1978 and over 700 by 1985. In Ghana, the number of commercial banks has increased to around 12 while the number of corresponding branches has risen from 19 in 1952 to about 237 at the end of 1980 (African Economic Digest, September 1981). In Sierra Leone, although the growth in banks and their branches has been much slower, there are at present 5, compared with 2 on achieving independence, and more than 45 branches (including 3 agency offices) are currently being operated.

In terms of per capita densities, the overall banking habit in West Africa is generally at a low ebb with a large proportion of the population, especially the rural population, remaining either unbanked or grossly under-banked. In Sierra Leone, for instance,

the bank branch per capita is over 75,000; it is over 1.25 million in Nigeria, and above 45,000 in Ghana. This awkward situation is worsened further by the markedly uneven distribution of bank branches between the rural agricultural areas which account for a significant proportion of GDP and the urban centres which are substantially net capital exporters. In Sierra Leone, for example, more than three-quarters of the banks' total 47 branches are concentrated within the capital city and the provincial headquarters. Although the banks have often stressed the lack of adequate commercial activity and operational security arrangements in the rural areas, the high per capita bank densities lower the performance of the banks in the savings mobilisation and monetisation processes.

#### 5.4.2.2 Monetary Survey

A comprehensive survey of monetary developments in any economy implies essentially the consolidation of the accounts of all financial institutions with a view to measure 'money' and its determinants, and to indicate its relative impact on the economy. In this study however, within the narrow range of its financial superstructure and infrastructure, the size and expansion of the West African financial system is further examined only in relation to the performance of the commercial banks relative to developments in government obligations, money supply, in the sense of currency plus demand deposits, and quasi-money bank liabilities. The array of assets available to savers is generally limited to time and savings deposits, although in the WAMU states, money supply also includes chequing deposits in the Post Office accounts as well as

deposits at the treasury since these have the character of deposits held by the commercial banks.

Undoubtedly, monetary developments in the region since 1970 have, as in the case of developments in the real sector - eg income, trade, balance of payments, etc - distinctly attested to the adverse impact of external events, notably, the series of oil price rises as well as to the rising dependence by governments on 'new money' for the financing of recurrent budgetary and non-budgetary expenditures. Government securities (ie domestic long-term and short-term bonds and bills) which constitute the largest single asset held by non-bank financial institutions have grown very markedly over the seventies. For instance, in Nigeria, short- and long-term bonds and bills (as defined in the IMF, Government Finance Statistics, Table E, Lines 1 and 2) have increased by more than sixty times, from 28.4 to 1765.6 million naira in 1972-77; by more than fifty-eight times, from 72.7-4254 million cedis in Ghana between 1973-81; and nearly three times in Sierra Leone in 1974-77. In these countries, treasury bills have constituted the major debt instrument by the central government. Moreover, the slower rate of economic growth experienced in most West African countries has automatically forced rapid expansion in government deficits, a feature which also explains the relative stickiness and low rates of interest rates in the member countries. Thus competition in the demand for bank credit is significantly between public sector borrowing against continued decline in private sector credit requirements.

**Table 5A      ECOWAS: Commercial Banks' Deposits, Assets and Liabilities**

(billion dollars)

	Demand Deposits	Quasi-Money	Demand Deposits Plus Quasi-money	Assets	Liabilities
1970	0.9	0.7	1.6	0.1	0.2
1971	0.9	0.8	1.7	0.2	0.2
1972	1.1	1.0	2.1	0.1	0.2
1973	1.4	1.4	2.8	0.2	0.2
1974	2.3	2.3	4.6	0.4	0.3
1975	3.4	3.3	6.7	0.3	0.4
1976	5.3	4.2	9.5	0.5	0.5
1977	7.4	5.0	12.4	0.7	0.6
1978	7.1	5.7	12.8	0.6	0.9
1979	8.8	8.3	17.2	0.7	1.2
1980	11.8	11.4	23.2	0.7	1.4
1981	10.7	11.3	22.0	0.7	1.3

Source: IMF, International Financial Statistics

Notes: 1 Data not available for Cape Verde, Guinea and Guinea-Bissau in all cases; for Benin in the case of Assets and Liabilities; and for Sierra Leone in respect of liabilities

As shown in Table 5A, both money supply, and the assets and liabilities of the commercial banks (also known as deposit money banks in the francophone states) have grown almost without interruption since 1970. Aggregate assets rose from \$0.1 billion in 1970 to \$0.3 billion in 1975 and by nearly \$0.7 billion each year

between 1979 and 1981. The corresponding level of liabilities increased to over \$0.4 billion and \$1.3 billion in 1975 and 1981 respectively from \$0.2 billion in 1970. There has been a fairly even spread between demand deposits and quasi-money with both liabilities rising respectively from \$0.9 billion and \$0.7 billion in 1970 to \$3.4 billion and \$3.3 billion in 1975, and \$10.7 billion and \$11.3 billion in 1981. This rise in the two deposit instruments resulted in a more than thirteenfold increase in total deposits of the banks from \$1.6 billion to \$22 billion during the last decade. These trends are graphically represented in Figure 5.2.

Over the same period, total domestic credit rose by around thirteenfold, from \$2.98 billion to \$38.43 billion, providing a fairly substantial deterioration by \$2.74 billion in aggregate net foreign assets. Similarly, total money increased from \$2.62 billion in 1970 to \$32 billion in 1981, representing a more than twelvefold rise (Table 5B).

As Table 5C suggests, in growth terms, aggregate money supply, on average has behaved in three phases. The first, up to the mid-1970s, showed relatively low and stable rates of monetary expansion. The crucial phase of rapid monetary expansion in practically all member countries (ie mid-1970s and early 1980s) reflected the short-term impact of the oil price crises on domestic prices, costs and overall public expenditures. The third phase (ie 1975/76-1980 and 1982-83) was generally one of relative decline in monetary expansion, reflecting the tighter fiscal and monetary controls which followed the events of the early 1970s and the second phase.

Table 5B ECOWAS: Money Supply and its Determinants<sup>1</sup> (million dollars)

	Commercial Banks		Money Supply		Demand Deposits		Quasi-Money		Currency in Circulation		Domestic Credit		Net Foreign Assets		Distribution of Credit (%)					
	Assets 1970	Liabilities 1981	1970	1981	1970	1981	1970	1981	1970	1981	1970	1981	1970	1981	1970	1981				
Benin	-	-	-	36.6	348.4	16.4	89.1	1.4	52.9	16.3	97.8	26.3	237.7	14.5	25.9	-1.9	-27.4	101.9	127.4	
Burkina Faso	1.2	3.5	6.0	55.2	223.7	10.8	78.5	0.8	51.8	20.8	86.4	6.5	233.2	34.9	16.8	-214.5	2.3	314.5	96.1	
Gambia	1.7	7.8	2.0	17.6	47.2	2.1	16.0	1.4	15.6	5.8	20.3	3.9	112.1	7.8	-40.0	-117.7	14.8	217.7	44.8	
Ghana	4.2	3.2	21.9	50.5	4239.6	147.9	1203.4	118.8	951.0	148.0	2199.4	588.2	5629.8	-19.7	-80.4	48.5	68.8	31.1	8.7	
Ivory Coast	91.1	100.9	50.6	482.1	381.8	158.4	823.9	87.6	623.1	123.2	799.7	280.4	3598.0	163.6	-1275.6	-19.8	6.2	119.8	91.7	
Liberia	11.2	15.5	15.3	56.4	76.0	20.2	41.3	23.8	51.1	8.0	11.6	89.6	317.1	-6.0	-177.7	10.2	60.1	89.8	39.9	
Mali	7.7	10.9	5.1	18.8	51.2	14.7	65.7	0.8	15.5	32.2	142.3	120.2	518.3	-54.5	-225.5	64.6	41.3	12.7	21.5	
Mauritania	0.5	14.5	3.9	79.3	23.5	10.9	99.0	2.6	36.3	8.1	54.7	25.7	277.6	-0.5	-39.8	-8.2	17.1	109.3	76.0	
Niger	1.0	19.4	7.9	99.5	31.8	12.9	134.9	2.8	67.2	17.6	121.2	30.4	350.7	16.2	68.6	-19.5	-4.1	119.6	103.0	
Nigeria	9.0	405.0	14.0	182.0	1341.2	22801.0	404.6	7663.7	471.8	9100.3	478.8	6063.7	1638.0	25113.7	218.4	4193.7	59.3	40.7	56.9	
Senegal	8.9	43.2	23.6	173.9	142.6	737.2	62.5	296.2	10.0	186.8	55.2	256.1	135.9	1285.3	18.9	-463.2	-0.1	100.1	84.8	
Sierra Leone	0.1	5.3	-	-	53.3	226.5	11.6	53.8	17.2	98.6	73.4	26.1	482.9	32.6	-214.2	11.3	81.8	88.5	17.5	
Togo	10.9	69.6	8.9	79.7	47.7	356.2	19.2	99.4	9.2	75.1	16.5	176.5	13.2	269.2	39.9	111.1	-130.6	20.0	230.9	
ECOWAS	147.5	698.8	159.2	1295.0	2623.0	32029.3	892.3	10664.9	748.2	11325.3	953.1	10103.1	2984.4	38425.1	466.1	-2269.1	-24.5	26.0	121.3	65.2

Source: IMF International Financial Statistics, 1981

- Notes: 1 Money supply (M1) is currency outside banks + demand deposits + quasi-money (M2)  
 2 1975 for money supply, net foreign assets, domestic credit, currency circulation  
 - Not available



Table 5C ECOWAS: Growth in Money Supply, 1970-1983

	Percent Change Over Previous Year											Money Supply 1970-83	Average Annual Percent Change						
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980		1981	1982	1983	Money Supply 1970-83	Domestic Credit 1970-81	Currency in Circulation 1970-81	Demand Deposits 1970-81
Benin	16.6	23.9	16.0	8.3	19.6	39.3	23.0	14.9	5.5	21.4	19.3	28.5	20.7	-1.6	18.2	22.9	17.1	46.6	44.3
Burkina Faso	16.1	3.1	6.9	24.0	32.2	26.7	33.7	16.8	20.6	15.4	9.4	23.1	11.2	12.1	18.0	38.2	13.8	21.4	46.9
Gambia	13.7	3.2	33.0	18.6	24.3	31.8	32.5	25.1	15.6	4.2	-0.5	9.3	22.6	26.7	18.5	36.4	13.5	24.3	26.4
Ghana	16.4	3.1	39.5	20.6	24.8	33.9	39.0	45.0	69.2	30.9	35.7	36.2	32.8	40.2	33.4	33.4	38.0	32.2	31.8
Ivory Coast	25.5	12.1	3.2	16.1	35.0	26.3	23.1	53.8	23.4	10.8	9.0	4.1	6.8	5.3	18.2	25.4	17.1	19.2	22.7
Liberia	-	-	-	-	-	-1.5	47.3	12.3	23.5	2.5	-25.9	-12.0	26.0	10.6	9.2	26.5	4.7	9.4	15.4
Mali	4.6	14.3	10.8	12.9	22.8	37.7	14.4	15.1	19.1	17.9	9.6	2.4	8.6	20.7	15.1	14.3	15.3	17.2	51.4
Mauritania	15.1	23.2	5.4	20.7	57.0	43.8	15.5	12.1	-0.5	32.3	-0.8	29.8	14.8	5.4	19.6	28.4	19.2	25.0	35.4
Niger	15.5	21.1	22.5	9.5	26.0	23.2	22.8	32.9	27.3	28.4	29.0	22.1	-1.1	-0.6	19.9	24.4	21.2	23.7	34.4
Nigeria	43.7	21.9	10.5	20.1	47.1	75.3	48.9	35.5	15.1	18.6	30.8	19.8	8.8	14.1	29.3	49.7	28.1	34.4	33.0
Senegal	7.8	10.0	16.6	7.1	36.7	29.8	30.9	17.7	9.9	19.3	2.2	5.4	25.9	3.9	15.9	22.1	13.0	16.9	36.4
Sierra Leone	4.6	-1.8	14.2	25.9	20.8	9.7	12.9	26.2	32.3	25.6	15.3	8.6	28.2	31.6	18.2	32.4	13.1	19.1	19.8
Togo	21.8	7.8	5.2	3.4	64.5	21.2	7.9	40.4	25.2	21.9	5.2	27.3	30.4	0.5	20.2	31.3	21.6	25.4	28.7
Average	16.8	11.8	15.3	15.6	34.2	30.6	27.1	26.8	22.0	19.2	10.6	15.7	18.1	13.0					
SD	10.5	9.0	11.3	7.2	14.7	18.2	13.0	13.7	16.8	9.3	16.2	13.9	10.6	13.2					

Source: See Tables 5A and 5B

Note: - Not available

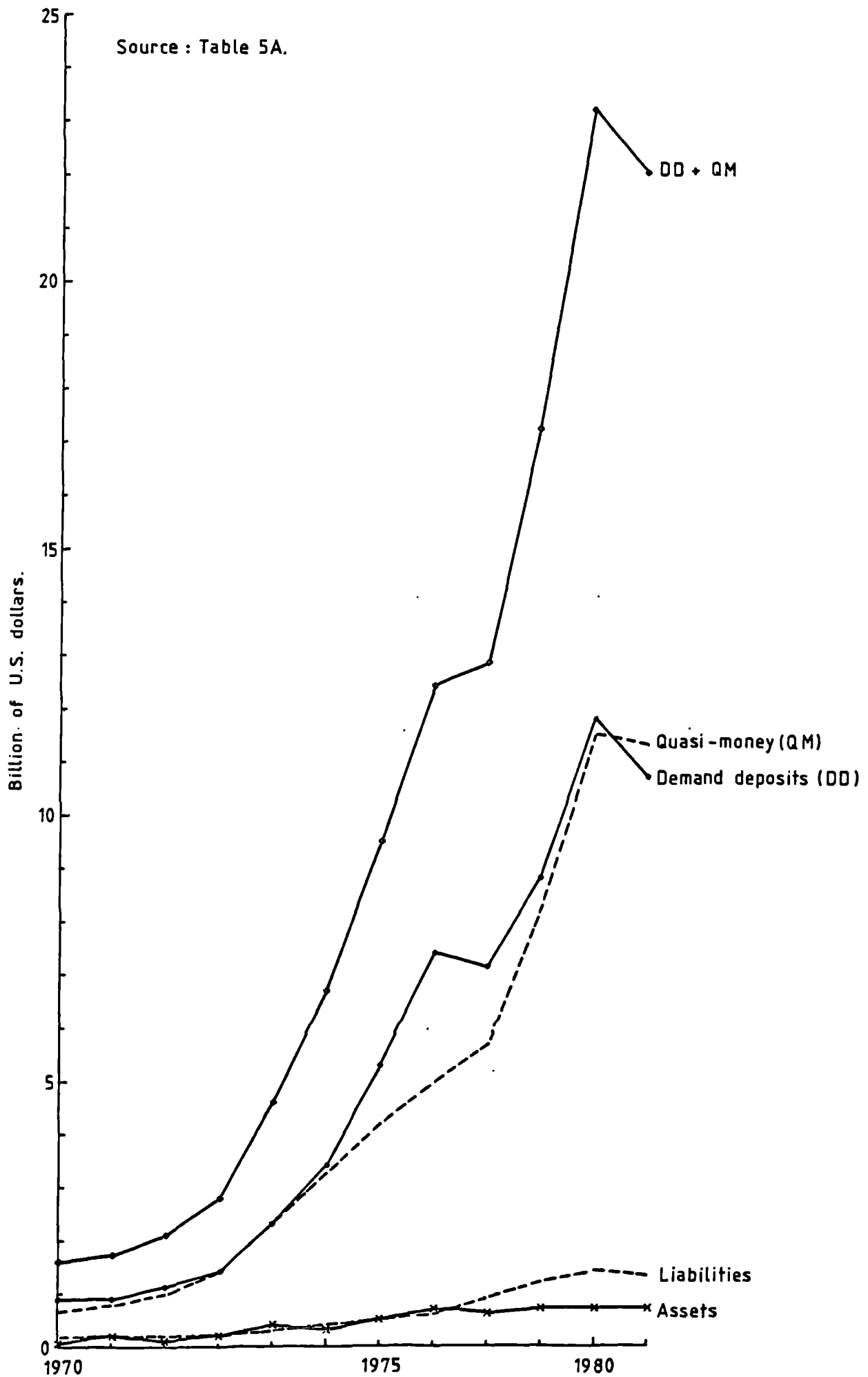


Fig.5-2. ECOWAS : Commercial banks deposits, assets and liabilities, 1970 - 1981.

Although monetary growth in most countries has been high and rising, the 14 year review period has also depicted some major differences between countries in the magnitudes of money supply and its determinants. The trends are relatively more erratic in Ghana than in most of the member countries, notably the French-speaking. More specifically, perhaps, the divergent trends can in part be explained by the high incidence of political change in countries like Ghana and Nigeria as well as by a high degree of exchange rate instability (eg Ghana).

For instance, commercial bank assets and liabilities have fluctuated more widely in Ghana than in most countries. The average annual expansion in total money supply during 1970-83 ranged 9-33 per cent between countries, with Nigeria and Ghana recording the highest rates at 33.4 per cent and 29.3 per cent respectively. The marked increase in the commercial banks' liabilities during 1970-81 resulted from the very high national growth in demand deposits and quasi-money, which varied between 17-47 per cent and 15-51 per cent per annum respectively. Both liabilities grew by more than 30 per cent a year in Benin, Ghana and Nigeria, although growth in demand deposits in these countries was marginally higher. Quasi money, on the other hand, grew much faster than demand deposits in the rest of the countries, with Mali (51.4 per cent) and Benin (44.3 per cent) recording the highest growth rates. Significantly, Sierra Leone recorded the lowest growth in quasi-money during the period.

The general acceleration in domestic credit expansion in the region worsened net foreign assets positions in virtually all countries except Benin, Niger, Nigeria and Togo where both instruments increased simultaneously during the twelve year period.

An examination of the distribution of credit between the government and the private sector in each country indicates that there are some countries which have relied consistently on the monetary authorities and the deposit money banks to finance their increasing expenditures, although in general the proportion of credit held by the government had risen substantially in practically all countries. The governments of Ghana, Mali and Nigeria have consistently taken more than 40 per cent of the available domestic credit. In Sierra Leone, this share increased remarkably from Le 2.46 million (\$2.9 million) in 1970 to Le 463.86 million (\$395 million) in 1981. On the other hand, the governments of Benin, Ivory coast, Niger and Bourkina Fasso have depended much less on domestic credit expansion, a situation that generally reflects the restrictions imposed by France within the WAMU monetary arrangements.

As between the francophone and anglophone countries, the statistics show that government borrowing from the banking system is more predominant in the latter than in the former group of countries, depicting in part the basic differences in economic structures, the extent of government expenditure and budgetary deficits. In addition, the dominance of excess assets held by the governments of the majority of the francophone states with the banking system, including the treasury, also reflects the practice of these governments in attempting to balance their current accounts in transfers and trade every year. Although there is no clear-cut pattern observable in the West African economies, one may, in trying to explain the supremacy of private sector credit over government credit in the francophones, note the argument that as an economy progresses, the public sector tends to lose initiative to the

private sector and the volume of private sector credit tends to exceed that of the government. The extent of private sector credit in relation to public sector credit is also an indicator of the degree of openness of an economy. In this respect the economies of the francophone states have tended to be more open than their anglophone counterparts as they are lacking in many of the very loose budgetary expenditures and tight trade and exchange restrictions that characterise economies like Nigeria, Sierra Leone and Ghana.

The rationing of credit to the private sector may have serious effects on overall economic activities if the government sector is too small compared with the private sector, although in this respect also, there is no clear-cut pattern observable in the data. It is apparent however that those countries which have substantial net public credits with the monetary authorities are relatively more privatised than centralised. Furthermore, the excessive dependence on central bank credit ('new money') without being matched by rational and productive economic activities have also endangered monetary stability and proved injurious to some economies. Indeed in Sierra Leone where the growth in the central bank credit to the Government has been above 30 per cent a year since 1975, serious implications have been evidenced in more recent years in a high incidence of parallel and black market activities funded to a large extent by rising and uncontrolled government expenditures, especially in wages and salaries in the civil service, in an occasional conflict between the Bank of Sierra Leone, the Treasury and the IMF on the extent of the 'ways-and-means advances', and in the apparent violation by Government of the Bank of Sierra Leone

(Amendment) Act of 1970 (Article 34) regarding the limits of central bank financing of government.

Under ideal circumstances, money supply aggregates should expand in the same direction as the volume of goods and services in the economy and this growth should be distributed between real growth and prices. Unfortunately, the experience in West Africa is such that money supply has been increasing very rapidly whereas growth in the GDP has remained comparatively very low. At the same time consumer prices have in countries like Ghana, Nigeria and Sierra Leone, accelerated equally as fast as the money supply (see Table 5D).

#### 5.4.2.3 Financial Intermediation and National Development

As noted earlier, the relative importance of financial intermediation both in relation to enhancing the spread of the banking habit and overall economic development is usually measured in terms of the extent of currency holdings outside the banking system and in the relationship between financial assets of all kinds - currency, bank deposits, shares, government securities, trade credits, etc - and the GDP and GNP. These relationships help to indicate the various roles of money as well as the assessment of the changing role and size of the financial superstructure in the development of an economy.

The relationship of currency in circulation to money supply attempts to measure the extent to which people and institutions want to hold money for either transactions or precautionary purposes while that between money supply and the sum of demand deposits plus quasi-money indicates the extent of the banking system's involvement

Table 5D ECOMAS: Growth in Consumer Prices (Percentage Change over Previous Year)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Average 1970-83
Burkina Faso	1.7	2.2	-3.0	7.5	8.8	18.8	-8.4	30.0	8.2	15.0	12.3	7.6	12.1	8.4	8.7
Gambia	-1.9	3.0	8.6	6.9	9.2	25.9	17.1	12.4	8.8	6.1	6.7	6.1	10.8	10.6	9.3
Ghana	2.9	9.6	10.1	17.7	18.1	29.9	56.1	116.4	73.1	54.4	50.1	116.5	22.3	122.9	50.0
Ivory Coast	9.4	-1.6	0.3	11.2	17.3	11.5	12.1	27.4	13.0	16.6	14.6	8.8	7.4	5.9	11.0
Liberia	1.5	-0.8	3.9	19.6	19.0	14.0	5.6	6.3	7.3	11.6	13.8	7.6	5.9	2.8	8.4
Mauritania	6.6	7.7	8.1	7.7	12.6	11.9	14.4	10.3	7.1	9.2	10.3	19.1	12.6	0.9	10.4
Niger	0.9	4.2	9.8	11.7	3.3	9.2	23.5	23.3	10.0	7.3	10.3	22.9	11.6	-2.5	10.4
Nigeria	13.9	16.1	2.6	5.7	12.5	12.5	24.3	19.3	18.7	11.1	10.4	20.9	7.5	20.0	15.5
Senegal	2.9	4.0	6.0	11.3	16.6	31.8	1.1	11.3	3.5	9.6	8.8	5.9	17.3	11.7	10.1
Sierra Leone	6.9	-1.7	5.5	5.7	14.4	19.9	17.2	11.6	7.6	21.2	11.1	23.3	31.1	69.7	17.4
Togo	4.3	6.7	7.7	3.6	12.8	18.1	11.6	22.5	0.4	7.5	12.4	19.7	11.1	9.4	10.6
Average	4.5	4.5	5.4	9.9	13.1	20.4	15.9	26.4	14.3	15.4	14.7	23.5	13.6	23.6	-
SD	4.4	5.4	4.1	5.1	4.7	8.7	16.4	30.8	20.0	13.7	12.0	31.7	7.4	38.3	-
Range	15.7	17.8	12.8	16.0	14.8	25.0	64.5	110.1	72.7	48.3	43.4	110.6	25.2	125.4	41.6

Source: IMF International Financial Statistics

in the settlement of financial transactions and other money transfers. Thus, an increase of currency to money supply denotes a decline in the involvement of the financial system in the process of development of the economy.

These ratios are shown in Table 5E for 13 of the 16 member countries of ECOWAS for which data was available. First, as an estimation of the size of the financial system, the financial assets ratio (defined in this study as total money supply,  $M_1$ , over the GDP) has been rising in practically all financial systems in the region during the last decade. In Ghana, for instance, the ratio rose from 17.9 per cent in 1970 to 26.1 per cent in 1977, before declining to 19.9 per cent in 1981. Similarly, in the Ivory Coast, it rose to 33.7 per cent in 1977 before sliding down to 25.3 per cent in 1981. In Benin, Mauritania, Nigeria, Senegal and Togo in particular, the financial system as a share of the GDP expanded from below 20 per cent to over 30 per cent. In general, the ratio has ranged between 9.3 per cent in Burkina in 1970 and 40.5 per cent in Togo in 1981. These figures compare with India (0.35), Ethiopia (0.15), Japan (1.40) in 1960 and the UK (1.70) in 1961 (see Goldsmith, 1966, p 9), indicating therefore that financial systems in West Africa have been assuming increasing importance in the national economies as they developed.

Secondly, this phenomenon is demonstrated further firstly, by the increase in the propensity to hold near-money (ie the ratio of quasi-money to the money supply) from 28.5 - 35.4 per cent; secondly by the drop in the proportion of money held outside the banking system (ie currency in circulation ratio) from 36.3 - 31.5 per cent; and thirdly by the relatively high demand deposits ratio, which



Table SE ECOWAS: Financial Intermediation and Economic Growth (Per Cent)

	Currency in Circulation Money Supply <sup>a</sup>					Demand Deposits plus Quasi-Money GDP					Quasi-Money GDP					Financial Assets <sup>b</sup> GDP								
	1970	1973	1975	1977	1979	1981	1970	1973	1975	1977	1979	1981	1970	1973	1975	1977	1979	1981	1970	1973	1975	1977	1979	1981
Benin	46.6	44.4	35.7	36.2	29.1	42.5	7.1	8.7	19.7	15.3	14.7	16.7	0.6	2.7	4.4	3.7	4.1	6.2	14.5	16.5	28.2	23.1	24.1	31.3
Burkina Faso	60.2	51.5	48.4	45.5	40.9	45.5	3.2	6.2	8.6	10.1	10.8	12.1	0.2	0.9	1.3	2.5	4.5	4.8	9.3	13.1	16.6	18.4	18.0	20.7
Gambia	62.9	62.5	65.6	54.7	58.3	49.7	8.8	12.0	12.0	11.8	11.0	15.8	3.6	6.0	6.1	6.1	6.0	7.8	23.7	30.9	25.0	16.2	18.4	23.6
Ghana	44.3	43.0	44.9	46.5	45.5	61.8	12.0	14.9	16.5	15.9	11.2	10.1	5.4	6.6	7.1	5.8	4.5	4.5	17.9	21.6	25.0	26.1	20.5	19.9
Ivory Coast	49.2	47.0	48.9	35.3	38.0	46.9	16.4	16.3	18.7	25.3	20.3	16.7	5.8	5.5	7.9	9.3	7.2	7.2	25.4	25.6	29.0	33.7	31.2	25.3
Liberia	20.5	17.4	19.2	23.2	23.2	-	-	-	11.3	16.4	16.9	11.0	-	-	5.7	9.8	9.3	6.1	-	-	12.5	17.6	17.9	12.3
Mali	65.8	60.3	58.5	63.3	63.5	64.5	-	-	-	-	8.7	7.3	-	-	-	-	1.4	1.4	-	-	12.5	17.6	17.9	12.3
Mauritania	39.2	41.9	39.0	38.0	40.5	38.5	6.6	9.5	13.7	13.8	13.7	21.5	1.3	3.2	5.5	4.0	4.4	5.8	11.6	17.1	21.6	21.7	23.5	31.5
Niger	51.5	47.5	49.5	48.6	46.7	45.0	-	-	-	-	10.5	11.8	-	-	-	-	2.1	3.9	-	-	20.3	26.7	22.2	32.2
Nigeria	53.8	46.6	41.4	33.0	35.9	38.5	11.1	11.3	13.9	18.7	16.5	23.7	6.0	6.5	7.7	8.0	8.8	12.9	17.0	16.6	20.3	26.7	22.2	32.2
Senegal	46.3	41.4	39.8	36.3	34.4	38.4	8.3	11.2	13.2	18.3	20.4	20.7	1.2	2.9	2.7	4.5	7.1	8.0	16.4	19.4	21.9	27.8	29.3	31.6
Sierra Leone	61.2	64.8	59.5	60.1	55.3	57.6	6.8	10.2	9.3	11.2	14.0	14.7	4.1	5.8	5.5	7.0	8.6	9.5	12.6	18.4	16.2	18.6	21.4	21.8
Togo	42.9	46.5	40.9	42.7	40.9	58.2	10.6	10.6	13.9	18.7	20.5	19.8	3.4	4.8	5.2	6.9	6.4	8.5	17.8	18.2	22.5	28.8	34.0	40.5

Source: IMF, International Financial Statistics; World Bank, World Development Report

Notes: a Money supply is currency in circulation plus demand deposits. Numerator is 'coin outside banks' for Liberia  
b Financial Assets comprise currency in circulation and demand deposits and quasi-money seasonally adjusted  
- Not available; also for Cape Verde, Guinea and Guinea-Bissau

stood at above 30 per cent in 1970 and in 1981 (calculated from Table 5B).

As a percentage of the GDP, currency in circulation is still high in most West African countries, varying between 23.2 per cent in Liberia and 64.5 per cent in Mali in 1981. The overall deposits ratio has improved a lot more remarkably in most countries - especially Gambia, Mauritania, Senegal and Benin - than the propensity to save which, though rising, is still below 10 per cent throughout the region except in Nigeria where it has risen fastest, from 6 per cent in 1970 to 12.9 per cent in 1981. These two ratios are lowest in Mali and Niger.

In addition to factors already discussed, the relative efficiency of the West African banking system in financial intermediation is further inhibited by existing banking legislation, most of which are inadequate, inflexible and have therefore been overtaken by current demands in the role of the banks they govern. Furthermore, the high default rate increases the level of conservatism of the banks in granting loans and this may also explain their excess liquidity problem.

Another perennial problem that affects banking efficiency in West Africa is the interest rate philosophy which is generally common in the region in that all the member countries have a low peg interest rate which has led to negative yield on savings. The resulting incidence of dis-intermediation - as the rational investor realises the consequence - could lead directly to large speculative demand for money and hoarding in some of the region's most valuable minerals (diamonds, gold) rather than the savings being held by institutions that would channel them into productive activities.

Table 5F ECOMAS: Sectoral Allocation of Credit (Per cent)

	BCEAO		Ghana		Nigeria		Sierra Leone		
	1977	1979	1977	1979	1977	1979	1977	1979	
Agriculture	11.0	6.6	10.2	8.8	4.5	6.2	1.8	3.8	4.0
Mining	2.0	2.4	5.1	5.7	1.2	1.0	4.4	4.9	14.2
Manufacturing	27.9	33.5	26.1	23.8	27.2	28.4	5.3	6.3	3.9
Construction	5.2	6.9	11.6	14.1	21.5	22.2	5.5	4.5	6.8
Transportation	5.1	5.3	7.4	11.0	7.6	7.1	-	-	-
Commerce	39.6	35.5	29.6	25.4	23.2	19.5	53.5	49.6	49.8
Miscellaneous	9.2	9.8	10.0	11.2	14.8	15.6	29.5	30.9	21.3

Source: ACMS, Monetary and Financial System of the Countries of West African Sub-region, (Dakar, 1981), pp 43-44  
 World Bank, Sierra Leone Financial Sector Study, Report No 4457-SL (Freetown, February 1984)

Consequently, the magnitude of the currency ratio reflects the degree of hoarding and the relative efficiency of the interest rate policy in West Africa. Of course, this ratio is also influenced by illiteracy about the banking habit, low personal incomes, insecurity and the incidence of tax evasion. On a seasonal basis, the currency ratio is observedly high during crop and festive periods. The hoarding of high currency denominations in particular is influenced by the high incidence of illegal currency and commodity operations especially in boarder market centres. This tendency greatly distorts the money supply measures in most countries; a reason why this study would not favour the issue of high currency denominations in West Africa unless where the rising incidence of currency counterfeiting and illegal trafficking often to take advantage of the different inconvertibility levels, are controlled.

Another skewed pattern of financial intermediation already highlighted regarding the allocation of credit to the various sectors of the economy is fully illustrated in Table 5F. The table indicates unsatisfactory availability of credit to agriculture other than 'general commerce' which principally involves import-financing and some aspect of export-financing.

## 5.5 CONCLUSIONS

This chapter has attempted to describe and analyse the monetary and banking systems of the West African sub-region on a comparative basis. It provides the groundwork for further comparative statistical tests later in the study on the performance and efficiency of the national monetary systems. Obviously, the greater the degree of disparity between them, the greater the problem of

achieving the level of common consensus required for regional monetary unification. Without pre-empting the results of the more specific comparative statistical analysis to be undertaken, it can be stated that in general while the structural features of the West African economies do not allow further extension in the banking practices and the application of the arsenal of monetary and financial instruments without being more selective and innovative, it has also not been possible to achieve monetary stability in many countries.

Several of the factors responsible for this have emanated substantially from domestic as well as external monetary relations. More significantly, the fragmented monetary and banking arrangements reviewed in the chapter exhibit various dimensions of financial illiquidity, lack of currency convertibility, market strength, and acceptability. The CFA franc with effective convertibility into key currencies (through the French franc) and the US dollar in Liberia coexist with eight other currencies all of which are very inconvertible. The structural set-up of the corresponding monetary and banking arrangements leads to three basic monetary systems in the sub-region: the CFA franc system, whose definitive basis is the trade-off between exchange and convertibility guarantees by France and variations in the member states' freedom to control monetary and financial policies, trade and payments, and the conditions of pooled reserves; the uniqueness of the situation in Liberia where the National Bank of Liberia does not discharge one of the traditional duties of the central bank, ie the issuing of currencies; and the former sterling area within which, in common with the rest of the

remaining countries, monetary and banking systems have also differed quite significantly in structure, management and practices.

Despite the relatively common structural changes introduced throughout the sub-region since the attainment of political independence, it can also be concluded that on their own the national monetary and financial systems can no longer cope with the problems of development as these are continuously taking new dimensions. The foreign exchange gap, as defined by the excess of import payments over export earnings (see Chapter 4) and the savings-investment gap (Table 5G) constraints have grown out of proportion in virtually all countries in the sub-region.

As in trade and production, the divergent institutional and operational structures of money and banking in West Africa have not complemented each other. Government holdings in banks are particularly dominant, ranging from 100 per cent (nationalisation) in Benin, Guinea and Guinea-Bissau to 48.2 per cent in Togo with a mean of 51 per cent overall. These changes have reflected on the indigenisation of the banks' management as well as their operational mechanism. Although foreign banks are still predominant, particularly in Liberia and some countries in the BCEAO, their activities are commonly subject to directive of the monetary authorities.

The West African banking systems have been characterised by steady growth of resources (assets and liabilities) and the expansion of activities in general. However, while interest rate policies seem to be similar in philosophy, the major instruments of monetary policy differ significantly between countries. The discount rate and re-discount ceilings that dominate the instruments

utilised in the BCEAO are not very effective in the FSA countries, in particular, mainly because of the excess liquidity position of the commercial banks. Consequently, much use is being made of selective credit controls (guidelines and sectoral allocations). Liquidity reserve requirements are less effective, also for reasons of the commercial banks' liquidity position, while the lack of efficient capital market limits the use of open market operations. Furthermore the FSA, in contrast with the other countries, have supplemented the instruments of monetary policy with special schemes such as loans guarantee schemes, and dealings in stabilisation securities to the commercial banks (in Nigeria) while the management of interbank funds, where banks could benefit from the excess reserves of each other, is in operation in the BCEAO.

Outside the less effective West African Clearing House arrangements, and the related West African Bankers Association formed to initiate correspondent relationships between the commercial banks in the sub-region, there is little co-ordination and/or interdependence between the West African money and banking systems. The fundamental consideration for monetary unification is the nature and extent to which the divergent banking structures and instruments of monetary policy can be harmonised. In principle, this should not be too difficult if only because all of them are equally structurally rudimentary, dependent and increasingly inefficient relative to coping with existing monetary, financial and overall economic problems. Harmonisation also has important implications for the disparate payments adjustment mechanisms that characterise the sub-region and these are examined and appraised in the next chapter.

Table 56 ECOWAS: Aggregate Savings and Investment, 1970-1981

	Savings <sup>a</sup>				Investment <sup>b</sup>				Savings-Investment Gap			Growth rate <sup>e</sup>		Savings <sup>f</sup>						
	1970	1973	1975	1977	1979	1970	1973	1975	1977	1979 <sup>c</sup>	1970	1973	1975	1977	1979	1970-80	Investment 1970-80	Propensity (%) 1970	1975	1980
Benin	23.9	36.1	16.5	-48.0	59.3	37.0	59.9	101.7	97.3	111.0	-13.1	-23.8	-85.2	-145.3	-51.7	-0.476	0.107	9.6	3.3	7.4
Burkina Faso	-5.3	8.5	-22.3	-55.7	-117.4	38.2	85.4	131.5	152.6	204.5	-43.5	-76.9	-153.8	-208.3	-321.9	-0.092	0.214	-1.2	-3.2	-9.4
Gambia	296.7	401.6	627.9	971.3	-	265.6	230.5	533.9	912.2	-	31.1	171.1	94.0	59.1	-	0.138	0.256	13.7	9.1	10.0
Ghana	376.4	554.3	787.4	2097.3	2512.9	304.0	518.3	820.0	1690.0	2537.2	72.4	36.0	-32.6	407.3	-24.3	0.290	0.285	25.8	21.9	31.4
Ivory Coast	154.1	159.4	248.5	182.4	226.2	77.8	85.5	161.2	234.3	277.6	76.3	73.9	87.3	-51.9	-51.4	0.061	0.130	59.7	51.1	17.7
Liberia	63.0	38.7	76.2	51.6	-16.3	42.4	71.6	144.3	212.7	128.8	20.6	-32.9	-68.1	-161.1	-145.1	-0.635	0.118	31.0	18.0	-0.16
Mali	1260.0	3290.8	8623.2	12184.9	13947.5	1236.2	2289.1	7881.2	12654.7	10523.5	23.8	1001.7	742.0	-469.8	3424.0	0.352	0.178	17.6	26.9	23.7
Niger	98.2	102.8	223.4	179.0	183.1	108.7	168.2	252.4	264.4	407.5	-10.5	-65.4	-29.0	-85.4	-224.4	0.438	0.398	11.3	12.3	6.6
Senegal	74.2	60.4	33.0	40.2	51.9	63.9	51.3	77.8	76.8	123.4	10.3	9.1	-44.8	-36.6	-71.5	0.265	0.142	17.9	5.8	0.87
Sierra Leone	35.5	57.3	60.2	144.5	224.4	33.5	73.1	130.3	249.4	504.5	0.0	-15.8	-70.1	-104.9	-280.1	0.012	0.166	13.5	11.1	21.3
Togo																0.346	0.295			

Source: Computed from IMF, International Financial Statistics; African Centre for Monetary Studies, Financial Statistics

- Notes: a Aggregate domestic savings are calculated by added trade balance to investment (ie exports - imports + gross fixed capital formation + increase in stocks)  
b Investment in gross fixed capital formation  
c 1978 for Benin, Ivory Coast and Nigeria  
d 1980 for Mauritania and Sierra Leone  
e Growth is measured by annual % change; 1970-77 for Ghana; 1970-78 for Benin, Ivory Coast and Nigeria; 1970-79 for Senegal, Togo and Burkina Fasso  
f Savings propensity is calculated by dividing total savings by GNP; 1981 for Liberia; Rest of region as per above  
- Data not available; as well as for Cape Verde, Guinea and Guinea-Bissau



## CHAPTER 6

### BALANCE OF PAYMENTS AND FOREIGN EXCHANGE POLICIES IN WEST AFRICA

#### 6.1 INTRODUCTION

The discussion in this chapter is devoted to a closer examination of two interrelated institutional arrangements in West Africa: first, the balance of payments, and second, exchange rate arrangements and the extent of trade and payments restrictions. With the growth in import costs since the late 1950s, the balance of payments of West African countries have moved into worsening deficits. The rising import trends, together with worsening export performance and external developments, especially since the beginning of the last decade, have for most countries, forced tremendous drain upon their international liquidity positions. This in turn has forced the adoption of varied exchange rate adjustment policies and stricter exchange and payments restrictions across the region, in particular, the non-BCEAO countries (except Liberia).

These institutional arrangements are at the heart of achieving monetary union. The critical point is that at the pre-union stage, the potential member countries are able independently to adjust trade and/or capital flows and hence monetary flows through the foreign exchange market, either directly through trade restrictions and exchange controls or indirectly by altering their international competitiveness through exchange rate adjustment. The range of action available to a member country once a union is formed, especially as it affects intra-union transactions, is narrowed considerably in that a balance of payments equilibrium and a high degree of monetary and fiscal policy harmonisation and

liberalisation become the principal ingredients for the process of monetary integration, including the penultimate objective of achieving convertibility within the region. Assuming an absence of externally-oriented disturbances, the period of transition towards monetary union should enable those member states with less severe balance of payments problems and payments restrictions to achieve appropriate equilibrium in their external accounts. At the same time the transition phase should also allow those with deepseated and in some cases structural exchange and payments problems to design and implement appropriate adjustment programmes.

It is required in this respect for each member country, at the outset, to clearly identify and appreciate the extent and nature of the payments problems affecting it and the adjustment policies adopted so far in order to achieve both internal and external balance. It is not often that these payments adjustment mechanisms have achieved their desired purpose in these countries. Yet, unless where potential members of monetary integration are assured of the potential integration benefits, membership for some becomes even more stuttering mainly for fear of potential detrimental reallocation effects.

In this context, the discussion in this chapter is divided into two broad sections: Section 6.2 analyses trends in the balance of payments as well as some of the major factors that have influenced the persistent deficit positions. Section 6.3 examines the nature and efficiency of the two major foreign exchange policies commonly practiced in West Africa as instruments of adjustment policy, namely, exchange rate adjustment, and exchange controls and payments restrictions. Conclusions to the chapter are in Section 6.4.

## 6.2 BALANCE OF PAYMENTS AND INTERNATIONAL LIQUIDITY

### 6.2.1 Trends in the Balance of Payments

In West Africa, as in several other developing countries, the structure of the balance of payments and the extent of its problem for the member states have reflected the small, open nature of the economies, the rudimentary stage of development, the dominating influence of primary production and the heavy reliance on foreign factors of production. This is manifested in the large share of merchandise exports and imports and the dependence on the outside world for services and capital. In most countries in the region, the balance of payments has persistently registered deficits in practically all its major components, reflecting by and large the rapid growth in imports which has not been matched by export growth and the marked deterioration in capital inflow which usually took the form of grants, direct foreign investment, and to a lesser extent, official concessional loans.

As in other economic indicators already reviewed, the obvious distortion in the combined balance of payments performance of the West African countries is Nigeria whose massive petroleum export revenues have since the 1970s transformed the total trade balance (and indeed, the overall balance of payments) of the West African region into rising surplus from rising deficit positions. As shown in Table 6A, the regional trade balance improved from a deficit of \$224 million in 1965 to huge surpluses of \$7934 million and \$3212 million in 1980 and 1983 respectively. Excluding Nigeria, the combined trade deficit worsened from \$87 million in 1960 to \$2533 million in 1980 and \$2477 million in 1983, with a large part of the deterioration taking place after 1974. There are however, a few

exceptional countries like Ghana, Guinea, Ivory Coast and Liberia where the balance of trade has fluctuated between deficits and surpluses, reflecting movements in the terms of trade and the general economic diversification.

As in merchandise trade, the Services Accounts of virtually all West African countries, with the exception of Senegal, have registered large and growing deficits since 1970. Deficits are recorded on all the major lines of services, eg freight and merchandise insurance, investment income, foreign travel and government-related transactions. These deficits have reflected the strong dependence of the economies on foreign supply and/or management of these various services, in particular, freight, shipping and air travel facilities. At the same time, the usually net overall surpluses registered by many countries in the major elements of 'unrequited transfers' (ie migrant transfers, expatriate remittances, government-related transfers) have been more than matched by the rising negative balances in these areas by Ivory Coast and Nigeria.

These developments in the goods, services and unrequited transfers accounts, as illustrated in Table 6B, have forced the regional overall current account to deteriorate by more than tenfold from a deficit of \$502 million in 1970 to \$6898 million in 1981. By contrast, the structure and movements in the capital accounts (consisting of net flows of investment as well as net other private and official flows which are essentially drawings and amortization on short-term and long-term loans), although differing among member countries, have generally registered surpluses. In many countries,

Table 6A ECOWAS: Balance of Merchandise Trade

(million dollars)

	1950	1955	1960	1965	1970	1975	1980	1983
Benin	1	-8	-13	-20	-31	-164	-706	-438
Burkina	-	5	-7	-22	-31	-107	-269	-151
Cape Verde	-1	-2	-1	-7	-14	-38	-96	-84
Gambia	-2	-3	-1	-2	-1	-12	-132	-62
Ghana	82	22	-38	-130	-47	17	-	176
Guinea	-	-	1	1	-22	-55	57	112
Guinea-Bissau	-4	-7	-7	-11	-23	-31	-44	-47
Ivory Coast	18	37	26	41	81	54	-43	543
Liberia	-	17	14	30	64	62	55	-1329
Mali	-	-	-	-24	-14	-123	-234	-237
Mauritania	-	-	-	34	33	15	-92	-252
Niger	-1	-4	-	-13	-26	-10	-28	-50
Nigeria	80	-10	-129	-30	181	1734	10467	5689
Senegal	-63	-112	-59	-34	-41	-122	-575	-399
Sierra Leone	-	-19	9	-19	-16	-59	-211	65
Togo	-	4	-11	-18	-10	-48	-215	-324
Total	110	-72	-216	-224	83	1113	7934	3212
Excluding Nigeria	30	-62	-87	-194	-98	-621	-2533	-2477

Source: See Table 4A

Notes: - Not available

however, notably Benin, Gambia and Burkina, these surpluses are not offset by the deficits in the other areas of the balance of payments, resulting therefore in overall balance of payments deficits. The region's overall balance of payments have worsened from a surplus balance of \$54 million in 1970 to a deficit of \$66 million in 1980.

Most countries in the subregion have a good agricultural and/or mineral resource base (Chapter 2) which if efficiently exploited and barring inhibiting political and economic influences should achieve and sustain comfortable balance of payments positions. However, many of the factors which have influenced the rising deterioration in the balance of payments in recent years are both exogenous and endogenous, reflecting natural events and changes in the international economic scene, as well as resulting from the domestic policies by most countries.

For the sub-Saharan landlocked member countries in particular, the balance of payments problem has largely been the result of worsening climatic conditions (ie drought). In general however, the most common reason advanced for the sharp increase in the trade deficit is the increases in petroleum prices which have moved inexorably upward since 1973 (representing a more than tenfold increase in ten years) and which have had a key pervasive influence on all prices and other cost-related elements of the balance of payments. In consequence, payments for imports as already illustrated, have particularly increased by more than 400 per cent across the board during the last decade while the share of fuel imports in the balance of payments problem has grown faster than that of other goods and services (see Chapter 4).

Furthermore, industrial expansion and the resulting increase in investment expenditures have, through corresponding increases in money incomes, put added pressures on the balance of payments in several countries, especially Nigeria. Worse still is the evidence that the share of direct foreign investment which used to be a very significant component of capital inflows in the 1960s (mostly by firms in the primary product and import-substitution manufacturing activities, banking transfers etc) began to decline steadily in the 1970s. For instance, in Ghana, the share of direct investment in the country in the Capital Account declined sharply from 278.1 per cent in 1975 to 10.2 per cent in 1982. In other countries, the ratio has fallen from 18.5 per cent to 4.4 per cent in the Ivory Coast between 1975 and 1980; in Senegal and Sierra Leone, from 28.2 per cent and 19.8 per cent in 1975 respectively to negative figures by 1980; from 82.1 per cent (1975) to 50.5 per cent (1977) in Liberia; and from 108.5 per cent (1976) to 4.7 per cent (1982) in Nigeria. It has risen however from 5.8 per cent (1975) to 15.9 per cent (1981) in Gambia; 0.6 per cent (1975) to 3.0 per cent (1979) in Burkina; and 1.8 per cent (1976) to 5.0 per cent (1982) in Mauritania (calculated from IMF, Balance of Payment Year Book, 1983). In most of these countries, the decline in the share of direct investments is also reflected in a significant drop in the absolute values despite the fact that total capital flows have increased over the years. The increase in net capital flows is attributable mainly to the increase in the net flow of loans, especially from private sources.

Table 6B ECOWAS: Selected Data on Balance of Payments, 1970-1981

(million dollars)

	Goods and Services			Unrequited Transfers			Current Account			Capital Account <sup>c</sup>			Balance of Payments							
	1970 <sup>a</sup>	1975	1980 <sup>b</sup>	1970 <sup>a</sup>	1975	1980 <sup>b</sup>	1970 <sup>a</sup>	1975	1980 <sup>b</sup>	1970 <sup>a</sup>	1975	1980 <sup>b</sup>	1981	1970 <sup>a</sup>	1975	1980 <sup>b</sup>	1981			
Benin	-21.3	-120.6	-154.5	NA	20.1	67.5	81.2	NA	-1.2	-53.1	-73.3	NA	7.4	30.4	36.8	NA	6.2	-22.7	-36.5	NA
Burkina Faso	-36.9	-186.1	-327.8	NA	-28.4	131.9	271.0	NA	8.5	-54.2	-56.8	NA	3.5	38.9	52.3	NA	12.0	-15.3	-4.5	NA
Gambia	-0.2	6.9	-115.3	-101.4	0.8	4.4	41.4	54.8	0.6	11.3	-73.8	-46.6	2.4	-15.5	20.7	45.3	3.0	-4.2	-53.2	-1.3
Ghana	-66.0	-27.0	-112.1	-289.1	1.7	44.6	69.1	80.3	-67.7	17.6	-43.0	-208.8	70.2	-25.5	104.6	297.4	2.5	-7.9	61.6	88.6
Ivory Coast	-17.9	-247.1	-1097.7	256.5	-20.0	-141.5	-705.8	-574.2	-37.9	-388.6	-1803.5	-317.7	73.2	374.5	1944.3	1204.8	35.3	-14.1	140.8	887.1
Liberia	NA	-96.0	-108.2	-117.4	NA	6.1	6.6	38.2	NA	-89.9	-101.6	-79.2	NA	98.4	141.5	83.3	NA	8.5	39.9	4.1
Mali	-22.0	-165.6	-274.2	-270.2	19.7	109.0	143.6	124.3	-2.3	-56.6	-130.6	-145.9	-0.2	67.9	NA	NA	-2.5	11.3	NA	NA
Mauritania	-7.5	-121.9	-222.7	-246.3	2.6	59.1	88.8	98.7	-4.9	-62.8	-133.9	-147.6	3.1	65.2	150.2	137.5	-1.8	2.4	16.3	-10.1
Niger	-28.6	-72.1	NA	NA	28.5	63.7	NA	NA	-0.1	-8.4	NA	NA	10.1	13.6	NA	NA	10.0	5.2	NA	NA
Nigeria	-431.0	168.8	4846.8	-5287.5	63.0	-126.3	-577.9	-562.5	-368.0	42.5	4286.9	-5850.0	339.0	-	-4429.0	6013.9	-29.0	42.5	-160.1	163.9
Senegal	-49.1	-169.6	-369.9	NA	33.0	83.9	125.5	NA	-16.1	-85.7	-244.4	NA	27.7	92.9	260.0	NA	11.6	7.2	15.6	NA
Sierra Leone	-21.0	-77.6	-235.3	-186.3	5.1	10.7	52.8	43.7	-15.9	-66.9	-182.5	-142.6	15.6	68.6	188.2	177.4	-0.3	1.7	5.7	34.8
Togo	-11.2	-116.4	-185.1	NA	-8.3	41.2	87.7	NA	2.9	-75.2	-87.7	NA	4.2	81.6	126.8	NA	7.1	6.4	39.1	NA
ECOWAS Excluding Nigeria	-713	-1224	1644	-6242	118	354	-316	-697	-502	-870	1338	-6898	556	891	-1404	7960	54	21	-66	1167
	-282	-1393	-3203	-954	55	480	262	-134	-134	-913	-2931	-1048	217	891	3025	1946	83	-22	94	1003

Source: Computed from IMF, Balance of Payments Statistics (conversion rates for the SDR were US\$1.00, 1.2142, 1.3015 and 1.1792 for 1970, 1975, 1980 and 1981 respectively)

- Notes: a 1969/70 for Gambia  
b 1978 for Benin and Senegal; 1979 for Burkina Faso  
c Capital Account is capital excluding reserves  
NA Not available; also for Cape Verde, Guinea and Guinea-Bissau  
- Nil



Furthermore, although a precise statistical correlation cannot always be ascertained, it can be argued that balance of payments disequilibria in West Africa have been accentuated by rising government budgetary deficits, the public debt in terms of higher debt-service payments, and the sharp deterioration in international liquidity positions.

### **6.2.2 Government Budgetary Operations**

In many ways West African states have broad similarities in their fiscal structures and policy objectives. Reliance on non-tax income as a source of government revenue to finance budgetary operations is low. Practically all the countries have a narrow base for direct taxation and in consequence, they have relied heavily on the various media of indirect taxation to raise budgetary revenues. Fiscal policies are generally development-oriented so that they all tend to adopt measures which in the main seek to attract and protect private foreign investment, diversify the economies and initiate a drive towards industrialisation. Moreover, the majority of countries have pursued expansionary fiscal policies during the last decade with moderate to large budget deficits financed mainly by recourse to the domestic banking system, primarily the central banks.

Table 6C illustrates the important differences that exist between countries in their fiscal approaches in relation to the distribution of governments' current domestic revenue sources as between tax revenue and non-tax revenue, the distribution of government expenditure between current and capital expenditure, the distribution of tax revenue between direct and indirect taxes, the

proportion of overall budgetary deficits relative to the GDP, and the way in which these deficits are financed, ie between foreign and domestic sources. Reliance on non-tax income varies between 7 per cent of total revenue in Ghana and 45 per cent in the Gambia. Tax income represents, on average, about 83 per cent of total current income in the region. Indirect taxes, despite the very low tax effort prevalent in most countries, provide between 31 per cent (Nigeria) and 81 per cent (Gambia) of total tax income, while the proportion of direct income to total income is below 50 per cent in all countries except Nigeria. Over two-thirds of West African countries depend on indirect taxation for more than two-thirds of their total current income.

Equally, the share of capital expenditure (which, unlike current expenditure, closely relates to a country's future productive capacity) in total expenditure is over 50 per cent in only four countries - Gambia (56 per cent), Niger (51 per cent), Nigeria (63 per cent) and Togo (56 per cent). More than half of total expenditure in most countries is on current items (eg wages and salaries, subsidies, purchase of local goods and services for government departments, etc), a situation which has generally provided fertile breeding grounds for the so-called 'die-man racket' (the practice of defrauding government revenues by over-invoicing government wage bills to include non-existent or fictitious names of persons and/or services) Current expenditure is as high as over 70 per cent of total government expenditures in Mali and Senegal.

Table 6C ECOWAS: Central Government Revenue, Expenditure and Budget Deficits (1980)  
(Per Cent)

	Share in Current Domestic Revenue Taxes	Non-tax	Share in Total Expenditure Current	Capital	Share in Total Direct Taxes	Revenue Indirect Taxes	Overall Deficit /Surplus to GDP	Share in Financing of Fiscal Deficit Foreign	Domestic
Benin	91	9	56	44	39	61	-0.6	257	-157
Burkina	92	8	84	16	21	79	-2.2	0	100
Cape Verde	82	18	-	-	-	-	-	78	22
Gambia	55	45	44	56	19	81	-10.0	76	24
Ghana	93	7	89	11	22	78	-3.1	16	84
Guinea	59	41	54	46	-	-	-	-1	101
Guinea-Bissau	61	39	75	25	-	-	-	79	21
Ivory Coast	88	12	55	45	26	74	-11.2	60	40
Liberia	92	8	57	43	37	63	-9.6	57	43
Mali	87	13	92	8	26	64	-4.9	94	6
Mauritania	87	13	76	24	41	59	-4.6	71	29
Niger	85	15	49	51	37	63	-6.7	86	14
Nigeria	87	13	37	63	69	31	-2.2	145	-45
Senegal	89	11	95	5	30	70	-	-85	185
Sierra Leone	90	10	80	20	25	75	-11.9	32	68
Togo	87	13	44	56	47	53	-1.9	80	20

Source: IMF, Government Financial Statistics

Overall budgetary deficits are a common feature in West Africa and are as high as around 12 per cent of the GDP in Sierra Leone. Nearly half of the countries resort to bank borrowing in order to finance their deficits. In this category, the most notable are Ghana, Guinea, Senegal, Sierra Leone and Bourkina Fasso. Some countries, noticeably Benin, Cape Verde, Gambia, Guinea-Bissau, Mali, Niger, Nigeria and Togo appear to have depended increasingly on foreign sources. Legislation in various countries define the extent to which budgetary deficits may be financed by the central bank - ranging from 10 per cent in Guinea to 50 per cent in The Gambia with 20 per cent being the mode in the region (ACMS, 1981, p 28). In practice many of these ceilings are almost exceeded.

These differences in fiscal approaches have serious implications for domestic money supply, inflation and the balance of payments, but equally critical for achieving monetary unification are the consequences for fiscal policy harmonisation. It is obvious that under these circumstances the elimination of intra-regional trade tariffs and, in particular, any levelling of external tariffs will have significantly different economic implications, especially for those countries heavily dependent on customs duties as a source of government income, and will thus lead to different levels of preparedness between countries in order to implement the trade liberalisation measures envisaged even in the ECOWAS Treaty. This is so despite the fact that the Treaty's Article 25 makes provisions for a compensation for loss of revenue due to tariff liberalisation.

### 6.2.3 The External Debt

The 1970s also marked the beginning of the rapid growth of the West African external debt burden. In the majority of cases, the mounting of external debt obligations has been the result of a web of interwoven internal and external factors many of which are practically the same as those affecting the balance of payments in general. But for the growth in the external public debt in particular, the main causes have included the contraction of hardcore loans to finance expanding government expenditure programmes (many of these are military and non-income generating), as well as bad debt-management policies which in many cases have allowed for the over-invoicing of debt commitments. The consequent increase in the external debt has for most countries outstepped the general capacities to borrow and repay as indicated by marked increases in the debt-service ratios.

The external public debt profile shown in Table 6D indicates a more than elevenfold increase in aggregate debt between 1970-83, rising from \$2.26 billion to \$26.16 billion. As a proportion of merchandise exports, this debt rose from 75.9 per cent to 126.0 per cent during the period. In terms of the GNP, it rose, as minimum, from 4.8 per cent (Nigeria) in 1970 to 17.7 per cent (Nigeria) in 1983. For most countries, it has accounted for over 50 per cent of the GNP, and has risen up to 158.2 per cent in Mauritania in 1983.

The levels of the debt-service ratio moved from a range of 0.6 per cent (Gambia) and 10.3 per cent (Guinea) in 1970 to 0.8 per cent (Gambia) and 31.0 per cent (Ivory Coast) in 1983. Debt service payments as a percentage of GNP accounted for between 0.9 per cent (Gambia) and 12.9 per cent (Ivory Coast) in 1983 from 0.2 per cent

Table 6D ECOMAS: External Public Debt, Debt Service Ratios and Terms of Public Borrowing

	External Public Debt Outstanding and disbursed		Debt Out As Percent -age of GNP		Interest payments on Public Debt		Debt service as a percentage of Exports and Services		Terms of Public Borrowing							
	1970	1983	1970	1983	1970	1983	1970	1983	Average Interest rate (%)	Average Maturity (years)	Average grace period (years)	1970	1983			
Benin	41	615	16.0	59.2	-	13	0.7	2.5	2.3	5.7	1.8	2.3	32	38	7	9
Burkina Faso	21	398	6.4	38.2	-	7	0.6	1.3	6.3	3.8	2.3	3.0	37	31	8	7
Gambia	-	214	-	-	-	-	3.6	5.1	0.6	0.8	-	-	-	-	-	-
Ghana	489	1095	24.2	28.3	12	30	1.2	1.9	5.0	14.2	2.4	0.7	39	50	10	10
Guinea	314	1216	47.4	69.2	4	22	2.2	4.0	10.3	22.2	2.9	4.6	13	24	5	6
Ivory Coast	256	4824	18.3	78.8	11	413	2.7	12.9	6.8	31.0	5.8	10.8	19	16	6	4
Liberia	158	699	49.6	72.1	6	21	5.5	3.2	5.1	6.6	5.4	8.7	19	14	5	5
Mali	238	881	88.1	89.3	-	6	9.2	1.3	1.3	6.1	0.3	3.1	27	26	11	7
Mauritania	27	1171	13.9	158.2	-	23	1.7	5.0	3.2	10.0	6.6	5.6	11	16	3	4
Niger	32	631	8.7	48.7	1	36	0.6	5.6	3.8	3.6	1.2	5.4	40	28	8	7
Nigeria	480	11757	4.8	17.7	20	974	0.6	3.1	4.2	18.6	6.0	11.0	14	7	4	2
Senegal	100	1496	11.9	61.2	2	31	0.8	1.9	2.8	13.7	3.7	5.3	25	22	7	6
Sierra Leone	59	359	14.3	34.5	2	3	2.9	0.9	9.9	7.2	3.5	0.8	27	47	6	10
Togo	40	805	16.0	113.9	1	28	0.9	6.3	2.9	16.8	4.6	2.7	17	36	4	8
Total	2255	26161	-	-	59	1607	-	-	-	-	-	-	-	-	-	-

Source: World Bank, Debt Tables; Development Report and ACMS Financial Journal

- Notes:
- 1 1975 for Gambia, Guinea and Liberia
  - 2 1979 for Gambia; 1980 for Benin, Burkina, Guinea and Niger
  - 3 Data not available for Cape Verde and Guinea Bissau
- Nil negligible or data not available

(Mali) and 5.5 per cent (Liberia) in 1970. For most countries, the interest-export ratios were about 8 per cent in 1983 as average interest rates were almost doubled during the 1970-83 period.

A number of general conclusions can be drawn from the data on these debt profiles. The first is that among the countries whose debt-service ratios are particularly high, the low income and in some cases lower economic growth countries, ie Guinea, Sierra Leone and Togo, have borne higher percentages, emphasising further that the least developed member countries are less capable of exploiting internal and external resources for development purposes. Secondly, the ratio has also risen steadily and significantly even among the most developed member countries - Nigeria, Ivory Coast and Senegal - which may in part reflect their increasing dependence on medium- to long-term foreign borrowing to finance their industrialisation (investment) programmes. Nigeria, which takes up around 45 per cent of total West African external public debt (1983) is rated the tenth highest country debtor (\$12 billion) in the world from a list of country debtors that is headed by Brazil (\$93 billion) (see The Sunday Times, 3 June 1984).

Thirdly, further classification of the sources of debts into bilateral (official), multilateral, contractor finance/suppliers' credit and financial institutions shows that the distribution varies between countries. However, except Benin, Ivory Coast and Nigeria, the choice between the various loan sources is importantly between bilateral (official) which is relatively more concessionary and multilateral. International financial institutions have provided over 77 per cent of Nigeria's total debt outstanding, 55 per cent in the Ivory Coast, 46 per cent in Benin and less than 1 per cent in

Table 6E ECOWAS: Credit Rating, Distribution of External Public Debt and Debt Per Capita

	External Public Debt Outstanding Including Multilateral Official					Undisbursed (1981) (Per Cent)	Financial Institutions	Others	Institutional Investors' General Credit Rating <sup>1</sup>	1983 World Ranking	1983 African Ranking	Debt per Capita <sup>2</sup> (million dollars)
	Bilateral	Multilateral	Official	Suppliers	Financial Institutions							
Benin	16	36	2	46	-	-	-	-	-	-	-	15
Burkina Faso	35	62	-	3	-	-	-	-	-	-	-	4
Gambia	39	51	4	6	-	-	-	-	-	-	-	307
Ghana	46	40	14	-	-	-	-	-	-	-	-	57
Guinea	64	19	12	4	-	-	-	-	-	-	-	210
Ivory Coast	15	21	8	55	-	-	-	35.3	58	8	-	46
Liberia	41	39	2	18	-	-	-	11.2	92	18	-	115
Mali	62	36	1	1	-	-	-	-	-	-	-	47
Mauritania	69	23	4	4	-	-	-	-	-	-	-	22
Niger	33	38	7	22	-	-	-	-	-	-	-	8
Nigeria	8	14	-	78	-	-	-	36.3	55	5	-	9
Senegal	40	41	2	16	-	-	-	16.3	83	15	-	23
Sierra Leone	33	39	21	7	-	-	-	3.5	99	22	-	22
Togo	51	25	3	21	-	-	-	-	-	-	-	20
ECOWAS	26	23	4	47	-	-	-	-	-	-	-	23
												162

Source: Calculated from World Bank, Public Debt Tables and Institutional Investor Magazine, December 1983

Notes: 1 Zero represents the least credit worthy country with the greatest change of default

2 Debt per capita is total debt divided by mid-1970 and 1983 population figures

- Nil, negligible or not available



Mali. The proportion taken by each source category in total regional external debt outstanding in 1981 was 26 per cent (bilateral), 23 per cent (multilateral), 4 per cent (suppliers' credit), and 47 per cent (financial institutions) (see Table 6E). The share of the IMF loans, including credit tranches, Compensatory Financing Facility drawings and Trust Fund drawings rose to around 5 per cent in 1983/84.

Fourthly, bankers commonly take a ratio of external debt to exports as a crude indicator of creditworthiness, with a decline in *actual ratios indicating that '(debtor) countries would be within sight of being able to borrow freely from the banks'* (The Sunday Times, 30 September 1984, p 64). Based on this central assumption, Table 6E further reveals that at the end of 1981, only four countries - Nigeria (59 per cent), Liberia (144 per cent), Ghana (149 per cent) and Sierra Leone (158 per cent) appeared creditworthy. Alternative credit ratings by the International Investor Magazine for five countries in West Africa are also shown in Table 6E.

Finally, the severity of West Africa's debt burden has not only precipitated major debt rescheduling operations by some of the most hard-hit countries (Table 6F). It has also placed increasing reliance upon the IMF, for instance, which as of 30 September 1984, was supporting economic adjustments in seven West African countries with a total theoretically available financing of around SDR 403.3 million (Table 6G). Published debt especially in LDCs are known to substantially underestimate real levels. Yet even the available estimates for West Africa indicate that over 1970-83, the repayment burden of the external public debt outstanding and disbursed on each

member of the population has on average risen by more than seven times, from \$23 to \$162 (see Table 6E).

**Table 6F ECOWAS: Paris/London Club Debt Rescheduling**  
(million dollars)

Country	Date	Paris Club (1976-84)	London Club (1980-84) <sup>1</sup>
Liberia	19 December 1980	35	-
	16 December 1981	30	-
	December 1982	-	27
	22 December 1983	1200	-
Niger	November 1983	70	-
Nigeria	July 1983	-	1350
	September 1983	-	480
Senegal	12 October 1981	75	-
	June 1982	-	77
	29 November 1982	74	-
	21 December 1983	75	-
	February 1984	-	97
Sierra Leone	15 September 1977	39	-
	8 February 1980	37	-
	20 February 1984	92	-
Togo	15 June 1979	260	-
	March 1980	-	69
	20 February 1981	232	-
	12 April 1983	300	-
	October 1983	-	84

Source: Jesse Wright, 'Adjustment Policies, Financial Relief with Sterling Attached', Africa Business, May 1984, No 69, pp 49-55

Notes: 1 Private sector reschedulings  
- Non

**Table 66 ECOWAS: IMF Stand-by Arrangements as of 30 September 1984**  
(thousand SDRs)

	Date of Arrangement	Expiry Date	Total	Undrawn Balance
Gambia	23 April 1984	22 July 1985	12,830	10,200
Ghana	27 August 1984	21 December 1985	180,000	150,000
Ivory Coast	3 August 1984	2 August 1985	82,750	41,370
Mali	9 December 1983	31 May 1985	40,500	18,500
Niger	5 October 1983	4 December 1985	18,000	8,400
Sierra Leone	3 February 1984	2 February 1985	50,200	31,200
Togo	7 May 1984	6 May 1985	19,000	11,000

Source: IMF Survey, 12 November 1984

#### 6.2.4 International Reserves

As total net inflows of financial resources (net transfers and capital flows) failed to finance fully the growing deficits in the balance of payments, most countries in West Africa (except to some extent Nigeria) resorted to fully utilising whatever balances they held on foreign exchange reserves. In some of the worst affected countries, eg Sierra Leone, reserve accumulation is terminated and reserve earnings are planned forward to cover current import requirements. The extent to which growth in imports outpaced that in foreign reserves is demonstrated in Figure 6.1 for the period 1970-83. Total reserves (excluding Nigeria) fell to \$65.3 million by 1983 after rising from \$552.8 million to \$700.4 million in 1970-80 (mainly as a result of higher prices of some primary products).

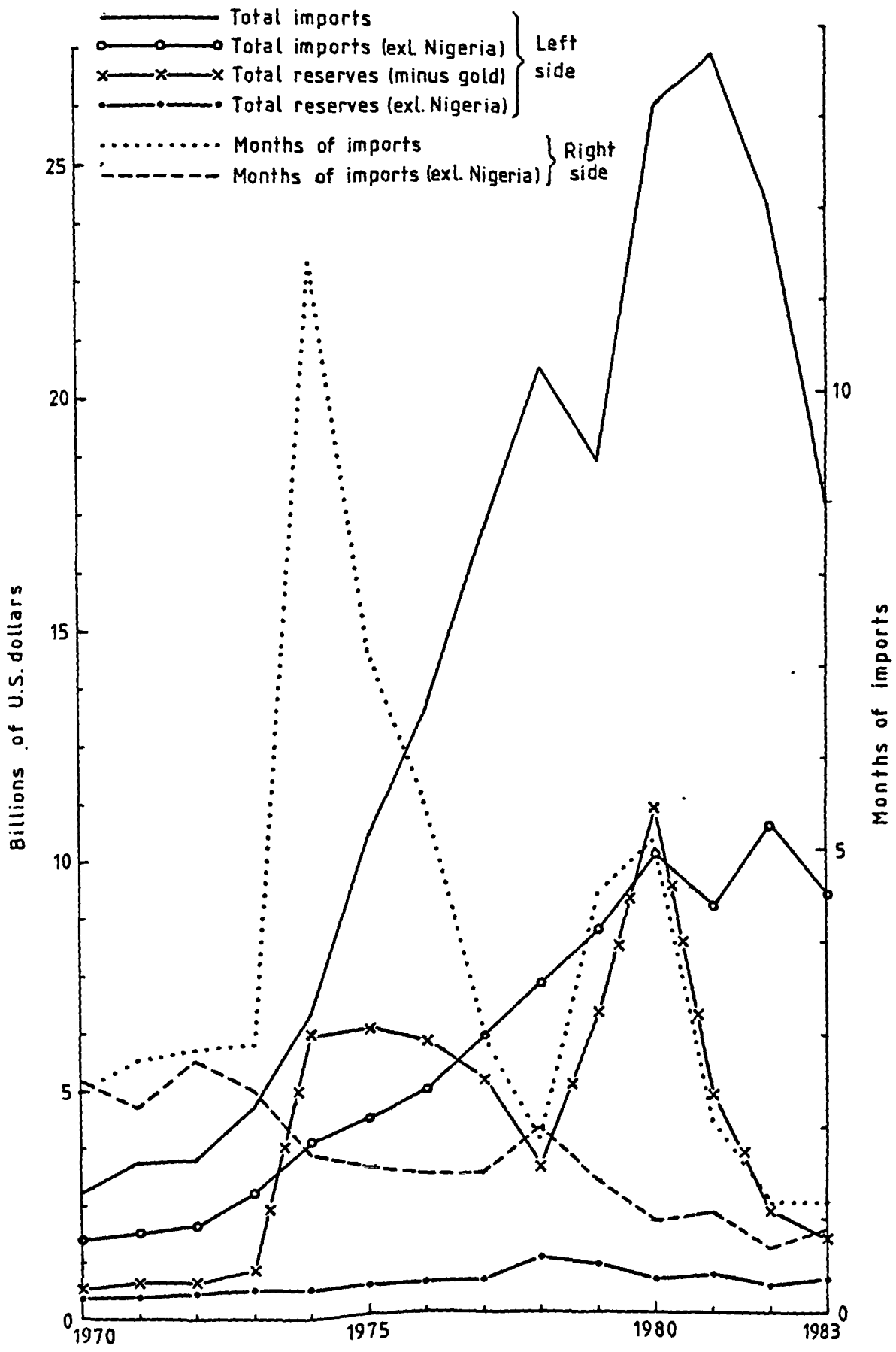


Fig. 6-1. ECOWAS : Total reserves and imports.

Table 6H ECOWAS: International Liquidity

	Total Reserves (million dollars)				Ratio of Foreign Exchange Reserves to Imports			Total Reserves in Months of Import Coverage				Ratio of Total Reserves to External Public Debt Outstanding & Disbursed		
	1970	1975	1980	1983	1970	1975	1980	1983	1970	1975	1980	1983	1970	1983
Benin	15.5	15.0	8.1	3.7	.18	.04	-	-	2.9	0.9	0.1	0.1	.38	.01
Burkina Faso	36.4	76.5	68.2	85.0	.68	.45	.15	.34	8.9	6.1	2.3	4.1	1.73	.21
Gambia	8.1	28.6	5.7	2.9	.39	.40	.03	.03	5.4	5.7	0.4	0.3	-	.01
Ghana	52.3	143.2	196.6	144.8	.13	.17	.17	.20	1.7	2.3	2.2	2.4	.11	.13
Ivory Coast	118.8	102.8	19.7	19.7	.27	.08	.01	.01	3.7	1.1	0.1	0.1	.46	-
Liberia	-	19.2	5.5	20.4	-	.03	.01	.01	-	0.5	0.1	0.1	-	.03
Mali	0.9	4.2	14.5	16.2	.02	.01	.02	.05	0.2	0.3	0.4	0.6	-	.02
Mauritania	3.2	47.7	139.9	105.9	-	.28	.49	.21	0.8	3.5	6.2	2.6	.12	.09
Niger	18.7	50.3	125.9	53.2	.26	.42	.19	.15	3.9	6.0	2.6	1.8	.58	.08
Nigeria	202	5586	10235	990	.16	.87	.59	.28	2.5	11.1	0.8	1.4	.42	.08
Senegal	22.1	31.1	8.1	12.2	.09	.05	.01	.01	1.4	0.6	0.1	0.1	.22	.01
Sierra Leone	39.4	28.4	30.6	16.2	.29	.13	.07	.02	4.1	1.8	0.9	1.4	.67	.05
Togo	35.4	41.2	77.6	172.8	.48	.19	.13	.31	6.5	2.8	1.7	3.7	.89	.21
Total	552.8	6174.2	10935.4	1643.0	.20	.59	.42	.14	2.5	7.5	5.1	1.4	.51	.08

Source: Calculated from IMF, International Financial Statistics

Notes: - Nil, negligible, or not available; also for Cape Verde, Guinea-Bissau and Guinea

Table 6H illustrates that by 1983 gross reserves covered far less than three months of imports in all countries, except Togo. The average for the region dropped from 7.5 to 1.4 months of imports between 1975-83. The average ratio of reserves to imports declined from 0.59 in 1975 to 0.14 in 1983. Similarly, the average ratio of reserves to total external public debt (outstanding and disbursed) dropped from 0.51 to 0.08 in 1970-83. By the end of 1983, reserves were less than 5 per cent of total imports in The Gambia, Ivory Coast, Liberia, Senegal and Sierra Leone.

The implications of these declining reserve trends for West African monetary unification are twofold. First, the extent to which reserve accumulation can be improved in time to support the common exchange rate arrangement. Second, whether reserve movements in West African countries have responded to different forces (eg fixed versus variable exchange rate systems, discrepancies between desired and actual reserves, or monetary disequilibrium situations), in which case monetary unification in the sub-region requires the harmonisation of the divergent reserve-demand functions (see for instance, Edwards, 1984 and 1983; Grubel, 1971). No clear relationship between reserve movements and these forces is postulated but the evidence in West Africa is that the degree of openness and payments variability plays an important role. There are also no well-defined demand functions as domestic credit expansion and illegal commodity and currency practices have also influenced reserve balances in many countries, especially the non-BCEAO. Undoubtedly, a successful reserve pooling process at the regional level would put pressure on Nigeria because of oil reserves

as well as on the existing reserve pooling arrangements of the WAMU member states.

### 6.3 FOREIGN EXCHANGE ADJUSTMENT POLICIES

Attempts to arrest and contain the deteriorating foreign exchange reserve and external payments situation in West Africa have commonly stressed the role of the exchange rate and the adoption of selective quantitative exchange restrictions. Consequently, besides Liberia, other countries in the sub-region have introduced legislations to control foreign exchange transactions in collaboration with import control measures. The prime objectives are to conserve foreign exchange, bring balance in the external payments situation, and direct imports from 'non-essential' import items with a view also to facilitate the industrialisation process.

In countries where these adjustment mechanisms have featured most predominantly, eg Guinea, Ghana, Nigeria and Sierra Leone, emphasis in the implementation of each policy instrument has tended to vary over the years and between countries, depending largely on the relative severity of the foreign exchange and payments problem. In general, however, the intensification of both policies since the 1970s, compared with the previous decade, has been influenced largely by the collapse of the international monetary system whose adverse implications for the LDCs in common have been compounded by the direct and indirect effects of the sharp rise in oil prices and the expansion of domestic money supply and credit. Against the background of the structural disposition of the member economies and circumstances outlined so far in this study, the most challenging problem of foreign exchange and overall economic management in West

Africa is the problem posed by the non-convertible, non-trading and non-intervention structure of the national currencies. Suffice it to say that even for Liberia and the BCEAO member states whose currencies are generally convertible, this is not without cost; the cost emanates from the lack of autonomous exchange rate policy.

After several years of 'experimentation', the main concern for West Africa is twofold: the relative efficiency of these policies in terms of the desired objectives, and the scope for regional harmonisation in order to achieve monetary unification. Indeed, for most countries, this experimentation has operationally been the most unpredictable and has introduced a great deal of uncertainty in the realism of continued pursuance of foreign exchange policies at the national level without intra-regional co-operation - which is sufficiently lacking at the moment. These considerations are thus appreciated by describing and critically analysing each foreign exchange policy.

### **6.3.1 Exchange-Rate Adjustment**

In practice, West African countries have since independence attempted to derive some rationalisation of their inability to sustain an effective independent exchange rate policy through more or less permanent alignment of parities with those of major currencies. In some countries, notably the BCEAO, linked parities have further imposed obligations not to restrict trade and capital movements within a wider monetary area, while in other countries, especially the FSA, variation in linked-parities through independent monetary initiatives has had only marginal or hardly any direct positive influence on their domestic price, production, foreign



exchange and growth levels. In contrast, apart from not being able to ensure compensatory movements of resources into the region, linked parities have, especially because they are generally 'wrong', particularly accentuated currency over-valuation and the transitional and continuing costs of adjustment. With the balance of payments and foreign exchange situation worsening in virtually all countries in the sub-region, the key question is whether the exchange rate systems have been 'right' and 'realistic' or whether variations in parities have been appropriately undertaken.

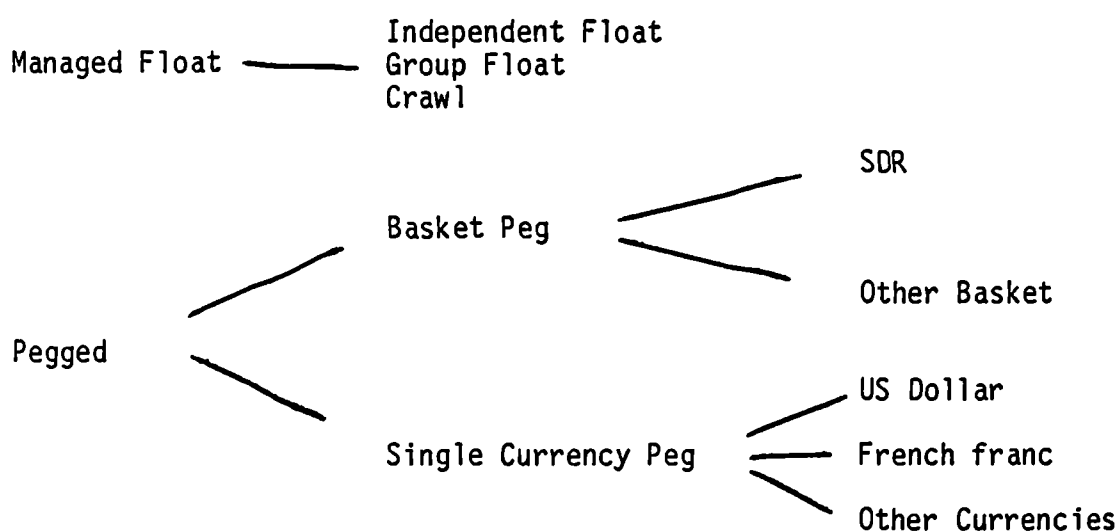
As noted previously, the break-up of colonial monetary structures after political independence did not eliminate the continued dependence of West African states on the 'master' currencies and exchange rate arrangements. Although, like every other member country of the International Monetary Fund, the ECOWAS countries are permitted to choose the exchange rate arrangements of their own choice (see IMF, Article IV, Section 2(6), 1979), the exchange rates which they have adopted over the years have historically been specified essentially as units of master currencies, notably the French franc, the pound sterling, and the US dollar.

A practical implication of such exchange rate dependence is that as the exchange rates of the major currencies change in response to speculative capital flows and other factors, the rates for pegged currencies also follow suit -even though the economic and financial circumstances of the pegging countries may point in a different direction and at a different rate. It follows therefore that for pegging countries, optimal decisions on the exchange rate cannot be made without first, taking a careful view as to the

probable future changes in the value of the major currencies to which they are pegged, and second, appreciating the role of exchange rate change and its relation to overall economic management. Essentially, these problems, as noted by the Group of Thirty (1982), arise not only from the nature of the chosen exchange regime itself, but also from the lags and rigidities in national policy-making as well as in the response of all the manifold markets affected by, and effecting exchange rates, and from the conflicts in national and international interests.

In principle, it is possible for a developing country to adopt exchange rate arrangements under which the impact of fluctuations in the major currencies would generally be minimised. As illustrated in Table 6I, alternative possibilities in this regard include a freely floating exchange rate system, a so-called crawling-peg system, or pegging to a basket of currencies such as the SDR.

**Table 6I Types of Exchange Rate Regimes**



However, since end-1981, this categorisation of exchange rate regimes has been modified by the IMF basically in line with the 'extent and form of the flexibility that the members' arrangements permit'. The new classification which is meant to 'facilitate the implementation of the Fund's surveillance over exchange rate policies' has defined exchange rate arrangements into three broad headings:

- (a) Currencies that are pegged to a single currency or to a composite of currencies (including the SDR);
- (b) Currencies whose exchange rates although not pegged, have displayed limited flexibility compared with either a single currency or a group of currencies; and
- (c) Currencies whose exchange rates are more flexible.

The major dichotomy in this new classification is between 'pegged' and 'more flexibility' arrangements, with the intermediate arrangements characterised by 'flexibility limited' against either a single currency or a group of currencies. In practice, however, the available options for LDCs are still limited, owing to various empirical considerations - including the thinness of foreign exchange markets in most countries and the institutional as well as *skill requirements for the operation of sophisticated exchange-rate systems*.

The weight given to the various factors in the actual choice of an exchange rate regime in LDCs is widely covered in the literature (see for instance, Rodrik, 1984; Connolly, 1982 and 1983; Williamson, 1982; Holden et al, 1979; Lipschitz, 1978; Heller, 1977; Crockett and Nsouli, 1977; Black, 1976; Laffer, 1973; and Mundell,

1973). Generally, the question of the optimal exchange rate system for a small developing country favours the adoption of a fixed exchange rate regime: firstly, because exchange fluctuations will probably be exacerbated if the market for the currency in question is thin; secondly, because the effects of transitory supply shocks - eg crop failures and other seasonal factors - are cushioned by the use of reserves under a fixed exchange rate regime; thirdly, because greater stability of exchange rate will most probably lead to greater levels of trade and what follows from that greater production of export goods, the greater the capital inflows, resulting in greater levels of capital formation.

Also important to the selection of an exchange rate standard and the determination of appropriate adjustments against that standard are the potential benefits and costs involved. Firstly, fixing to a single major currency is from a practical view, perhaps the simplest option. Crockett and Nsouli (1977, p 129) attribute four main advantages to fixing the value of a developing country's currency to that of its major trading partner:

- (a) Compared with other alternatives, this system reduces the fluctuations of the exchange rate between the LDC and the developed country. This enhances trade between the two countries by reducing the uncertainties associated with changes in relative currency values. For the same reason, capital flows for investment purposes from the developed country may increase.
- (b) To the extent that the exchange rate of the developed country is more stable in relation to the rest of the world than that

of the LDC would have been without fixing, trade with and investment from the rest of the world may be stimulated.

- (c) A developing country that chooses to fix its currency to an external standard, such as that of a major country, gives expression to its intention to align its policies broadly with those of the partner country. If the latter policies are regarded as adequate to the promotion of relatively stable prices there might be increased confidence in the currency of the LDC. Consequently, foreign investment may be stimulated. Furthermore, fixing provides a clear criterion for intervention in the foreign exchange market.
- (d) The disciplinary aspects of fixing can sometimes be viewed as an advantage if fixed rate acts as a 'lever' for domestic stability.

There is no doubt that single currency fixing does not have the same consequences in a world of floating major currencies as in that (pre 1970s) with stable parities. Crockett and Nsouli (1977, pp 129-30) have accordingly also distinguished four main disadvantages of the single currency peg system:

- (a) Reserve need may increase and movements in the fixed exchange rate of the LDC will not reflect actual developments in its balance of payments. Rather, they will reflect development in the balance of payments of the industrial country to which the LDC is fixing. Whether or not this will result in greater or lesser need for reserves depends on the nature of the relationship between the equilibrium rates of the two countries.

- (b) Exchange rate fluctuations may interfere with the pursuit of internal objectives since they are exogenous and independent of government policy.
- (c) To the extent that exchange rates between the currencies of developing countries are subject to variation, because of their disparate pegged arrangements, this will be particularly disadvantageous when many of these countries, being small and largely open, are trying to attain some of the advantages of market size by promoting intra-regional trade.
- (d) There is a possibility of a tendency towards higher import prices. Suppliers in the industrial country to whose currency the developing country is pegged, their strong market position, as a result of the diversion of trade patterns in their favour, will increase their ability to claim higher profit margins.

By contrast, the logic behind a basket peg is to attempt to retain the advantages of a single currency peg while minimising the disadvantages associated with it, especially the problems associated with tying a currency too closely to the monetary policy of a single country.

Crockett and Nsouli (op cit, p 131) maintain that changes in the exchange rate are intended to measure the hypothetical uniform change in the exchange rate of a currency against all other currencies that would be equivalent in its impact on the balance of payments of the country concerned to the pattern of exchange rate changes that actually occurred. Ideally this measure of a country's effective exchange rate would take into account a number of factors, but more importantly its trade and payment structure. This in turn

must reflect such factors as the price effects generated by exchange rate changes, the price elasticities for its traded products, the competitive relationships of its exports in foreign markets, the pattern of bilateral and/or intra-regional trade, and the effects of capital flows. In other words, such a measure would involve an index reflecting the country's weighted trade and payment flows from and to its trading partners who comprise the basket.

Three trade related indices have been considered, an export-weighted index, import-weighted index and a bilateral trade index, all of which determine the exchange rate relative to the share of trade held by trading partners. Crockett and Nsouli (op cit, pp 131-32) argue that the import-weighted index provides the closest approximation among the three, although, in essence, they admit that all three indices have major drawbacks in that they do not take into account repercussions on prices, substitution effects, changes in competitive relations in foreign markets, and effects on the service, transfer and capital accounts. These drawbacks increase rather than minimise the costs of peg arrangements. Furthermore, the use of an unfamiliar peg for a small developing country's currency might render it less attractive for foreign investment or where it is too complex, it may pose serious problems of data collection and processing.

As a third option, pegging to the SDR is a simpler solution and provides the following stated advantages:

- (a) It reduces cross-rates variability between LDCs - desirable in stimulating mutual trade between them.

(b) It is practically convenient as it has an established value that is determined and published daily on the basis of exchange rates in major financial markets.

(c) It is based on trade shares of the five major industrial countries.

**Table 6J ECOWAS: Exchange Rates and Exchange Arrangements**

(30 September 1985)

	Currency	Exchange Rate Pegged To	Intervention Currency	Exchange Rate <sup>1</sup>
Benin	CFA franc	French franc	French franc	50.00
Burkina	CFA franc	French franc	French franc	50.00
Cape Verde	Escudo	Basket	US dollar	87.0472
Gambia	Dalasi	Pound sterling	Pound sterling	5.00
Ghana <sup>2</sup>	Cedi	-	US dollar	57.00
Guinea <sup>3</sup>	Syli	SDR	US dollar	24.6853
Guinea-Bissau	Peso	-	US dollar	163.641
Ivory Coast	CFA franc	French franc	French franc	50.00
Liberia	Dollar	US dollar	US dollar	1.00
Mali	CFA franc	French franc	French franc	50.00
Mauritania	Ouguiya	Basket	US dollar	77.13
Niger	CFA franc	French franc	French franc	50.00
Nigeria <sup>3</sup>	Naira	-	US dollar/ sterling	0.9225
Senegal	CFA franc	French franc	French franc	50.00
Sierra Leone <sup>2</sup>	Leone	SDR	US dollar	5.74119
Togo	CFA franc	French franc	French franc	50.00

Notes: 1 Rates as reported to the Fund in terms of currency units per unit listed; rates determined by baskets of currencies are in currency units per US dollar

2 Ghana and Sierra Leone appear to maintain fixed parities to the US dollar.

3 Middle rate in terms of the US dollar as of 6th November 1985



The significant drawback, however, is that the SDR standard does not reflect movements in the effective exchange rate quite as closely as an import-weighted basket. It is argued further that the SDR peg is favoured the smaller the deviations of its basket from the import-weighted basket and, the greater the level of intra-regional trade that will occur.

In practice, the failure nonetheless by most developing countries to institute more flexible, less dependent exchange rate arrangements but to maintain for protracted periods the colonial-currency exchange links and at fixed parities has been explained not only in terms of power and economic interests in these countries and the protectiveness of business units. As noted already, it has also reflected indecisiveness or inadequacies on the part of the LDCs to fully appreciate, in the light of existing socio-economic conditions, the potential of the exchange rate as a policy instrument, the attributes of alternative possibilities, and the scope and limitations for choice and management.

Typically for West African countries, the role of the exchange rate as an instrument of monetary policy has been severely limited, owing to various other empirical considerations including the underdeveloped nature and thinness of the foreign exchange markets whose transactions are largely dominated by central bank operations and with limited forward exchange rate facilities; the inconvertibility of the national currencies; the high degree of dependence of the economies on external trade, and in any case, the inability to influence world demand and pricing of primary export raw material commodities; the relatively weak domestic supply capacity that is excessively reliant on imports; private sector

capital movements that are largely determined by political than the purely economic factors; and the lack of institutional as well as skill requirements for the operation of more sophisticated exchange rates systems.

The historical orientation apart, exchange rate management in some countries (eg Ghana and Sierra Leone) seems largely a 'hit-or-miss' affair. Inevitably, often considerable disagreements persist between the monetary and fiscal authorities, including the government, as to the choice, direction, timing, extent, relevance and probable effects of exchange rate adjustments.

Being non-traded currencies, there are, strictly speaking, no external (extra-regional) demands for and supplies of West African currencies, which impact significantly on currency prices or official exchange rates. The types of markets that exist for them constitute unorganised and largely illegal markets where finance is generated and allocated for unrecorded frontier and transit trade, and in which unconventional and rudimentary money and exchange market transactions are conducted. These activities are even of substantial proportions, especially as the widespread exchange controls and payments restrictions become all-embracing and as official exchange rates diverge very widely from market ('black' or 'parallel' market) rates. Besides, the considerable excess of internal demand for foreign exchange -including demand by government and the financial institutions - over available supplies, limited by balance of payments constraint and the bluntness of exchange controls, have further exaggerated the informal foreign exchange market in which national currencies are traded at large discounts on official rates, allowing the operators to make very huge profits.

In Sierra Leone, for instance, the two-tier exchange rate system was introduced in 1982/83 to align the official and market rates as the latter was rising (in terms of local currency) at over three times the former.

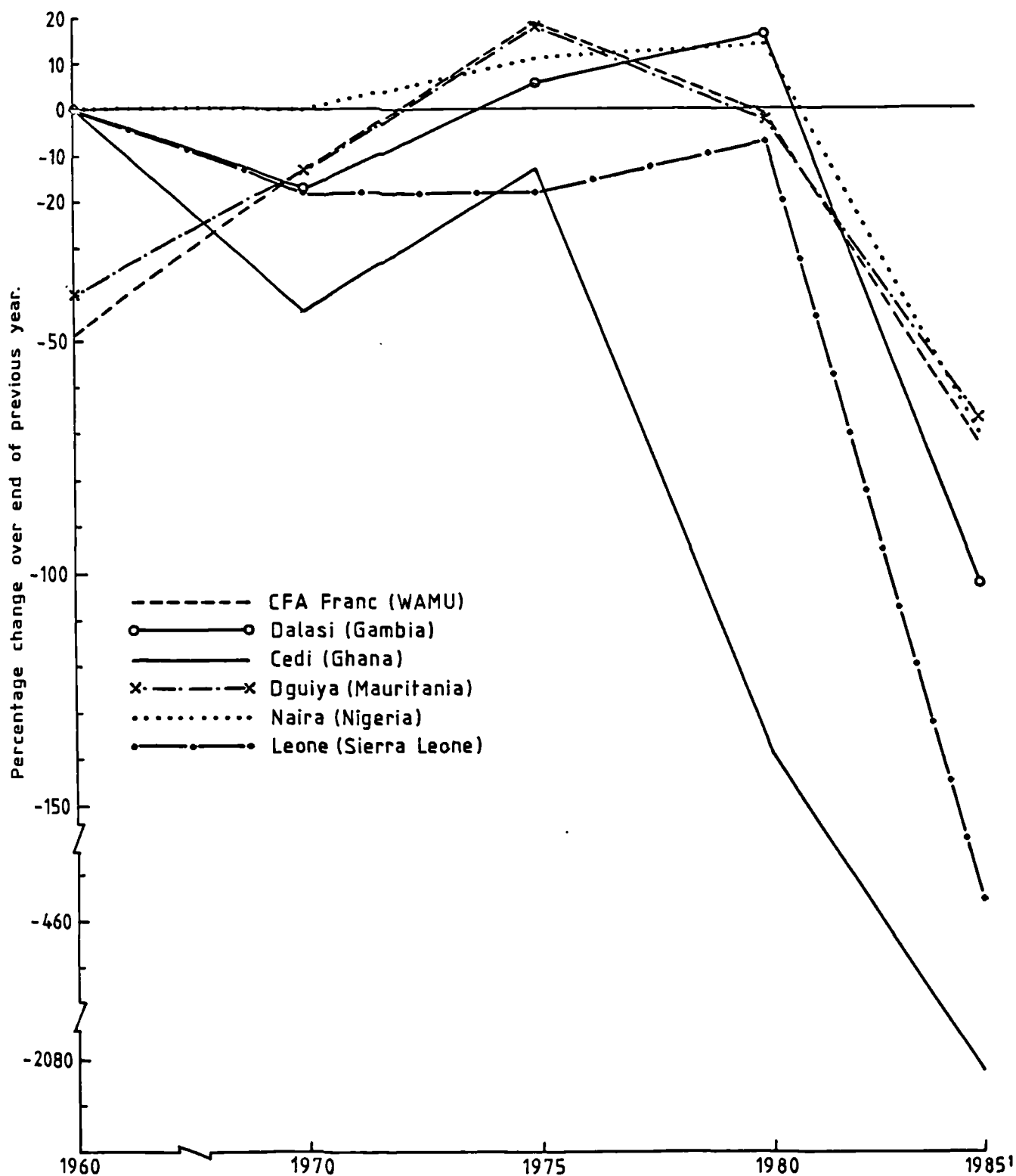
Table 6J shows that as of 30 September 1985, three of West Africa's ten currencies were in practice pegged to single currencies at some fixed parities. The CFA franc is pegged to the French franc at a fixed parity with no commissions and exchange rate margins for transfers among them. The Gambian dalasi is tied to the pound sterling while the US dollar is legal tender in Liberia. Among the remaining currencies, Sierra Leone's leone, the Guinean Syli and Guinea-Bissau's peso are tied to the SDR, whereas two others, the Mauritanian ouguiya and the Cape Verdean escudo, are pegged to weighted baskets representing seven (French and Belgian francs, German marks, Italian lire, sterling, Spanish peseta, and the US dollar) and nine important trading partners respectively. Nigeria maintains margins in respect of exchange transactions and pursues an independent and flexible exchange rate policy with the naira pegged to an import-weighted basket of seven currencies which determines the mid value of the US dollar, the intervention currency. The Ghanaian cedi is not pegged but maintains 'flexibility limited' against the US dollar. Thus, both as trading and intervention currencies, the French franc and the US dollar are the most commonly used in Africa.

Before this period, a number of countries, noticeably Ghana, Nigeria and Sierra Leone, had undertaken a series of administrative changes and adjustments in their par value systems. In the mid-1970s, Ghana and Nigeria switched from sterling to a US dollar peg.

However, on 4 April 1974, the naira/dollar link was severed and Nigeria has since then adopted a policy of 'progressively appreciating the external value of the naira', although it had at times been necessary 'to allow the naira to depreciate against the dollar or sterling in order to reduce the arbitrage margins between naira/dollar and naira/sterling rates' (Falegan, 1978). Ghana's link with the dollar has survived although indirectly, the cedi is said to be 'floating'. In Sierra Leone, on the other hand, the sterling link was replaced in November 1978 by a link to the SDR which was later replaced by a US dollar link (1982). On 17 December 1982 a system of dual exchange rates - official and commercial - was introduced which lasted until July 1983 when the two markets were merged and a new exchange rate was fixed against the dollar. In April 1985 the leone/dollar link was replaced by an SDR link but, as in Ghana, with a relatively fixed parity with the dollar. The rest of the countries have either retained their colonial currency link (BCEAO) or have sustained stable post-independence exchange regimes.

The most significant characteristic of the West African exchange rate systems is the wide margins of discrete or announced variations (mainly downward) in the international values of the national currencies. The magnitudes of the nominal variations for each currency against (a) the SDR, and (b) the US dollar, are shown in Table 6K for the period 1970-83, and are graphically illustrated (against the dollar) in Figure 6.2 for 1960-85.

Of the 10 member currencies, the Ghanaian cedi has been subjected to the most severe and frequent exchange adjustments. Between 1967-1984, the cedi was devalued seven times, once each year in 1972 and 1978, twice in 1983, and three times in 1984.



1. As of 27 November 1985.

2. Rates are middle rates [see line ae/ag (IMF, IFS 1984); West Africa, 2 December 1985, p. 2541.]

3. Rates not available for the Escudo (Cape Verde), Syli (Guinea) and Peso (Guinea-Bissau). However the three currencies depreciated by 11%, 20% and 404% respectively against the U.S. dollar between 1980 and 1985.

Fig. 6-2. ECOWAS : Exchange rate variation vis-a-vis the U.S. dollar.

Table 6K ECOWAS: Currency Fluctuations (Per cent Change over Previous Year)  
(a) Against the SDR

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Average	Standard Deviation
CFA	-6.93	-0.09	-1.49	3.05	-8.94	10.03	-6.03	-3.96	1.51	2.71	-0.07	-16.50	-13.23	-12.28	-3.25	7.71
Cedi	-	-1.10	-38.79	3.03	0.40	-0.96	4.91	-1.13	-41.25	-87.32	-0.75	9.40	6.38	-21.46	-12.97	27.80
Dalasi	-	1.1	-5.29	7.34	-2.32	-6.27	-16.98	-4.63	2.48	6.63	8.12	-3.93	-8.45	-11.72	-2.61	7.58
Leone	-	0.84	-4.30	-12.03	-5.76	-6.28	-16.98	-4.64	2.12	-4.39	0	0	0	-31.25	-6.36	9.22
Dollar	-	-0.30	-8.25	-9.80	-0.88	-0.96	4.92	-1.13	-7.24	-3.19	-0.74	9.40	6.38	3.17	-0.66	5.69
Naira	-	-0.09	0.08	-9.80	3.58	1.18	3.19	-4.03	-5.66	2.07	8.65	-1.74	-2.69	-4.05	-0.72	4.72
Ouguiya	-6.93	-0.09	1.48	3.05	-2.68	4.01	0.68	-2.39	-8.60	-2.62	-0.75	5.01	-1.11	-2.09	-0.47	3.54

(b) Against the US Dollar

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Average	Standard Deviation
CFA	-6.33	0.20	8.48	11.70	-7.99	10.89	-11.51	-2.80	8.15	5.71	0.67	-28.60	-20.94	-15.96	-3.22	12.90
Cedi	0	-0.80	-28.21	11.67	1.28	0	0	0	-31.74	-81.55	0	0	0	-25.42	-22.11	31.10
Dalasi	0.23	1.96	2.32	15.63	-1.42	-5.27	-23.01	-3.48	9.06	10.52	8.80	-14.71	-15.86	-15.40	-2.37	12.0
Escudo	-	-	-	-	-	-	-	-	-	12.81	-10.91	-19.77	-23.01	-16.09	-11.39	14.3
Leone	0.23	1.97	2.30	-2.02	-4.84	-5.28	-23.01	-3.47	8.72	-1.06	1.05	-10.29	-6.94	-35.58	-6.03	11.70
Naira	-	0.21	7.70	0	4.43	2.12	-1.81	-2.81	1.47	5.10	9.35	-12.31	-9.68	-7.46	-0.28	6.52
Ouguiya	-6.33	0.30	8.48	11.70	-1.78	4.92	-4.45	-1.25	-1.27	0.56	-0.01	-4.85	-8.00	-5.44	-0.08	5.60
Peso	-	-	-	-	-	-	-	-	-	14.57	-2.27	-10.35	-8.52	-112.35	-23.78	50.50
Sylli	-	-	-	-	-	-	-	-	-	3.09	0.73	-10.33	-8.50	-11.18	-5.24	6.65

Source: Calculated from rates obtained in the IMF International Financial Statistics  
South Magazine (120), October 1984  
West African Magazine, various issues

- Notes:
- 1 1971-83 for the average standard deviation
  - 2 The minus (-) sign indicates depreciation and position change indicates appreciation of the national currency
  - 3 Rates are based at end of year or on an average annual basis
- Not available  
o No change

Since 1970 when the rate was around 1.02 cedis to \$1, the cedi has, as of October 1985 (when it was devalued further from 57 cedis to \$1 to 60 cedis = \$1) depreciated 5,782.4 per cent against the US dollar. It has depreciated 2,081.8 per cent against the dollar since October 1983 when the rate was 2.75 cedi = \$1. The average annual rate of depreciation of the cedi in 1971-83 was 22 per cent against the dollar and 13 per cent against the SDR.

Another currency with an equally traumatic record of devaluations (many of them discrete) is the leone. Officially, each of the links that succeeded the fixed parity leone/sterling link represented a direct devaluation of the leone: 5 per cent against the sterling in 1978; 100 per cent and 140 per cent against the dollar in 1983 and 1985 respectively. The leone's revealed depreciation against the US dollar since 1970 when the rate was Le 0.83 = \$1 to the current rate of Le 6 = \$1 is 622.9 per cent. Average depreciation in 1970-83 was 6.36 per cent and 6.03 per cent against the SDR and the US dollar respectively.

Other currencies have also shown substantial depreciation in their international exchange values. In particular, the dalasi has indirectly depreciated by around 106.6 per cent against the dollar from a rate of D2.11 = \$1 in 1970 to D4.36 = \$1 in 1984. This depreciation is however a direct result of the official devaluation of the dalasi/sterling rate as well as the dollar/sterling relationship. In a similar fashion, the peso was down by over 154 per cent against the dollar between 1980 and 1984.

Exceptionally, the Nigerian currency was for several years allowed to appreciate against the major currencies despite their devaluations. This was mainly a result of the government's

deliberate insistence upon maintaining the par value of the currency in terms of gold. The dollar value of the Nigerian pound for instance depreciated from \$2.80 to \$3.04 with the dollar devaluation in December 1971, and the value of the naira, upon its introduction (1973), was consequently fixed at \$1.52. On severing the naira/US dollar link in April 1974, the appreciation of the naira against both the dollar and sterling reached a peak of around \$1.84 at the end of 1980. Although no deliberate devaluation policy was pursued by Nigeria, the market value of the naira in terms of the US dollar is observed to have fallen by 27.3 per cent in 1980-83 and 7 per cent in 1983-84. In the period 1970-1984, the naira depreciated by 12.7 per cent in local currency terms or 11.3 per cent in dollar terms, from a dollar value of \$1.40 in 1970 to \$1.24 at the end of 1984.

At the other end of West Africa's exchange rate spectrum are the WAMU countries whose common currency the CFA franc, has remained pegged to the French franc at the fixed rate of  $1 \text{ CFAF} = 0.02 \text{ FF}$  (or  $1 \text{ FF} = 50 \text{ CFAF}$ ) in 1948. The French franc is the only intervention currency and transactions in other currencies are carried out on the Paris market rates between the French franc and these currencies. The CFA franc's international exchange value has therefore moved *pari passu* with that of the French franc and has thus fallen against non-franc currencies only on the occasion of discrete or announced French franc devaluations (eg August 1969, September 1981, June 1982). Thus between 1970-1984, the CFA franc, after appreciating for most of the time in 1970-1980 against the dollar has deteriorated continuously by wider magnitudes in the early 1980s. During the period under review, the CFA franc depreciated by an



annual average of 3.22 per cent and 3.25 per cent against the dollar and SDR respectively.

Developments in the exchange rates of the remaining West African currencies have reflected those of either the SDR or the US dollar (as the common intervention currency). For the region as a whole, the early 1980s are characterised by wider margins of currency depreciation.

Exchange rate variability in the industrial countries is now evidently related to instability in the capital markets, which in turn is seriously influenced by fits and starts of speculative panic in the futures markets (notably oil prices), expectations regarding future spot exchange rates, and interest rate parity relationships. By contrast however, in those West African countries where exchange rate changes have featured more as a deliberate adjustment policy, private capital movements are clearly less responsive to exchange rate variability and interest rate differentials but mainly to such factors as political instability, smuggling and 'black'/'parallel' market activities. Because of the continued shortage of official foreign exchange reserves in relation to the volume of import requirements, and the fragmentation of financial markets, relatively few people and businesses have had access to foreign capital markets. As a result, the size of private capital flows through the banking systems has remained relatively small and, as mentioned earlier, recorded capital movements are in many cases largely dominated by official government-related transactions.

Another revealed phenomenon of the West African monetary and financial system is that some of the relatively low inflation countries (see Table 5D) such as the CFA franc countries have had

their currencies more or less permanently pegged to a depreciating currency in terms of other major currencies - the French franc - particularly in the last few years. On the other hand countries with higher rates of inflation - in particular Ghana, Nigeria and Sierra Leone have had their currencies either directly pegged or very closely linked to the US dollar whose average effective rate against major trading currencies since the mid-1970s has appreciated fairly strongly (between 1979-1980, the dollar appreciated by over 10 per cent against the French franc but depreciated by around 6.1 per cent against sterling). More specifically, a comparison of Tables 5D and 6K (ie average inflation rates and currency variations) reveals that the countries with higher rates of inflation are those which have implemented higher margins of exchange rate adjustment. The heavy toll taken by such contradictory movements on internal price developments, capital movements, and on expansion possibilities, industrial diversification, and the competitiveness of import-competing and export-directed activities is probably incalculable but cannot be ignored in the process of monetary integration.

### **6.3.2 Exchange Controls and Payments Restrictions**

The comprehensive schedule of trade and payments restrictions commonly practised in West Africa constitutes the imposition of controls on all types of payments and receipts-controls on imports and exports, current invisibles, particularly those relating to exchange allowances for travel, education and income remittances by or to non residents, as well as on capital transactions. However, the diversity with which these restrictions are practised in the

region ranges from the application of relatively none in Liberia to the imposition of some of the most stringent regulatory programmes in Ghana, Guinea, Guinea-Bissau, Nigeria and Sierra Leone on virtually all forms of external transactions. In particular, Ghana and Sierra Leone have in more recent years pursued stricter exchange restrictions along with substantial downward exchange rate adjustments.

The member countries of WAMU have some variety in restrictions on their respective exchange transactions with countries outside the union, but in general these restrictions are applied quite liberally. Among themselves and between them and France, Monaco and the other Operations Account countries there is complete freedom of payments for current and most capital transactions. The system of exchange restrictions in the Gambia and Mauritania is also significantly less rigid. West African countries as a whole maintain exchange prohibitions for selected countries (ie South Africa) in accordance with United Nations Resolutions or for some other reason (ie Israel).

A comparative summary of the main payments rules and restrictions adopted in each country is provided in the remaining parts of this section.

#### 6.3.2.1 Imports and Import Payments

The essential features of import controls in the region constitute the imposition of licensing and/or authorisation, certification and attestation requirements on the one hand, and bonuses, surcharges and/or advance import deposits on the other, many of which reflect sectoral commodity or other exchange

priorities. For almost all countries, these priorities are laid down in formal foreign exchange and/or import programmes on the basis of which import licences/authorisations are issued, exchange allocations made, and exchange control approvals granted.

The schedule of controls presented in Table 6L demonstrates that 13 of the 16 member countries adopt some form of import/foreign exchange programming much of which is on an annual basis. Individual programmes in the WAMU countries are based on broad foreign exchange forecasting and planning that takes place within the context of the group's overall monetary planning.

In general, importers are required to obtain general and/or specific import licences prior to placing orders abroad. The system of Open General Licensing (OGL) provides for the unrestricted importation of items which are neither prohibited nor subject to individual or specific licensing (SIL). The issuance of specific import licenses is normally subjected to the formula which allocates licences according to priority lists/categories of import commodities with greater emphasis on 'essentials' such as raw material inputs, spare parts and machinery, public and strategic commodities such as medicines or petroleum products in most countries, certain major food items (rice) and other essential services. The exact composition of the basket of SIL imports differs between countries in relation to commodity and foreign exchange allocation. In principle, these imports are given preference in the allocation of foreign exchange but more often than not, because of the high incidence of politicisation in such allocation, they have formed the major source of price/cost and exchange rate distortions.

Table 6L ECOWAS: Schedule of Import and Export Controls

	Formal Import Plan/ Programme Exists	IMPORT CONTROLS		Import Surcharges/Advance Deposits Imposed	EXPORT CONTROLS	
		Licensing System	Licensing System		Licensing System	Surrender Requirement on Proceeds
Benin	Annual/WAMU programmes	Open	None/Visa	None	Open	Surrender
Burkina Faso	Annual/WAMU programmes	Open/specific/ certification	Stamp/surcharge/ statistical fees	-	Open	Surrender
Cape Verde	-	Open/specific	-	-	Specific	Surrender
Gambia	-	Open/specific	Import tax	-	Open/specific	Surrender
Ghana	Annual programme	Open/specific	Surcharges	-	Specific	Surrender
Guinea	5-year plan, Annual programme	Specific	Surcharges	-	Specific	Surrender
Guinea-Bissau	Monthly foreign exchange programme	Specific	-	-	Specific	Surrender
Ivory Coast	WAMU programme	Open/ attestations	-	-	None/Visa	Surrender
Liberia	None	None	None	-	Selected products	None
Mali	Annual/WAMU programme	Specific/ certification	-	-	Specific	Surrender
Mauritania	Informal programming	Open/import- export cards	-	-	None/import- export cards	Surrender
Niger	Annual/WAMU programmes	Open/ certification	-	-	Specific	Surrender
Nigeria	Annual foreign exchange budget	Specific	Advance import deposits	-	Specific	Surrender
Senegal	Annual/WAMU programmes	Open/ certification	Import tax on non-exempt items	-	Open	Surrender
Sierra Leone	Annual foreign exchange budget/quarterly import programmes	Open/specific	Import entry/licensing fees	-	Open	Surrender
Togo	WAMU programme	Open/specific	-	-	Open	Surrender

Source: IMF, Exchange Arrangements and Restrictions, Annual Report 1984  
West Africa, various issues, 1984/85  
Information from National Central Banks

Notes: - None or information not available

Consequently, some countries have preferred to maintain a larger percentage of their imports on the OGL system but at the same time maintaining the flexibility to be able to resort temporarily to specific licensing for an appropriate range of imports when problems of balance of payments make such action necessary. Among this group are Cape Verde, the Gambia, Ghana, Mali and Sierra Leone. In Guinea, Guinea-Bissau and Nigeria stricter rationing of foreign exchange in import programmes is practised, whereas all imports without exception are permitted under an OGL in Benin, Ivory Coast, Mauritania, Niger and Senegal. In this OGL group of countries payment for approved imports is generally freely available, except that for payments for imports valued above certain limits, a declaration, certification or attestation of intent to import is normally required. In Mauritania, only holders of import-export cards are permitted to engage in import transactions, while no import licence is required in Liberia. Because of the build-up of commercial arrears (or the 'pipeline' in Sierra Leone) in Ghana, Guinea, Guinea-Bissau and Sierra Leone, the automaticity of foreign exchange allocation in relation to import licence quotas has been considerably reduced, thus making it less certain for an import licence holder to be sure of obtaining all or even part of the licence quota.

In Ghana, Nigeria and Sierra Leone, the issuance of import licences, as indeed several other forms of foreign exchange allocation, has been related to the prior presentation of a tax clearance certificate by the importer, showing settlement of all tax liabilities over a given period (the previous three years in Nigeria). Furthermore, Ghana, Ivory Coast and Nigeria (1978-1984)

have variously engaged the services of the Swiss firm, Societe General de Surveillance, SA (SGS) to provide pre-shipment price, quality and quantity inspection on all imports. In all countries, the importation of certain specified goods is prohibited for reasons ranging from politics (South African imports; Israeli imports in Mauritania) to those for social, health, public policy, security and/or infant industry protection requirements. There is no general system of import controls in Liberia but the importance of some items (biscuits, brooms, automobile batteries, insecticides, etc) is subject to licensing and quantitative restrictions to protect local industry. In most countries, imports of essentials such as petroleum, basic food items and other strategic goods and services are controlled by government and private monopolies.

About a third of the ECOWAS countries levy import surcharges, advance import deposits and/or other forms of import fees. In The Gambia all imports, except those by the government, diplomatic missions and charitable organisations, are subject to an import tax of 3.5 per cent of the CIF value unless otherwise specified, while in Guinea too all commodity imports are subject to import surcharges, except those by the 'mixed-economy companies' (ie private export/import firms which commonly pay for their imports with foreign exchange earned from own exports or other own sources rather than with foreign exchange officially allocated to them).

In Nigeria, rates of advance import deposits required for several commodities range from 10 per cent of value for raw materials, 15 per cent for spare parts, 50 per cent for books, food (excluding rice), medicaments, building materials and capital goods, 200 per cent for motor vehicles and trucks, to 250 per cent for

motor cars and all other goods, irrespective of origin. In terms of foreign exchange allocation though, banks in Nigeria are commissioned (as of June 1984) to sanction 58 per cent of their foreign exchange reserves for spare parts or raw materials, 18 per cent for food, and 12 per cent each in respect of firstly commercial inputs including capital equipment and secondly, invisibles including educational and medical expenses (African Business, June 1984, p 15).

Sierra Leone imposes a 12 per cent invoice entry fee (IEF), a 12 per cent special licensing fee (ILF) and a 2.5 per cent tax for the issue of import licences for all imports except for industrial raw materials, while in Senegal, a 20 per cent tax is imposed on 'non exempt' items only. Finally, in Bourkina Fasso, most imports are subject to a customs stamp tax of 6 per cent, an import surcharge of 6 per cent and a statistical duty of 3 per cent. Ghana imposes a 10 per cent tax (Special Development Tax) for imports requiring no foreign exchange from official sources while in Sierra Leone, a 50-100 per cent penalty tax (or forfeiture of goods) is levied on the invoice value of customs arrivals of imports financed outside the domestic banking system without prior authorisation.

#### 6.3.2.2 Exports and Export Proceeds

Like imports, most exports in West Africa are also subject to licensing and/or some form of authorisation systems with the stated objectives of ensuring adequate supplies, domestic needs, assuring that foreign exchange earnings therefrom are surrendered, most preferably through the banking system, re-exports are controlled and, export receipts are received in an appropriate currency. All



West African countries, except Liberia, have prescription of currency requirement, although there are some minor variations as regards the authorised settlement currencies. In general, however, settlements of export receipts are restricted to purely the major convertible international currencies although of course foreign payments can be settled in a wider range of currencies. In Benin, Ivory Coast, Mauritania and Bourkina Fasso, all exports are free of a licensing requirement, although in the first two countries, an export 'visa' is required. Mauritania permits only holders of import-export cards to engage in export transactions. By contrast Cape Verde, Ghana, Guinea, Guinea-Bissau and Nigeria insist upon the licensing of all exports, while in the Gambia and Liberia licensing applies only to a few selected products.

Table 6L further illustrates that the surrender of export proceeds is required in all countries except Liberia where exporters are allowed to dispose of their export earnings freely. In a few countries, notably Niger, Nigeria and Sierra Leone a prior exchange commitment regarding surrender obligations is required from the exporter before export is authorised. In general export proceeds must be collected and surrendered within a maximum of 180 days of shipment. However, in Sierra Leone, export proceeds are generally due not later than 30 days, or 60 days for diamonds, and 10 days for coffee and cocoa, unless permission to do otherwise is obtained. A number of countries, especially Guinea and Sierra Leone, do, perhaps as an export incentive, allow some selected exporting enterprises to retain part of their export receipts overseas in order to meet the cost of some operating requirements so as not to obstruct the continuity of production.

Explicit quantitative restrictions on exports are not a popular feature in most countries, except in Guinea-Bissau where a general export fee of one per cent of export value and other taxes are enforced or in Bourkina Fasso, where most exports are, like imports, also subject to a customs stamp tax of 6 per cent and a statistical duty of 3 per cent. Most countries maintain export prohibitions for selected countries, but generally against South Africa. Guinea has a formal export programme which guides the issuance of export licences. Finally, in most countries, the export of some of the main products is a monopoly of state or other appointed agencies.

#### 6.3.2.3 Invisible Transactions

With the exception of intra-WAMU transactions which are permitted freely, and Liberia which imposes no restrictions at all, payments for and proceeds from invisible transactions are equally subject to some form of prior approval and/or authorisation. Table 6M indicates that more stringent forms of regulation are applied in countries like Ghana, Guinea, Guinea-Bissau, and Nigeria. Payments for invisibles related to trade are permitted by a general authorisation when the basic transaction has been approved or does not require any authorisation (CFA franc states), or as part of the import licence (Guinea), whereas in the more rigid countries, they require specific prior authorisation.

Basic exchange allocations are prescribed in all countries (excepting Liberia) for invisibles affecting travel of different types - medical, tourism, business, educational, etc. Remittances of non-resident profits, dividends, interest and royalty are restricted in Ghana, Guinea, Guinea-Bissau and Nigeria.

Table 6H ECOWAS: Schedule of Controls on Invisibles and Capital Transactions

	Approval/Authorisation Required	Limits on Transfer of Profits, Dividends etc	INVISIBLE PAYMENTS AND RECEIPTS				Import/Export of local currency	Surrender requirement on receipts	CAPITAL TRANSACTIONS				Formal Investment Law Exists
			Limited Allocation	Limited Travel Allocation	Limited Home Remittance Allocation	Restricted			Approval/Authorisation of Capital Outflows	External Borrowing	Foreign Investment Required		
Benin	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment code, 1982	
Burkina Faso	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment code	
Cape Verde	Yes	-	Yes	-	Prohibited	Yes	Yes	Yes	Yes	Yes	Yes	-	
Gambia	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	No	No	No	-	
Ghana	Yes	Yes	Yes	Yes	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment code, 1981	
Guinea	Yes	Yes	Yes	Yes	Prohibited	Yes	Yes	Yes *	Yes	Yes	Yes	Foreign investment law, 1960-80	
Guinea-Bissau	Yes	Yes	Yes	Yes	-	Yes	Yes	Yes	Yes	Yes	Yes	Investment code, 1980	
Ivory Coast	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment incentive code 1966-73	
Liberia	No	No	No	No	Unrestricted	No	No	No	No	No	No	Investment code, 1976	
Mali	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment code, 1979	
Mauritania	Yes	No	Yes	Yes	Prohibited	Yes	Yes	Yes	No	No	Yes	Investment code, 1979	
Niger	Yes	No	Yes	Yes	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment code, 1968	
Nigeria	Yes	Yes	Yes	Yes	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Decreases	
Senegal	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment code	
Sierra Leone	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	No	No	Yes	Ordinance 1960, Development of Industries Act, 1983	
Togo	Yes	No	Yes	No	Restricted	Yes	Yes	Yes	Yes	Yes	Yes	Investment Law	

Source: IMF Exchange Arrangements and Exchange Restrictions, Annual Report 1984  
West Africa, various issues 1984-85  
Information from national sources

Notes: - None or information not available  
\* Prohibited for Nationals

They are allowed relatively freely in other countries although in some cases (Sierra Leone) they are subject to foreign exchange availability and provided that exchange control permission was obtained initially for the investment. Exchange allocations are also maintained for other non-resident income such as wages and salaries, personal insurance, pension and provident fund contributions, etc. In Ghana, for instance, expatriate workers are allowed to remit overseas 40-70 per cent of net salary; 30-40 per cent in Guinea; varying percentages in Guinea-Bissau and Mauritania; 50 per cent in Niger and Nigeria; and 40 per cent in Sierra Leone. There are no limitations in the rest of the countries. Furthermore, the import and export of local currency notes and coin is unrestricted only in Liberia. It is even prohibited in Cape Verde, Guinea and Mauritania. Also in all countries, except Liberia, surrender obligations are stipulated for all invisible earnings.

Purchases of foreign exchange in respect of education, travel and medical treatment abroad and for private onward transfers are subject to a 5 per cent tax in Ghana, while in Sierra Leone, all overseas travel is subject to a travel tax of 10 per cent of the price of the ticket, payable at the time of purchase of the ticket. Special airport charges are also levied (eg Sierra Leone) on travelling passengers.

#### 6.3.2.4 Capital Transactions

Table 6M further shows that with the exception of Liberia, capital transactions in all countries are subject to controls. In most countries explicit restrictions are maintained over inward and outward direct investments, overseas borrowing, the issuing and

offering of foreign securities as well as over the transfer of proceeds accruing therefrom. In principle, capital receipts normally are permitted relatively freely in all countries but in practice all countries, except Gambia and Liberia, institute some form of supervision or controls both for statistical and future amortization reasons. Borrowing from abroad requires prior approval/authorization in all states except the Gambia, Liberia, Mauritania and Sierra Leone. Capital exports are prohibited for Guinean nationals.

In almost all member countries, foreign direct investment is guided by formal legislation and/or decrees which provide various conditions, fiscal and monetary incentives for investment. In Guinea, for example, the foreign investment law (1962) does not only grant preferential tax treatment, but also guarantees against nationalisation of investments in the industrial and mining sectors. Among the WAMU countries, capital transactions are permitted freely.

#### 6.3.2.5 Exchange Restrictions on Intra-ECOWAS Transactions

One significant drawback of the comprehensive set of exchange controls and restrictions practised by the West African countries is the absence of any meaningful prescribed preferential treatment for intra-regional transactions. Only very few member countries grant some form of express preferential treatment to imports originating in all the other member countries. In Mali, intra-Community imports are exempted from individual licensing and require only an import certificate. Imports of Community matches require no prior authorisation in Niger, while in Sierra Leone, the 12 per cent invoice entry and licensing fees charged on all imports are reduced

to 5 per cent in each case for ECOWAS imports. In Senegal, ECOWAS is exempted from a regulation which prohibits the import of certain goods from all countries.

Apart from Mali which as in the case of imports also exempts exports to ECOWAS countries from the usual licensing requirement, the only countries to provide some aspect of preferential treatment on exports to Community members are Guinea-Bissau which has a special regime of restrictions applicable only to exports destined for the Community, and Nigeria where petroleum exports to member countries are allowed an increased 90 days credit as against the 30 days general OPEC credit facility (West Africa, 15 October 1985, p 2100).

With the exception of controls on foreign securities, the WAMU countries are the only group to exempt other West African states from restrictions on other capital transactions - borrowing abroad; foreign direct investments, etc.

#### 6.3.2.6 Scope for Regional Harmonisation

Indeed, this widespread imposition of exchange restrictions by member countries without substantially overt preferences for intra-regional transactions is bound to aggravate the problems related to regional monetary co-operation. Initially one is tempted to presume that the geographically distinct francophone and anglophone countries may stand to gain significantly both from the liberalisation of trade and autonomous capital movements within their areas and from the application of uniform discrimination against extra-West African transactions. In this light, we are confronted with the problem of trying to validate the implicit

presumptions, firstly, that gains from free trade and capital transactions exceed losses through restrictions on them, and secondly, that substantial trade creation and factor movement would materialise within them, being colonial common currency areas.

During the pre-independence era, particularly in the 1950s, nonetheless, free trade and factor mobility within the former sterling area countries (FSA) and the discrimination against the franc zone and other countries failed to produce appreciable growth in mutual trade and in other exchange transactions amongst them (Nana-Sinkam, 1978). This situation, especially as regards commodity trade, has hardly changed even after independence. In fact even in the francophones, with greater freedom of trade and capital mobility within and amongst them, the quantum and growth of mutual trade has remained small. Consequently, for the West African region as whole, reciprocal exports and imports as was reviewed in Chapter 4, have on average stagnated at less than 5 per cent relative to total foreign trade. But for the trade in Nigerian petroleum production, this proportion for some countries (eg Ghana and Nigeria) is much less.

The rationale for instituting exchange restrictions by many countries in the region has been partly historical in origin, especially in the pre-independence era, and political and economic, afterwards, as these countries strove hard to establish greater national autonomy in both political and economic management.

West Africa's first experience of exchange restrictions dates back to the inter-war period when both Britain and France introduced exchange controls as part of emergency war regulations aimed at not only protecting the value of sterling and the French franc but also,

more importantly, as a way of mobilising and controlling the flight of capital from the former colonial territories where both currencies were legal tender. The intention apparently was to finance the war effort.

In the former British colonies, the legislative foundations of these controls were based first, on the Defence (Finance) Regulations issued under the Emergency Powers (Defence) Act of 1939, which led to the formal establishment of the Sterling Area, and later, the Exchange Control Act, 1947, which to a large extent merely 'transmuted the temporary wartime regulations into a permanent feature of the (UK) economy (Miller and Wood, 1979). This Act was then distributed to the former colonies (and to other sterling area countries) in the form of a model Exchange Control Ordinance which, in Sierra Leone, became operative in 1950 and was transformed into an Act four years later and further into the Exchange Control (Amendment) Act, 1965. In Ghana and Nigeria, the Ordinance was modified into the more detailed Exchange Control Act, 1961 and Exchange Control Act, 1962 respectively. As the economies worsened in the light of external circumstances during and after the 1970s, and the need to control and regulate trade and capital flows more directly became an active option of monetary and overall economic management policy instruments, exchange controls became more elaborate, comprehensive and demanding in terms of severity, institutional arrangements and transactions coverage. The corresponding legal backing constituted the enactment of a series of amendments (eg 1972, 1974 and 1975 in Sierra Leone) and of several supporting Orders and Decrees to the legislative provisions of the 1960s.



However in Nigeria, exchange controls were not so rigid throughout the 1970s mainly in reaction to positive shifts in the balance on current payments deriving from the oil price changes. They have, however, become equally extensive and intensified in the last few years chiefly through the continuous fall after 1980 in export sales of oil and the consequential rapid decline in public exchange revenues to support the uncontrollably rising pace of import bills, to the extent that on 9 February 1984, imports under the OGL system were discontinued, thereby leaving in the country only two categories of imports as against three - prohibited imports, and imports subject to licensing requirements (SIL).

For the francophones, their closely co-ordinated exchange controls developed from France's 1939 Executive Orders which created the Franc Area as an exchange control area in the form of the pooling and centralisation of exchange reserves by French Treasury and of the eskewing of these controls amongst the member countries of the Area. These controls were reinforced in 1967-68 after a short spell of interruption to protect the French franc and stop foreign exchange flights in the wake of France's economic problems deriving largely from the events of May 1968. Since then the system of controls has been continuously modified either to discourage the inflow of short term hot money, or to stop or reduce the flight of capital, depending on the financial and economic situation of the national economies. Guinea entered the regime of quantitative exchange restrictions immediately after independence in 1958.

For the WAMU states in particular, developments in exchange restrictions have, despite some minor differences at national level, generally been in line with their conscious efforts at sustaining

the economic and monetary relationship among themselves and with France, Monaco and the rest of the French Franc zone, which in general constitutes the liberalisation of exchange transactions among them and the harmonisation of exchange restrictions vis-a-vis the rest of the world, including the rest of ECOWAS. Despite their varying economic problems and payments situations this principle has remained substantially unimpaired, albeit, purely at the instance of France.

Testing the economic effectiveness of exchange controls, especially on the balance of payments objective of the imposing country is by no means easy and straight forward in the light of the multivariat nature of the balance of payments problem itself. Factors such as trends in the terms of trade, general inflationary tendencies and the rising external debt servicing, the rapid growth in the money supply with its concomitant influence on import growth, the high import propensities and the slow down on export revenues and overall economic growth, domestic economic structures and problems in industrial markets have all combined to whittle down any economic impact exchange controls may have had on overall economic performance. Nevertheless, the years since 1975 have witnessed in some countries (Ghana, Sierra Leone) both a worsening of current account deficit positions and an intensification of exchange controls. Similarly, the capital account too in these countries has shown no predictable improvement in line with the desired exchange control objectives.

In practice, the ensuing administrative bottlenecks and consequential corruption apart, exchange controls are known simply to suppress for some time the fundamental factors underlying the

balance of payments disequilibrium, and for West Africa in particular, they have also tended to aggravate some of the structural distortions entrenched in underdevelopment. These distinctions include production bottlenecks arising from shortage of essential imported inputs and spare parts, increased monopoly and oligopolistic practices, establishment of questionable import-substitution industries, smuggling and illegal commodity and currency activities all of which further distort the true balance of payments position, as well as more pronounced lopsided income distribution patterns as private profit and property incomes rise faster than wages and income mainly because of control inefficiencies and tax evasion.

In Sierra Leone for instance, Dixon-Fyle (1978) has observed that exchange controls are largely nominal, particularly for multinational mining firms, with minimal de facto compliance and enforcement; the foreign multinational firms whose intra- and extra-corporate transactions have been exposed to the exchange risks have been able to 'hedge' through a variety of changes in their financial arrangements (through a cut back on inward capital flows but with expansive borrowing from local banks); and, above all, that both exporting and importing enterprises have learned to live with uncertainty as well as with the new exchange controls and payments measures rather better than either the monetary or fiscal authorities themselves.

Furthermore, the greater dependence on administrative controls on external transactions has produced massive over-valuations of currencies at their official rates, appreciably so in Ghana, Guinea, Guinea-Bissau and Sierra Leone where the demand for foreign exchange

at the officially-set rate by far exceeds the available supply. As exchange restrictions get tighter in these countries, the high incidence of currency and commodity black market activities in circumventing these controls as well as the continuing decline in official exchange reserve balances have further provided wider margins between the black market and official exchange rates at an average ratio of nearly one to three against the latter.

Currency overvaluations can be regarded both as a cause and consequence of severe distortions in domestic prices. The effects of strongly overvalued exchange rates tend artificially to lead to various forms of multiple currency practices or to administrative rationing of foreign exchange or, as usual, to both. The real costs of the overvaluation of currencies and its tendency to drive currency and other exchange transactions outside official markets equally pose serious implications for West Africa's trading relations.

Another important factor undermining the effectiveness of exchange restrictions in West Africa has been the inadequacy of border policing, which in part is made extremely more difficult by the very close traditional cultural links between the same or related communities settling on both sides of national frontiers. Consequently, it does not require great ingenuity on the part of financiers or businessmen to devise means whereby, in effect goods and capital would move relatively freely between the high restrictions countries and those with more liberalised exchange transactions and generally at the expense of the former. There is a high level of noticeable illegal movements of agricultural and mineral export commodities, re-export of manufactured imports and

the lucrative unofficial currency exchange markets along border areas between Sierra Leone, Guinea and Liberia, for instance.

Against this background, there are therefore several satisfactory economic and political bases on which more substance and cohesiveness can be restored to the West African region simply by asking for the complete liberalisation of all exchange transactions. National currencies, we have already noted, exhibit various dimensions of illiquidity, lack of convertibility, market strength and acceptability as the CFA franc with 'limited' convertibility and the generally convertible Liberian dollar co-exist uneasily with eight other largely inconvertible currencies. Official capital movements are practically insensitive to national exchange rate and interest rate changes. At the moment, however, national interests appear to lie in preserving the 'traditional' but acquired character of exchange restrictions whose complete abandonment, many countries fear, may leave their economies more deeply vulnerable to the already active market speculators, thereby making them even weaker in terms of deeper balance of payments problems. At the same time, the continued operation of autonomous exchange restrictions in the region without regional preference is an obstacle to the standardisation of exchange rates and other monetary arrangements, and encourages the operation of parallel exchange markets which only exaggerate the balance of payments and foreign exchange difficulties.

#### 6.4 CONCLUSIONS

In the foregoing, we have tried to identify the nature of the balance of payments deficits in West Africa and the extent to which

the member countries have differed in realising these deficits as well as in the use of the exchange rate and exchange controls and payments restrictions as instruments of adjustment. The general pattern is one in which for virtually all West African countries, current account deficits, in particular, have widened and become more persistent as internal and external revenues are increasingly outmatched by import volumes, budgetary expenditures and debt-service obligations. Consequently, the overall balance of payments position in the majority of countries has become increasingly acute and desperate. For most countries, other than Liberia and the BCEAO, the mechanisms of adjustment have featured a combination of official changes in exchange rate regimes (pegging arrangements) and parities (exchange rate adjustment), and the imposition of stricter exchange controls and payments restrictions on all forms of payments and receipts.

Under conditions actually prevailing in the region, the expected positive real effects of either single or basket pegs, and of exchange rate alteration or payments restrictions cannot be fully ascertained in each practising country. Firstly, in the case of the BCEAO countries, an important part of imports is not sensitive to exchange rate movements in the short-run since France is the first supplier. Secondly, devaluation has tended to exert a depressive (or deflationary) impact on the overall level of economic growth (J-curve) together with rising inflationary tendencies. With long gestation periods for export projects and limited scope for the effectiveness of orthodox instruments of monetary and financial policy, the J-curve phenomenon is too easily apt to transform itself into a U-shaped curve - ie a devaluation action leading to a

deterioration of the financial situation and movement to a new position hardly better than the old (Mogae, 1978).

The conventional view to the avoidance of the U-curve lies in supplementing currency devaluation with appropriate and adequate adjustment in the areas of monetary, credit and fiscal policies. As would be clear from our discussion of the various features of the West African economies, the main elements of a supporting package for exchange rate adjustment would therefore include the mobilisation of higher revenues, moderation in the growth of budgetary expenditure, measures to restrain the expansion of domestic money and credit, and measures to ensure economically viable pricing of public sector goods and services. Ideally, these measures should not be seen as mutually exclusive, but inter-dependent, and with a considerable scope for some trade-off options.

Thirdly, in the light of empirical evidence and the prevailing experience, the efficiency of exchange controls and payments restrictions, as is further evaluated in terms of:

- (a) the ratios of net foreign assets to monetary assets;
- (b) net foreign assets to imports; and
- (c) growth rate of net foreign assets, is equally doubtful.

While the ratio of net foreign assets to total monetary assets (ie net foreign assets plus domestic credit) signifies the extent to which the issuing currency is covered by foreign assets, in other words the strength of the local currency, the ratio of net foreign assets to imports signifies the extent of solvency in connection with imports (see Table 6H for other ratios). In general the higher the ratios the better as exchange restrictions are instituted to ensure maintenance of foreign exchange reserves. Similarly, in

general, the faster the net foreign assets are growing the better the economies are doing. As shown in Table 6N, the ratios have worsened even more in countries with stricter controls, except to a lesser extent in Nigeria due largely to oil reserves.

Monetary unification in West Africa stresses the critical importance of the type of exchange rate policy and payments restrictions practised by each country. Under present circumstances, the implications for monetary unification are that, especially for most of the non-CFA franc countries, a much clearer appreciation is required of the nature and extent of the balance of payments problem and of the corresponding adjustment programmes. The immediate conclusion is that the dismantling of exchange restrictions for instance will be a much greater problem for most of the non-CFA franc countries in that these practices are now very delicately entrenched within their economic systems. In addition, the extent of exchange rate adjustment that will be required of them is much greater.

To build solid and formidable economic foundations for monetary unification in West Africa requires therefore a more rapid improvement in the balance of payments and international reserve positions in the individual countries. This prerequisite in turn must reflect the adoption of adjustment programmes comprising improved budgetary operations; a more efficient management of the external public debt; more careful and objective appraisal of reserve sources and use in order to restore, at least, some of the comfortable levels attained during the colonial and immediate post-independence years; and a more practical rationalisation of the



exchange rate, exchange controls and payments restrictions as policy instruments.

Monetary unification in West Africa, against the experience of the member countries since the early 1970s, is easily justified by much more comprehensive needs than merely stressing the foregoing expansion of reciprocal trade. From the foregoing analysis, these arise in the following areas:

- (a) diseconomies associated with small, open economies having structurally weak, dependent monetary systems and infeasible currency areas;
- (b) adjustment and liquidity problems posed by the structure and performance in external trade, payments and monetary relations;
- (c) low rate of development that can equally be explained by inefficient mobilisation of domestic resources;
- (d) the lack of progress in intra-regional monetary and economic relationships.

The more definitive monetary unification is towards a West African common currency arrangement, the more realistic it is for solving these constraints.

Table 6N ECOWAS: Net Financial Assets, Monetary Assets and Imports

	Net Financial Assets <sup>1</sup>					Net Financial Assets Imports (CIF) <sup>5</sup>					Net Financial Assets (Annual Average)	
	1970	1975	1980	1983	1983	1970	1975	1980	1983	1983	1970-80	1980-83
Benin <sup>4</sup>	0.36	-0.15	-0.04	-0.05	0.23	0.13	-0.02	-0.02	-0.02	3.79	1.89	
Burkina Faso	0.84	0.49	0.06	0.17	0.70	0.49	0.04	0.02	0.02	9.34	6.08	
Cape Verde	-	-	-	-	-	-	-	-	-	-	-	
Gambia	0.67	0.58	-0.37	-0.95	0.44	0.57	-0.18	-0.59	-0.27	20.35	-108.84	
Ghana	-0.03	0.08	0.02	-0.22	-0.05	0.16	0.06	-0.27	-	126.64	-1461.00	
Guinea	-	-	-	-	-	-	-	-	-	-	-	
Guinea-Bissau	-	-	-	-	-	-	-	-	-	-	-	
Ivory Coast	0.37	0.01	-0.33	-0.85	0.42	0.01	-0.33	-0.77	-	-1.20	-393.15	
Liberia <sup>5</sup>	-	0.06	-0.94	-1.22	-	0.02	-0.26	-0.11	-	-19.23	-199.15	
Mali	-0.83	-1.15	-0.75	-0.80	-1.59	-1.19	-0.63	-0.66	-	-73.61	-143.47	
Mauritania	-0.02	0.00	-0.15	-0.57	-0.01	0.00	-0.12	-0.53	-	-439.64	-3791.00	
Niger	0.35	0.39	0.10	-0.17	0.28	0.50	0.07	-0.12	-	13.38	-3.81	
Nigeria	0.12	0.70	0.34	0.03	0.20	0.99	0.62	0.13	-	2261.18	2507.00	
Senegal	0.12	-0.10	-0.42	-0.71	0.10	-0.08	-0.39	-0.48	-	-19.46	-148.00	
Sierra Leone	0.55	0.12	-0.41	-2.22	0.28	0.08	-0.28	-1.88	-	1.31	-324.53	
Togo	0.75	0.18	0.06	0.41	0.61	0.16	0.04	0.22	-	9.79	34.00	

Source: Calculated from IMF, International Financial Statistics

- Notes: 1 Line 31n  
 2 Lines 31n and 32  
 3 Line 71  
 4 1982; 1980-82  
 5 1974-80

## CHAPTER 7

### MONETARY INTEGRATION: CONCEPTS AND MODALITIES

#### 7.1 INTRODUCTION

The main task of this research, it will be recalled, is to appreciate as fully as possible the need for and the process of achieving a monetary union in West Africa against the hypotheses: firstly, that *monetary union* despite its being a difficult objective is necessary for progress towards economic and political integration; and secondly, that against the background of sombre internal and external economic environment, worsening economic and political structures and threatening economic divergencies between the member countries, as reviewed in the previous chapters, monetary union becomes a delicate but very pressing option for improving and achieving the objectives of ECOWAS. Specifically, the study is undertaken on the premise that the absence of a common regional monetary policy together with the rapid depreciation of the member currencies and the violent, uncontrollable, and massive fluctuations in their external exchange values constitute a major brake on national development and on the achievement of the integration objectives of ECOWAS.

Both in theory and in practice, the transition towards a monetary union in particular, and to monetary integration in general has been widely debated. As a result several alternative routes towards monetary integration, especially in relation to European monetary integration, have been proposed, compared and critically evaluated. This chapter is intended to survey the conceptual,

theoretical as well as empirical aspects of monetary integration, including its relationship to economic integration.

It is divided into five main sections. Section 7.2 deals with the conceptual definition of monetary integration and its relationship with the concept of economic integration. Two broad concepts of monetary integration are examined: partial monetary integration and complete monetary integration. Section 7.3 considers the alternative steps for achieving partial monetary integration, while Section 7.4 is devoted to the alternative routes by which complete monetary integration might be achieved. The last section is devoted to the conclusions.

## **7.2 CONCEPTS OF MONETARY INTEGRATION**

The concept 'monetary integration' has been generally approached in the literature to comprise two broad categories of integration schemes: first, the co-ordination among the participating countries in the use of trade and payments practices, maintaining the stability or rigidity of exchange rates and the application of monetary and fiscal policies; and second, the eventual creation of an area in which there is complete harmonisation in all aspects of monetary and fiscal policies and national currencies are replaced by a uniform money for the entire area.

These broad stages of monetary integration have been discussed in the literature under different nomenclatures, but the definitional aspects of each transition component are relatively the same. Kafka (1969) for instance, distinguishes between 'limited monetary integration', which may comprise no more than a common international reserve or mutual credit arrangements or other kinds

of arrangements conceivable without pegging the exchange rates of the participating countries to each other, and 'complete monetary integration'. The IMF (1980) distinguishes between 'limited convertibility' and 'full convertibility'. The process of monetary integration in this respect is viewed as the movement from a system where each country or subset of countries within a region has its own separate currency and exchange arrangement, with differing degrees of convertibility, but there is unrestricted intra-regional exchange and use of national currencies to the system where all countries share a common currency, and consequently, a unified exchange arrangement. Lamfalussy (1976) has defined monetary integration to embrace virtually any kind of fiscal or factor market integration.

The distinguishing nomenclature that is followed in this study is that between 'complete (full) monetary integration' and 'partial monetary integration'. Full monetary integration is generally defined to entail either the direct creation of a common currency for the integrating countries, the management of which has to be undertaken by a supra-national monetary authority (Williamson, 1980), or indirectly, through an exchange rate union within which exchange rates must bear a permanently fixed relationship to each other, combined with the establishment of a unified capital market with a permanent liberalisation of all current and capital transactions (Corden, 1972).

Corden thus distinguishes between two essential components of monetary integration:

- (a) an exchange rate union, which requires that exchange rates in the area bear a permanently fixed relationship to each other; and
- (b) convertibility (or capital market integration), in the sense of a permanent absence of exchange controls in respect of both current and capital transactions within the area.

Conceptually, Corden has also drawn a distinction between a 'pseudo' exchange rate union and a 'complete' exchange rate union. He describes the former as an arrangement whereby the various member countries still retain their national monetary authorities and foreign exchange reserves and, therefore still determine their own monetary policies. By contrast, in a complete exchange rate union, foreign exchange reserves are pooled and there is a central monetary authority.

From the various conceptualisations of 'partial' monetary integration, Williamson (1980) has carefully identified seven broad forms. First, a payments union whereby multilateral clearing and/or credit arrangements are established for the main purpose of improving upon currency inconvertibility. The first version of the Keynes Plan for an International Clearing Union and the celebrated European Payments Union of 1950-80 provide the major historic examples of this form of partial monetary integration. A second form constitutes the partial or complete pooling of international reserves by the member countries. Robert Triffin (1958) is leading advocate of reserve pooling. Two other forms include capital market integration and the adoption of common policies towards external capital flows both of which are intended to increase the

liberalisation of capital movements within the integrated area. The remaining three forms of partial monetary integration - exchange rate co-ordination, monetary co-ordination and parallel currency - have all featured very prominently in plans for European monetary integration which have culminated in the establishment of the 'Snake' in 1972 and the European Monetary System (EMS) in 1978.

Several of the proposals for partial monetary integration have been advanced in the hope that they would enhance not only the transition towards full monetary union but, also that they would help in moving to economic and monetary integration. Significantly the establishment of complex monetary integration is thus considered an essential condition for attaining full economic integration of the participating countries. While the characteristic features of the forms of monetary integration, many of which overlap within the wider conceptual definitions of monetary integration, will be discussed in some detail in the next section, it may be useful at this stage to examine briefly the conceptual relationship between monetary integration and economic integration as is discussed in the literature.

The process of economic integration as was observed in Chapter 3 involves in general the abolition of national barriers to economic and financial transactions between the integrating states with a view to achieving a greater mobility of goods, capital, and labour between them. The resulting benefits are expected to stem from improved resource allocation as well as from the exploitation of economies of scale involved in the production and consumption processes at both the national and regional levels.

In the words of Fritz Machlup (1977, p 18), 'complete economic integration implies the actual utilisation of all potential opportunities for the efficient division of labour'. Factors and goods move freely within the integrated area and ultimately, they should enter production and consumption at the levels where their marginal product and/or marginal utility per unit marginal cost are equal to their respective prices and maintain that ratio in time. In this optimal setting of interdependence and interrelatedness between all economic activities, economic efficiency is maximised and the welfare of all is enhanced.

As economic integration encompasses the three traditionally distinct areas in which economies can interact - goods and services, factors of production, and the means of payment - it is required that the liberation of factors of production and of all goods and services must be a necessary condition for its realisation. These flows and the integration of their markets do generate symmetrical monetary flows, and are bound up with integration of currency and capital markets. This in turn brings about a high degree of integration of the real markets. Thus, the essence of monetary integration in the process of economic integration is seen in the establishment of arrangements that facilitate external payments and the most thorough way of doing this is to 'replace separate national currencies by a common currency' (Machlup, 1977).

In this perspective, Machlup argues,  
'trade calls for payments, .... capital movements call for the exchangeability of different currencies and ... migrations .... call for chances to take possessions along and to remit earnings. Hence an international



payments system that allows payments and foreign exchange transactions without restrictions or controls - in short, monetary integration - is an integral part of complete economic integration'. (p 20)

From these interpretations, monetary integration is subsumed in economic integration. However, the conventional theory of economic integration treats integration as comprising two related bodies of theory, namely, a stage theory of economic integration and a roughly parallel theory of monetary integration. For instance, Machlup's discussion of the relationship between the two treats monetary integration as a means of the end of economic integration. Monetary integration appears in the formation of a theory of integration among developed market economies. This situation is different within the context of formulating an integration theory among the developing countries. In both groups of countries, nonetheless, the significant observation is that monetary integration tends to arise at some definite stage of economic integration. This is not surprising for the developing countries whose integration formulations are merely the mirror image of conventional, hence West European strategies.

Integration therefore becomes a problem of strategy: should monetary integration precede or follow upon economic integration? This issue is further complicated by the failure of integration treaties to make explicit reference to or provision for monetary integration within the economic integration process. In the CMEA grouping, monetary integration (defined in terms of simultaneous existence of a collective currency - transfer rouble - a system of

multilateral and bilateral settlements in trade and other specified operations in this currency, and a system of short and long-term credit arranged respectively by the International Bank for Economic Co-operation - IBEC, and the International Investment Bank - IIB, without limiting the sovereignty of the member countries in the pursuit of independent monetary policies) is within the provisions of the Comprehensive Programme of socialist economic integration adopted in 1971 and which determines the character, prospect and lines of development of the member countries' monetary and financial systems (see Babashkin et al, 1977).

It is within the institutional framework of the European Economic Community that more clearly documented competing explanations of both the processes of economic and monetary integration and the relationship between the two concepts can be identified. The Treaty of Rome makes no explicit mention of monetary integration but does incorporate elements relating to currency convertibility and policy co-ordination among the Community states (see for example, Articles 3, 6, 67, 70, 103, 105, 106, 108 and 109).

The theoretical foundation of monetary integration is based largely on the stage theory of economic integration. Machlup's discussion of monetary integration, cited above, treats it as a means to the end of economic integration. Significantly, the wealth of plans that have emerged out of the EEC's efforts towards monetary integration have reflected two major divergent views regarding the strategy and timing, and therefore on the apparent positional relationship between monetary integration and economic integration. One view - 'monetarists' - is that positive steps towards monetary

integration (ie a pseudo-exchange-rate union) as a first step would develop tensions that would then lead to economic integration - and hence to a complete exchange rate union (the tensions being the pressures from surplus countries on deficit countries). The other view - 'economists' - is that economic integration should come first; the exchange rate union could then follow without tensions, and surplus countries would not find themselves involuntarily financing deficit countries. Corden (1972, p 7) takes the view that since economic integration is a much bigger step than establishing a pseudo-exchange rate union, and since the establishment of the latter will set up tensions to move to the former, the chances of both being eventually attained are greater if the pseudo-union comes first.

There may still be divergent views on this question, especially in relation to the attainment of full European economic and monetary union. However, in accordance with Machlup, monetary integration implies the removal of all monetary obstacles to the 'full exploitation of all the potential benefits of specialisation within an area' (economic integration). In this respect, monetary integration, especially for the LDCs, whose economies are still characterised by the lower stages of economic integration, becomes a catalyst for development and for improving upon their economic integration process. Contrasting opinions are hard to find in so far as the recommended opinion of 'limited monetary integration' for this group of countries is concerned, except that the principal objective in this study is to attempt to assess the common currency approach as a means of improving the ECOWAS economic integration.

Initially, however, clarity in the transition processes for either monetary or economic integration is important not only because of the transitional impact on major economic indicators - eg unemployment, inflation, production and consumption levels - or of the costs associated with each stage of the integration process. It is also because where the various steps are not clearly identified and decided in advance, the implementation of successive stages and the whole integration process can be impaired. In the final analysis the process of economic integration would be reflected in the developing of substantial improvement and complementarity in all aspects of economic activity, especially the production and consumption profiles of the participating countries and a consequent increase in intra-regional transactions. To underpin the smooth working of monetary integration, this process should also involve a narrowing of the differentials in various financial and overall economic imbalances between member countries.

For LDCs, economic and monetary integration, though distinctive concepts, are necessarily part of the same process of economic development. Optimal relationships between the different dimensions of the two may be less clear-cut but can be quite discernible. At the same time, monetary integration must be adjudged practicable and thus justified only where it unambiguously underwrites the integration of trade, product and factor markets and expand the monetary and fiscal domains. This is because the basic monetary requirement of an effective customs union or an economic community is the achievement of current intra-regional convertibility in the absence of exchange restrictions. This enhances intra-regional liberalisation of trade flows, capital and labour movements.

To the extent that exchange rate stability is achieved through the process of monetary integration, the major implications for the process of economic integration are routed from the general effects of fixed or floating rates within the grouping. If the evidently important monetary obstacles to economic integration are to be eliminated or minimised from an exchange rate management point of view, exchange rate realignments and control on monetary expansion will minimise exchange transactions costs arising out of violent currency fluctuations and accentuate monetary policy harmonisation. All of these elements have serious implications for economic integration through the grouping's price relationships. These implications are of course evidently far-reaching in groupings among developing countries because of the high degree of inconvertibility that is apparent in many of their national currencies.

While it is agreed that the attainment of monetary integration would be much easier if there were sufficient economic integration and similarity among the national economies to justify a uniform, union-wide monetary policy, it is also certain that achieved economic integration could also be threatened by the failure to make progress in monetary integration since it is essentially through this that the monetary and financial obstacles to regional trade and production can be minimised or eliminated. At the highest level, the full realisation of the aims of a common market, namely complete freedom of goods, services and factors of production, is substantially enhanced by the fixity of exchange rates between member states and the replacement of national currencies by a common currency at a later stage. When exchange rates are not fixed, the possibility of changes in the values of national currencies vis-a-

vis each other always exists and can result in substantial economic and socio-political costs for most member states, especially the weak ones. Such a situation can be worsened by the existence of a high degree of divergencies in the convertibility levels of the member currencies.

Clearly, the consequent uncertainty has adverse effects on trade and impedes the free movement of goods, services and factors of production between member states. Even so, exchange rate fixity cannot be maintained unless the trend in nominal prices and productivity follows the same pattern in all participating states. Thus, economic policy integration within a monetary and economic grouping is crucial because it can secure similar patterns in the trend of nominal prices and other monetary indices while at the same time it tends to reduce the margin of differences in general growth and productivity trends.

### **7.3 MODALITIES OF PARTIAL MONETARY INTEGRATION**

Two types of partial monetary integration arrangements are reviewed, namely, clearing and credit mechanisms, and exchange rate co-ordination.

#### **7.3.1 Multilateral Clearing and Credit Arrangements**

The major historical example of a clearing and credit payments arrangements institution as noted previously was the European Payments Union (EPU), established in 1950 in a post-war European environment that was characterised by a high degree of bilateralism and by trade barriers against the rest of the world (the dollar

area) and within Europe itself. Once assurances were obtained on issues regarding:

- (a) its co-existence with the IMF
- (b) its designed transformation into a 'self-sufficient high-cost soft-currency area' with permanent discriminatory institutions against the 'dollar area'
- (c) British initial opposition to the idea, and
- (d) the 'vexing problem' of the special position of sterling, (Hirscham, 1951), the EPU survived until its replacement in 1958 by the European Monetary Agreement.

While it existed, the EPU, supported largely by Robert Triffin, one of its principal architects as a means of preserving the convertibility of European currencies (Triffin, 1958, 1980), had as a major objective, liberalisation of intra-European trade and payments transactions through the institution of 'off-setting' and 'settlement' mechanisms. Through these arrangements, all intra-European trade was balanced multilaterally and automatic credit was made available by surplus partners to cover a part of the net imbalances in mutual trade. Another significant feature of the Payments Union was the institution of a special contributory 'dollar' fund to finance its capital operations.

There is hardly any quantitative evidence on the EPU's success in terms of its contribution towards improving intra-European trade. It is believed however that during its existence, the EPU contributed to the restoration of the free convertibility of European currencies; it provided a useful forum for international consultation and co-operation among the member countries; and in the

event, it served as a forum for the establishment of trust and a sense of community after years of nationalist policies and war-time hatred even among European countries (Grubel, 1981).

Since the EPU, experiments on clearing and credit arrangements have featured mostly among the developing countries, in accord with the consensus that these mechanisms provide the only practicable and desirable means of monetary integration between them. Accordingly, about nine clearing arrangements (4 in Africa, 3 in Latin America and the Caribbean and 2 in Asia) covering a total of more than 70 countries, and five credit arrangements (3 in Latin America and 2 in Asia) comprising 47 countries, have so far been established among LDCs over the last two decades (see Table 7A)

With the search for some theoretical evidence on their operational framework probably going as far back as Keynes' plan for an International Clearing Union in the mid-1940s, the most common explicit objectives of clearing and credit mechanisms are to facilitate the settlement of overall reciprocal foreign exchange positions among the participating countries, to reduce the cost of monetary transfers eligible for clearing, and to minimise the use of official foreign exchange reserves for the settlement of intra-regional balances. The West African Clearing House for instance acknowledges these broad goals and states them in Article II, section 2 of its Agreement as:

- (a) to promote the use of the currencies of the members of Clearing House for sub-regional trade and other transactions;
- (b) to bring about economies in the use of foreign reserves of the members of the Clearing House;



**Table 7A Multilateral Clearing and Credit Arrangements Among Developing Countries**

**A Clearing Arrangements**

**(a) Latin America and the Caribbean**

- 1 Central American Clearing House (5), 1961  
Cost Rica, El Salvador, Guatemala, Honduras and Nicaragua
- 2 Latin American Integration Association (LAIA)<sup>(a)</sup> Payments and Reciprocal Credits System (12), 1965  
Argentina, Bolivia, Brazil, Colombia, Chile, Dominican Republic, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela
- 3 CARICOM Multilateral Clearing Facility (6), 1977  
Barbados, Belize, East Caribbean Currency Authority, Guyana, Jamaica and Trinidad and Tobago

**(b) Africa**

- 1 West Africa Clearing House (16), 1975  
Benin, Burkina, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo
- 2 Grand Lakes Economic Community's Monetary Arrangement (3), 1978  
Burundi, Rwanda, Zaire
- 3 Central African Clearing House (5), 1979  
Central African Republic, Congo, Gabon, United Republic of Cameroon and Zaire
- 4 Eastern and Southern Africa Clearing House (18)<sup>(b)</sup>, 1981  
Angola, Botswana, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Seychelles, Somalia, Swaziland, Tanzania, Uganda, Zambia

**(c) Asia**

- 1 Regional Co-operation for Development (RCD) - Union for Multilateral Payments Arrangements (3), 1967  
Iran, Pakistan and Turkey
- 2 Asian Clearing Union (7), 1974  
Bangladesh, Burma, India, Iran, Nepal, Pakistan and Sri Lanka

## B Credit Arrangements

### (a) Latin America and the Caribbean

- 1 Central American Stabilisation Fund (FOEM) (5), 1969  
(Membership as in CACH)
- 2 Santa Domingo Agreement (12), 1969  
(membership as in LAIA)
- 3 Andean Reserve Fund (FAR) (5), 1976  
Bolivia, Colombia, Ecuador, Peru and Venezuela

### (b) Asia

- 1 Arab Monetary Fund (AMF) (21, as in the Arab League), 1976  
Algeria, Bahrain, Djibouti, Egypt (suspended 1979), Iran,  
Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman,  
Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, UAR, Yemen  
AR and Yemen PDR
- 2 ASEAN Swap Arrangement (5), 1977  
Indonesia, Malaysia, the Philippines, Singapore and Thailand

- Notes:
- (a) Latin American Free Trade Area (LAFTA) until 1981
  - (b) Full potential membership as in the Preferential Trade Area (PTA)

- (c) to encourage the members of the Clearing House to liberalise trade among their respective countries; and
- (d) to promote monetary co-operation and consultation among members of the Clearing House

In general, credit arrangements some of which are linked with clearing arrangements, are designed to sustain the trend towards trade and payments liberalisation by providing short to medium term intra-regional trade and balance of payments financing. The necessity for such support facilities is made clear as participating countries facing serious balance of payments disequilibria can hardly be expected to accelerate their trade and payments restrictions, especially if such disequilibria were in one way or another to be associated with the adaptation to the requirements of economic integration.

These objectives are achieved through direct central bank interchanges of reciprocal holdings of foreign exchange claims (bank notes, cheques, money lenders, etc), which are then reported to a central agent for multilateral clearance and settlement, which normally involves interim financing by the creditor central banks repayable at short fixed intervals with mutually agreed interest rates. The operational sequence actually begins at the level of the commercial banks which are authorised to channel the exchange documents acquired through their corresponding central bank; the banks get immediate credit in the central bank in local currency. Each central bank in turn sorts out all documents purchased and mails them to the central banks of the countries in whose currency the documents are expressed. The Clearing House Office receives a

copy of each transaction and operates them in the central accounting system in order to derive periodic net settlement positions of the participating countries, ie net credits and debits.

Although all clearing and payments arrangements are essentially designed to facilitate monetary transfers among participants on a multilateral basis by explicitly contemplating the use of national currencies, there are undoubtedly some fundamental differences between them in their specific objectives and in operational features relating to interim financing, adoption of the unit of account, the degree of multilateralisation of clearings, the eligibility of transactions, the period and form of final settlements, and pronouncements concerning exchange guarantees and default. These divergencies are apparent as each system is expectedly adapted to the requirements and possibilities of the underlying regional integration scheme.

Against these major divergencies, seven out of the existing eight clearing arrangements among LDCs are connected with regional economic integration and free-trade agreements, the exception being the Asian Clearing Union, while full multilateralisation characterises most clearing mechanisms in so far as the clearing of eligible transactions, the settlement of net balances and the credit margins granted to and received from the facilities are concerned.

Significantly the LAIA and CMCF use the US dollar in their clearing house arrangements, the CACH has the 'Central American Peso' as a unit of account equivalent to US\$1, while clearing arrangements in Asia, West Africa and Central Africa operate on the basis of units of account closely linked to the SDR (equal to 1 SDR).

Credit schemes have also differed among countries in several operational aspects including the automaticity or conditionality of credit facilities, the form and terms of credit and their capitalisation. The Arab Monetary Fund and the Andean Reserve Fund for instance, are institutionally constructed as reserve funds with over 90 per cent of capital contributions paid in 'hard' currencies. In the AMF only 2 per cent of capital contributions is paid in local currencies. Foreign exchange contributions to the Andean Reserve Fund represent around 2.5 per cent of the combined gross reserve holdings of members, whereas in the Central American Monetary Stabilisation Fund, this ratio has varied between 7-40 per cent (del Valle, 1980). The Santa Domingo Agreement consists of a set of credit lines which do not require paid-up capital contributions, while the ASEAN Swap Arrangement provides a short term and unconditional credit facility. Access to this facility is gained by a participating member which exchanges or swaps its own currency for US dollars provided by the other members. Basically, all credit arrangements require strict convertibility of the claims against borrowing participants, and, unlike a conventional 'payments union' (ie the EPU), accessibility to credit is neither automatic nor extended in terms of exclusively intra-regional imbalances. In all of them, credit agreements are based on global balance of payments needs, in line with IMF conditions.

The fundamental question is whether clearing and credit arrangements constitute a realistic monetary integration framework among LDCs especially in the light of prevailing development constraints as have been analysed in the case of West African countries. There seems little doubt that the dimensions of these

constraints are such that they cannot be directly attacked by these arrangements. In present circumstances, clearing and payments arrangements can not eliminate the obstacles to intra-regional trade to which they are chiefly addressed and can therefore save little foreign exchange compared with member countries' global convertibility currency obligations as intra-regional trade itself is small relative to total foreign trade and, partly in consequence, little use is made of regional currencies for settlement of regional balances. Even in schemes where credit provisions are specifically laid down, often, the inadequacy of credit funds in providing the system with flexibility particularly in periods of hard-core creditor/debtor net positions, and of widespread balance of payments difficulties puts additional pressure on their credibility and success rate as an instrument of improved mutual trade, payments liberalisation and regional convertibility.

### **7.3.2 Exchange Rate Co-ordination**

Exchange rate co-ordination involves an agreement among participating countries to pursue policies that will limit the extent to which the exchange rates between their currencies can diverge (Williamson, 1980). Conceptually termed as 'pseudo-exchange-rate union', this form of limited monetary integration constitutes the maintenance of fixed exchange rates within the union but there is no explicit integration of economic policy, no common pool of foreign-exchange reserves, and no single central bank (Corden, 1972).

'The members of the union', Corden states 'might determine that for accounting purposes, one of their currencies is to be the reference currency. Alternatively, they might establish a new accounting currency for the purpose. Then each of the other partners agrees to keep its exchange rate fixed relative to this reference currency. Each country has its own foreign exchange reserves and conducts its own monetary and fiscal policies. If it finds that it is running out of reserves, then - to make good its solemn promise - it must engage in a monetary or fiscal contraction sufficient to restore the reserve position. Every six months or so, or perhaps much more frequently, the finance ministers or central bank governors meet and consider whether they wish to change the parity of the reference currency. If it changes, then all the other currencies must, of course, move with it' (p 3).

In this regard, the central issue for monetary integration through exchange rate co-ordination is the choice of a pivot currency as the reference currency. Then the participating countries are required either by 'talk' or by 'rule' to define the central rates of their local currencies relative to this unit. And, thereafter, some obligation is required of them to restrict deviations from the agreed central rates, such that any likely variations through monetary and fiscal intervention policies must be undertaken only in order to maintain a high level of stability in the parities.

This requires two further decisions. Firstly, regional stability in exchange rates may mean either general pegging, or joint pegging, or joint fluctuations of the integrating currencies vis-a-vis those of the rest of the world. In other words, as Kafka

(1969) explains, participating countries must choose between pegging their currencies to each other and allowing them to float in the international currency market, or pegging them as before and adjusting them jointly by deliberate action vis-a-vis third currencies in the event of 'fundamental disequilibrium' (ie a disequilibrium which looks like being rather substantial and irreversible in the medium run) between the region and the rest of the world, or pegging each currency vis-a-vis all others but readjusting it in the face of fundamental disequilibrium between each country and all other countries, including regional partners. Kafka suggests that because changes in economic conditions differ between the integrating countries with respect to fundamental disequilibrium, all but the third option are ruled out. But the first obstacle, he points out, is the concerted need for a common conceptual definition of 'fundamental' as opposed to 'temporary' disequilibria as this is a central issue in the debates on freely floating and fixed exchange rate systems and the impact on each by speculative capital flows as an instrument for the stabilisation of the regional exchange rates.

Secondly, in the event regional currencies are largely traded on competitive exchange markets thereby necessitating central bank intervention in order to limit the deviations from the agreed parities and then sustain exchange rate stability, concerted agreement is required on a number of issues including:

- (a) the structure of central rates;
- (b) the margins around the central rates that are to be defended by interventions;



- (c) the intervention medium; and where intervention is in the members' own currencies,
- (d) the division of responsibility for intervention between the country whose currency is at the ceiling and the one whose currency is on the floor.

In the absence of competitive exchange market supply and demand forces, exchange rate co-ordination requires an assurance that member countries' published exchange rates remain constant relative to each other. Williamson (1980) suggests that it may be highly convenient if the currency against which parities are set is also the intervention medium so that intra-area exchange rates, which are the product of published buying and selling rates, are established directly.

The above features are in themselves a major source of difficulty that is likely to emerge in sustaining exchange rate co-ordination. These operational difficulties stem largely from the apparent limitations on national autonomy on exchange rate management and the lack of permanence in the co-ordinated arrangements. The system is highly vulnerable to erratic and sometimes destabilising speculative capital flows and, as Corden (1972) warns, with each member country having to 'fight for that common exchange rate most appropriate to its own balance of payments situation, agreement will certainly be difficult to reach; bargaining will be hard, and the system will be subject to continuous strain'.

Moreover, as Corden adds, each negotiating session for a common exchange rate will be accompanied by speculation about its outcome and hence speculative capital movements into and/or out of the integrated area, and that in so far as the system does not assure the permanence of the relationships between the member currencies (implied in 'complete monetary integration'), there is always the possibility that one or several of the participating countries will not agree to pursue a national exchange rate adjustment policy (eg an exchange rate depreciation by a deficit country and the building of foreign reserves, or appreciation by a surplus country) that may be required to maintain the agreed parities.

The IMF study (1980) acknowledges these views and confirms that even where exchange rates are declared fixed or irrevocable, a certain element of uncertainty would remain resulting primarily from the fact that, as long as member countries maintain their own currencies, the possibility that a country may at some time separate from the system or change its exchange rate cannot be totally ruled out.

While a policy of deliberate co-ordination of exchange rates is yet to be a considered option for monetary integration among the developing countries, in Western Europe, especially within the institutional framework of the European Community, exchange rate co-ordination was the sole object of the Snake-in-the-Tunnel scheme (1972), a significant part of the Werner approach (1970), and it is an essential component of the current European Monetary System (EMS) instituted in 1979. These schemes constitute major alternative conceptual proposals for attaining monetary union and are therefore discussed in the next section.

On exchange rates proper, it would not be unfair to say that even in the EEC, these had never been firmly on the agenda of Community organs prior to the EMS discussions of 1978. At least up to the events of 1970-72 which sparked off the urgent need for co-operation in this area, there was, in principle and in practice, no perceived need to discuss exchange rate adjustments in a regional context since intra-EEC exchange rates were assumed to be fixed as part of the global system of fixed rates then embodied in the Articles of the IMF Agreement. Negotiations thereafter did not survive for long because 'there was no attempt to get to grips with procedures and criteria for adjusting the designed central rates themselves, nor were there any initiatives for closer co-ordination of monetary and other domestic economic policies' (Thygesen, 1979).

#### **7.4 MODALITIES OF COMPLETE MONETARY INTEGRATION**

Allen (1976, p 4) has drawn a distinction between 'the characteristics that are essentials for any monetary union and the additional characteristics that are necessary for the continued and successful existence of the monetary union'. Accordingly, he has defined the minimum essential for a monetary union as:

'first, a single currency, or if there are several currencies, these currencies must be fully convertible, one into the other, at immutably fixed exchange rates, creating effectively a single currency; second, .... an arrangement whereby monetary policy for the union, including control of high powered money and regulations effecting the commercial banks' ability to create money, is determined at the union level, leaving no national

autonomy in monetary policy; third, since there can be only one rate of exchange between an external currency and the union currency, there must be a single external exchange rate policy. Towards this end, the national authorities must relinquish individual control over their international reserves and invest such control in a union authority'.

This definition is essentially in accordance with other definitions of complete monetary integration, many of which have emerged in the analysis of European monetary integration (see for instance, Werner Report, 1970; Corden, 1972; Ingram, 1973). As already noted, Corden's definition has gone further, however, and included complete lack of capital controls within the union as a prerequisite for monetary union. Corden (1972, p 2) has characterised as 'complete exchange rate' or 'monetary integration', an 'area within which exchange rates bear a permanently fixed relationship to each other eventhough the rates may - in unison - vary relative to non union currencies', and one in which there is 'the permanent absence of all exchange controls, whether for current or capital transactions within the area'.

In practice therefore all the various definitions of monetary union (once agreement on setting it exists) have specified three major requirements - effectively a single currency, an explicit harmonisation of monetary policies, and a common control of international reserves. These conditions inevitably require the creation of a union central monetary authority.

As Allen emphasises, it would probably not be difficult to find a consensus, in principle, on the necessity of these conditions for a monetary union, though certainly not on their sufficiency and on the steps by which the union can be attained. There is no doubt, however, that the additional characteristics that are necessary for the success of a monetary union - eg policy harmonisation or convergence - are more subjective and controversial, varying with the underlying political and economic conditions and aspirations at the union and at the national levels. As emphasised by both Allen and Corden, a workable monetary union requires that the participating countries, their financial institutions, firms, households and above all, political leaders and fiscal authorities, must believe in it and be committed to its permanence and be able to perceive the net benefits of remaining in the union to exceed the potential gains from staying outside it.

There are important reasons for stressing these specifications. As Allen (1976, p 8) explains, the absence of such confidence by member states on the union would force them to continue to presume that intra-union transactions would involve exchange rate risk and risk of discriminatory capital controls. This would reduce their willingness to hold the other national currencies, to incur debts or acquire assets with each other's financial institutions, or to even make viable contracts across national borders of the union. The resulting separation of national money and capital market transactions would constitute a failure to achieve the union objectives and would certainly make more difficult the achievement of policy convergence as well as its implementation at the union level. Furthermore, if the union were suspected to be temporary or

unstable, there would be an apparent reluctance to grant the union monetary authority significant powers that it might need to operate effectively.

The other area of major concern for a monetary union is the 'dispute' over the means by which it can be created. As indicated earlier, the many alternative routes that are available so far in the literature have essentially emanated from the various arguments for and against monetary (or currency) unification in the EEC. These alternative strategies can be divided into two broad categories: the 'big-leap' approach, and the gradual approach.

#### **7.4.1 The Gradual Approach**

The attainment of monetary union by steps has one important desired feature, namely, 'automaticity'. This approach involves in essence the gradual introduction of the components of 'partial' monetary integration with the hope that the process would eventually lead to the introduction of the essentials of 'complete' monetary integration. Consequently, member states may define the sequence differently and with different elements. Some, for example, may decide to initially reduce exchange rate margins; at a second stage, to eliminate exchange rate margins; at a third stage, to pool international reserves; and at a final stage, to replace national currencies with a union currency and to establish a central monetary authority. Alternatively, some member states may decide that they would enter the union whenever they are ready (ie after attaining policy harmonisation), or the union may decide that member states would retain the right to withdraw. The various steps can be

decided and well planned in advance or they can rest on successive negotiations.

In the case where all the steps are carefully designed in advance and a firm commitment to stay in the scheme is available, automaticity can also be said to be present in this respect. However, where the member states reserve the right of withdrawal, they may choose to pursue their own monetary policies at a time when, perhaps, their national interests are considered to conflict with those of the union. But as a firm commitment to stay in the scheme imposes self-discipline on national monetary authorities, it is likely to lead to full monetary union. On the other hand, if the various steps are not decided and firmly agreed upon in advance, the gradual route has the drawback of relying on successive negotiations for the implementation of successive stages. This in effect increases the possibility of failure and eventual collapse of the union as political support may vanish with the changing interests of the member states. The implication is that timing in the implementation of successive stages becomes a most crucial part of the monetary unification process.

Vaubel (1979, p 25) has argued that because graduation lacks automaticity, relying instead more on discretion, all its different components (Vaubel describes them as co-ordination strategies), especially at the initial stages, fail to give the appropriate and sufficient guidance to the member states on matters of exchange rate prediction and expectations, wage and price setting, inflation tendencies, unemployment levels, etc. The key defect of this approach therefore rests entirely on the problem of expectation adjustments by the general public. Clearly, the public is bound to

resent union membership under a situation where its expectations of government and the monetary authorities' compliance to union targets are very low. The rationality of the public in terms of risk and transactions and the loss of national currencies in place of common currency therefore becomes an additional factor that is equally crucial for achieving monetary union.

Gradualism towards monetary union in Europe is conceptualised into three main approaches, namely, the Werner Plan, the Snake and the EMS.

#### 7.4.1.1 The Werner Plan

The concerted step-by-step approach as proposed in the Werner Report (1970) was specifically defined as follows:

- (a) exchange rate margins are gradually narrowed;
- (b) at first some limited financing of deficit countries by surplus countries takes place;
- (c) at some stage foreign exchange reserves are pooled;
- (d) and at some stage exchange margins are completely eliminated; a firm commitment to stay within the arrangement is made;
- (e) then, finally, a single central bank is established.

Thus, in essence, the transition to monetary union envisaged by the Werner Committee consists of gradually reducing autonomous parity adjustments and margins of fluctuation between the member currencies.

Even though the delayed implementation of the first part of the Werner Plan was attributed to the highly unstable international monetary conditions prevailing at the time, the Plan, as a concept



for attaining monetary integration, is operationally limited by the high element of discretion that is implied in the implementation of the transition stages. As Corden (1976, p 13) observes, the Werner proposal is such that until the last stage is accomplished, the separate national monetary authorities are to stay in existence, and the right is reserved for the pursuance of independent national monetary policies for withdrawal from the arrangement if necessary and for refusal to finance partners in deficit. Commitment for permanence is clearly lacking and while there remains separate political influences, trade and financial transactions would naturally rest on expectations that each authority would follow its own policies.

Indeed, the broad skepticism about such a strategy is the requirement for all member states to move in unison in implementing each step. The main concern here is the likelihood that this may never happen either because not all members are equally prepared because of time or simply because others already have firm alternative commitments for fixing their exchange rates irrevocably to each other. This in turn leads to another very crucial element, namely, the degree of readiness at the national level for member states to go beyond successive stages. Obviously the longer the time lag between stages, the more likely it is for successive stages to be overtaken by unforeseen adverse events, thereby forcing the initial commitment, especially for the more adversely affected member states, to fade. As it happened, it was apparent that at the time the Werner Plan was unveiled, France, Britain and Italy were in particular not ready to participate, and so its adoption was further slowed down.

However, aspects of the Werner Plan became visible after the series of negotiations which followed the 1971 dollar crisis and the floating of EC member currencies against the dollar. In April 1972, the EC member states entered the Basle Agreement, which was basically the 'snake' agreement.

#### 7.4.1.2 The Snake Agreement

Conceptually, a 'snake' exchange rate arrangement, which has its origins in the events of 1971 (the Smithsonian Agreements), involves a scheme in which member countries agree to move towards a narrower band of fluctuations of the exchange rates among their national currencies. Once central rates are defined, member countries are expected to keep their exchange rates linked to each other so closely that the deviations between them should be within the width of an agreed intervention margin on either side of par or the central rate. In theory, the wider the margin, the more widely national member countries are permitted to diverge between them without declaration of changes in central rates because of a simple mathematical cross rate valuation. In practice, member countries would strive to sustain stability in their exchange rate arrangements either by directly trading the relevant national currencies (selling the strongest and buying the weakest member currencies) to keep them within the agreed band, or by allowing market forces in the international exchange markets to determine the band level and the likely form of possible intervention.

The 'Snake-in-the-tunnel' (1972), with a maximum intervention margin of 2.25 per cent on either side of par, remains one of historical significance in the evolution of possible routes to

monetary integration. In addition to the strains created on currency, political and overall economic systems by the events during this period (eg the renewed currency crisis, 1972; the Arab oil embargo, 1974), the scheme was finally abandoned at the Community level (it became largely a German mark zone), lacking the 'political will (by member countries) to sacrifice national sovereignty in order to gain the uncertain advantages of a joint programme of action' (Grubel, 1981).

Tindemans (1976) had advocated specifically for an agreed system whereby exchange margins between national member currencies would be steadily narrowed. In contrast to the Werner proposal, the various steps in this approach would not have to be concerted; countries could join at their own will. Specifically, a 'two-tier' Community may emerge; one pair consisting of member countries in the snake for adhering to a narrower margin agreement, limiting exchange rate fluctuations and moving towards complete exchange rate union; and the other tier comprising of those not so taking part.

The Snake scheme is considered more pragmatic and slightly more practicable than the Werner approach. But this is only in so far as countries may be more inclined to join it and protect their exchange rates once they have managed, outside the scheme, to align their domestic inflation and monetary targets. This supposition is based on the assumption that realistically, the movement towards exchange rate union would follow the alignment of economic policies, not vice versa, or at least the two processes would be simultaneous.

Nevertheless, as in the Werner Plan, the main problem with a Snake system is that until an irrevocable commitment is made to staying in it, there can be no certainty that national monetary

developments will produce unified monetary targets and stable exchange rates. 'It is no more than an adjustable peg system ..... (and) there is not even a pseudo exchange rate union' in it (Corden, 1976). And until foreign exchange reserves are pooled and a common central bank is established evidencing some irrevocable commitment to staying in it, there is certainly not a complete exchange rate union. Furthermore, even when operated in conjunction with harmonised monetary targets, the snake approach may still be fragile and practically unworkable as it lacks the operational guarantee that the agreed monetary targets are consistent with the exchange rate targets - and in the last resort, participants can opt out.

In practice, these fears became imminent as membership of the EC 'snake' scheme actually fluctuated between the years. For instance, the UK participated in the scheme from 1 May 1972 to 23 June 1972; France, 24 April 1972 to 19 January 1974, and 10 July 1975 to 15 March 1976; Denmark, 1 May 1972 to 13 June 1972 and 10 October 1972 onwards; Sweden, 19 March 1973 to 29 August 1977; Norway, 23 May 1972 to December 1977; and Italy from 24 April 1972 to 13 February 1973. The permanent members of the snake were West Germany, the Netherlands, Belgium and Luxembourg. Between April 1972 and December 1978, parities between the member currencies were adjusted on nearly ten occasions (Kruse, 1980, pp 111-17; Vaubel, 1978, p9).

#### 7.4.1.3 The European Monetary System (EMS)

The EMS, basically a variant of the 'snake' system, was adopted in 1979 within the EEC as 'a scheme for the creation of closer

monetary co-operation, leading to a zone of monetary stability in Europe' (paragraph 1.1, Resolution of the European Council, 5 December 1978). Kruse (1980) provides a detailed account of the background and operational features of the EMS while various aspects of its performance and prospects are also appraised in a number of other reputable studies including Trezise (1979), De Vries (1980), Masera and Rossi (1980), Cohen (1981) and Ungerer et al (1983).

The EMS was launched with the immediate support of 6 of the 9 EEC nations, Ireland and Italy (generally classified as the less prosperous among the members) joined some weeks later after 'time for reflection', whereas the United Kingdom Government expressed a 'spirit of sympathetic co-operation' (El-Agraa, 1980) and still maintains that joining the EMS is not a 'soft option' for Britain (Keegan and Hamilton, The Observer, 17 February 1985).

Officially, the main features of the EMS are stated in the annex to the conclusions of the EEC Presidency (Bulletin of the European Communities No 6, 1978) and are grouped into two broad components:

- (a) an agreement about a Community exchange rate regime; and
- (b) the creation of a European Monetary Fund and of a system of mutual credit facilities.

The features also have an indication of measures in favour of the less prosperous member states. Within these broad categories, the EMS has the following intentions:

- (a) the implementation of an exchange rate arrangement that would facilitate the minimisation of exchange deviations between member currencies as well as enhance the co-

ordination of the member countries' exchange rate policies vis-a-vis third currencies;

- (b) the issue of a new reserve asset; and
- (c) the pooling by members of part of their monetary reserves and the extension of mutual credits, both of which are to be consolidated within the European Monetary Fund.

The exchange rate agreement is essentially a system of fixed but adjustable exchange rates in which parities are fixed vis-a-vis the European Currency Unit (ECU; the acronym is also the name of an ancient French silver coin - Cohen, 1981), which consists of a basket of fixed amounts of the 9 EEC currencies (excepting for the time being, the Greek drachma). Margins of fluctuation (ie 6 per cent for the weaker lira on the one hand and 2.25 per cent for the rest of the member currencies) are allowable on either side of parity. Intervention by member central banks at these margins is obligatory and unlimited and can be effected in both participating and third currencies. The grid of bilateral central rates and intervention limits is supplemented by a 'divergence indicator' which provides an in-built early warning signal to indicate that a member country's currency has begun to diverge too far away from the weighted average movement of the other member currencies. This indicator signal would therefore precipitate the need for appropriate and prompt corrective measures by the affected country either in the exchange market or by adjusting domestic monetary and fiscal policies.

The EMS will be supported by a proposed European Monetary Fund (EMF), the successor of the existing European Monetary Co-operation

Fund (also known as FECOM by its French initials) in supervising all Community credits which will be extended for exchange rate and balance of payments financing. The Fund will be backed by 20 per cent of national gold and US dollar reserves and by a similar percentage in national currencies. It will issue ECUs which will be used as new reserve assets. All mutual credits to support intervention will be dominated in ECU and interest paid at the weighted average discount rate in the member countries. The ECU is the official settlement currency.

Thus, at the heart of the EMS is the ECU; it serves as the numeraire for the exchange rate mechanism, as the denominator for operations in both the intervention and credit mechanisms, as a reference point for the divergence indicator, and as a means of settlement and a reserve asset of the member central banks.

Viewed with respect to the 'minimum' requirements for a full monetary union, the EMS, despite its institutional superiority over the previous proposals, does lack a key requirement, ie a common central bank. The EMF is yet to be established. Pending this, however, reserve pooling within the system is carried out initially in the form of revolving three-month 'swaps'. An eventual transformation of an established EMF into a supra-national central bank would in turn enhance the transformation of the ECU into a common Community currency.

Nonetheless, its performance since its inception and in relation to its stated objectives should make the EMS an instructive example among the variety of proposed routes to attaining complete monetary integration. Despite more realignments and interventions and less economic convergence than many of its original protagonists

had hoped for, the EMS has attained some relative stability in the exchange rates between the member currencies, compared with the variability of exchange rates of non-EMS currencies such as the US dollar, the yen and sterling (Ungerer et al, 1983). Besides, according to the Ungerer study, this stabilising influence within the EMS has spread to the exchange rates of the currencies of those European countries outside the EMS which have close economic and financial ties to the EMS participants. In contrast, the exchange rate variability of the major currencies not tied to the EMS - sterling, the yen and the US dollar - appears to have risen significantly. These comparative variations are summarised in Table 7B.

Ungerer (1983) concludes that the performance of the EMS during the period 1979-82 has also disproved a number of contrasting expectations and fears raised initially against the exchange rate mechanics in relation to the consequences of strict adherence to a system of fixed, though adjustable, on economic developments and policies of participating countries. Some of the most significant of these 'exaggerated' concerns have centred largely on three possible risks (Cohen, 1981):

- (a) the danger of increased world-wide exchange rate instability;
- (b) the potentials for either deflationary or inflationary biases in the system; and
- (c) the possible erosion of the status of the SDR and the IMF and the weakening of any impetus towards global monetary reform.



**Table 7B Comparative Variability of EMS and Non-EMS Exchange Rates, 1974-82**

Variability of	Average EMS	Average Non-EMS	Av European Non-EMS	Round Sterling	US Dollar	Yen
<b>1 Nominal Effective Exchange Rates</b>						
1974-78	23.6	28.3	29.3	32.6	21.2	40.4
1979-81	20.0	28.3	26.4	42.9	27.5	54.2
1982	21.9	31.1	31.1	20.0	44.3	35.1
<b>2 Nominal Exchange Rates Against EMS Currencies</b>						
1974-78	28.5	34.5	30.5	32.6	34.7	44.4
1979-81	14.1	36.5	27.8	44.1	45.0	66.6
1982	26.2	27.0	22.0	21.3	47.9	19.9
<b>3 Nominal Exchange Rates Against Non-EMS Currencies</b>						
1974-78	36.3	39.6	42.5	49.6	34.1	46.2
1979-81	44.7	43.2	45.7	56.1	38.6	60.5
1982	34.1	31.5	29.2	26.0	36.8	45.5
<b>4 Bilateral Real Exchange Rates Against EMS Currencies</b>						
1974-78	25.9	31.6	27.2	28.1	33.0	40.3
1979-81	16.9	38.6	31.0	53.5	44.8	64.9
1982	21.1	24.3	18.3	15.7	43.3	25.2
<b>5 Bilateral Real Exchange Rates Against Non-EMS Currencies</b>						
1974-78	34.4	35.1	36.8	40.0	31.5	43.5
1979-81	45.7	47.1	49.1	61.3	43.4	67.1
1982	30.7	31.8	29.1	26.2	36.9	51.9

Source: Underer, Horst et al,  
The European Monetary System: The Experience 1979-82  
Occasional Paper No 19, IMF, May 1983

Notes: 1 Average for 1974-78 and 1979-81

Ungerer notes further that the EMS has so far also disproved the initial fear that such a system would not sustain for long because, as the argument went, it would be unreasonable to expect countries with highly divergent economic developments to be able to

align their policies to the degree necessary to keep a system of fixed exchange rates function; that as a consequence, speculative capital movements would disrupt foreign markets and force authorities to make sudden and substantial exchange rate changes; and hence, leading to an exchange rate crisis of a type that characterised the final phase of the Bretton Woods system.

The ECU, on the other hand, is still in a rudimentary state of development, with its use manifested mainly in bond flotations and as a unit of account for settling intra-EEC central bank balances. Its transformation into an international reserve currency is yet to gain positive momentum, as pace and confidence appear to be adversely affected by the lack of sufficient privatisation, policy convergence and, perhaps, also by the absence of the pound sterling in the EMS. Its popularisation, it is argued, may be increased through, for instance, the creation of ECU denominated travellers cheques and/or using it as an alternative to Eurocurrencies in the rapidly growing Eurocurrency market. By the end of 1984, the ECU-denominated bond market represented about 6 per cent of the \$46 billion total Eurobond market (The Times, 8 November 1984).

However, a few salient points have been raised regarding the role of the EMS as a transitional alternative towards monetary union. Firstly, as in the 'snake', there is no commitment to irrevocably fixed central rates as the national banks can always bargain for changes in the central rate. Then the problem is whether this characteristic strengthens the system by making it more elastic or weakens it by imposing on the members a smaller pressure for monetary discipline. A very loose system would result in

continuous realignments of the central rates, thus causing it to fail as a step in the direction towards monetary union.

Secondly, the establishment of a divergence indicator as an early warning device within the EMS is generally accepted as a significant development and that the prescribed procedures for the application of the indicator should reinforce pressure for convergence (Baquiast, 1979, p 53; Thygesen, 1979). It is stressed nonetheless that when the divergence threshold is crossed and the authorities of the country concerned are required to promptly correct the situation by taking adequate measures, or inform the other countries in the event of failure to apply any corrective measures, there is no firm obligation that either would be done. The system establishes only a 'presumption' that action should be taken. The major question then is whether the mechanism will or will not be binding in nature. The question is also raised whether the nature of the required adjustment will be symmetrical or whether the entire burden will be borne primarily by the diverging currency, which, more often than not, represents the weakest currencies in the exchange rate system.

A third concern relates to the ECU. As a 'parallel' currency the unit's performance, as already noted, has been relatively slow, limited only to bond flotations and as a unit of account. Hitiris and Zervoyianni (1983) fear that in its present form, the ECU may out-compete only the weaker currencies and thus attract its privatisation only if it has to be a choice between it and these currencies.

Since its inception, a number of realignments in central rates have been made and several revaluations and devaluations have been effected in EMS member currencies. For instance, in September 1979, the German mark was revalued by 2 per cent and the Danish krone devalued by 3 per cent against the other currencies in the system. A further 5 per cent devaluation of the krone was made in November 1979. In 1981, the mark and the Dutch guilder were revalued by 5.5 per cent, the franc devalued by 3 per cent and the lira devalued again twice, by 6 and 3 per cent. In 1982, both the Belgian franc and krone were devalued again by 8.5 per cent and 3 per cent respectively.

Thus, in the light of the foregoing, the debate on the effects of the EMS on the participating countries and other non-participating industrial countries has centred around questions related to the objectives of the system itself and whether it would be able to achieve these objectives. Apart from the issues on what exchange rates the EMS should and can stabilise (effective exchange rates, rates against the Deutschemark, or rates against a basket of European currencies), questions have also been raised on the capacity of the EMS to enhance convergence of policy variables (inflation rates, productivity growth levels, money supply and credit expansion, interest rates, and exchange rates vis-a-vis the ECU). These issues have come up at the back of some statistical indications that European countries' performances were more divergent at the time of launching of the EMS than of the European Common Margins Arrangement (The 'Snake'); indications which created doubts that the EMS may either not survive or may not have any impact on the performance of the participating countries.

Table 7C illustrates the level of divergence that still exists with respect to growth rates in money supply, credit expansion, interest rates and inflation, and in the changing values of the member currencies vis-a-vis the ECU. The table does reveal, in particular, the dominant position of the German mark and the Dutch guilder both of which have continuously appreciated against the ECU and the inability by the member states except Germany and the Netherlands, in dampening inflation expectations. As far as interventions are concerned, Vaubel (1979, p 15) has emphasised that 'they are incompatible with the principle that everybody has to bear the full consequences of his actions. They run counter to the notion of individual responsibility which is a necessary condition for the functioning of the market's feedback mechanism of incentives and disincentives. In fixed exchange-rate systems that permit interference, responsibility for national and overall monetary policy tends to get lost'.

It is argued further that any deliberate attempts at converging (downward) in national monetary policies, especially in relation to the high inflationary tendencies in some countries, would cause a 'severe and quite unnecessary stabilisation crisis with considerable additional unemployment'. Against this background (the UK may have provided an example of this expected sequence), monetary policy convergence would be difficult to achieve and speculative capital movements would feature in large quantities (Vaubel, 1979, p 18).

Table 7C EMS: Money Supply, Interest, Prices and the ECU

	Money Supply <sup>1</sup> (Per cent change over previous year)			Domestic Credit (Per cent change over previous year)			Consumer Prices (Per cent change over previous year)			Discount Rate <sup>2</sup> (End of Period)		Exchange Rate Change <sup>3</sup> (National Currencies per ECU per cent)				
	1979	1981	1983	1979	1981	1983	1979	1981	1983	1979	1981	1982	1983			
Belgium	7.1	6.0	8.3	14.8	12.8	14.3	4.5	7.6	7.7	10.5	15.0	10.0	-2.52	-1.00	-8.56	-1.71
Denmark	9.5	12.3	27.2	12.3	14.5	19.4	9.6	11.7	6.9	11.0	11.0	7.0	-1.93	-1.16	-2.19	-0.84
France	13.0	11.4	11.4	14.1	14.1	13.3	10.7	13.4	9.6	9.5	9.5	9.5	-2.53	-4.41	-5.16	-5.85
FRG	8.2	4.7	5.7	11.9	8.8	6.7	4.1	6.3	3.3	6.0	7.5	4.0	-2.70	+4.43	+5.90	+1.85
Ireland	23.5	19.4	-	30.4	15.2	12.7	13.2	20.5	10.4	16.4	16.5	12.3	-2.58	+0.16	-0.89	-5.21
Italy	19.8	10.8	13.8	16.0	12.7	14.5	14.7	17.8	14.7	15.0	19.0	17.0	-4.99	-7.29	-1.70	-3.49
Netherlands	10.4	8.5	5.0	17.2	5.9	4.6	4.2	6.7	2.8	9.5	9.0	5.0	-1.61	+3.83	+5.26	+0.20
UK	11.8	22.4	12.7	9.8	28.2	12.4	13.4	11.9	4.6	17.0	-	-	+14.0	-2.33	-5.97	+4.95
Greece <sup>4</sup>	20.5	27.2	20.7	21.4	34.6	18.5	19.0	24.5	20.5	19.0	20.5	20.5	-	-	-	-

Source: IMF, International Financial Statistics

- Notes:
- 1 Money supply plus quasi-money (IFS Line 351)
  - 2 SIF rate for Ireland and bank rate for the UK
  - 3 Percentage changes of the values in the national currencies of one ECU. The signs (+) indicate appreciation, and (-) depreciation vis-a-vis the ECU
  - 4 The Bank of Greece's currency was included in the ECU basket on 17 September 1984; became a part to the EMS Agreement as of 1 July 1985; but has not initially participated in EMS exchange rate mechanism
- Not available

#### 7.4.2 The Big-Leap Approach

The 'big-leap' approach is conceptually defined to favour the immediate establishment of a monetary union specifically by setting up a central monetary authority, pooling the members' reserves, and directly replacing national monies by a common currency. The major operational feature in this case is the advantage of 'automaticity' as opposed to 'gradualism'. The emphasis is on the currency substitution strategy and practically the most vital question in this respect is whether the common currency should displace the national currencies 'all at once' or gradually.

On European monetary integration, the 'big-leap' approach has been advocated for by Roy Jenkins (1977) who said:

'We must now look afresh at the case for monetary union because there are new arguments, new needs, and new approaches to be assessed ... Let us suppose at some stage a currency by a European monetary authority, and the adoption by this authority of a determined and relatively independent policy of controlling note issue and bank money creation. The authority would start by adopting target rates of growth of monetary expansion consistent with a new European standard of monetary stability following the best traditions of our least inflationary member states ... We have to look before we leap, and know when we are to land. But leap we eventually must'.

Roy Jenkins (1979) posed a reminder:

'Just over a year ago, I tried to set out in a speech at Florence the reasons for re-examining the case for economic and monetary union...

I spoke of the so far unexercised ability of the Europeans to create a currency of their own, based on a spread of wealth and power comparable with those of the United States ...

I said that control of a single European currency by a single European monetary authority could achieve a measure of anti-inflationary discipline beyond the reach of most individual member states'.

Corden (1976, p 12) provides perhaps a more lucid explanation of the transition process that is implied in the establishment of a 'monetary union all at once':

'The first route is to set up a complete exchange rate union all at once. On one day a central bank is established in the European Community. It takes over the foreign exchange reserves of the member countries; and it acquires the sole right to manufacture the legal tender and hence base money. If this is seen as a decisive and irrevocable transformation then expectations will be immediately adjusted. The great transformation would have to be clearly decided upon and announced well in advance. There is then no need for gradualism. Different governments could still have their own budgets, borrow and lend, tax and so on, .....



In contrast, other variants of the 'big-leap' approach, as far as the eventual introduction of the common currency is concerned, have introduced an element of gradualism into the transition process. Together, these different variants, dubbed the 'currency competition route' (Hitiris and Zervoyianni, 1983), have been presented in two broad versions. In the first - 'survival of the fittest' - all capital controls in the member states are abolished and all national currencies are accepted for use within the prospective union. With free competition among national currencies, only one currency - the relatively most stable - would survive in the long run and effectively become the union's common currency. Thus, it is argued, monetary union evolves through the market process.

The second version suggests the establishment of a 'parallel currency' which would be allowed to circulate alongside national monies, and if it proved more attractive than national monies, it would eventually become the union's currency. Here too, a number of 'parallel currency' alternatives have appeared in the literature in terms of both definition and operational modalities. The common essential feature is that the parallel currency is seen in all respects as a 'basket' currency consisting of all national currencies properly weighted or an entirely new currency with different weights.

For instance, Magnifico and Williamson (1972) called for the establishment of a common currency (the Europa in the case of the European Community) backed by a foreign currency (they suggested the US dollar), gold and SDRs, as well as by the currencies of the member countries, to be held by central banks alone or by the

general public as well. Operationally, each country could still alter the exchange rate of its currency relative to the common currency which would be a kind of intermediary. Its rate relative to the chosen intervention foreign currency would be carrying with it the various separate currencies of the union and member countries could if they wished establish narrow margins or permanently fixed rates relative to the common currency. And the hope, according to the authors, is that they would do so.

Alternatively, Caincross et al (1974) defined the proposed new parallel currency that would first circulate side by side the national monies and gradually replace them, in terms of a bundle of member-country currencies and always having a value equal to that of the strongest member country currency.

Perhaps, a more complicated version of the parallel currency proposal has been presented by the All Saints' Day Manifesto (1975). The suggestion is for the establishment of a parallel money of 'constant (union) purchasing power'. This precise value guarantee, the Manifesto argues, implies that the parallel currency would fluctuate vis-a-vis the national currencies, essentially on the basis of the rates of inflation in the member states. It would be issued by the union monetary authority in exchange for the national currencies at the exchange rate implied by the purchasing power guarantee and would eventually out-compete the national currencies. Thus, the new currency would be market- instead of government-determined, with no restrictions on its holdings by the general public. The Manifesto explains further that backing for the parallel currency would firstly be by investments which would have to yield at least a zero real rate of return to provide the

necessary assurance, at least initially, and secondly, it would have to come from the possibility that the union could raise funds by taxation. As a store of value, this new currency, according to the Manifesto, is identical to an indexed bond yielding a zero real rate of interest.

There are varying potential advantages and limitations regarding each variant of the 'big-leap' approach. As a general concept, this approach has the advantage of automaticity, avoiding, according to Corden (1976, p 12), all the problems of transition. Corden argues further that the 'big-leap' approach would tend to converge inflation rates within the union and that wage rate increase differentials would fall in line only with trends in production. He claims, however, that any long-term problems of monetary integration would not be avoided but that the uncertainties generated by gradual approaches would be by-passed.

The case for the 'big-leap' strategy can be said to rest succinctly on the political assumption that only a shock can induce all member governments to accept currency merger at the same time and that such a favourable political constellation which can be short-lived must be exploited at once and completely. As Hitiris and Zervoyianni (1983) put it, '... it is hard to see how such a radical change could be accepted by national governments in the absence of any significant external shock as it implies the immediate transfer of national powers to central monetary authority, and an immediate erosion of national sovereignty'. External shock can be political or military (Corden, 1976, p 13). But referring to the European Community, Corden states:

'The fact that the explicit establishment of a monetary union is politically inconceivable brings home the element of illusion and of play-acting in the whole movement ... that espouses the cause of economic and monetary union. At present it appears that if monetary union is to be achieved, it will have to be achieved in some other, more stealthy way'.

Indeed, it is probably against this background that the step-by-step approach has come to be more popular than the big-leap approach.

The main political objection to such a 'crisis' theory of history, it is further argued, is that it is too categorical. The possibility cannot be excluded that disillusionment with monetary policy would induce governments increasingly to accept piecemeal unification engineering (Vaubel, 1979). In addition, this automatic route may also be very costly for the less prosperous member states in that as they would have to adjust, say, their inflation rates to possibly the union's lower inflation rate at once, unemployment may result if the adjustment of price expectations is not instantaneous. But it is believed that the obvious situation is to announce this radical change well in advance in order for expectations to have time to adjust.

The main advantages of the 'currency competition route' are centred on the probable advantages of gradualism which in a way avoids costs which are consequent on a high degree of automatic adjustment. A parallel currency in particular would preclude privileges attaching to a particular national currency. Successive negotiations and discussions, as in the case of the step-by-step approach, are not necessary. The Manifesto (1975), specifically

argues that their type of parallel currency approach works without foreign exchange interventions and, hence, without mutual interference and moral hazard or ex ante agreements on national money supply variables. It provides a common standard of value, store of value and means of payments, thus facilitating market integration while still leaving control over national monetary policies with the member governments. Therefore with a stable purchasing power guaranteed and to the extent that the parallel currency is market-determined and without being subjected to a governmentally regulated process, Vaubel (1979) maintains that the uncertainty associated with national governmental discretion and the danger of a stabilisation crisis in the monetary unification process can be avoided.

The crucial element that is implied in these prescriptions is that if the basket of parallel currency is to become a successful union currency, it must out-complete both the weak and the strong national monies. If it is operationally constructed to have a more stable value than the weak currencies but a less stable value than the strong currencies, then eventually both itself and the strong currencies would survive and monetary integration would be severely impaired. With stable purchasing power guaranteed, and with no special convenience attached to national monies, it is likely that risk-adverse economic and financial agents would prefer to hold the parallel currency in terms of purchasing power rather than the more unstable national currencies.

Despite these potential attributes of the 'parallel currency', Corden (1976) states that such a currency might not lead to the attainment of 'complete exchange rate union'. Referring in

particular to the Manifesto's 'index-linked' purchasing power guarantee proposal, Corden's concern is that such an incentive for the holding of the parallel currency could be too attractive. He argues that the indexed-currency approach could deprive national central banks of their inflation tax on the monetary base underlying that part of the money supply which the market has rejected in favour of the stable parallel money. This could therefore force national authorities to raise nominal interest rates on national money interest-bearing deposits or increase real interest earnings by eliminating taxes on receipts. They would only be willing to be deprived of this inflation tax if they accepted the full implications of monetary unification. Failing to do this would create a two-tier portfolio holdings - a parallel currency portfolio balance providing an assumed ex-post zero real rate of interest and an interest-bearing national currency portfolio balance - whose main determining factors are the ex-post real interest rate and the expected rate of corresponding depreciation of the affected national currency. Secondly, in replacing national currencies as a numeraire for wage contracts, the parallel currency would deprive the national monetary authorities of the ability to influence the short-run rate of unemployment.

Another area of concern in the process of currency substitution is the seignorage issue. It is based on the very likelihood that the monetary union would be impaired if it gives rise to seignorage from the creation of international money which accrues exclusively to the monetary authority whose currency survives as the union's common currency.

## 7.5 CONCLUSIONS

The foregoing has tried to review the main conceptual issues that are relevant to an understanding of the transitional process and the underlying implications for the participating members that are available in monetary integration. Each transitional scheme, in essence, implies the creation of a given set of 'optimal' monetary relationships in a more effective framework of regional institutional infrastructures and the introduction of appropriate elements of co-ordination in monetary and financial policies. Whether or not the advantages of political monetary integration (implying the establishment of a common currency) will more than offset the corresponding costs is a question that rests on the degree of the expected political loss of national sovereignty in aspects relating to institutional building, market integration and harmonisation of monetary and financial objectives and instruments of policy. This in itself is largely subjective, depending on the 'will' and interpretation of the political and monetary authorities of each participating country. Consequently, as Parkins (1972) puts it, the transition to a monetary union 'contains within it a formula for discovering whether governments and central banks are yet ready for the kind of co-operation which such a union would involve'.

The decisive issue towards the attainment of a monetary union rests on the elements of 'gradualism' and 'automaticity'. The more firmly committed participating countries are towards the establishment of a common currency the greater the incidence of automaticity in the transitional arrangements. On the other hand the main drawback of a gradual step-by-step approach is the fact that member countries implicitly reserve the right to withdraw from

the scheme, or they may choose to follow their own monetary policies at a certain time, when, for example, their national interests conflict with those of the scheme. In either case, the process of monetary co-operation and its potential advantages are undermined, a situation which may result in the final collapse of the integration efforts. At the same time, where the various steps are not decided and firmly agreed in advance, gradualism has also the drawback of relying on successive negotiation for the implementation of successive stages. This situation as is argued, increases the possibility of failure, as political will to support the scheme may vanish if member states' interests diverge over time (Vaubel, 1979).

Evidently, in the choice of successive steps towards monetary union, the Werner Committee (1970) had the initial problem of evolving a scheme that compromised between the so-called 'monetarists' and 'economists'; both groups were clearly distinct in the respective definitions of the transitional process to attaining a European Monetary Union. Conceptually, the economists (or structuralists) argued that the first step should involve the setting up of EEC targets, harmonising national economic policies as an easy way of then fixing exchange rates to lead to the next step of establishing a Central European Monetary Authority, pooling of reserves, etc. On the other hand, the monetarists argued that the first step should be to narrow exchange rate fluctuation margins, pool reserves, and increase existing credit facilities to member states. They felt that the need to maintain a fixed exchange rate would impel policy co-ordination on member states.



The fundamental concern for monetary integration in Western Europe has in recent years been the choice among possible routes to attaining complete exchange rate union (or common currency). In the literature, the situation is different for the LDCs where the logic of the conspicuous absence of meaningful discussion on exchange rate co-ordination clearly suggests that there is hardly little scope for such a scheme: firstly, because of the deep financial, monetary and economic dependence and disintegration inherent in developing economies and the low levels of development and economic integration; and secondly, because LDCs are unlikely to be able to cope with the relatively high degree of operational sophistication that is involved in an exchange rate unification mechanism. Indeed, an exchange rate co-ordination strategy will for the LDCs initially involve massive exchange rate realignments necessary to reduce the pronounced elements of currency overvaluation and will be combined with the need for substantial improvements in regional convertibility in the context of trade and payments standardisation and liberalisation. Thereafter, problems of intervention policies, financial support mechanisms and the confidence factor, as are already apparent in the EMS, will surface.

Specifically, the implications of the EMS in West Africa depends on its success or failure in achieving the stability of the exchange rates of the member countries as well as that of other key currencies, notably, sterling and the US dollar. It also depends on the relative success of the system to achieve greater convergence of financial and economic policies and development in Europe. To the extent that the EMS succeeds in these respects and in curbing the member countries' inflation rates, both of which will enhance

economic recovery in Europe, expand world trade and facilitate the efforts towards a stable global exchange rate system, there are combined positive effects for the West African monetary integration process. The obvious explanations for the likely implications for the EMS for West Africa relate to the very close trade, financial and overall economic relationships that exist between West African countries and Western Europe and the United States.

On exchange rate management, as already noted, West African currencies are either pegged directly or indirectly (intervention currency) to either an EMS currency or the US dollar (see Table 6J). The variability of these currencies on the exchange markets, therefore, directly causes the variability of West African currencies. Hence, the ability of the EMS to calm the exchange market and stabilise the exchange rates of all the key currencies, including the dollar, would assist exchange rate and monetary management in West Africa at both the national and regional levels.

Moreover, as has already been shown in this study, West African countries are also highly dependent on the EMS and other developed industrial countries (notably the UK, US and Japan) for trade, services and capital. More than half of the region's total foreign trade is with the European Community and because of the EMS this share of trade will be subjected to a fixed or semi-fixed exchange rate system (the BCEAO's total trade is practically subjected to the special fixed relationship between the CFA franc and the French franc). Also a significant proportion of the region's trade and financial commitments (in terms of oil and public debt obligations) is linked to either sterling or the dollar. Because of this high dependence, the stability of the European and other developed

economies through the EMS would, quite apart from the exchange rates, also help West African export proceeds and make them more predictable and plannable. The slowdown of European inflation that the EMS arrangement would help bring about would also help to reduce import payments of the West African countries.

The above potential benefits of a successful EMS to West Africa are obviously more certain if the EMS objectives are attained without being deflationary. Alternatively, if, for instance, through the EMS, European currencies were to rise against the dollar then West African exports whose prices are quoted in dollars would suffer a loss of proceeds. The rise against the dollar would also hurt the exports of countries that are pegged to the French franc because their exports would become much more expensive than those of other West African countries. Also, if the EMS were to become deflationary that would further reduce European demand for West African exports.

As is however argued in this study, the establishment of a common currency other than the pursuance of forms of partial monetary integration (ie clearing and payments, and simple exchange rate co-ordination) is, in the light of existing circumstances, the most realistic framework for monetary integration in West Africa. This automatically involves the theory of optimum currency areas against which the practicality or feasibility of a common currency arrangement is more specifically discussed in the literature. The extent to which the OCA theory is applicable in the context of West Africa is examined in the next chapter, which, in essence, provides the more direct theoretical foundation against which the realism of the main hypothesis of this study is appreciated.

## CHAPTER 8

### OPTIMUM CURRENCY AREA THEORY AND MONETARY UNIFICATION IN WEST AFRICA

#### 8.1 INTRODUCTION

The theoretical assumptions for the delineation of a currency area imply the adoption of a common currency or the maintenance of fixed exchange rates within the area. The pioneering works along these lines (Meade 1957 and Scitovsky 1958) considered the problem of monetary integration as part of the wider issue of economic union and favoured the idea of a single currency area in Western Europe (except that for Meade, a common currency provided the best longrun solution to the achievement of payments equilibrium in the area). Meade argued that in the shortrun the conditions for a common currency did not exist in Europe and that, especially because of the lack of factor mobility in the area, a system of flexible exchange rates would be more effective in promoting external balance and internal stability.

It was Mundell (1961), in his classic paper by that title, who coined the phrase 'Optimum currency areas' and since then the concept of optimum currency areas has received the critical attention of eminent analysts, especially McKinnon (1963), Kenen (1969), Snider (1967), Ingram (1969), Grubel (1970), Fleming (1971), Corden (1972), De Cecco (1974), Presley and Dennis (1976), Vaubel (1979) and Nana-Sinkam (1978).

The term 'optimal' may appear to refer to an ideal or perfect position as it would do in welfare theory, the objective being the maximisation of the achievement of the standard macroeconomic targets of full employment and payments equilibrium. But from the

different theories that have emerged on the subject, the concept of OCAs itself is hardly a unified body of analysis. Its origins can be found in the longstanding controversial decision in the optimal exchange rate regime, with the controversy revolving around the relative desirability of fixed and flexible exchange rates and in the recognition of the need to weigh between the factors which crucially influence the optimal exchange rate regime. In theory and in practice, these factors have differed and the policy targets have also widened to include internal price stability and the realisation of fiscal and monetary economies of scale. The general issue on which the OCA concept is built is largely that, given a workable system of flexible exchange rates, and given certain targets of economic policy, what would be the criteria for finding the optimal area in which to have a common currency or a permanently fixed exchange rate plus perfect convertibility.

The theory of OCAs thus offers important considerations as to the conditions under which a country may join a currency group with possible accomplishments of maximum net benefits and suggests how countries may be grouped into currency zones that would yield cost minimisation in the attainment of economic goals and objectives. With exchange rate variations excluded among potential member countries, an OCA maximises the opportunities for optimum adjustment processes. Whether the advantages of fixed exchange rates will outweigh the cost related to the loss of exchange rate as an instrument of national policy depends on a number of suggested considerations, the analysis of which underlie the established criteria for an OCA.

In its various conceptual interpretations, the OCA has become a proposition that is relatively advantageous to a region that has a high degree of trade interdependence and factor mobility. These conventional criteria have been expanded to incorporate the extent to which the OCA is also socially, politically and geographically homogenous enough to inspire the institutionalisation of currency areas, especially in the case of developing countries (Nana-Sinkam, 1978). The cumulative effect of these factors is to provide a definition of OCAs in the sense of fixing geographical and socio-political-economic confines to such areas.

Curiously these factors are prescribed in practically all statutory provisions that support and give weight to the establishment of regional economic groupings as the hallmark of integration. Thus, it is worthwhile understanding their main theoretical perspectives in the monetary integration process. Without pre-empting the conclusions of the analysis in this chapter, the undoubted fact is that like other regions - including the EEC - the sixteen ECOWAS member countries under consideration in this study do not, in terms of the prescribed criteria, constitute a currency area. The evidence as we have partly seen in previous chapters, is that despite their substantial openness in terms of external trade dependence (Chapter 4), little progress has been achieved in improving either trade inter-dependence (Chapter 4) or factor mobility (Chapter 3). In various parts of previous chapters also, it has been shown that there is considerably little convergence in political and economic thinking among ECOWAS countries (eg convergence in political institutions and philosophy, of a stable pattern of balance of payments, in currency and exchange

rate arrangements, in many other aspects of monetary, financial and fiscal policies, etc).

The discussion in this chapter of the theoretical framework for currency areas does not only provide a critical survey of standard criteria of OCA theory (Section 8.2), it seeks also to examine the implications of the theory for the process of monetary integration in West Africa (Section 8.3)

## **8.2 OPTIMUM CURRENCY AREA CRITERIA AND MONETARY INTEGRATION**

### **8.2.1 Factor Mobility**

One of the early contributions to the literature on optimum currency areas was Mundel (1961) who stressed factor (labour) mobility as a criterion for the formation of such areas. Mundell argues that flexible exchange rates among national currencies may eliminate disequilibria in external payments only if labour mobility is high internally and low internationally. He maintains that if however, the area under consideration is divided into regions within which only mobility is high and which do not correspond to national boundaries, flexible rates cannot bring about adjustment unless currencies are reorganised along regional lines.

To determine the OCA, Mundell considers the case of two economic units (ie regions or nations) which have at the start full employment and payments equilibrium. On the assumption that a demand shift between them is the cause of balance of payments disequilibrium, he maintains that factor mobility can, for the purpose of adjustment, act as a substitute for variations in the rate of exchange. If there is complete mobility of labour, the required adjustment of the balance of payments should not cause

unemployment in the case of a deficit or inflation in the case of a surplus. Hence the exchange rate is not needed as a policy instrument and currency areas are delineated therefore by factor mobility. 'If the world can be divided into regions within each of which there is factor mobility and between which there is factor immobility', Mundell writes, 'then each of these regions should have a separate currency which fluctuates relative to all other currencies'.

Mundell describes the functioning of the factor mobility mechanism as follows. First, suppose there is a shift in demand from region B's output to that of A, where both regions are defined by a high degree of factor mobility, and that the standard mechanism of restoring external balance through exchange rate variations works. Then, if regions A and B coincide with countries A and B, a depreciation of B's currency and an appreciation of A's currency will relieve unemployment in B and restrain inflation in A; thus, reflecting a favourable case for flexible exchange rates. But, if in A credit is restricted to prevent a rise in prices, the burden of adjustment will fall entirely on B. Since the fall in B's real income, necessary to maintain stability given the new demand conditions, cannot take place through price changes - terms of trade - (monetary authorities in both A and B, ex hypothesis, maintain price stickiness), adjustment will have to be accompanied by a decline in B's productivity and employment.

Secondly, if it is assumed that the shift in the demand from B's to A's goods takes place not between two countries but between two regions of the same nation, inducing unemployment in region B and inflation in region A, monetary expansion in both countries to



solve the unemployment problem in the depressed regions would not solve the inflation in the prosperous regions; nor will a contradiction of money supply in order to solve the inflation problem in the prosperous region cure unemployment in the depressed region. Therefore, Mundell concludes, a flexible exchange rate system may solve the external imbalance between the two countries, but it fails to achieve a simultaneous solution to the problems of unemployment and inflation. Full employment is maintained by monetary policy, but at the cost of monetary instability as the monetary expansion aggravates the inflationary pressures in A, modifies the terms of trade unfavourably in B and thus corrects the surplus in A.

Consequently, in a currency area comprising many national currencies, the level of unemployment in the deficit countries is determined by the surplus countries' willingness to accept inflation, whereas in a currency area with several regions but with a single currency, the rate of inflation is determined by the authorities' willingness to accept unemployment in the deficit regions. The fact that a currency area of either type cannot prevent both unemployment and inflation among its members, Mundell maintains, depends not on the type of the currency area which is adopted, but on the extent of the area itself. The OCA, he asserts, cannot include the whole world. Its borders (that which allow both monetary stability and full employment to be simultaneously maintained), according to Mundell, coincide with the borders of economic regions, defined only in terms of internal factor mobility as opposed to inter-regional factor immobility.

In a further illustration of his factor mobility concept, Mundell (1961) considers the case where consumer demand shifts from cars (Eastern goods) to lumber products (Western goods). As a result, the East develops a current account deficit and an excess supply of labour, while the West experiences a current account surplus and an excess demand for labour. If labour cannot move from East to West, the East has to accept worse terms of trade, sufficient to reallocate aggregate demand and thereby to eliminate the disequilibria in both regions' labour markets. If money wage rates are sticky in both regions, Eastern currency must depreciate in relation to Western currency. East and West should not be joined in a monetary union, nor be made to peg their currencies once and for all; they do not comprise an optimum currency area. But in the event that labour is freely mobile between East and West, the westward migration of unemployed Eastern labour will serve to ameliorate the labour market problems of both regions and, at the same time, will help to solve their payments problem. As workers move from East to West, their purchases of cars will be transformed from home demand into extra Eastern exports; then purchases of lumber products will be transformed from Western exports into extra home demand.

In sum, Mundell contends that inter-regional factor mobility can substitute for changes in regional exchange rates, and that the entire zone through which labour can move freely delineates the right domain for a monetary union or for a fixed exchange rate regime; with labour mobility, East and West do comprise an OCA.

Mundell's stabilisation approach has however required two broad qualifications. The first, which he himself recognises, is that if strictly followed, his argument leads to the dilemma that the OCA has always to be small as many currency areas are preferred, notwithstanding the increased costs which are likely to be associated with the maintenance of many currency areas. As these areas would inevitably be very small, the benefits derived from labour mobility would be more than offset by its cost in terms of the utility of the currency as a medium of exchange and store of value.

Mundell concedes that 'such an arrangement hardly appeals to common sense'. The role of money as a medium of exchange diminishes and the costs of valuation and currency conversion increase as the number of currencies rise under flexible exchange rates. Investors would be deprived of a stable-valued liquid currency to hold as a store of value or use as a standard of value.

Mundell explains further that too small a currency area necessarily implies a thin foreign exchange market that may stand hopelessly vulnerable to the price dictates of any single speculator. Speculation would disrupt domestic monetary policy. He notes that in the extreme case, in order for the system to work adequately, a very high degree of money illusion would be required of the workers of each productive activity. Thus as the degree of money illusion necessary for the proper functioning of the system becomes greater the smaller the currency area, this sets an 'upper limit' to the number of currency areas necessary for the optimal functioning of the adjustment mechanism.

Secondly, if labour intensities in the industries of the regions among which migration takes place are different, labour mobility may not be sufficient to eliminate payment imbalances. As Kenen (1969, p 45) has noted, 'rather special patterns of consumer demand and methods of production may be needed in each region if a simple labour movement and the corresponding locus of demand are to end an imbalance in the two regions' labour markets and also to equilibriate the trade flow between them'. In other words, perfect intra-regional mobility requires perfect occupational mobility, which in turn requires the homogeneity of labour or identical skills in the industries effected.

In his two-country-world example - Canada and the United States - with separate currencies, Mundell (1961) assumes the existence of regions characterised not only by internal factor mobility but also by productive homogeneity. His condition for optimality of currency areas, in the strictest sense, applies only to single-product regions. He adopts the classic Ricardian assumption on which the theory of international trade was built as a body distinct from the general theory of exchange; namely that productive factors are mobile internally but immobile internationally. Ricardo (1964, p 83) argues that 'the difference .... between a single country and many is easily accounted for by considering the difficulty with which capital moves from one country to another, to seek a more profitable employment, and the activity with which it invariably passes from one province to another in the same country'. The only difference is that Mundell takes into account the fact that areas of perfect (labour) mobility may not coincide with national boundaries.

The most serious criticism of Mundell's analysis is based on the grounds that in the real world factors of production are never perfectly mobile. Moreover, not all that are mobile are readily adaptable to other uses. There is therefore a continuum of different degrees of labour mobility both internally and internationally. It is unlikely that there should exist, in practice, sufficient inter-regional labour mobility which can be counted upon as a mechanism for payments adjustment, and that even if there is mobility, the costs associated with workers' movements cannot be ignored. However, the argument that labour flows can be relied upon as a substitute for exchange rate adjustment, which itself is seen as a substitute for changing real wage levels as a consequence of changing demand and supply conditions, falls down under two practical conditions: first, when it is recognised that differential changes in unit factors costs are not the only possible causes of payments disequilibrium, and secondly, when the reluctance of workers to move even within the same country is fully appreciated.

In reality, even if it is conceded for example, that the original payments disequilibria were caused by higher unit labour costs in country A, for instance, relative to country B, and hence higher export prices in country A, factors may still not flow from A to B. This is because higher unit labour costs may reflect higher real wages in A, depending upon the relative levels of labour productivity in A and B. Workers, even though unemployed, may not be prepared to move from high wage areas to low wage areas even if more jobs may be available in the low wage areas. It is more likely that they would wait, anticipating job opportunities in the high

wage area. Besides, if labour is prepared to flow from A to B, like capital, it may set up disequilibrating forces in the two countries.

The adjustment process through labour mobility is complicated further by the many other discussed factors which in practice, seriously inhibit the willingness of workers to move. Some of these include the barriers to inter-industrial labour exchange (Lanyi, 1969), the real costs of migration as well as the psychic costs of adjusting to a new environment (Corden, 1972 and Dunn, 1973), monopolistic distortions of resource allocation due to trade union aggressiveness (Corden, 1972), deliberate national government barriers to geographical and/or occupational labour mobility, the inflexibility of wages and prices, the degree of homogeneity of labour, and a country's labour absorptive capacity. Labour mobility is also affected by the existence of a host of other economic, geographical, socio-political and cultural conditions. These factors are more likely to influence the movement of workers than changing supply-demand relationships.

In commenting on Mundell's East-West illustration in particular, Kenen (1969, p 43) asks the questions: 'what should be done for instance, when there is a major difference in the labour intensities of eastern and western production? And are we really sure that factor movements can restore a perfect balance in the region's trade even when it does resolve both of their employment problems?' Kenen argues that migration might leave a residential imbalance in one region's labour market - enduring excess supply in the East or excess demand in the West.

Fleming (1971) argues that a transfer of labour provoked by unemployment, while it may mitigate the more obvious signs of disequilibrium, is not necessarily justifiable from a structural point of view, and may later have to be reversed. This view appears to imply that factor mobility should not be encouraged. Presley and Dennis (1976) reckon that such a view formed the basis of regional policy in a number of countries in the past, including the United Kingdom. The implication in such policy is that work must be encouraged to move to workers rather than vice versa. The justification for this policy, according to Presley and Dennis, is partly to be found in the under-utilisation of social capital which labour mobility creates in the depressed areas of the economy, and the over-utilisation and shortage in the prosperous regions. In addition, one may find damaging repercussions on the social and economic environment in the depressed areas. Effectively, factor movements tend to persist in certain directions for much longer periods rather than being reversed frequently as expected in Mundell's adjustment mechanism. Factor mobility takes time with its intensity more often than not, fluctuating with the extent to which excess factor demand tends to bring about a differential in remunerations high enough to overcome the attitudes which make for immobility. Besides, its limitation as a criterion for OCA determination and hence in providing an equilibrating mechanism for the area may be more conspicuous where capital is lacking and the participating countries are the subject of massive unemployment at the same time.

Fleming (1971) has noted further that an important distinction has to be drawn between the mobility of labour and of capital. This is because the mitigating effect of factor mobility is more certain in the case of labour than capital mobility. The effect of labour mobility may be reduced but not eliminated by the fact that it is likely to be associated with a change in the location of workers' expenditure from countries of emigration to those of immigration. Whether a high degree of capital mobility can provide a good precondition for the formation of a currency area is much more doubtful than in the case of labour mobility because the former depends on such forces as the nature of the payments disequilibria between the member countries, the sensitivity of investment to the level of economic activity, and the stipulated period of adjustment. It is therefore not certain whether capital mobility will reduce the costs associated with exchange rate fixity.

If in the light of Mundell's two-country demand-shift illustration it is assumed further that exchange rate is rigidly maintained between the two national currencies, and that payments equilibrium is restored partly by deflation (and unemployment) in one member country, and partly by inflation in the other, then the incentive to investment would decline in the former (deficit) country and rise in the latter (surplus country). What happens to the interest rates in the two countries depends on the response of investment and savings to the changes in the level of activity: they will rise if investment increases more (or declines less) than savings and vice versa. If the investment incentive declines more than the level of savings in the deflating country, and rises more than savings in the inflating country, both unemployment and



inflation are expected to aggravate in the two countries respectively. In this case, capital mobility worsens internal disequilibrium, although the possibility of equilibrating capital flows may also exist. Since capital flows will move towards areas with higher interest rates, they may well constitute a destabilising, rather than a stabilising factor.

Moreover, because international capital flows are, in practice, not geared entirely to changes in demand for capital, the assumption that an increase in demand for output in one country creates an increase in the demand for capital in that country and therefore a flow of capital into that country from the demand depressed partner no longer holds. The flow of international capital is determined partly by the anticipated rate of return on it and country risk, as well as by the level of economic activity and absorptive capacity. The increased demand for capital in one country does not necessarily imply that the rate of return on capital is higher than in the other country, nor that investment is less risky there. The fact that potential investors do have specific views over time of the riskiness of investment in certain areas, this is more likely to interfere with the free flow of capital in response to disequilibria.

Fleming asserts therefore that the higher the degree of capital mobility the greater will be the shift in capital flows - whether of an 'equilibrating' or of a 'disequilibrating' kind, and that the response of capital flows to disequilibria is crucially important, since capital is needed to finance investment, investment in turn determines employment through the multiplier process. Where capital is more a destabilising than a stabilising factor, a high capital

mobility would make adjustment with a fixed exchange rate more difficult, not easier. The likelihood that capital mobility will be a destabilising influence is greater if surplus countries attempt to use monetary policy for internal rather than external stability. The deliberate hiking of interest rates in this case to check inflationary pressures, which will in turn stimulate capital flows, will worsen the deficit countries' external positions.

### 8.2.2 The Openness of an Economy

The 'openness' of a country's economy provides another basis on which currency areas may be identified. The argument is that currency areas should comprise highly open economies. This view has been stressed particularly by McKinnon (1963) whose impression of the optimality of a currency area is related to the area's ability to achieve external as well as internal equilibria:

'Optimum is used here to describe a single currency area within which monetary-fiscal policy and flexible external exchange rates can be used to give the best resolution of three (sometimes conflicting) objectives:

- (a) the maintenance of full employment;
- (b) the maintenance of balanced international payments;
- (c) the maintenance of a stable internal average price level' (1963, p 717).

A currency area should be imposed in so far as it minimises the costs of achieving these objectives, with particular emphasis, in contrast to Mundell's stress on payments equilibrium, upon internal price stability. McKinnon is of the opinion that what matters most

in delineating currency areas is the size of the area and its degree of openness.

For analytical purposes, McKinnon defines openness in terms of the 'ratio of tradable to non-tradable goods'; where tradable goods are defined to constitute exportables (ie goods produced domestically which are either consumed domestically or exported; hence, exportables will exceed exports by the extent to which domestic consumption takes place from potential export production) and importables, which are both produced and consumed domestically and imported. The smaller that ratio, the easier it will be to maintain both external and internal balance by means of flexible exchange rates. That is, the higher is the ratio of tradables to non-tradables, the more beneficial will be the formation of a currency area. What differentiates tradables from non-tradables, McKinnon assumes, is the fact that the former can be transported internationally.

McKinnon argues that if the ratio of non-tradables to tradables is high, primary reliance on monetary-fiscal policy for reducing domestic demand in order to maintain external balance will bring with it higher unemployment. If on the other hand the ratio is low, fixed exchange rates will be more appropriate. The achievement of internal price stability is considered the key economic objective as domestic price instability would not only undermine the liquidity value of individual currencies, or induce domestic capital to be transferred into other more stable currencies. It is seen also as an impairment to savings and capital accumulation, trade development and a discouragement to economic specialisation. Mundell (1961) did, of course, recognise the importance of equalisation of unit

factor costs in the adjustment but this might involve price variations and therefore leading to domestic price instability. As a result, Mundell's contribution to the OCA theory has not placed as much emphasis on internal price stability as McKinnon's.

McKinnon stresses that the higher is the proportion of tradables to total domestic consumption, the greater will be the impact of an exchange rate adjustment upon the domestic price level. In other words, by emphasising flexible exchange rates to correct an external deficit, an open economy (compared to a closed economy) is likely to suffer from greater domestic price instability. Because the economy is open and exposed to highly elastic external demand for and supply of goods, the domestic currency prices of its tradables would change in more or less equal proportions with the magnitude of the exchange rate variation.

The desired effects of a devaluation, for instance, would be to correct a trade deficit, stimulate increased domestic production of tradables and to diminish domestic consumption of tradables. Exports can then be increased and imports reduced. Since the desired effect may only be accompanied through a rise in the domestic price level, the higher the marginal propensity to import, the greater the disturbance to the price level, the less will be the amount of unemployment that will be required over time to correct a given payments deficit, or the amount of excess demand required to correct a given surplus; hence, the more valid the case against flexible exchange rates. As the domestic prices of tradables move with the exchange rate, the higher is the proportion of tradable commodities in the economy, the less is the possibility that adjustments to domestic consumption can take place to export and

import flows; the more also will the general price level be affected, since tradable goods prices take an increasing weight in the determination of the domestic price index. If stabilisation of the overall price index were rigidly pursued, a depreciation and the resulting price rise in tradables would need to be offset by a decline in the price of non-tradables, requiring a severe contraction in demand and unemployment. Thus, a number of open economies with very high propensity to import from each other would find it beneficial to form a relatively closed common currency area.

However, the higher the propensity for one member to import from the other members of the area, the greater will be the influence of the costs of imports from other group members on the overall cost of living of each member (Fleming, 1971). Cost disequilibria between member countries, however rising, will lead to disequilibria in relative consumption price levels, and their correction will therefore involve large real income changes for wage earners in member countries that are out of line with the rest.

As in the case of Mundell's factor mobility criterion, the degree of openness of an economy also affects the presence of money illusion. The effectiveness of exchange rate variations in correcting external imbalances largely depends on the existence of money illusion, defined as people's readier acceptance of reductions in real income brought about by price increases than of the same reductions brought about by reducing their money income. Mundell (1961) had argued:

'The thesis of those who favour flexible exchange rates is that the community in question is not willing to accept variations in its real income through adjustments

in its money wage rate or price level, but that it is willing to accept virtually the same changes in its real income through variations in the rate of exchange. In other words, it is assumed that unions bargain for a money rather than a real wage, and adjust their wage demands to changes in the cost of living, if at all, only if the cost of living index excludes imports. Now as the currency area grows smaller and the proportion of imports in total consumption grows, this assumption becomes increasingly unlikely'.

The implication for OCAs is that because of the downward inflexibility of prices and national wages, deliberate variations of the exchange rate might succeed in changing real wages and hence, restore external balance. By this kind of money illusion, workers are less likely to recognise that a devaluation, for instance, would lead to a corresponding rise in the cost of living and a reduction in real incomes. In a small area, where the import propensity is high, the real income effect of exchange rate variations would be so obvious to the inhabitants that they would not accept changes tied to a price index excluding imports. If this were the case (absence of money illusion), then the exchange rate variation would become an ineffective instrument in correcting external imbalance. The more open an economy becomes, the more unlikely it becomes that this kind of illusion will persist. In this instance, McKinnon emphasises that exchange rate variations would sooner or later cause exactly equal variations in costs; workers would be more certain to recognise the decline in living standards and real wages which result, and

their corresponding resistance to prevent this decline would in turn deprive the flexible exchange rate system of its effectiveness in correcting the payments imbalance.

It is observed further than an indexation of wages seldom operates instantaneously and only partially offsets the effects of exchange rate adjustment (Fleming, 1971). In Fleming's opinion, money illusion may well be relevant the other way around. Since national currencies have a strong tendency to sustain their traditional functions, especially where wage settlements and payments are concerned, once a common currency is set up, it may be very difficult to revoke it, even if its establishment has proved to be a mistake.

Corden (1972) has observed that McKinnon's conclusion depends crucially on the implicit assumptions that:

- (a) the principal need for payments adjustments arises from micro-economic changes in demand and supply conditions, and
- (b) conditions (price) in the external world as a whole are relatively stable.

If this is not the case (ie if the disturbances leading to price instability are macro in nature and emanate from abroad), flexible exchange rates should be used to attempt to insulate the economy from such external macroeconomic disturbances, and the more open is the economy, the more important is this insulation. In this latter situation therefore, McKinnon's argument appears reversed, with fixed exchange rates being detrimental to a very open economy.

Corden also makes the point that even where McKinnon's world price stability implicit assumption holds, a positive gain in employing fixed exchange rates cannot be ascertained. It only means that the more open the economy compared to a closed economy, the less the costs of maintaining fixed exchange rates in terms of the required increase in unemployment to effect the same degree of improvement in the payments imbalance.

The currency stability requirement touched on earlier provides yet another way in which the 'ratio of tradables to non-tradables' affects the desirability of joining a currency union. If inflation is zero, the domestic currency of a small economy characterised by a high ratio of tradables to non-tradables will have a stable liquidity value in terms of non-tradables, whereas its value in terms of tradables will depend on the exchange rate vis-a-vis the foreign currency. In these circumstances, and with the existence of trade disturbances, exchange rate variations may lead to a severe impairment of the liquidity of the domestic currency. With the purchasing power of the domestic currency not sufficiently guaranteed in terms of the range of goods which domestic owners of financial wealth deem it to be representative, the result is likely to be a shift from domestic to external assets even though the former may be of higher rate of return. The resulting capital outflows is therefore determined purely by the insufficient monetary quality of the domestic currency rather than the country's real characteristics. Consequently, the formation of a large currency area may ensure that variations in the exchange rate of the common currency will not impair its liquidity.



The operational difficulties surrounding McKinnon's 'openness' criterion derive essentially from three areas. The first is from the relative effectiveness of monetary and fiscal policies to correct, for instance, an unemployment which initially occurs in a very open economy through, for example, technological changes affecting the capital/labour intensiveness of industries. Secondly, the assumed constancy of the world prices of tradable commodities does not hold in the present economic climate. The third major practical problem relates to the appropriateness of McKinnon's definition of openness. The variety of analytic interpretations of 'openness' which have emerged from economic analysis, have made openness a multidimensional concept.

Consequently the openness of an economy has also been expressed in terms of:

- (a) the share of trade in the economy's GNP (commercial openness);
- (b) the volume of domestic financial transactions and external capital movements (financial openness); and
- (c) the degree of international factor mobility (see for instance, Mundell, 1961; Wallich, 1969 and Whitman, 1969).

Cross and Laidler (1974) have also represented McKinnon's openness criterion in terms of the importance of tradables and non-tradables in the output or consumption of an economy in the context of an inflation model for 'open' and 'closed' economies.

The empirical difficulties in the applicability of these measures constitute the actual defining and measuring of the relevant aggregates as well as finding an adequate practical justification for applying each measure in a given economic

environment. Commercial openness (both in terms of average and marginal propensities) is often criticised as unsatisfactory because GNP data give only a very rough indication of aggregate volumes of commercial (trade) transactions (see for example, Vaubel, 1978) whereas financial openness, on the other hand, cannot be measured directly, largely because of the difficulties in obtaining comprehensive and reliable statistics of both the volume of domestic financial transactions and gross external capital movements. In some instances, financial openness has only been ascertained in terms of the pattern of net capital movements between countries (Whitman, 1969), or net flows and net outflows (Hawkins, 1972), or the ratio of some foreign assets to more or less comparable domestic assets, eg the ratio of commercial banks' foreign assets to total money stock (Heller, 1976).

The conclusion in the light of the above analysis is that in a relatively open economy, variations in the exchange rate will lead to greater domestic price instability. In this respect therefore countries with high interpenetration will find it beneficial to form a fixed exchange rate area. In its logical conclusion, McKinnon's analysis for currency areas would involve the introduction of such an area at the world level; the world cannot have external disequilibria, and worldwide monetary and fiscal policies can be relied upon to yield internal world objectives. The difficulties to be encountered in the estimation of the 'openness' indices make it extremely arduous to rely on McKinnon's theory, in particular, as a general guide to practical assessment of optimum currency areas. As in the case of the factor mobility criterion, the various interpretations of openness also indicate the likely implications

and limitations of exchange rate variations for restoring internal and external equilibria - eg cost/price, and factor mobility effects. This is important, especially for the LDCs whose characteristic features often impair the success of adjustment policies through this instrument.

### 8.2.3 Product Diversification

While Mundell and McKinnon stress factor mobility and economic openness respectively, Kenen (1969) provides another major contribution to the OCA theory by emphasising yet another condition on which optimum currency areas may be delineated; this being 'the diversity in a nation's product mix, the number of single product regions contained in a single country'.

Kenen proposes that:

- (a) a well diversified national economy will not have to undergo changes in its terms of trade as often as a single-product economy;
- (b) when a diversified economy does not confront a drop in the demand for its principal exports, unemployment will not rise as sharply as it would in a less diversified economy; and
- (c) links between external and domestic demand, especially the link between exports and investment, will be weaker in diversified economies, so that variations in domestic employment 'imported' from abroad will not be greatly aggravated by corresponding variations in capital formation.

These factors, all of them deriving from the insurance principle (or the law of large numbers), provide reasons for Kenen's argument that countries with high product diversification can tolerate fixed exchange rates better than those with less diversified national economies. Thus, a low degree of product diversification, particularly in relation to exports, provides a good reason for the formation of an independent currency area. The more diversified is an economy in this respect, the more independent it will be of external disturbances. In other words, foreign disturbances will have less repercussions on the payments as well as the domestic income and price stability positions of an economy with a greater variety of export commodities than they would in a less diversified economy.

The thrust of Kenen's argument is the assumption that positive changes with respect to some of the exports will be offset by negative changes with respect to others; as demand for some exports rises, that for others drops. Thus, the greater is export diversification, the greater will be this offsetting mechanism. In contrast, the offsetting mechanism will be less in a less diversified economy whose payments equilibrium is more likely to be sensitive to micro-economic demand disturbances. Consequently, substantial exchange rate changes as an equilibrating instrument would be less necessary in a more diversified than in a less diversified economy because of the averaging of the external shocks - the variety of shocks on different export commodities would tend to keep export earnings rather stable.

Kenen points out however that diversification of output and exports cannot guarantee domestic stability even when external shocks tend to average out. Sufficient occupational factor mobility will be necessary in order to reabsorb the factors idled by adverse disturbances. If there is a drop in the demand for one export product, for example, aggregate unemployment would not rise so sharply in a more diversified economy because in the former each industry subject to an external shock provides only a fraction of total employment and hence the effect becomes less. Kenen shows that when exchange rate variation is employed to maintain the pre-disturbance employment level, in the event of a deterioration in the terms of trade or a downward shift in the foreign demand curve, it must be greater in a less- than in a well-diversified economy.

Kenen maintains further that in protecting the economy from external shocks, a greater diversity in exports will help to stabilise capital formation, hence, easing the burden that has to be borne by internal prices. He acknowledges that where changes in export demand arise from business-cycle swings, the whole range of exports will be hit, and therefore export diversification in this instance may not be expected to forestall imported instability.

In practice, Kenen's product-diversification criterion suggests that small areas with less diversification are optimum currency areas. In this respect, flexible exchange rates are better suited to the peculiar problems of the developing countries most of whose economies are less diversified, depending essentially on 1-3 export commodities. In contrast to the widely diversified developed economies, the extent of export commodity concentration in LDCs (ie the proportion of the three principal exports to total exports) is

very high, averaging about 79 per cent for sub-Saharan Africa in 1976/78 (World Bank, 1981); export diversification for the LDCs is costly in the presence of scale economies as well as of other domestic and external economic and market forces; and their relatively more diversified consumption bundle is reflected in large dependence on imports, thus making them very 'open', though many of them are small in size. Yet the LDCs, it is argued, should have a stronger claim on exchange rate flexibility not only because of the greater need for changes in their terms of trade, but also because, as already indicated, capital is less mobile among them than among the developed countries.

Another dimension is that the output of a large economic region with a relatively small foreign trade sector is likely to be highly diversified. It may be possible that by joining together, the small 'open' economies will create a large economic region that is more diversified. On Kenen's criterion, these regions should prefer a fixed exchange rate regime and pursue external balance by means of monetary and fiscal policies. But the smallness of the trade sector does imply greater instability when monetary and fiscal policies are employed for internal balance, thereby leading to the 'tail-wagging-the-dog' situation, ie wide variations in domestic demand and employment would be required to correct relatively minor imbalances, which is clearly not an optimal solution (McKinnon, 1963). The contradictions between Kenen and McKinnon arise essentially from the different assumptions underlying the major source of the payments disequilibria; internal shocks for McKinnon, and external shocks in the case of Kenen. When stability is assumed to exist in the rest of the world, exchange rate flexibility becomes the inevitable

policy choice in order to insulate the economy from outside disturbances. This divergence in policy prescriptions does indicate the relative importance of basic assumptions in the OCA debate. Some analyses (see for instance Massell, 1970; Tower and Willet, 1976) do affirm that competing considerations (particularly when a freely floating exchange rate is taken as the alternative to membership in a currency area) may well reverse Kenen's conclusion.

Furthermore, the validity of Kenen's argument is limited to imbalances of a microeconomic nature, eg arising from shifts in demand as between the products of different participating countries. But, as noted by Fleming (1971) if the imbalances are of a macroeconomic type - eg when they are due to cost-push forces affecting all economic sectors alike - the need for adjustment will be equally great, whether product similarity among countries is high or low.

Compared with Mundell, Kenen's distinction between regions (characterised by the same economic activity) and optimum currency areas (characterised by internal factor mobility) hardly differs. Both authors stress the principle of labour mobility between economic activities as opposed to capital movements. To enhance adequate labour mobility however, Kenen assumes further that the economy is made up by activities with similar factor intensities, ie activities producing goods that are optimum substitutes of each other. It does not necessarily follow that capital/labour ratios are equal in expanding and contracting industries; if not, there is bound to result unemployment of either factor through even changes in export demand which totally offset one another.

Similarly, Kenen's implicit assumptions, firstly, that labour supply is infinitely elastic with respect to a given nominal wage rate, and secondly, that the international price of the import good and the nominal wage rate change at the same time appear rather restrictive. To the extent that these assumptions are removed because they do not hold in the real world, it becomes practically impossible to prove his intended propositions, at least formally (Shiyama, 1975). Certainly, in the real world, wages and prices may not remain constant and so export demand changes may not be neutral in a well diversified economy. Where the demand for export products rises, prices and wages may probably rise within those sectors, but where it falls, it is unlikely that these will drop correspondingly.

Kenen's analysis has been criticised on more technical grounds by Flanders (1969) and Ingram (1969). Flanders concentrates on Kenen's use of the word 'diversified' and maintains that Kenen has not really demonstrated his second proposition as stated. In his formal model, Kenen has used the term only to refer to an economy having an import-competing industry, not an economy exporting many products. Comparison is made between two economies exporting and importing only one commodity. 'What is not clear to me from his model', writes Flanders, 'is what happens if there are two export goods rather than one'. This would involve him, of course, in a three commodity model, and life would be complicated'. This point (on which Kenen concedes) makes his two-product economy not so much a more diversified as a less open economy.

Ingram, on the other hand, believes firstly that what is implied in Kenen's analysis of OCAs is that when one region has unemployment, other regions will have to accept inflation in order



to relieve the unemployment. Thus differing degrees of inflation are expected in the regions. Ingram also points out that the analysis further implies that the terms of trade will vary more for regions with few products than for those with many products. He argues nonetheless that instead of the change in the terms of trade, Kenen should be referring instead to the changing greatness in the amplitude of fluctuation. The empirical evidence on the relationship between payments instability and export concentration refers to macroeconomic swings in foreign trade and not to the kind of microeconomic instability that Kenen considers. This evidence does raise the possibility that instability in the composition of trade may not be as important as Kenen's analysis makes it out to be. Like Flanders, Ingram too does doubt whether comparison of one product and two product economies provides sufficient grounds on which to determine the influence of product diversification.

In the light of these observations, especially the last, Ingram maintains that although plausible on theoretical grounds, Kenen's theory may be too abstract and its assumptions are too extreme and unrealistic to warrant practical conclusion thereon. More specifically, the operational limitations of Kenen's analysis relate firstly, to the means by which 'diversity in a nation's product-mix' can be measured or the mode of identifying a single product region, since his approach is to calculate the number of single product regions in a single country. Both Kenen and Mundell concentrate on the delineation of a country into regions between which factors are immobile, and within which they are mobile.

Another operational difficulty is that, as in the case of McKinnon's 'openness' analysis, Kenen's diversification criterion also stops short of indicating a critical value above which a country satisfies it such that the country can forego the ability to vary its exchange rates. As with Mundell and McKinnon's criteria, Kenen too has failed in his representative condition, to offer practical guidance as to the size (at the lower and upper limits) and other evaluation of any group of countries as a proposed OCA.

In Presley and Dennis (1976), diversification in the EEC, for instance, is estimated on the basis of the industrial origin of the GDP in each member country. A percentage contribution of each of eleven sectors to the GDP is calculated and a diversification statistic (DS) computed as the number of sectors contributing more than 9.09 per cent to the GDP. The larger the DS, the greater is the diversification of a country's GDP. But, in this case too the 9.09 percentage indicator is chosen arbitrarily. The test statistic provides the surprising result that West Germany (DS = 3) is considered less diversified than Denmark (DS = 5), hence casting doubts on the procedure.

In another attempt, diversification has been measured by the share of the largest export commodity group in total exports (Heller, 1976). Similarly, the Commonwealth Secretariat (1981) adopts a proxy in which an export diversification index ranges between zero and one, with one representing the most extreme concentration, and therefore the lowest diversification. But, as Presley and Dennis (1976) concludes on the basis of their statistical results, the EEC, for instance, would, even though most countries are less diversified, in a monetary union be highly

diversified and would then satisfy Kenen's criterion in contrast to the individual member countries.

The basic problem with these diversification proxies is that they all ignore diversification in imports and capital movements. This is particularly an unsatisfactory state of affairs because low export diversification (the limit case is a single producer) implies high diversification of imports, and it is difficult to see how the one can be weighed against the other in an imaginary 'index of aggregate diversification of foreign transactions' (Vaubel, 1978).

#### **8.2.4 Degree of Policy Integration**

The basis of this criterion is that the degree of financial market integration, policy attitudes and policy coordination, rather than economic characteristics, are more relevant for the successful formation of currency areas, and hence, on the desirability of a fixed exchange rate area.

Ingram (1969) asserts that by referring to the real economic characteristics of the economy, the models by Mundell, McKinnon and Kenen have little scope for money; as, in their models, prices are expressed in real terms of trade, and all external adjustment occurs on current account, thus eliminating issues relating to the rest of the balance of payments and general economic management. In Ingram's own words: 'I do not think the optimum size of a currency area can be discovered by looking for real economic determinants of it, such as degree of labour mobility or homogeneity of output, although these factors may certainly affect the speed and ease of adjustment'. Ingram thinks that the 'efficiency of a currency area depends on policy positions taken by (participating) governments and

on the firmness of their commitments on them, on attitudes of the population towards the adjustment process involved on the nature of financial and other institutions...'. Consequently this seems a useful basis, perhaps, to recommend OCA/integration in LDCs which have reached some partial financial market integration. Together with Scitovsky (1958 and 1967), Ingram believes that under a high degree of financial integration, especially in relation to long-term securities, the need for flexible exchange rates would be eliminated because only fractional variations in interest rates would evoke sufficient equilibrating capital movements between member countries. These equilibrating capital flows would be enhanced by a rigid permanent link among member currencies and by the liberalisation of payments transactions among partners.

The exact content of 'policy integration' as well as the exact rules for obtaining optimality therefrom are not adequately defined in this context of policies, although the extent to which countries are co-ordinated, centralised or harmonised in these areas is obviously relevant in considering the scope for an effective currency area among them. Fleming (1971) emphasises the establishment of centrally financed schemes among member countries to assist, in particular, the more economically depressed members, and, where practicable, to enhance the harmonisation of incomes policies for the mitigation of the currency area's payments imbalances and the quickening of the adjustment process. He points out, however, that a unified fiscal policy (a transfer of financial resources from prosperous to depressed countries) will be helpful in mitigating inter-member country disequilibria only to the extent

that relative prosperity among them is correlated with relative payments strength.

With specific reference to the EEC, Fleming has expressed doubts whether the centralisation of banking through the establishment of a supra-national central bank or the issuing of a common currency for the area would improve upon the existing arrangements whereby central banks of the member countries in a relatively strong payments position could lend on short or medium term to those central banks of countries in relatively weaker payments positions in order to mitigate mutual payments disequilibria. Such a step, he points out, would probably encourage equalisation of short-term interest rates and mobility of capital throughout the area, but it is by no means always helpful in mitigating inter-member country imbalances because of the likely disequilibrating effect of capital mobility.

These conclusions are very crucial because of the potential critical role of inter-central bank credit facilities (implicitly from the strong and surplus to the weak and deficit members) in monetary integration. For the developing countries, the establishment of credit arrangements as discussed in Chapter 7 has also formed part of their initial, and perhaps the only hopeful, steps in their monetary integration process. Even in such sophisticated arrangements as the EMS, credit has also been an important element of the scheme.

The more usual argument has been that all increases in official international liquidity are likely to be inflationary because they permit central banks to issue more of their own money without incurring exchange rate depreciation. This belief has also been

countered on the basis that central banks or their governments cannot or do not have access to foreign exchange in the private sector capital market. As Vaubel (1978, p 13) argues, to the extent that there is free access to such markets, the extension of credit facilities between central banks cannot be inflationary in itself unless these credits are available at the lower rates than free-market loans. Of course, this outcome is also possible where inter-bank credits are used to finance non-income generating and inflation-inducing projects.

What is equally important is that credit facilities can also be financing rather than adjusting. In the EEC, for instance, the three 'less prosperous' member states - Italy, the UK and Ireland - (as they were called in the text of the conclusions of the Bremen European Council of July 1978) claimed substantial budgetary resource transfers as part of the package, while France sought a stronger policy for reduction of agricultural monetary compensation amounts (ie the realignment of farm support prices). These countries had argued, firstly, that the process of adjusting to the rigours of the EMS entailed a short run risk of weakening the real economy, and secondly, that, since economic and monetary union contained a strong public finance redistribution function and since the EMS was meant to be a major step towards such a union, its setting should be accompanied by some significant parallel progress on the budgetary side. In addition, the UK's case was that the Community budget involved perverse, negative net transfers as far as it was concerned. The outcome of these arguments, especially for Italy and Ireland, has been access to substantial financial

assistance bilaterally from other EMS participant countries (see Kruse, 1980, pp 246-47; Emerson, 1979, p 40).

The practical significance of policy integration on a wider scale has been an integral part of discussions on the evolution and review of both the EEC and the EMS. Monetary integration in the EEC as has already been noted has involved two major schools of thought - the 'economists' who have maintained that monetary integration could usefully be implemented only when certain economic preconditions were obtained, and the 'monetarists' who favoured an early monetary integration in the belief that this would force policy co-ordination.

Apart from the possible disequilibrating effect of capital mobility which is thus hastened by policy integration, the general difficulties confronting the applicability of this criterion also derive from the fact that monetary and fiscal policies have the wide roles of achieving economic growth, income and wealth distribution, resource allocation, etc. Joint action in these policies designed for internal and external balance may conflict with the attainment of these other broader objectives of general economic management. Besides, internal balance does not lend itself to a simple definition. In most developed economies, there is an explicit or implicit trade-off between inflation and unemployment, while in most developing countries, internal balance implies a fierce battle with both rising unemployment and inflation and with several other structural distortions.

Moreover as the financing problems of countries become more varied, acute and complex, it becomes increasingly important to distinguish from a functioning perspective, between a type of

financing requirement that is 'correcting' (merely provides for an accounting balance within the various accounts of the balance of payments), and that which is of an 'adjustment' type (designed to correct structural deficiencies in the economy). Corden (1972) doubts the true adjustment impact of 'correcting' financing since it is merely a short-run stop gap measure, much like the Mundellian argument for manipulating the fiscal-monetary policy mix for the simultaneous realisation of internal and external balance. Policy integration must therefore facilitate the flow of 'real' long term funds if it is to transform a group of participating countries into a successful currency area.

At the same time, drawing from the experiences of the EEC, it is apparent that the restrictive functions of monetary and fiscal policies as well as policy integration per se cannot be depended upon as independent tenable criteria on which to resolve the problem of OCA formation. The EEC has however provided a valuable guide in assessing the importance of policy integration not only for attaining monetary unification but, also, in ascertaining some of the most crucial practical policy considerations which confront such integration.

#### **8.2.5 Similarity in Rates of Inflation**

The level and diversion of inflation rates has also been of central importance for assessing the feasibility and desirability of establishing optimum currency areas. Most of the criteria discussed so far in the literature on OCAs have assumed that external shocks arise principally from macro-economic sources, ie, changes in demand and supply conditions in specific industries. Recent experience in



exchange rate management, in particular, suggests, however, that this may not be the case and supports the importance of differential rates of inflation and the discord of national demand management policies behind them as a major source of payments imbalances.

Fleming (1971) argues, 'at least as important as any of the (other) factors ....., though occupying a much less prominent place in the literature on OCAs, is the extent to which costs in the various part of the fixed exchange rate area tend to rise at similar or at different speeds when employment is at nationally acceptable levels'. And Magnifico (1971) suggests that countries with similar national propensities to inflation (PI) should form currency areas.

The need for an equalisation of inflation rates as a requisite for a currency area is strengthened by the relevance of inflationary pressures in present-day economic conditions. Inflation is at the heart of the economic policy debates, especially as countries are forced by the complexity of modern economic problems to divert attention from microeconomic payments disturbances in demand and supply conditions and to focus increasingly on the macroeconomic aspects. Whether or not countries should form currency areas is answered by an examination of the respective inflation-unemployment trade-offs.

Magnifico (1971) defines the PI concept as a function of the trade-off existing in a country and the government's view of the desirable rate of price change. If national PIs differ between countries, he argues, the formation of a currency area is not feasible since the consequential differences in inflation rates

would bring payments difficulties which would need to be corrected by exchange rate adjustment.

Apart from the similarity in trade-offs between countries, the formation of a currency area also requires initial identical preference points on that trade-off curve (Presley and Dennis, 1976). The argument is that an improvement in the trade-off as countries attempt to synchronise their individual Phillips curves is not necessarily a reflection that all of them are subjected to welfare gains in excess of losses. For example, it is possible that one member country may view the reduction in inflation as inadequate compensation for the required increase in unemployment.

Against the background of the long-run Phillips curve analysis, the PI argument implies that currency area formation will have to be based on the national 'natural' levels of unemployment. The lower the national rates, the lower will be the costs of attaining a common inflation rate, and therefore the more worthwhile the formation of a currency area will be.

The usefulness of the inflation criterion depends on the significance of differential inflation rates and productivity growth as a source of payments disturbances. It implies that by equalisation of rates of inflation, member countries can avoid payments difficulties. Some authors believe that participation in a currency union may itself be a powerful instrument for correcting the price trends of the most inflation-prone member countries. This latter argument emerged, with particular reference to Italy, during the formative discussion periods of the European Monetary System. In the real world payments disequilibria and inflation have become compound and complex concepts resulting from a wide variety of

complex conditions and forces, all of which remain closely interrelated. Payments imbalances constitute a delicate combination of both micro- and macro-economic disturbances the treatment of which requires an integrated policy approach. The rate of change of export/import value for instance can be affected by fluctuations in prices as well as in demand and supply conditions, the latter which is reflected in the PI debate. Also, it is doubtful whether national governments which were not able to implement anti-inflationary policies before joining a currency union could easily persuade their electorates to tolerate the cost of the operation, simply in order to maintain an agreed rate of exchange. The UK is presently not a member of the European Monetary System. Nonetheless, the expressed conflict between its people and the government on the inflation-unemployment trade-offs in more recent years as the government stress the desire to obtain rates of inflation comparable to the lower rates in other EEC member countries, notably West Germany and France, does provide an appropriate experience manifesting this line of thought.

It is essential, in applying the PI concept, to ascertain the ultimate causes of divergencies in inflation rates as well as the nature of the inflation - unemployment relationships between countries. Where these are mainly determined by deep-rooted differences in national employment and social goals, industrial relations and trade union aggressiveness, inflationary expectations occasioned by the failure of price stabilising and general productivity and import trends, and domestic monetary and fiscal policies, the maintenance of a fixed exchange rate may prove unfeasible or exceedingly costly. It is also noteworthy that as

countries differ in the composition of their trading partners, so are they more likely to differ in the rates of 'imported' inflation (Connolly, 1983). This aspect is important in that the PI criterion appears to concentrate on the degree of intractability of divergent costs and inflation trends among member countries without actually dealing with inflationary tendencies in trading partners outside the currency area.

The formation of a currency area, thus, needs in practice, to be decided according to the ability of the area, to work together to achieve differential rates of inflation necessary to preserve dynamic payments equilibria in the member countries while considering the other goals and objectives of general economic management. It is undoubtedly difficult, particularly in the case of the heavily dependent LDCs, to state the equalisation of PIs as a sine qua non consideration for the formation of an optimum currency area. Not only is the PI criterion difficult to apply even with respect to the developed industrial countries, it is extremely difficult to quantify for many developing countries.

In the more practical sense, the EMS, for instance, has focussed attention on the convergence of inflation rates as a way of achieving success in the exchange rate scheme. At the moment empirical results as well as assessments of this objective are mixed. A very significant fact worth pointing out again (see Chapter 6) is that recent events in the world exchange markets have suggested that exchange rates can also be misaligned as much by other factors like speculative capital flows, domestic interest rate policies, speculation regarding movements in oil prices, etc, as inflation differentials. The increasing dependence in activities in

the private foreign exchange markets has made asset/portfolio management an important element in determining exchange rate behaviour (asset market approach). At the same time the implicit overvaluations of many currencies' real/nominal rates have also highlighted some of the problems involved in first taking inflation differentials as key monetary integration factors.

#### 8.2.6 The 'Cluster' Framework

The review so far has attempted to highlight the importance of the OCA theory in providing theoretical insights into the identification of the relevant determinants of exchange rate policies. Evidently, some of the issues have been attacked not in the abstract all-or-none terms of much of the debate over fixed versus floating rates, but rather in terms of the search for the major factors that influence the relative desirability of alternative exchange rate systems (see Tower and Willet, 1976). Thus on the basis of the OCA conventional criteria reviewed above, the logical domain of an OCA as a region is a fixed exchange rate common currency area, and flexible rates are justified only when based on a regional currency, not national currencies. The more the argument for flexible exchange rates is strengthened, the less nations correspond to OCAs. In practice, there appears to be still only few guidelines available for determining the relative significance of these 'optimality' conditions or even of the qualifications which an OCA must fulfil since nearly all of them present formidable problems of operational definition and quantification.

Significantly, although 'size' as an optimality criterion constitutes one of the main pillars of the OCA theory, yet none of these conventional optimality conditions it is argued, appears to offer a satisfactory basis on which countries can claim membership to a currency area or, indeed, on which the optimum size of the area can be adequately ascertained or identified in the sense of particular geographical entities or the kind of currency area it could be. This makes OCA delineation still an open issue.

McKinnon (1963), for instance, observes that 'the analytical framework for considering a large number of countries jointly and then deciding how they should be divided into optimum currency regions ... does not exist'. Ingram (1967) provides no clear-cut guideline since the size of a currency area 'can be whatever we want it to be', although governmental policy positions and commitment are critically important in determining the geographical confines of the OCA. In addition, Mundell's pioneering discussion on OCAs has carefully defined 'region' in the classical sense, namely internal factor mobility and external immobility of factors. He notes nonetheless that constructing OCAs is a process of dynamic adjustment in which currency blocs form and reform through trial and error into OCAs, but depicts the process of resulting mainly from structural/secular changes among nations in political jurisdiction and power relations.

Consequently, another analytical task has been to look elsewhere to develop, albeit within an OCA framework, combinations of socio-economic characteristics of countries and principles of bloc formation on which basis individual countries can be assigned to specific currency areas capable of achieving predetermined policy

objectives. Nana-Sinkam (1978) has thus argued that an adequate theory of monetary integration should significantly enhance the definition of a region and the determination of the number and structure of OCAs into which it is divisible. Nana-Sinkam observes:

'Optimality criteria, even when we can agree about them, are helpful in delineating a currency area and how it might function only when the region is an optimum currency area. When it is not, it is hardly possible to determine, with their aid alone, whether a region, of several countries having infeasible or suboptimal currency areas should have one or more than one OCA' (1978, p 162).

The question, how does one define an OCA is the 'which-country-which-optimum currency area problem'. Neither in conventional arguments for large size nor in the rationalisation of small scale is there an adequate basis for determining an optimum size for a regional grouping. The problem of which countries are to participate therefore in which co-operation agreement is still a live issue, precipitated mainly by the high degree of uncertainty regarding the reform of the International Monetary System to evolve determinate and stable global exchange rate relationships. This, understandably, has intensified more or less the desire for more meaningful and practically representative monetary co-operation schemes among both those countries with evidently feasible national currency domains (mainly the developed industrialised countries) and those relatively without (generally the LDCs). In the EMS, the question can be asked whether the exclusion of sterling makes the

system less optimal in size, or whether the inclusion, for instance of the US dollar, yen and Swiss franc, into a broader arrangement could form a larger but optimal North Atlantic currency area. Similarly in Africa, it can be asked whether the existing CFA franc zone or the defunct FSA, both of which reflect de facto colonial traditions would constitute OCAs purely in terms of conventional criteria.

In a relatively broader (multi-dimensional) analytic framework, Nana-Sinkam (1978) has suggested the delineation of OCAs in relation to their homogeneity in not one but in as many structural characteristics (integration variables) as are functionally identifiable or implicit - ie, national and/or sub-regional geo-political, financial, monetary and other socio-economic considerations. This approach, as in the case of the recommended 'dynamic' extensions to the conventional economic integration theory, specially for LDCs, attempts to include as many variables as possible which seem equally likely to affect trade-offs between sub-regional and national goals and consequently to influence an individual country's choice of prospective partners and the resulting negotiations with minimum losses arising out of integration. OCAs are thus delineated on the basis of clustering or clumping countries in 'strong-attribute' domains - where they share to a significant degree a sizeable set of integration characteristics, or in 'weak-attribute' domains - where they do not.

As in the case of the conventional single-criterion approach, delineating countries into one or more OCAs as geographical entities against this multi-dimension framework can appear equally inconclusive.



Evidently, the existence of cross-country differences and similarities among countries in the applied structural characteristics can create several and generally less realistic OCAs with a cross-country membership structure. But, as Nana-Sinkan discusses, although it may be more difficult to group African countries specifically according to 'political' (Clump 1) than 'regional' (Clump 2) and 'financial' (Clump 3) factors, in general, it could be much easier to do so largely on the basis of geographical contiguity, historical perspectives and on the existing levels of co-operation among them. In this event, the delineation of the Continent into North, West, East and Central monetary zones becomes somehow apparent, but with the optimality of each sub-region into an OCA framework remaining inadequately resolved.

The initial problems encountered in the Clump approach are those of trying to systematically determine the relevant integration variables, quantify them and then identify an optimum grouping strategy. Clearly, greater sensitivity and refinement are inevitably imminent in both the choice and definition of Clump variables and in the choice of integration variables among the many country characteristics, there is also the problem of determining the so-called optimal variables on the basis of which regional optimality is defined. Moreover, integration criteria are fundamental and seldom representable by any single variable. There are the familiar issues of defining these criteria with some operational precision in choosing empirical correlates that are sufficiently measurable for institutional and other relationships.

Also, the 'strong-attribute'/'weak attribute' criterion appears to make no provisions for the common statistical 'extreme' influence in the final score as well as for 'middle order' cases. For example, where countries are classified into country clusters on the basis of geographical contiguity and socio-cultural homogeneity, the possibility seems excluded of forming OCAs among them where other integration characteristics are complementary.

The overriding advantage of the clump approach for identifying OCAs, nonetheless, is that the set of country/regional characteristics and institutional relationships which are more likely to surface in the analysis are treated consistently in general integration theory as much in classical customs-union theory as in its varied extensions to include 'dynamic' factors and in conventional OCA theory. Furthermore, as already indicated, the integration variables applied seem most likely to affect trade-offs between regional and national goals and consequently to influence an individual country's choice of prospective partners and the resulting negotiations. The more systematic, realistic and objective the assignment of the variables, the more likely it is to evolve a more feasible OCA out of the Clump criterion. But like all other criteria, this too provides no conclusive answers to the main OCA problem: which country - which optimum currency area? It does however emphasise the view that in its conceptual aspects the process towards monetary unification must be seen in the broader politico-socio economic system.

### 8.3 OPTIMUM CURRENCY AREA THEORY AND THE ECOWAS

The OCA criteria reviewed in the foregoing pages have reflected both the so-called 'single criterion' approach and the wider socio-economic framework (Cluster analysis) in determining the optimum configuration of currency domains. While differing on the approach to optimality and on the required speed of adjustment (only Mundell's factor mobility has claimed automaticity), OCA criteria do in general have a bearing on firstly, the magnitude of costs and benefits that are potentially involved in currency area formation, and secondly on the nature and the degree of convergence that may be required for the inception and sustenance of such an area. The traditional criteria in particular indicate the instances under which exchange rate changes can be either ineffective (ie the absence of money illusion) or unnecessary, even though perhaps effective (ie high degree of factor mobility, product diversification or similarity in inflationary tendencies), as an argument for having a common currency within a group of countries.

Among the major drawbacks of the traditional criteria is the argument that in attempting to provide those characteristics which set out the rule of optimality as well as those which point towards the efficient attainment of internal and external balance, they have not sufficiently emphasised those potential benefits and costs that accompany the members' loss of national autonomy in the pursuit of monetary and fiscal management. The complexities of monetary integration, and indeed of currency area formation, are such that the feasibility of an integration framework is, in the real world, not only an optimality issue. Wood (1973) and Lamfalussy (1974) have particularly stressed the need to weigh between the potential

benefits and costs in relation to the structural divergencies between the participating states as these are more likely to inhibit currency area formation. Added to this is also the fact that in the real world, the 'automatic' adjustment theories of the OCA literature are relatively inappropriate to the extent that government intervention in all aspects of economic management is an accepted thing.

The OCA criteria do however indicate the importance of homogeneity, compatibility, convergence and complementarity in the process of economic adjustment between the participating countries in a unified currency area. Whether the unified currency area will face severe regional disequilibria or whether adjustment can be relatively smoothly achieved depends on the economic characteristics of the whole union. Broadly speaking, it can be stated that the process of adjustment to economic disequilibria within a currency area will be smoother:

- (a) the greater the degree of factor mobility within the area,
- (b) the greater the degree of economic diversification,
- (c) the more similar the rates of inflation in the member countries,
- (d) the greater the share of intra-regional trade in the national income in member countries.

Furthermore, OCA conditions do constitute those economic structures whose polarisation could form a fundamental obstacle to the acceptance of unified stabilisation policies. They ease the process of monetary unification. Therefore, clarity is required initially on how the participating countries in a unified currency

area differ in such areas as commercial ownership, socio-economic planning, the prevailing power and authority structures in political life, transport, information and communication systems as well as in their respective values and basic aims of economic activities.

Most of these structures have been examined in earlier chapters with respect to the ECOWAS economies. The overall need for an effective co-ordination of socio-economic activities, most of all developmental processes and growth, forms a strategic part of the region's integration process. Theoretically, the measurement of the degree of convergence in each case could be directed either at empirical data about convergence that has actually taken place, or at projections and anticipated trends. Clearly the latter possibility, especially in developing countries, is even less tangible than the former. The methodological and conceptual difficulties of monetary integration as reviewed in this and the previous chapter are formidable especially for a group of countries that are collectively at the low stages of development. Indeed, even in the EEC, the apparent failure to come to agreement on these basic issues have in part constituted the major problem that has affected the economic and monetary unification of the member states. The EMS scheme, which for now provides perhaps the most hopeful sign of possible progress towards international monetary reform since the collapse of the Bretton Woods, has, within its institutional framework, safeguard measures to ensure co-ordination and flexibility, even though the preconditions for an OCA in particular are not met and the currency area established.

Thus, as already indicated, the evidence and conclusions on the optimality of the ECOWAS as a currency area are presented in this study without biasing the need for currency unification within the area. It is argued that the establishment of a common currency within the ECOWAS would generate incentives for improving upon the constraints posed by currency area theory.

### **8.3.1 Mobility of Factors of Production**

Official records on intra-ECOWAS factor mobility are scanty and unreliable. The empirical evidence nonetheless is that this is low and non-complementary. Sometimes seasonal occupational opportunities, motivations for higher incomes and political concern have aroused labour migration between countries. In more recent years, Nigeria and Ivory Coast have attracted proportionately massive drift of 'guest workers' from other states for purely very short-term income gains (although this is reversing in the case of Nigeria). There are large settlements of immigrant population in border market centres where parallel market activities are dominant. Political reasons had influenced, in part, the movement of Guineans (mainly of the Fulani tribe) into Sierra Leone but this too is reversing since the death of the Guinean President Sekou Toure in 1984. In general the close similarity in economic structures and the lack of cross-country employment opportunities have provided little scope for labour migration. The Community programme for free intra-regional migration (ECOWAS Protocol on Free Movement of Persons, Residence and Right of Establishment, May 1978), though having been fully ratified by all 16 member states, is yet to be compiled with. In any case the number of wage-salary-earners in the

region represents on average no more than 10 per cent of the economically active population and many of these are engaged in either the urban informal sector, in agriculture alongside owner-operations, family labour and apprentices or in government service (Rimmer, 1984, p 95).

Capital or 'enterprise' has had no greater mobility in the ECOWAS than has labour, although the prospects for this may be better than labour through increased liberalisation and currency convertibility as well as the regionalisation of activities in the Nigerian and Ivorian Stock Exchange Markets. It is evidently clear that non-regional enterprises have played a preponderant part of direct investment in the ECOWAS than indigenous firms. This can be explained by a number of factors including the profound external-orientation of general economic activities, comparative costs and low domestic savings. Aggregate domestic savings (defined as exports minus imports plus gross fixed capital formation plus increase in stocks - see Table 5F) as a proportion of GNP is marginally above 30 per cent only in Ivory Coast (1980). It is negative in Burkina and Mauritania and less than one per cent in Sierra Leone. Quasi-money as a ratio of money supply is less than 40 per cent (1983) in all countries except Nigeria (40.7 per cent) and Ivory Coast (49 per cent) (see Table 9H). This latter ratio compares with 59.4 per cent in the USA and 62.3 per cent in the UK during the same year.

The lack of 'official' intra-ECOWAS capital flows is demonstrated in part, in the absence of 'capital transactions' in the Clearing House Operations. It is feared that current upheavals in the domestic and global economic scene and the widely differing

external payments positions in the member countries may pose serious problems on any thoughts of encouraging capital mobility at the regional level as such thoughts are often subsumed in nationalistic responses to external disturbances.

### 8.3.2 Economic Size and Openness

The degree of 'openness' in the ECOWAS economies is estimated in terms of:

- (a) the ratio of imports plus exports to GDP (PT);
- (b) the ratio of imports to GDP or the average propensity to import (APM); and
- (c) the incremental ratio of imports to GDP or the marginal propensity to import (MPM).

These ratios have already been examined in Chapter 4 (see Table 4R).

The results reported for 13 member countries for which data was available suggest the growing importance of trade especially during the last decade. The PT ratio is over 40 per cent in all countries, except Ghana where it is below 10 per cent purely because of the astronomically growth in the GDP. In Liberia, the ratio had reached 120 per cent by 1981. In 1981, imports ranged between 26-85 per cent of GDP in the region (except Ghana ). With the exception of Mauritania and Sierra Leone, the MPM was positively high in 1981. As noted in Chapter 3, the rate of growth of imports in most West African states is represented more in terms of rising cost following the oil-price increases than actual rise in volume.



Subject to their respective limitations as appropriate indicators of openness, the calculated PT, MPM and APM were tested for West Africa using 1981 values. The pooled T statistics ( $T = 1.401$  for the MPM against APM; and  $T = 1.356$  and  $-2.214$  for PT against MPM and APM respectively;  $df = 24$ ;  $p = .05$ ) show that in practice (except for the PT against APM) there is no empirical difference between them in demonstrating the largeness of the foreign trade sector in the region.

A significant drawback to the application of the openness criterion as indicated earlier is that neither it nor other optimum currency area criteria provide a clear indication as to whether the 16 countries of ECOWAS, for instance, should form a complete monetary union. In terms of market area, the region as a whole represents over 150 million potential customers. In principle however, ECOWAS can be sub-divided into a number of potential 'currency areas', although the question remains how large or small each would be to achieve optimality.

Firstly, in terms of traditional colonial attachment, currency domains can be delineated into:

- (a) the former sterling area (FSA) comprising Gambia, Ghana, Nigeria and Sierra Leone;
- (b) the CFA franc area, comprising the WAMU countries;
- (c) the Escudo area, comprising the former Portuguese territories, Cape Verde and Guinea-Bissau;
- (d) the dollar area with Liberia as the sole member country;  
and
- (e) the heterogeneous area comprising the French franc zone break-away countries, Guinea and Mauritania.

Apart from the CFA franc area which has survived and may be expanding, and the dollar area, it is very unlikely that the FSA and Escudo areas would be recreated.

Secondly, currency domains may be delineated in terms of the intervention currencies that feature most significantly in the current exchange rate arrangements of the member countries. In this respect the two most prominent currencies are the US dollar and the French franc. As shown in Table 6I, each intervention-currency area comprises seven countries. The Gambia is tied to sterling while in Nigeria the flexible exchange rate system is maintained around the dollar and sterling. The French franc area is synonymous to the CFA franc. A dollar area by this definition is highly unlikely to exist if only because of the heterogeneous nature of the countries involved, but the dollar itself will feature prominently in discussions on the choice of an optimum peg for regional monetary arrangement. Except for the franc zone, there is no institutional or collective monetary relationship between members of the dollar intervention-currency area beyond what is provided for all countries in the WACH framework.

Finally, in so far as national market size is concerned, Nigeria, the largest and most powerful country in the region, is the only country of substantial economic size and potential to probably constitute an independent currency domain on its own. The only problem is that because of its relative inconvertibility, the national currency may lose its moneyness through escalated parallel market activities were Nigeria to establish such a zone without cooperating with other ECOWAS member countries.

### 8.3.3 Economic Diversification

The economic base of individual West African economies is severely undiversified in practically all aspects of economic activity, except, perhaps in the highly diversified import sector (in terms of the wide range of imported goods). This characteristic feature does not only disqualify them for currency area formation but, as we have explained elsewhere, it has made them critically more vulnerable to external market conditions, especially in terms of exchange rate costs.

The degree of diversification in these economies is however estimated in terms of the composition (or distribution) of:

- (a) the GDP;
- (b) export commodities, and
- (c) trading partners.

Agriculture and/or mining remain the principal contributor to the GDP and foreign exchange earnings and are occupationally the largest employers. On the basis of IMF sectoral classification of the GDP, the agricultural and services sectors combined account for over two-thirds of GDP in virtually all countries in 1981. Agriculture alone provides over 60 per cent of the GDP in Ghana and over 40 per cent in five other countries. The services sector on the other hand represents more than 70 per cent of GDP in Cape Verde and over 40 per cent in ten other countries. In Cape Verde, the importance of the services sector is explained in respect of foreign exchange receipts from Cape Verdeans resident overseas. In 1981, these receipts (also known as home remittances in Exchange Control terminology) amounted to US\$25 million as against the US\$20 million GNP (West Africa, 1 July 1985, p 319). From this sectoral

perspective, the analysis indicates that of the bigger economies, Ivory Coast and Senegal are the most diversified while Ghana is the least diversified. The industrial base is generally small in all countries, comprising very similar and simple value-added manufacturing processes (these features are discussed in more detail in Chapter 2).

On the basis of the degree to which exports are concentrated in a single or closely related group of products (ie the percentage of total exports to exports accounted for by the largest commodity export), the range of exports in West Africa is concentrated on 1-3 products and as a group, all exports are of primary nature, contributing agricultural and mineral commodities with little value-added domestic processing. The relative importance of each commodity for the national economies is discussed in Chapter 3 (see Table 4E). Earlier in Chapter 2 (see Tables 2E and 2G) it was shown that as a region West Africa produces no less than 23 primary commodities many of which have had (or still have) viable export potential. Because of its relative significance in national import bills, the availability of crude oil reserves is actively being explored in practically all coastal states. Currently, crude oil is of growing importance in the Ivorian export economy while in Nigeria, it has represented over 90 per cent of the country's total export revenues.

Despite growing competition from the USA and Japan, the traditional markets of France and the UK still occupy prominence in West Africa's limited list of trading partners. The geographical concentration of trade in the region is such that in most countries the sources of imports is much wider than the geographical

distribution of their export markets. The EEC countries as a group have taken up over 40 per cent of West Africa's total trade (see Table 4H). Special trading arrangements between the EEC and West African states have developed through the EEC/ACP institutional relationship. In 1983, total exports accounted for by exports to the largest market - the USA - was 20.6 per cent and France was second with 13.9 per cent. The importance of the US market as explained earlier is due mainly to the direction of Nigeria's crude oil which in turn has represented over three quarters of the region's total export value. The share of the EEC was 44.5 per cent. In practice, the exchange rate arrangements of many developing countries have been influenced in part by the degree of geographical concentration of their trade. On this perspective, three currencies are most important for West Africa - the US dollar, the French franc and sterling.

#### **8.3.4 Divergence between the Rates of Inflation**

Evidence on the historical record of inflation rates in the ECOWAS countries shows that the discrepancies between them are considerable and although this record cannot be taken as a firm guide to future movements, the marked differences in the national policy responses to external (or domestic) inflation impulses are likely to sustain this divergent behaviour. There is however no guarantee, as the EMS experience has shown, that convergence in inflation rates can be maintained even where it is an emphasised policy of monetary unification. Besides, its limitations as an instrument for achieving exchange rate stability have been made very obvious by events during the last few years. At the same time, the

EMS experience also indicates that the lack of convergence in inflation rates is substantially a result of divergent diagnosis for domestic inflation, ie monetarists versus economists/structuralists. While for the developed countries inflationary pressures have arguably been related to the Phillips Curve behaviour, developing states have tended to stress 'imported inflation' than inflation induced by domestic monetary and fiscal expansion. What is certain is that in general the differences in rates of inflation appear to arise partly for structural reasons, such as divergent rates of growth in productivity and variations in the institutional structure of wage bargaining and agreements and partly from divergences in national policy objectives. While there could be some hope that in a monetary union co-ordination in economic policies may resolve the latter, the more deep-rooted structural differences between the member countries seem likely to be less tractable and this would tend to increase difficulties of economic adjustment within the monetary union.

As can be observed from Table 5D, inflation rates in the ECOWAS have on average ranged from around 9 per cent in Burkina to 50 per cent in Ghana in 1970-83. In 1983, the rate varied between -2.5 per cent in Niger and 122.9 per cent in Ghana. National rates have deviated (as measured by the standard deviation) by 42.4 in Ghana (widest deviation) and 4.3 in Mauritania (least deviation) over the 14 year period.

Regional averages over the reviewing period indicate that inflation rates were worse in 1977, 1981 and 1983. The regional standard deviation peaked at 38.3 in 1983 after improving from 30.8 to 12.0 in 1977-80 following the severe restraint in domestic

policies which has tended to follow each oil price increase. It is also evident that these regional measures have been pulled very substantially by Ghana's worsening inflation after 1975, with recorded rates of over 100 per cent in 1977, 1981 and 1983.

#### 8.4 CONCLUSIONS

There are good reasons, against the foregoing, to doubt the optimality of the ECOWAS as a currency area and hence, whether the member countries should create a common currency or a system of immutable exchange rates. The same is true for the sub-regional currency domains delineated in Chapter 5. The inadequacies of the countries in meeting the OCA criteria (except to some extent, openness in foreign trade) are worsened further by the very low inter-penetration of trade among them. Yet what is perhaps of the greatest importance to any discussion of monetary unification for the region, as pointed out in earlier parts of this chapter, is the emphasis on potential characteristics, costs and benefits. The traditional theory because of its static nature has not stressed this aspect. Even if the feasibility of an ECOWAS monetary union is judged purely on the basis of existing economic characteristics, it does not follow that the necessary structural transformation and policy co-ordination cannot be undertaken to bring about a favourable configuration for such a union. The fact is that the move towards its success implies a process of gradual convergence in such areas as general economic policy, inflation policy, monetary and banking structures, wage differentials, etc. Besides, it should be recognised that cultural, historical and political bonds are as important as economic factors in determining the feasibility (see

discussion on clump/cluster analysis) and success of monetary unification.

These factors imply the abandonment of the conventional search for a single criterion formula to identify the desirable extent of the currency domain in ECOWAS. They provide considerations which, collectively, are powerful enough to justify immense support for an ECOWAS monetary union. Most significantly, there is no doubt that support for such transformation must, most urgently, derive from the inability for developing countries on their own individually to manage their monetary systems and overall economies in a floating and highly volatile currency world whose reform is less imminent now or in the foreseeable future. Meanwhile such an unsettled international monetary system continues to be difficult and costly for the developing world. The failure by West Africa to meet the OCA criteria also means that such conditions require sufficient attention in the process of monetary unification.



## CHAPTER 9

### TRANSITION TO ECOWAS MONETARY UNION

#### 9.1 INTRODUCTION

The empiricism of this chapter represents an assessment of the need for monetary unification in West Africa; first, against the background of analysis and arguments raised in the previous chapters, and second, in the light of a critical evaluation of the experiences of the existing West African Clearing House and the West African Monetary Union. Although optimum currency area theory has also taken for granted that pegged rates automatically imply full convertibility, the specific implications of this for West Africa are explored. The thrust of the arguments in this study is that serious and beneficial monetary integration in West Africa can only be carried out under a common currency and a central monetary supranational monetary authority, a point to which early arguments for monetary integration among LDCs were somewhat oblivious. They have undoubtedly overemphasised the scope of clearing and payments arrangements, especially where the objectives of monetary integration for LDCs are assessed against the background of existing socio-economic developments and the apparent failure of multilateral clearing and credit schemes to tackle the development constraints.

In more recent years, however, many countries in West Africa have expressed some political will either to rejoin common currency arrangements to which they originally were members or to re-inforce bilateral economic relationships. In this regard, Mali, which had left the WAMU in 1962 has rejoined the union (June 1984), while Guinea, which had also opted out of the French Union in 1958 is

considering reentry (West Africa, 11 June 1984, p 1227 and 17 September 1984, p 1905). The Gambia is 'discussing modalities' with Senegal for joining WAMU (West Africa, 1 April 1985, p 608), while Burkina has expressed the need for a common currency with Ghana (West Africa, 6 February 1984, p 303). The idea for a uniform currency has also been indicated within the Mano River Union (IMF, Exchange Arrangements and Exchange Restrictions, 1984, p 48).

The latest and easily the most significant step towards monetary unification in West Africa has been the development of political commitment of the 16 ECOWAS member countries to create an 'ECOWAS Monetary Zone' within the institutional framework of the Community. This commitment, first stated in the Conference of Heads of State of ECOWAS in Conakry, Guinea in May 1983, was reaffirmed by the leaders during their 7th Annual Summit in Lome, Togo in November 1984. The leaders have resolved:

'to adopt as soon as possible measures to facilitate the creation of an ECOWAS Monetary Zone to promote stable monetary and financial conditions for sustaining regional economic growth' (West Africa, 3 December 1984, p 2448).

This chapter is divided into five main sections. In Section 9.2 the analysis and arguments in the previous chapters are condensed to state the 'overwhelming case' for currency unification in West Africa. Section 9.3 analyses the operations of WACH and WAMU and critically evaluates their implications for an ECOWAS monetary union. The section also discusses the compatibility of monetary unification in West Africa with the search for a new and stable international monetary system. Section 9.4 argues that the

creation of a common currency is more practical and gainful for West Africa than a simple fixed exchange arrangement and then looks at available options for establishing a West African common currency. Concluding remarks are provided in Section 9.5.

## **9.2 THE ECONOMIC BENEFITS OF MONETARY UNIFICATION IN WEST AFRICA**

In the spectrum of monetary integration, as surveyed in Chapter 7, potential member states can opt for schemes that range from limited liberalisation of trade and exchange restrictions to the use of a single, uniform currency for the area. While the former could form an integral part of a simple payments and clearing arrangement for the settlement of international transactions at the regional level, the latter implies the formation of a monetary union that also exhibits supranational control over monetary and fiscal policies. Somewhere in the spectrum are programmes for the realignment of exchange rates and/or the co-ordination of all or some aspects of national monetary and fiscal policies (eg taxation) as is shown in the European Monetary System. The most important repercussions of this transition are upon internal and external equilibria and on the liquidity problem of the adjustment mechanism. These encompass, for the member countries, the specific aim of establishing a 'zone of monetary stability' internally and externally. External stability implies exchange rate stability, whereas stability at home represents the adoption of monetary developments consistent with stable domestic costs and prices. In general, the stability of exchange rates as well as of costs and prices is interpreted as an essential precondition for attaining a reasonable degree of economic integration among the participating

countries, for economic growth and the narrowing of economic divergencies.

The basic elements of the balance of payments of a developing economy, expressed in terms of the simple equation:

$$B_t = X_t - M_t + NST_t + NOT_t + NCI_t + R_t$$

where, at time (t)

$B_t$  = overall balance

$X_t$  = commodity exports

$M_t$  = commodity imports

$NST_t$  = net services and private transfers

$NOT_t$  = net official transfers

$NCI_t$  = net capital inflows

$R_t$  = residual variable  
(exogenous natural factors - eg climate, politics)

are more easily affected by endogenous and exogenous factors where fluctuations have a very immediate and relatively irreversible impact on the overall balance of the country concerned. The monetary and balance of payments of developing countries therefore reflect the basic structural characteristics of their economies - small and open with heavy reliance on external factors of production. Because of their economic structure, West African countries, in common with other developing countries, are more sensitive to external shocks on any of the elements determining their balance of payments and overall economic development.

Aside from other constraints - politics, climatic conditions, global economic development - there is no doubt that the core of West Africa's monetary and overall development problems since the

1970s has been the foreign exchange constraint. The summary of the balance of payments components in Table 6B reveals that the overall situation for practically all countries has been severe. The current account deficit has widened for most countries and as a proportion of GDP, as shown below, has risen substantially even in the more developed member countries. In 1970-81 this index rose from below 5 per cent to over 8 per cent in Nigeria and Senegal, and from around 2.5 to 3.7 per cent in the Ivory Coast. It rose up to 14 per cent in Sierra Leone and 23 per cent in Mauritania and The Gambia.

**ECOWAS: Balance of Payments Current Account Deficit as Per Cent of GDP**

	1970 <sup>a</sup>	1981 <sup>b</sup>
Benin	0.5	6.7
Burkina	(2.4)	4.6
Cape Verde	-	-
Gambia	(1.5)	22.1
Ghana	3.1	1.0
Guinea	-	-
Guinea-Bissau	-	-
Ivory Coast	2.5	3.7
Liberia	-	8.6
Mali	-	13.0
Mauritania	2.4	23.4
Niger	-	-
Nigeria	4.7	8.3
Senegal	1.9	8.6
Sierra Leone	3.8	13.7
Togo	(1.1)	8.3

Source: Table 6B; IMF International Financial Statistics

Notes: a Surplus for Burkina, Gambia and Togo

b 1980 for Benin, Burkina, Senegal and Togo

- Not available

The international liquidity and adjustment problems have arisen, in part, from the need of a growing economy for a corresponding growth in earned foreign exchange reserves to support it. The gap between demand for new reserves and available supply has widened over the years as the commodity export-import gap worsened for all countries, except Liberia and to some extent, Nigeria. Externally, factors such as the rising import costs of oil in the 1970s, the rising prices of imported manufactured goods compared with primary export prices, and the slow growth of world trade in primary commodities have combined with the rising costs of external borrowing and the massive reduction in concessional foreign assistance to impinge on foreign reserve balances and the balance of payments. As shown in Table 6D, West Africa's combined external public debt outstanding in 1981 was over US\$29 billion and for the individual countries it ranged between 59 per cent of commodity exports in Nigeria to nearly 800 per cent in the Gambia. In practically all cases the precipitating factor for the rising debt-service burden and hence the formal Paris Club negotiations for some countries (eg Sierra Leone) was the inability to service the sharp increase in commercial debt. The implications as illustrated in Table 6E are that creditworthiness appears to be the major constraint for further borrowing by a number of countries, especially Senegal, Liberia and Sierra Leone, rated among the least creditworthy in the world. The consequent drain on foreign exchange reserve balances has been such that by the end of 1981 these balances could not cover up to 10 per cent of total import bills in at least seven of the thirteen countries for which data was

available. For most countries - notably Gambia, Ivory Coast, Nigeria - the situation worsened further between 1982 and 1983.

The deterioration has also been the result of domestic factors as short fall in export receipts, fiscal and demand management problems, and the maintenance of unrealistic exchange rate policies further impinge on the balance of payments. The over-expansion of aggregate demand in most countries, usually arising from unsound fiscal and monetary policies, has given rise to huge government budgetary deficits that are financed increasingly by borrowing from the domestic banking system and external sources. The resultant implications for the money supply aggregates, inflation and import demand have supported the worsening of the foreign exchange situation. It can be observed in Table 5C that money supply whose growth was more conspicuous during 1973-79 for all countries, slowed down remarkably for most states during the early years of the 1980s. The average annual growth in money supply over the 14 year period ranged from 9.2 per cent in Liberia (1975-83) to 33.4 per cent in Ghana. The rate of inflation, on the other hand, which has risen substantially over the period, ranged from around 8 per cent in Liberia to 50 per cent in Ghana (Table 5D). In general, West African countries have experienced high and unstable rates of inflation and monetary growth. Indeed in some countries - eg Ghana and Nigeria - political instability has also been present, indicating perhaps the close relationship between political instability and monetary instability.

These relationships are demonstrated in Table 9A and Figures 9.1 and 9.2. Figure 9.1 plots the average annual rate of inflation along the horizontal axis and the standard deviation in the annual

rate of inflation along the vertical axis while a similar graph is also produced in Figure 9.2 for growth in the money supply. We regressed these two relationships and obtained the following (1970-83):

$$(a) \quad SD_i = -1.65 + .88i$$

$$R^2 = .96$$

$$N = 11$$

$$(b) \quad SD_m = 11.8 + .086m$$

$$R^2 = .02$$

$$N = 13$$

where

$SD_i$  = standard deviation of the rate of inflation

$SD_m$  = standard deviation in the rate of money growth

$N$  = number of cross-section countries for which data was available

**Table 9A ECOWAS: Growth in Inflation and Money Supply, 1970-83**

	INFLATION		MONEY SUPPLY	
	Average Annual Rate	Standard Deviation	Average Annual Rate	Standard Deviation
Benin	NA	NA	18.2	10.0
Burkina	8.7	9.4	18.0	9.2
Gambia	9.3	6.5	18.5	11.3
Ghana	50.0	42.4	33.4	15.2
Ivory Coast	11.0	7.2	18.2	14.2
Liberia	8.4	6.3	9.2	21.8
Mali	NA	NA	15.1	8.7
Mauritania	9.9	4.3	19.6	16.6
Niger	10.4	8.1	19.9	10.5
Nigeria	15.5	8.2	29.3	18.8
Senegal	10.1	7.9	15.9	11.2
Sierra Leone	17.4	17.3	18.2	10.6
Togo	10.6	6.3	20.2	17.5

Source: Tables 5C and 5D



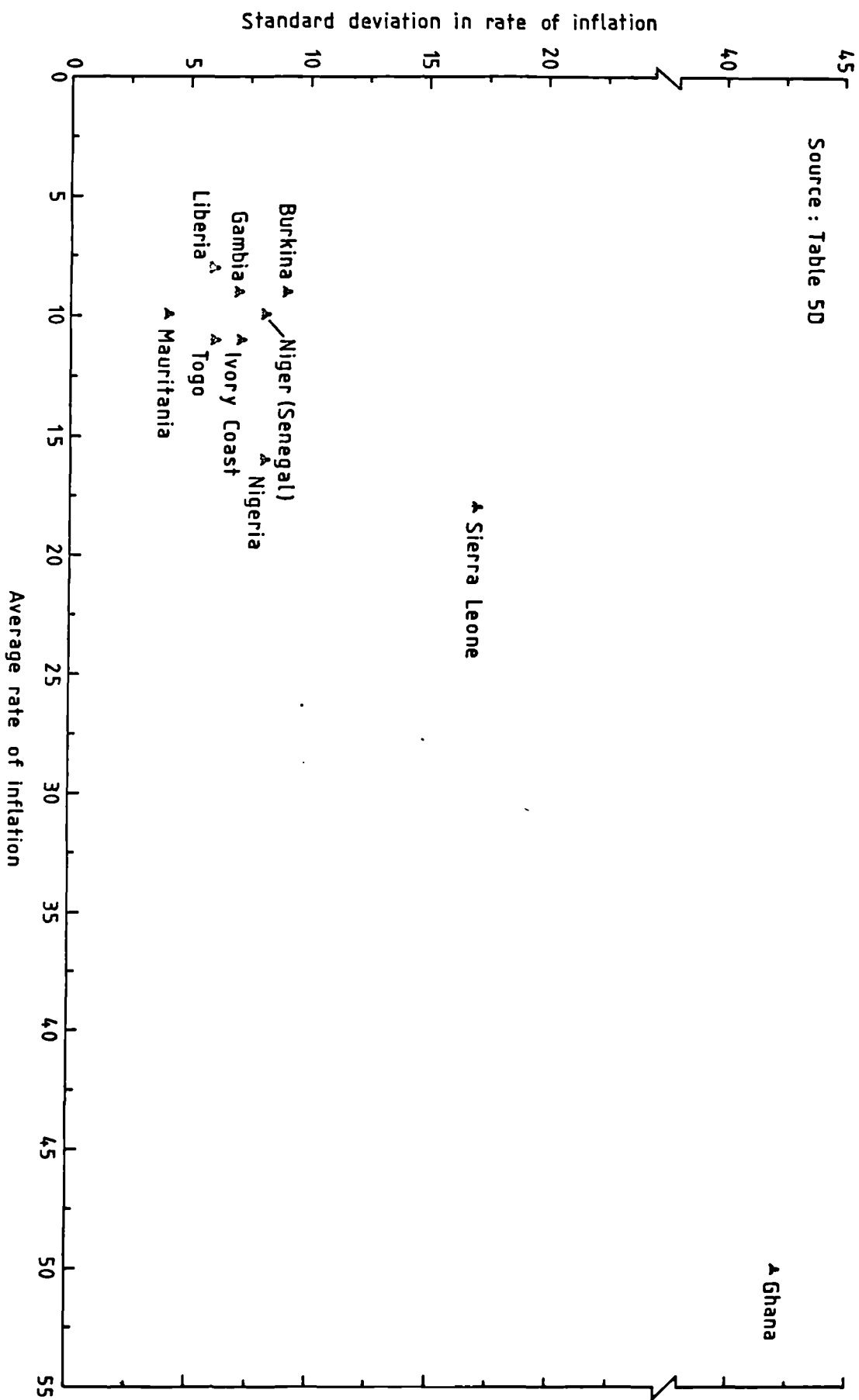


Fig. 9-1. ECOWAS : Measures of price stability, 1970 - 1983.

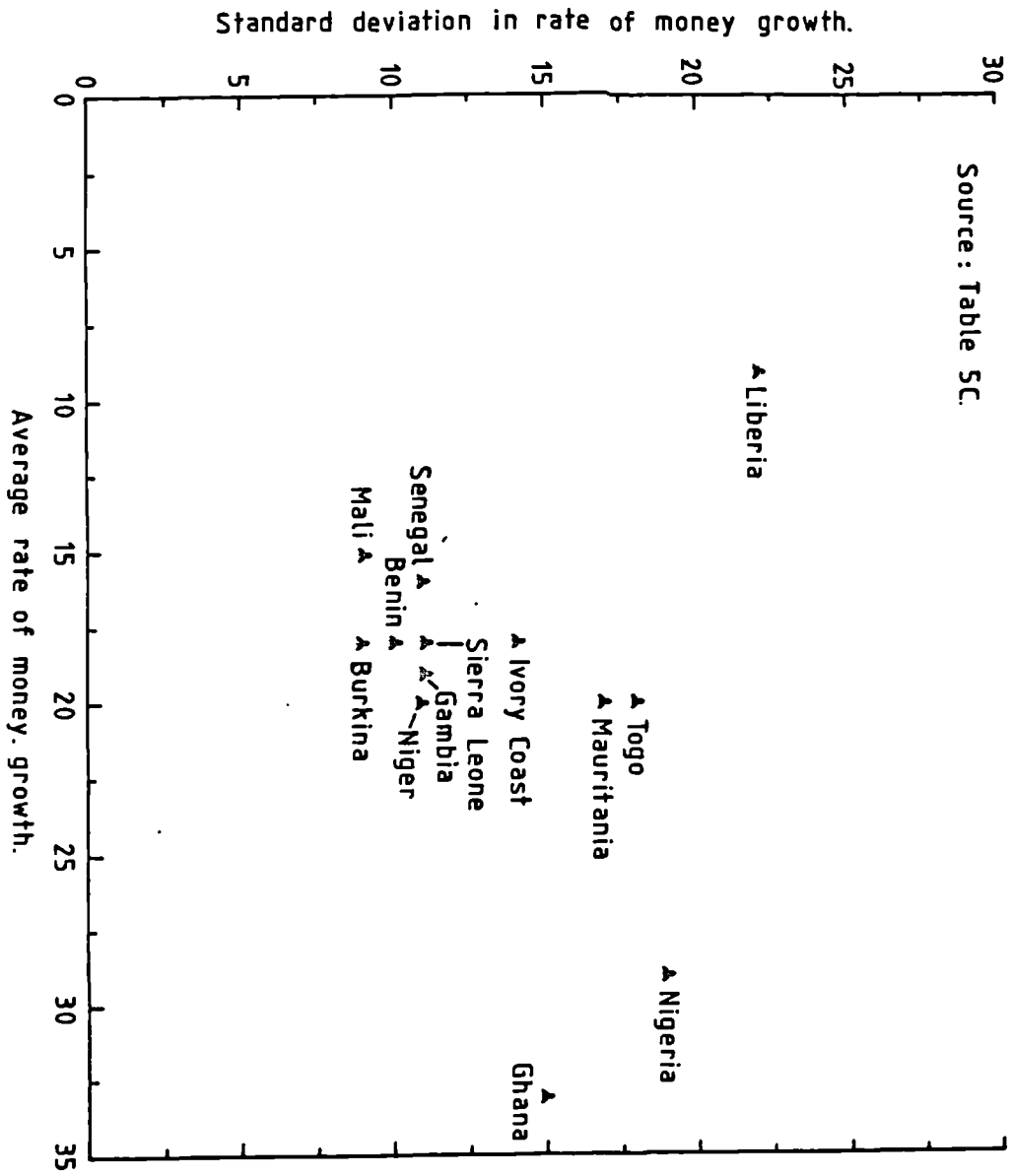


Fig. 9-2. ECOWAS : Measures of monetary stability, 1970 - 1983.

These results indicate that while the relationship between high and unstable rates of inflation remains significant, it is much weaker in the case of money growth. The growth in money supply has been high and relatively consistent over the years.

We also regressed the rate of inflation (I) on the rate of money growth (M) for the same period and obtained the following equation:

$$I = -14.0 + 1.43_m$$

$$R^2 = .58$$

$$N = 11$$

In practice high inflation is generally associated with high money growth. In West Africa, the relationship is statistically apparent with a half percentage increase in money supply adding about one per cent in the rate of inflation. However, a very suggestive factor for the high inflationary tendencies in several countries, notably Ghana, Sierra Leone and Nigeria, strongly relates to the high incidence of parallel (black) market practices, aggravated largely by the persistently high import demand, amid the growing acute shortage of foreign exchange (official) and commodities together with the corresponding lack of or ineffectiveness in domestic price controls. These relationships have appeared extremely stronger in Ghana as is shown in Figure 9.3.

To the extent that excessive bank borrowing (or development by inflation) has not supported projects that are directly productive or improved economic performance, the expected 'neutralising effect' of domestic credit expansion on the general price level and the balance of payments has not materialised in most West African

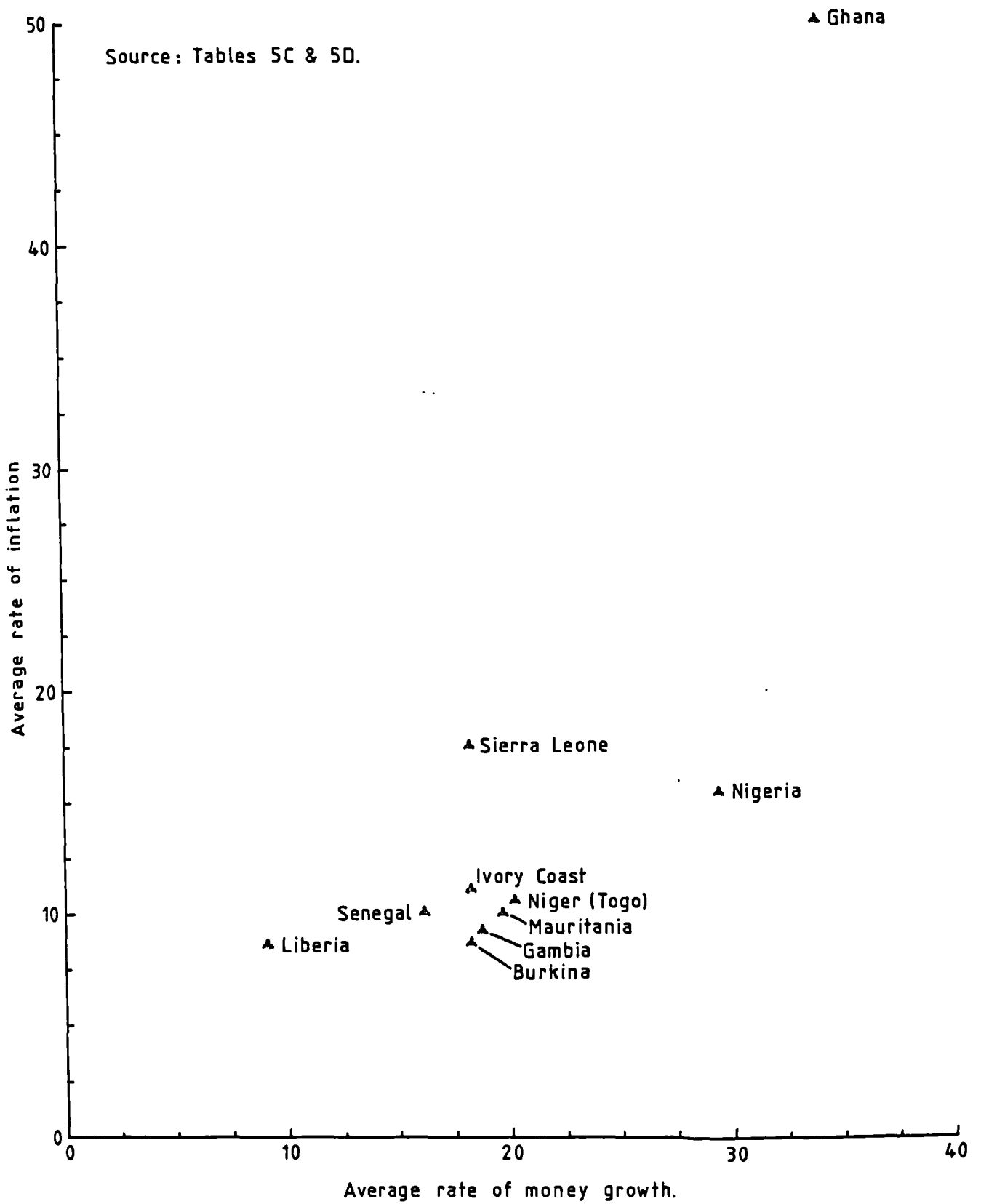


Fig. 9-3. ECOWAS : Inflation and money growth, 1970 - 1983.

countries. At the same time the excessively high levels of domestic inflation and the wide differentials that exist between the national rates, especially as between the francophones and the anglophones, do not only provide an additional inducement for the skewed pattern of intra-regional trade, they also discourage the expansion of this trade in favour of trade with third countries. This situation as was shown (Chapter 3), provides for only minimal gains from the trade diversion and creation effects of integration within the ECOWAS. In other words, the higher the domestic rates of inflation, the greater the external tariff that will be required to equalise the price of domestically produced goods with that of imported goods from third countries, and the higher this tariff wall, the greater is the welfare loss to the grouping as a whole. The massive differential in inflation and money growth rates between member countries does create a major obstacle for tariff harmonisation.

The additional problems of adjustment and confidence have arisen as the currencies of many West African countries appear to be losing domestic confidence and exchange value, and thereby becoming increasingly inconvertible. Corrective measures have been sought along the lines of introducing greater exchange rate flexibility (5 currencies have basket pegs while Nigeria and Ghana appear to maintain relatively independent floating currencies) and massive exchange rate depreciation (eg Ghana, Gambia and Sierra Leone). In addition, three countries, Guinea, Ghana and Nigeria have had currency change-overs. The objectives are mainly to reduce the attractiveness of speculative activities, restore a more realistic and responsive exchange rate system, provide price stability and

facilitate economic performance by stimulating exports and discouraging imports. The growing distrust of national as well as foreign economic agents in the value of national currencies and their obsession regarding the frequent devaluation exercises have urged many to aggressively evolve channels for exchange rate and capital evasion. This surge in parallel market activities in currencies and commodities have caused further distortions in resource allocation, resulting in an even more severe economic slowdown.

In practically all cases, previous attempts at exchange rate flotation and then outright devaluation - to reflect parallel market exchange rates - have failed as the parallel market continued to exploit the relative scarcity of foreign exchange in the banks. Consequently, since the temptation to go to the parallel market for foreign exchange is not eliminated by the official exchange rate adjustment policy, the corresponding parallel market exchange rate - supported largely by smuggling, official foreign exchange retention facilities, excessive claims of government on bank credit and the non-compliance to the surrender obligation by private as well as parastatal institutions - is generally more than doubled the official exchange rate after every devaluation.

In Sierra Leone for instance, in 1982, when the leone was devalued from Le 1.25 to Le 2.50 to the dollar, the parallel market rose to Le 8 from Le 4 to the dollar. A further devaluation in 1984 from Le 2.50 to Le 6 to the dollar also led to a further rise in the parallel market rate which is currently estimated at an average of Le 10 to the dollar. Similarly, in Ghana, the cedi/dollar parallel market rate stood at around 200 cedis to one dollar after the cedi

was devalued to 50 cedis to the dollar in 1985. In Nigeria also, although no official devaluation has taken place, the parallel market naira rate for the dollar is currently estimated at around 6 nairas to \$1 on average, compared with the official rate of 0.88 naira to \$1. These exchange rate divergencies influence the corresponding intra-regional currency exchange rates, especially in the parallel market, compounding smuggling as well as the situation in which the banking system is continuously starved of foreign exchange.

**Table 9B ECOWAS: Estimates of Currency Over-Valuation**

	1970	1975	1978 <sup>1</sup>
Burkina	-22.7	-0.4	24.1
Ghana	-5.7	35.9	298.3
Ivory Coast	-7.0	24.8	58.2
Mauritania	-8.1	34.9	40.7
Nigeria	9.1	72.9	117.1
Senegal	-13.0	35.0	28.5
Sierra Leone	-3.7	-3.3	-3.7
Togo	-21.2	16.8	25.7

Source: ACMS, 'Balance of Payments Problems of African Countries and their Effects on the Development Objectives', August 1979, p 69

Notes: 1 1977 for Nigeria  
2 Position change indicates high overvaluation; the sign (-) indicates low over-valuation

The over-valuation of exchange rates has further distorted the price relationships such that imports have become more attractive in most domestic markets than domestic products. While many of these

corrective solutions have induced further shortages, higher inflationary pressures and dampened economic growth, their frequently intensive adoption and the high failure rate associated with them clearly manifest the lack of capacity of individual West African countries to eliminate the consequent growing economic imbalances. As shown in Table 9B, the West African currencies have been increasingly over-valued in recent years. The over-valuation has been more severe especially for Ghana and Nigeria. With the exception of Sierra Leone, the anglophone countries have tended to be more overvalued than the francophone states.

Institutionally, the role of monetary integration in ECOWAS is linked to the trade liberalisation programme of the Community (Article 13 of the Lagos Treaty). The need for co-operation in monetary and fiscal policies is expressed in Article 36 of the Treaty. These provisions by and large have required the liberalisation of exchange and payments restrictions, the harmonisation of monetary and fiscal policies, the setting up of a balance of payments support fund, and the inception by 1989 of an exchange agreement within the Community. As was observed in Chapter 3, the impressive and optimistic time-table set against each of these objectives has hardly been achieved and no new dates have been fixed, ostensibly because member states may still be studying the potential effects of these measures on their fast declining economies. In the meantime while the West African Clearing House exists as the first and only all-embracing post-independence and post-ECOWAS institutionalised form of monetary co-operation, the Community, as has been noted in Chapter 1 and elsewhere in this study, has commissioned three separate studies (see IMF, 1980;



Cincin-Sain and Marshall, 1983; and Frimpong-Ansah, 1983) on measures for the improvement of albeit, 'limited' monetary integration, and their main conclusions and recommendations have not differed in this direction. Consequently, it is not surprising that as was commissioned, these studies have independently merely stressed payments and exchange liberalisation and the institutionalisation of credit and balance of payment support schemes within WACH. These recommendations may be derived of course from the recognised member states' fear for total or partial loss of national autonomy.

In principle, the gains to be derived from monetary integration are associated with savings from foreign exchange resources, from reallocating resources to higher yielding activities, increasing mutual trade, reducing uncertainties and improving the efficiency of the monetary mechanism.

A common currency is typically expected to yield advantages in terms of removing some uncertainty in transactions between member countries, by extending the area over which one currency acts as a medium of exchange and a store of value and through the establishment of free factor mobility which will augment the gains from trade and the pooling of shocks from social disturbances or economic fluctuations. Political and socio-economic disturbances in a country can lead to pressure on the country's reserves, speculation against the currency, and hence to the adoption of often uneconomic adjustment policies, eg exchange controls and devaluation. If, however, that country is joined to others in a currency or monetary union, the discipline of the fixed exchange system is enforced and monetary and financial discipline, in terms of

contraction of monetary expansion combined with realistic interest rates and exchange rates, automatically follows.

A wider currency area would take the national exchange rate and monetary management out of politics, ensure protection against disturbances that arise from central government or interest group domination. In Africa, because of the smallness and dependent nature of the economies, economic cartels or interest groups have been powerful enough to influence exchange rate changes and threaten the viability of the national currencies.

There are three principles which provide a direct source of reserve saving from having a common currency (see for instance Mundell, 1973, p 53; Nana-Sinkam, 1978, p 99). The first is the insurance principle - in the sense of smothering the losses and gains in trade between countries or, in other words, balancing intra-regional trade. The algebraic sum of the average deficits of members of a reserve pool is less than the average of the deficits of the individual countries. This is due to both price and quantity variations. Thus, because the prices and production volume of export products do not move together, neither will the balance of payments of different countries. The same holds for imports of goods, services and capital.

Secondly, reserve saving is ensured through the internationalisation principle. Credit-backed reserves can substitute for hard-currency-backed reserves due to intra-regional trade. Elements of a deficit arising from intra-regional trade would not require foreign exchange cover and could indeed be financed by mutual bank balances.

Thirdly, in the context of the externalities principle, there are economies of scale associated with the spreading of overhead costs of management, the sharing of 'public goods' such as information, communications, etc. Other dimensions of externalities are due to the pooled exploitation of natural and industrial production capacities and the efficiency of reserve and overall management of financial resources.

These three principles yield reserve saving, and therefore extra interest-aggregate reserves in addition to greater confidence in the regional currency. But the major gains arise from the increase in recorded trade itself. By breaking away from all financial barriers to intra-regional trade, smuggling and black markets, rife throughout West Africa, would be reduced to those arising from tariff barriers, which can themselves be eliminated by more rational (from the standpoint of regional interests) tariff policies.

It is expected that after a common currency has been in operation for some time, habits and expectations are formed which make withdrawal relatively difficult and costly. To the extent that the currency area sustains, West African countries would gain from a strengthened ability not only to deal with the rest of the world in financial and socio-economic negotiations, but also in imposing improved financial discipline and stability within the region. Real economic convergence and greater mutually beneficial growth among the member states would be enhanced.

Thus, the role of monetary integration for West Africa in the context of our study is in sum related to its capacity and effectiveness as a catalysing element in solving the complex

problems of foreign exchange liquidity, balance of payment adjustment, currency inconvertibility and confidence, and exchange rate stability. In dealing with some of the 'deep-rooted' structural transformations that are fundamental in enhancing domestic and external financial stability, and against which the attainment of sustainable levels of economic growth is critically dependent, monetary integration should catalyse economic integration and overall development in West Africa. As in Europe during the early post-war years, monetary integration in West Africa must be seen as a medium through which the economies of the region can be 'reconstructed' after the 'shocks' of the 1970s and early 1980s. These transformations, many of which are largely dependent and historic in nature, cannot be replaced or avoided by an integration strategy that is too far short of significant political and economic sacrifice in national autonomy on aspects of fiscal and monetary management.

The associated costs of monetary integration to a participating country cannot, however, be ignored. In the literature, they stem mainly from constraints imposed on national sovereignty in the pursuit of monetary and fiscal policies and the possibility that such policies taken at the regional level would not always work in the individual partner's national interests. The nearer the process of monetary integration is towards the establishment of a full monetary union, the greater the degree of potential inflexibility in the pursuance of national economic policies, and the more pronounced and perceived the cost indicators are. This, from a definitional point of view, is because as countries enter into a monetary union, they relinquish control of their monetary and, possibly, fiscal

policies to supra-national authorities controlled only at the union level. Decisions relating to monetary policies, in particular, would have to be made at the union level and the flexibility of seeking central banks (or overall bank financing for budgetary deficits or exploiting inflation finance) would be limited through collective decision making.

It is recognised at the same time that within the monetary grouping, economies may diverge in their stages of development and growth with different degrees of financial and structural disequilibria as well as in their response to variations in demands for their goods and services. These divergencies appear partly as a result of long histories of national identity and preference of national policies to create artificial barriers between national economies. Moreover, as Allen (1983) explains, a national government within a monetary union continues to represent a national constituency, which holds the government responsible for the health of the national economy. Yet in a monetary union, the government must give up, for instance, a major instrument of national economic policy, control of money and credit. This juxtaposition of continued accountability and a perception of weakened capability makes the question of how to address divergent national interests particularly important. One notes however, that in a formal model, Allen and Kenen (1980) argue that countries may not have much real national monetary independence to lose in joining a monetary union. This, according to them, presupposes that there is market integration between the prospective members and also that they maintain fairly stable exchange rates among themselves, thus begging the issues which forming a monetary union is all about.

In the lower forms of monetary integration, designed essentially to liberalise exchange restrictions, and, hence improve currency convertibility, participating countries are obliged to adopt monetary and fiscal policies that are consistent with a sustainable degree of external balance. This, in turn, will impose certain constraints on the use of policy instruments at the national level. As the higher degrees of monetary integration are attained, ie fixed exchange rate parities or the adoption of one currency within the union, the principle cost for a participating country is related more to the loss of the use of the exchange rate as a basic instrument of international adjustment policy and/or the loss of national identity in the issuance of the currency notes and coin.

The exchange rate aspect is emphasised by Corden (1972) who concludes that if countries deprive themselves of appropriate exchange rate adjustments (or trade and payments restrictions) as policy instruments, they 'impose on themselves losses that are essentially the losses resulting from enforced departure from internal balance'.

Corden explains this enforced departure from internal equilibrium by assuming further that a country is initially in internal balance but with a deficit in the external account. If the exchange rate instrument were available, the appropriate policy would consist of a combination of devaluation and expenditure reduction to achieve simultaneously, external and internal equilibria. When the exchange rate is not available as a policy instrument, it is necessary to reduce expenditure by more than is required in the optimal situation with the result of extra unemployment. The excess unemployment, which can be valued in terms

of output, represents the cost to that participating country of depriving itself of the exchange rate as a policy instrument. The extent of this loss is determined, *ceteris paribus*, by the marginal propensity to import and to consume exportables, or, more generally, by the marginal propensity to consume tradeables relative to non-tradeables. The expenditure reduction that is required for eliminating the initial external deficit will be smaller the higher the marginal propensity to import.

The perceived cost of monetary union is also explained in terms of a loss associated with a trade-off in achieving economic goals. For instance, against the framework of the Phillips Curve, a common monetary policy makes it impossible for countries to opt for different trade-offs between inflation and unemployment along their Phillips curves. Hence, it would be likely to result in an unwanted combination of unemployment and inflation in some or all members of the union. So, if optimal domestic policies require different rates of inflation in different member states but, as in the case in a monetary union, exchange rates are fixed, some countries will have to depart from their optimal positions if a uniform change in costs is to be ensured. In the circumstances, some member states will be compelled to accept more inflation than they would choose, while others will have to accept more unemployment. For those obliged to suffer additional unemployment, the excess, valued by the loss of output that it represents, provides a measure of the cost of monetary integration.

Further empirical evidence on the existence of the Phillips curve trade-off (see for instance Phelps, 1968; Friedman, 1975) suggests, however, that this trade-off exists only for very short

periods and has no significance for long-range macroeconomic policy formation. The evidence shows that monetary policy, whilst influencing the rate of inflation, cannot reduce the 'natural' rate of unemployment, ie, the rate of unemployment which is determined by such factors as labour market conditions, taxation policy and a variety of structural and institutional characteristics. Consequently, any attempt to drive the rate of unemployment below the 'natural' rate through the use of expansionary monetary policies will be self-defeating and will engender a process of accelerating inflation. A single exchange rate change will therefore not have lasting effects on employment, so that the ability of a country to achieve relatively low unemployment by depreciating its exchange rate is also a short term matter. Under these conditions a very significant source of welfare cost from monetary integration is eliminated. Unification of the rate of inflation in all member countries brought about by monetary integration does not therefore cause added unemployment, but through the medium of fixed exchange rates, increases price stability and encourages trade and specialisation.

However, as Robson (1980) points out, the costs of monetary integration cannot be discussed merely by describing them as shortrun or transitional. To the extent that there are differences between the Phillips curves of participating countries, adjustment costs will necessarily occur to some as a result of the adoption of a common inflation rate even if the countries were initially on their longrun Phillips curves. Determined by several factors, including the form of the shortrun Phillips curves, the time it takes for inflationary expectations to stabilise, the initial



divergencies between the national and union-adopted rates of inflation, and the period it takes to attain the common inflationary rate, the magnitude of the transitional costs would, where they exceed the benefits, seriously jeopardise the future of a hastily arranged monetary union. Against the background of differential inflation rates among prospective integrating countries, the issues of determining the union optimal rate and of the extent to which collective money supply should be managed in dealing with short-term employment problems cannot be underestimated.

Moreover, even where capital market integration is obtained in enhancing the union's adjustment policies, the outcome may be equilibrating or disequilibrating for some member countries. The freeing of capital movements, as Robson (1980) notes, may lead investors in an area of higher unemployment to invest in other member countries because the marginal productivity of capital is relatively low at home. This may then result to further unemployment. 'From this standpoint capital mobility is Janus-faced' (Fleming, 1971). Also, if the union interest rates were set at levels higher than the return in the 'low-return' member countries and at a lower rate than the return in the 'high-return' member countries, investment in the former may be wiped, thereby increasing further inter-country-disparities.

In addition, there are other implications of monetary integration for regional development. First, the least developed member countries might be forced to follow excessively austere financial policies that may adversely affect their investment and economic growth. Second, the more advanced member states, in terms of infrastructural build-up, can become 'poles of growth' within the

region attracting more capital and investments. These tendencies, as in 'pure' economic integration, could obviously be minimised through the introduction of fiscal transfers between member countries (from the high to low productivity members) and/or deliberate adoption of union policies designed to equalise the growth rates of productivity in the member states. Experience with regional integration policies in a national context suggests, however, that both fiscal transfers and an equalisation of regional productivity growth rates might be extremely difficult to achieve. It would still be more difficult for a monetary union to be accompanied by a convergence in real wages. As a result, some countries, especially those which may be adversely affected by those equalisation policies, will be unlikely to see monetary integration in itself as an attractive proposition. It is also likely, on the other hand, that a decision on the part of such countries to participate in monetary integration would presumably be determined by whether their loss in real income growth would be more than compensated for by other related benefits, such as trade gains or gains of a potential nature.

In the final analysis, the question of participation in monetary integration automatically becomes one of weighing the expected net benefits against the potential net losses. The decision to join is as purely economic as it is political, as the weights that would be necessary during the evaluation process would have to be established by political considerations. In reaching decisions at each stage or form of monetary integration, short term net positions for each prospective member country are just as important as longer term net positions. It is argued that in the

short run, some countries entering the integration process could find themselves incurring net costs, but that, as the process attains towards higher degrees and develops, the original parameters might gradually change with the result that net benefits could eventually emerge. In any case it is observed from the preceding discussions that any disagreements about the benefits and costs for a country joining monetary integration appear to set in only where the latter are discussed.

No doubt, the costs of monetary integration, for the region as a whole, have also to be closely related to the opportunity costs of not achieving it. For the individual country, costs can be associated with the opportunity cost of staying outside monetary integration. The cumulative effects of both costs on the countries or country concerned should vary, depending more on their geographical contiguity, their relative economic strengths and perhaps, more importantly, on the relative convertibility of the national currencies both internally and externally.

Arguably, the expected opportunity costs for a country staying outside the integrated area relate to a depreciation of the liquidity value of its money and to the loss of price competitiveness. For such a country the rigour of monetary, fiscal and overall economic policies has to constantly be demonstrated in 'fine-tuning' and by providing greater monetary and financial incentives (eg high interest rates, low business taxes, etc) in order to defend the economy in general, and the national currency in particular. In short, the 'recalcitrant' country would under such circumstances be enjoying more of the disadvantages of membership of monetary integration.

Obviously, these conclusions could be reversed in favour of the 'recalcitrant' country in which case such country has the likelihood of 'stealing' a competitive advantage by allowing its economy to slide rather than by deciding to control it in unison with the integrated group.

In practice, these arguments have featured very prominently (on exchange rate management prices, and interest rates) in discussions as to whether or not Britain should become a full member of the European Monetary System. In the ECOWAS, the issue could arise should: (a) Nigeria - because of oil revenues, political and economic size; (b) Liberia - because of a convertible dollar and US assistance; or (c) the WAMU countries - either because the union has survived for so long or for fear of Nigerian domination and/or the relative financial instability of non-WAMU countries - each decides to opt out of an ECOWAS monetary union. It could also arise should some countries appear complacent with the existing Clearing House arrangement and therefore show little enthusiasm for further stages in monetary co-operation.

It is obvious that the magnitude of the potential benefits and costs do vary with different levels of monetary integration. Until these contrasting aspects are firmly established and reasonably understood at the initial stages, monetary integration in any form is, as Grubel (1981) puts it, 'putting the cart before the horse'. The crucial question for the participating countries at each stage or form of monetary integration is therefore whether that level (or further levels) is (are) worth striving for in respect of the potential gains and losses, although in most cases, the latter appear more obvious than the former. Indeed, as most writers have

observed, the benefits of a monetary union accrue in the form of externalities and in small doses to the general public but these should become more apparent as the processes of monetary and economic co-operation gain an impressive pace. This is because in the short to medium term, the nature and level of the benefits of integration are determined largely by existing production structures and infrastructural facilities than the pure monetary obstacles. In the longer term, the costs, which are more readily identifiable at the beginning of the integration process - especially as they affect special interest groups in the participating countries, are more than offset by the gains.

### 9.3 THE TRANSITION PROBLEM

The difficulties of reconciling national views and interests, of shaking the traditional inertia of bureaucracies and of accepting the political and economic risks apart, the promise and prospects for the issuance of a common currency in West Africa, for the pooling of reserves and the unification of domestic monetary policies have important implications for the all-embracing West African Clearing House and the all-francophone West African Monetary Union. At the same time neither institution could provide a profound basis for the transition towards monetary unification, although the latter poses greater threat than the former. As noted earlier, the actual post-independence experience of monetary co-operation in West Africa up to the present time centres largely on these two institutions. A critical appraisal of their operations and experience would therefore serve to highlight some of the issues

and problems already touched on regarding the feasibility and scope of further advances in monetary integration in West Africa.

It should be noted, however, that while the WAMU had its foundation from the Franc zone established in the mid-forties between France and its colonies, the origins of an all-embracing monetary co-operation scheme in West Africa were in two previously unsuccessful attempts at creating an African Payments Union (APU). The first was in 1962 between Algeria, Egypt, Ghana, Guinea, Mali and Morocco. It failed as the members became reluctant to execute the formulated 'Casablanca Charter'.

The second attempt in 1963 was inspired by the Economic Commission for Africa (ECA). The Commission invited the Executive Secretariat to:

'study the possibility of creating a clearing system within a payments union of African countries and to present the study of the Commission during its 7th meeting in 1965' (Resolution 98(v) of the 5th Assembly of ECA, 1963)'. .

In the ECA's view, the APU was necessary as the 'situation of exchange and payments in Africa in the early 1960s was rather poor and called for immediate correction'.

The emerging study on the project by Professor Triffin recommended a gradual process towards the creation of a continental monetary union and the African Monetary Co-operation Charter which he advocated required African states to:

- (a) periodically examine discriminatory restrictions and measures in matters of payments with a view to gradually suppressing them;

- (b) encourage mutual assistance agreements and policy co-ordination with a view to overcoming possible obstacles to this liberation and arising from balance of payments; and
- (c) to seek for and enlarge similar agreements on a wide an area as possible.

These objectives according to Professor Triffin, were to be achieved through the establishment of a 'Pan-African Advisory Body' dealing with monetary and payments matters. He maintained that the monetary co-operation charter he envisaged could only be an integral part of a much wider economic co-operation charter for the continent.

This project too never materialised as the preliminaries for its realisation - eg statutory matters, membership, policy and implementation strategies, and other logistics were never adequately resolved. It was however on the basis of the foundations laid by it that the signing, on 14 March 1975 and the ratification on 25 June 1975 of an agreement providing for the establishment of the West African Clearing House (WACH) were effected. Through the Association of African Central Banks (established in 1966), the African Payments Union project was more or less transformed into the formation of four sub-regional (monetary) committees (delineated geographically as North, West, Central and East African sub-regional committees) with basic responsibilities to facilitate payments and clearing arrangements at the sub-regional level. The WACH was hence the first concrete 'indigenous' experiment of multilateral monetary co-operation in West Africa and in Africa as a whole; the second in Africa was the Central African Clearing House, established in 1979.

### 9.3.1 The West African Clearing House (WACH)

The objectives of the West Africa Clearing House as stated in Article II, section 2 of the Articles of Agreement are:

- (a) to promote the use of member countries' currencies for sub-regional trade and other transactions;
- (b) to secure economies in the use of foreign reserves of member countries;
- (c) to encourage trade liberation between member countries; and
- (d) to promote monetary co-operation and consultation between member countries.

The WACH's other essential operational features as addressed in the Articles include provisions for a unit of account and exchange guarantees (Article VII), and for credits, eligible transactions and exceptions in the clearing mechanism (Article VIII). Centralised in Freetown, Sierra Leone, operations in the Clearing House commenced on 1 July 1976, a year after its establishment.

The WACH arrangement was thus originally justified largely in terms of its ability to provide a framework through which certain subsidiary benefits of monetary integration could be secured within the ECOWAS. For a group of countries lacking a common currency, the stated aims of the Clearing House imply the desire to use the clearing mechanism as a vehicle through which some of the major monetary obstacles which have hampered intra-regional trade (ie multiplicity of currencies with varied convertibility levels, and trade and payments restrictions which to a large extent do not discriminate against mutual trade) might be minimised, thereby



improving such trade relations and hence, secure savings in foreign reserves.

More specifically, the role of the WACH was seen against the background of the established modes of settlement for intra-regional transactions. The common feature in West Africa is however that while unrecorded and recorded border trade is normally transacted in cash (often through a parallel market utilising regional or other convertible currencies, eg CFA, dollar), the principal channel for effecting intra-regional settlements is through the region's commercial banks, which in turn settle in convertible currencies through correspondent banks overseas. This was the system that the establishment of the Clearing House was designed to improve upon.

There are thus three major areas on which we now attempt to evaluate the performance of the multilateral clearing system after nearly a decade of operational experience:

- (a) the relationship between the clearing operations and intra-regional trade;
- (b) the degree of currency convertibility and the level of savings in international reserves accomplished; and
- (c) the extent of monetary consultation and integration achieved and prospects for further advances in monetary co-operation.

#### 9.3.1.1 Intra-Regional Trade Expansion

The WACH Agreement provides that all current account transactions (ie goods, services, income and unrequited transfers) are eligible for clearing through the system. Transactions exempted are:

- (a) those specified by the WACH Exchange and Clearing Committee (comprising at least two representatives from each member central bank or monetary authority), and
- (b) payments relating to goods of 'non-local origin', ie, goods from third countries.
- (c) trade among member states of WAMU as they share a common currency between them (the CFA franc). In practice also, oil transactions with Nigeria are not channelled through the Clearing House, although ECOWAS countries are allowed 90 days credit in contrast to the official OPEC pricing policy of allowing 30 days credit across the board for all countries.

The initial implications of these exemptions can be illustrated by drawing from the intra-ECOWAS trade matrices discussed in Chapter 4 (Tables 40 and 4P). WAMU trade has represented over half of total intra-ECOWAS trade; rising from 54.1 per cent in 1970-75 to 57.0 per cent in 1983 after declining slightly to 49.7 per cent over 1976-80. Of this, over half is among its member countries, ie 52.6, 51.6 and 53.1 per cent in 1970-75, 1976-80 and 1983 respectively. Until it rejoined the union in 1985, almost all of Mali's trade in the ECOWAS (representing 7-9 per cent) was with the WAMU states, ie 92.1, 97.2 and 100 per cent over the three periods respectively. Nigeria's exports to the Community has accounted for 17-22 per cent of total intra-Community trade in 1976-83 and virtually all of this can safely be assumed to be in respect of oil. Thus, taking intra-WAMU-Mali trade together with Nigeria's ECOWAS exports (which are assumed to correspond with ECOWAS imports from Nigeria), it means in practice that an average of over two-thirds of their share in total

intra-ECOWAS trade (ie 69.1, 71.0 and 70.3 per cent in 1976-80, 1981 and 1982 respectively) or around 60 per cent (ie 54.1, 60.8 and 61.3 per cent) of total trade among ECOWAS member countries is automatically not a part of the WACH mechanism. Furthermore, when compared with the corresponding total value of WACH transactions (derived in Table 9C), it is further revealed that of the remaining intra-ECOWAS trade (ie \$3099, \$754 and \$659 millions), only up to a quarter of this trade has been channelled through the Clearing House, ie 14.4, 25.7 and 15.5 per cent in 1976-80, 1981 and 1982 respectively.

The underutilisation of WACH is illustrated further in terms of the ratio of total clearing transactions to total intra-regional trade. The evidence is that eventhough the value of WACH transactions has shown a steady rise since the commencement of the operations, rising by several fold between 1976 and 1981, only around 10 per cent of intra-regional trade has actually been channelled through the mechanism (Table 9C). The steady rise though in this ratio from 2.4 per cent in 1976 to 6.5 per cent in 1979 and 10.1 per cent in 1981 compares unfavourably with performance by the Central American Clearing House whose proportion of total clearing transactions to intra-regional trade grew spectacularly from 10 per cent to 77 per cent during the first two years of its operations - 1961/1963 (Del Valle, 1966).

The Table also indicates that the proportion of intra-ECOWAS trade that is theoretically compensable (ie on the assumption that all intra-community trade is channelled through the WACH) is limited

Table 9C ECOMAS: WACH Operations, 1976-1983

	Intra-Regional Trade		WACH Transactions		Compensable Trade <sup>c</sup>		Trade Transactions through WACH <sup>d</sup>		Transactions Cleared		Settlements <sup>e</sup>		
	Exports	Imports	(million \$)	% of total Trade	(million \$)	% of total Trade	million \$	Percentage of Intra-Regional Trade	WACH transactions	WACH transactions	(million \$)	% WACH transactions	
1976	483.6	394.1	877.7	18.4 <sup>a</sup>	21.2	2.4	10.90	12.6	1.4	59.2	4.27	4.9	23.2
1977	644.9	594.9	1239.8	45.2	52.8	4.3	35.0	40.9	3.3	77.4	13.09	15.3	29.0
1978	577.2	581.1	1158.3	52.0	65.1	5.6	35.70	44.7	3.9	68.7	14.15	17.7	27.2
1979	723.1	735.4	1458.5	72.8	94.1	6.5	45.52	58.8	4.0	62.5	18.04	23.3	24.8
1980	1002.3	1022.1	2024.4	162.7	211.8	10.5	50.42	65.6	3.2	31.0	23.70	30.8	14.6
1981	946.4	976.6	1923.0	164.3	193.7	10.1	38.31	45.2	2.4	23.3	31.82	37.5	19.4
1982	866.6	838.2	1704.8	92.7 <sup>b</sup>	102.3	6.0	69.00	76.2	6.7	74.4	17.02	18.8	18.4
1983	870.9	756.4	1627.3	-	-	-	-	-	-	-	-	-	-

Source: WACH, Annual Reports, 1976, 1977-81/82

- Notes:
- a Covers July to December 1976
  - b Covers January to August 1982
  - c Theoretical maximum compensable trade = Lower of exports/imports X 2
  - d Trade or commercial transactions. Other classifications of WACH transactions are Financial (Embassy transfers, grants etc); Capital (government and private); and unclassified
  - e Represent final settlements in fiscal years 1976/77 - 1981/82
  - Not available

to around 50 per cent and has not improved since the Clearing House's creation. The implication is that at best only about half of total intra-West African trade can be freely financed in regional currencies through the WACH. The total volume of 'trade' transactions cleared through the WACH (as against non-trade transactions - financial, capital and unclassified) as a percentage of the theoretical maximum compensable trade has also remained significantly low at less than 10 per cent; falling to 4.2 per cent in 1981 from 7.7 per cent in 1979. The continuous decline in 'trade' transactions in terms of total WACH transactions (from 77 to 23 per cent in 1977-81) appeared to favour non-trade transactions (although there has been no capital transactions), which might have suggested a change in emphasis for clearing mechanism from trade to non-trade transactions, but the reverse was the case in 1982.

Furthermore, the value of transactions actually cleared as a proportion of total WACH transactions has also remained low. After reaching a peak of 29 per cent in 1977, this ratio dropped steadily to 18.4 per cent in 1982. This continuous decline implies a corresponding rise in the proportion of WACH transactions requiring non-regional currency settlement, which is contrary to the foreign exchange saving objective of the WACH. The failure of the Clearing House to provide or stimulate savings of international reserves by bringing about a substantial reduction in the use of such foreign exchange assets in relation to intra-regional transactions (since only net balances after clearing operations have to be settled in foreign convertible currencies) is demonstrated further in the Table by the continuous rise in the ratio of final settlements to total WACH transactions. The overall picture is that well over two-thirds

of WACH transactions are actually due for settlement in foreign currencies.

Another critical feature of the WACH's operational experience is shown in Table 9D in that the pattern of clearing transactions and settlements have merely reflected the pronounced mutual trade imbalances as were shown in Chapter 4. In particular, the skewness is between the francophone countries as a group and the rest of ECOWAS. The Table indicates the predominance of the WAMU countries (BCEAO as central bank) as net creditors in the clearing system as against persistent debtor positions by such countries as Ghana, Guinea and Mauritania. Inclusion of oil payments for WACH clearing would not only greatly augment the overall volume of transactions cleared, it would also reverse Nigeria's chronic debtor position.

Payments (or receipts) in favour of the BCEAO, as a proportion of total WACH transactions, increased from 68.98 per cent in 1976/77 to 82.80 per cent in 1981/82, while the proportion of the corresponding payments it has had to order has dropped consistently. In general, the WAMU states as a group have not manifested any significant utilisation of the clearing facility, although this is also true for most countries in the ECOWAS. Although it may appear that some of the countries with the more highly inconvertible currencies, owing to stricter exchange restrictions (eg Ghana, Guinea and Nigeria) have channelled an increasing proportion of their payments for intra-regional transactions through the WACH, Ghana's participation has been steadily declining. Liberia, the most liberal in terms of trade and payments restrictions, Guinea-Bissau which joined the WACH only in 1978/79 and Sierra Leone, with

Table 90 ECOWAS: WACH Transactions and Settlements by Member Central Banks, 1976/77 - 1981/82

	TRANSACTIONS (million WAUA)					NET SETTLEMENT (million WAUA)								
	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82		
BCEAO	3.92	3.12	3.82	5.33	9.65	10.69	30.94	24.57	52.41	79.60	131.96	108.01		
Gambia	4.50	3.20	2.62	3.33	5.24	9.27	-3.44	-1.00	-0.32	-1.01	-1.59	-6.84		
Ghana	18.21	15.88	15.59	26.03	29.10	37.64	-14.18	-13.11	-13.01	-23.21	-23.96	-32.66		
Guinea	-	0.65	2.95	5.71	14.70	10.45	-	-0.65	-2.85	-4.88	-14.65	-10.38		
Guinea-Bissau	-	-	0.14	0.13	0.08	0.01	-	-	-0.09	-0.12	-0.07	-0.01		
Liberia	-	1.27	0.02	0.09	0.01	0.02	2.13	0.49	2.91	4.60	3.65	3.76		
Mali	0.27	0.09	0.16	0.10	0.74	0.05	0.24	1.75	1.29	1.00	0.08	0.84		
Mauritania	-	-	-	0.44	33.24	28.27	-	-	-	-0.32	-30.30	-26.99		
Nigeria	22.15	17.24	47.12	65.09	71.68	45.52	-17.54	-12.02	-40.64	-57.92	-64.00	-36.29		
Sierra Leone	1.65	2.34	1.86	2.11	3.22	1.30	1.85	-0.02	0.30	0.26	-1.12	0.56		
Total	50.70	43.79	74.28	108.36	167.66	143.22	-	-	-	-	-	-		
			PAYMENTS (%)							RECEIPTS (%)				
	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82		
BCEAO	7.84	7.13	5.14	4.92	5.76	7.46	68.98	63.23	75.69	78.38	84.47	82.88		
Gambia	8.98	7.31	3.53	3.07	3.12	6.48	2.27	5.02	3.11	2.14	2.18	1.70		
Ghana	35.22	36.27	20.98	24.02	17.36	26.28	8.98	6.33	3.46	2.60	3.07	3.47		
Guinea	-	1.48	3.97	5.27	8.77	7.30	-	-	0.13	0.77	0.03	0.05		
Guinea-Bissau	-	0.19	0.12	0.12	0.05	0.01	-	-	0.07	0.01	-	-		
Liberia	0.22	2.90	0.03	0.08	0.01	0.01	0.16	4.02	3.95	4.32	2.18	2.64		
Mali	0.63	0.20	0.22	0.09	0.44	0.03	1.14	4.19	1.95	1.02	0.49	0.62		
Mauritania	-	-	-	0.41	19.82	19.74	-	-	8.73	0.11	1.75	0.90		
Nigeria	43.77	39.37	63.43	60.07	42.75	31.79	11.58	11.92	8.45	8.45	4.58	6.45		
Sierra Leone	3.34	5.34	2.51	1.95	1.92	0.90	6.89	5.29	2.91	2.20	1.25	1.29		
Total														

Source: WACH Annual Reports, 1976/77 - 1981/82

- Notes : 1 Financial Year is 1 September to 31 August  
 2 WAUH 1 = SDR 1  
 3 Postcoin change denotes surplus; negative change denotes deficit  
 - Non or negligible

restrictions almost as tight as in Ghana and Nigeria, have also shown little participation in the clearing operations.

#### 9.3.1.2 Regional Convertibility

The performance of the WACH after 10 years of operation can also be appraised in terms of its effectiveness in fostering greater convertibility among the currencies of the region. The concept of currency convertibility relates to the ability to exchange one currency for another at a given conversion rate and to the usability of a currency to settle external transactions (IMF, 1980). In practice this definition encompasses various degrees of convertibility, ranging from total (or perfect) convertibility - the unrestricted exchange of one currency into all other currencies without limitations imposed on its usability for any type of foreign transactions - to total (or complete) inconvertibility, which refers to the complete inability to exchange one currency into any other currency or to use it for any foreign transaction. While perfect convertibility applies to the case where a country has no payments and exchange restrictions vis-a-vis the rest of the world, by contrast, total inconvertibility would require the complete absence of international transactions in that country, ie, a completely closed economy. Along this spectrum, the degree of currency convertibility is identified mainly by the scope and intensity of exchange and other financial restrictions towards international transactions, ie, the ease with which a currency can be converted into other currencies and the extent to which it can be used for various types of foreign transactions.



A more formal treatment of the concept of convertibility is provided in Article VIII of the IMF Articles of Agreement which expresses the current convertibility obligations for all Fund members. The convertibility matrix presented in Table 9E defines more clearly the concept of 'limited convertibility' which, as already noted, is widely recommended as the most appropriate form of convertibility which developing countries must aspire towards in their monetary integration efforts. Preconditions for achieving other forms of convertibility (total and Fund convertibility) or indeed, complete inconvertibility are also shown in the matrix.

In general terms, limited convertibility refers to the unrestricted exchange and use of national currencies within a region. Or, in line with IMF provisions regarding restrictions imposed on residents on the making of payments and transfers overseas, limited currency convertibility, especially for those developing countries whose national currencies are generally not held by non-residents would mean the 'absence or a minimum of restrictions on residents in respect of their ability to use such currencies for the purchase of other currencies' (Cincin-Sain and Marshall, 1983) and it is only this type of convertibility is what has been variously recommended for the ECOWAS member countries. Hence, the institution of WACH arrangements it was argued, should provide for a larger degree of payments liberalisation between member countries and for a much larger reliance on national currencies through an ad hoc intra-regional accounting unit as a means for settlement of mutual balances incurred in exchange transactions between them.

Table 9E Currency Convertibility Spectrum

	Trade	Current Transactions	Invisibles	Capital Transactions	Convertible into all Currencies	Convertible into some defined set of Currencies
Total Convertibility	No exchange restrictions No trade restrictions	No exchange restrictions No trade restrictions	No exchange restrictions No restrictions on invisibles	No restrictions	Yes	Not applicable
Article VIII Convertibility (IMF)	No exchange restrictions Possible trade restrictions	No exchange restrictions Possible trade restrictions	No exchange restrictions Possible restrictions on invisibles	Possible restrictions	Not necessarily	Not applicable
Limited Convertibility <sup>a</sup>	Possible exchange restrictions Possible trade restrictions	Possible exchange restrictions Possible trade restrictions	Possible exchange restrictions No restrictions on invisibles	Possible restrictions	No	Yes
Total Inconvertibility	Comprehensive exchange restrictions Comprehensive trade restrictions	Comprehensive exchange restrictions Comprehensive trade restrictions	Comprehensive exchange restrictions Comprehensive restrictions on invisibles	Comprehensive restrictions	No	Not applicable

Source: IMF, Report on Currency Convertibility in the Economic Community of West African States, 1980, p 7

Notes: a Only vis-a-vis countries outside the region. No exchange restrictions would be applicable within the region. The defined set of currencies would be the regional currencies

Where countries within a region do differ significantly in their initial degree of restrictions, as is the case in West Africa, it is expected that to improve regional convertibility, those countries with more highly restrictive exchange systems would have to more positively adopt liberalisation measures in order to achieve the degree of liberalisation of the least restrictive member countries. In other words, the dismantling of exchange restrictions within the region would be accompanied by a shift into those regional currencies which display the highest degree of convertibility. Those countries with greater currency convertibility would in practice act as a conduit for the foreign exchange transactions of the region as a whole and this may have negative consequences for the balance of payments of countries with weaker currencies. This 'conduit effect' is worsened further by the divergencies in the exchange rate regimes of member countries. Obviously, the best way of preventing it is by the creation of a full monetary union with member countries sharing a uniform currency.

Currency inconvertibility in West Africa is explained largely by the observance of a range of exchange restrictions by most countries. As noted previously (Chapter 6), some countries maintain exchange systems that are free or relatively free of restrictions, while others continue to apply severe restrictions on virtually all types of payments and transfers for current external transactions. Perfect convertibility can be said to exist within the member states of the WAMU which has a common currency issued by a common central bank and whose residents can freely exchange transfers to one another, whereas Liberia, with the US dollar as national currency

and with relatively no exchange restrictions on international transactions, displays the highest degree of convertibility in West Africa. The rest of the currencies are highly inconvertible although many of them are traded illegally in large quantities in border areas.

As in the case of any multi-currency clearing arrangements, regional convertibility is initially promoted in West Africa through the introduction of a common unit of account within the WACH mechanism. The West African Unit of Account (WAUA) (Cincin-Sain and Marshall, 1983 have suggested the name, the 'African' or 'West African) is equivalent to one SDR. To record and settle transactions through the Clearing House, national currencies are converted into WAUAs through cross rate mechanism involving their respective intervention currencies and the SDR. This tedious exercise has required, as a first stage, determining the central rate of each currency relative to its intervention currency, and on the second stage, converting the currency in terms of the SDR via the intervention currency's rate in terms of the SDR. Official settlement rates in WACH (the average of daily rates) are calculated over two determining periods each month (1-15 and 16-end of month).

Although this rate determining procedure is designed to minimise fluctuations in rates used for clearing operations and reduce the administrative burden and operational costs, there is still an imminent exchange risk, arising out of exchange variations which originate from the daily intervention currency and SDR relationship. WACH procedures do require that in the event of a more than 2.5 per cent discrete devaluation of a national currency with respect to its intervention currency, the new rate of that

currency in terms of the WAUA applies immediately for the country's WACH transactions.

Some form of convertibility is maintained as member countries provide exchange guarantees which require the free conversion of their domestic currencies into the WAUA in respect of all eligible transactions cleared through the WACH. The member central banks are however not committed to hold prior consultations with the WACH in the case of changes in their official exchange policies, but must promptly notify the Clearing House and other member banks. In addition, the WACH arrangements also ensure full convertibility in one of five foreign convertible currencies - US dollars, pound sterling, French franc, Swiss franc, and German mark - in all net settlements. This implies that a member country forced to maintain exchange restrictions on international transactions could in no case impose such limitations on the convertibility of its debt obligations in the WACH.

Other basic provisions of the WACH to improve regional convertibility include an assurance by member banks for prompt settlement of debt obligations and the institution of credit facilities. While considerable delays in effecting settlements (25 delayed settlements in 1982) and in some cases, an actual incidence of default (16 cases in 1981 and a monthly average of 2.8 million WAUA in 1982) have characterised WACH operations since their commencement, the WACH as an institution, has not, unlike other regional clearing institutions such as the Santa Domingo Agreement (1969) and the CARICOM Multilateral Clearing Facility (1977), been designed typically to support balance of payments imbalances, or protracted debtor balances in clearings or long settlement

periods. The credit facility that is provided for in the WACH system is the minimum possible - WAUA 0.5 million or 25 per cent of the previous year's cleared transactions for debtors or twice that for creditors - and the mechanism is meant to function as an accounting office. Notwithstanding this limited and very short term technical credit facilities, all debtor positions are required to be settled monthly and promptly on demand or not later than 15 days after the month to which the debt relates.

As the extended debtor positions persist, this fundamental limitation of the WACH to enhance a meaningful credit mechanism is manifested in continuous delayed settlements and several cases of actual default. Calculations in Table 9F of the theoretically available credit facilities in WACH show that net ceilings for debtor member countries between 1980/81 - 1982/83 range from WAUA 8000 in Liberia to WAUA 2.672 million for the BCEAO, whereas credit limits span a range of WAUA 0.016 to 5.344 million for the two areas respectively. The inadequacy of the credit mechanism is demonstrated here by matching the calculated credit facilities against actual net settlement positions. In 1980/81 and 1981/82, the BCEAO's respective net settlement balances of WAUA 131.96 million and 108.01 million, were 49 and 22 times the stipulated credit limits, while for Nigeria, net settlements were over 20 times the allotted debit ceilings. For the region as a whole, net credit facilities are about 7 times short of the volume of net settlements needing financial support. Purely on the basis of country intra-regional trade imbalances, it appears that only surplus countries - Nigeria, Ivory Coast and Senegal, are more capable of extending

Table 9F ECOWAS: Available Credit and Debit Lines in WACH (million WAUA)

	Cleared Transactions				Credit Lines				Debit Lines				Net Settlement Position			
	1979/80	1980/81	1981/82	1979/80	1980/81	1981/82	1979/80	1980/81	1981/82	1980/81	1981/82	1980/81	1981/82	1980/81	1981/82	
BEAO	5.325	9.624	10.689	2.663	4.827	5.344	1.331	2.414	2.672	131.96	108.01					
Gambia	1.823	2.787	2.430	1.000	1.494	1.215	0.500	0.747	0.608			1.59	6.84			
Ghana	2.817	5.143	4.320	1.408	2.572	2.160	0.704	1.286	1.080			23.96	32.66			
Guinea	0.358	0.046	0.070	1.000	1.000	0.035	0.500	0.500	0.018			14.65	10.38			
Guinea-Bissau	-	-	-	1.000	1.000	1.000	0.500	0.500	0.500			0.07	0.01			
Liberia	0.084	0.156	0.033	1.000	1.000	0.016	0.500	0.500	0.008	3.65	3.76					
Mali	0.102	0.009	0.019	1.000	1.000	0.095	0.500	0.500	0.048	0.08	0.84					
Mauritania	0.118	2.938	1.283	1.000	1.469	0.641	0.500	0.734	0.321			30.30	26.99			
Nigeria	9.117	7.295	9.233	4.539	3.648	4.616	2.279	1.824	2.308			64.00	36.29			
Sierra Leone	1.572	1.132	0.845	1.000	1.000	0.422	1.000	0.500	0.211			1.12				
Total	21.316	29.360	28.922	15.630	19.010	15.544	7.814	9.505	7.774	135.69	113.17	135.69	113.17			

Source: West African Clearing House, Annual Report and Accounts

Notes: 1 Net credit and debit lines for each succeeding year are based on 50% (or minimum of 1 million WAUA) and 25% (or a minimum of 0.5 million WAUA) respectively of the previous year's clearings

credit to countries such as Benin, Ghana, Guinea and Mali which have incurred pronounced intra-regional trade deficits. On a sub-regional basis, credit must come from the WAMU member countries to the rest of the ECOWAS. In terms of overall balance of payments performance, only the Ivory Coast and to a limited extent Liberia, Nigeria and Senegal could be capable of extending credit to deficit-stricken countries - Benin, Gambia, Burkina and Sierra Leone. These assumptions do re-emphasise the expected additional role for the larger and relatively more developed member countries of the ECOWAS to the smaller and relatively more vulnerable states.

#### 9.3.1.3 Prospects for Monetary Union

The foregoing analysis clearly shows that in its existing state, the West African Clearing House mechanism is significantly insufficient as a medium for establishing regional convertibility, stabilising exchange rates within narrow margins of fluctuation, creating liquidity support even for mutual imbalances, promoting intra-regional trade, and hence, for securing the much desired saving in foreign exchange which could have been used to finance part of the overall external trade imbalances.

Often in discussions on the apparent weaknesses of the WACH mechanism, attention is focused largely on those factors which, as outlined in Chapter 7, are inherent in virtually all clearing house institutions. These inhibiting factors include the narrow range of eligible transactions, protracted delays and default in executing transfer orders and net settlements, problems of insufficient transport, communications and publicity networks, the lack of active participation by the commercial banks, other financial institutions



and the general public, as well as the marked inadequacy of credit facilities within the clearing system. There is no doubt that these weaknesses have partly resulted in the marked underutilisation of the WACH.

There are nonetheless obstacles which are much more structural and fundamental in nature and for which the realisation of monetary integration in West Africa only in the form of the WACH can provide no penetrating solution. To begin with, it is extremely likely that a number of member countries would deliberately want to avoid the embarrassment of becoming hardcore debtors in the system should they institute stricter regulations to encourage greater participation by their nationals. In some countries, there is simply not enough enthusiasm to increase participation, especially by the fiscal and treasury authorities. It can also be argued that the timing and speed with which WACH was established in relation to the inception of the ECOWAS hardly provided enough time for the type of preparedness and concerted efforts that was required for appreciating its role more meaningfully with respect to regional financial and overall economic problems which began in the 1970s and which have exaggerated in the early 1980s. No doubt then that WACH has had limited capacity to influence both the frequent and, in almost all cases, the massive and generally downward exchange rate adjustments as well as the continued severity of quantitative controls and exchange restrictions adopted in several countries. These policy options, as already noted, are to a large extent symptomatic of the sustained balance of payments pressures experienced in these countries and against which WACH has no scope. Moreover, they provide the main source of the high incidence of

black market commodity and currency activities. Above all, WACH has lacked the scope to stimulate and expand reciprocity in trade, financial and production profiles of the member countries as well as that with which to effectively disturb the predominance of non-regional currencies in settlement operations. There have been no capital transactions through the WACH system.

Whatever the theoretical virtues of the WACH, its scope and ability as a medium for furthering monetary integration among the West African states is practically constrained by both its operational weaknesses as well as by the structural problems and distortions that have characterised the region. With the continued deterioration in overall export performance and other international reserve sources, what is required is a monetary integration framework that should in the first instance eliminate or minimise the scope for foreign exchange leakages and restore confidence for domestic transactors, foreign investment, and mutual and international assistance. In the medium to longer-term, the mechanism required is one through which the more structural problems of food shortages, stabilisation of export supplies and prices, rationalisation of concessionary aid, external public debts and import demand can be grappled with more concertedly.

It is all too apparent that for most financial and commercial operators in West Africa, the utter desire is to seek to maximise the relatively risk-free profits which can be extracted from the fragmented and unco-ordinated systems of fiscal and monetary (exchange rates) arrangements. These, of course, contribute further to destabilising the overall economic system by increasing domestic

fiscal expenditures and money stocks, thereby injecting further inflationary bias.

A number of proposals have recently been put forward with a view to improving the scope and performance of the WACH. Frimpong-Ansah (1983) has recommended the upgrading of the WACH into a credit institution with legal powers to mobilise regional and extra-regional resources and to provide for larger but short-term credit tranches and longer settlement periods. There have also been proposals for expanding the moniness of the *West African Unit of Account* and these include:

- (a) the introduction of West African travellers cheques denominated in WAUA for travel within the region;
- (b) the prompt repurchase of a member country through the clearing system, of its currency notes held by individuals and institutions in other member states; and
- (c) the establishment of a West African Confirming House for intra-regional trade.

These proposals do have conceptual appeal, but their ultimate realisation and impact on furthering monetary co-operation in the region cannot be ascertained. Firstly, it should be pointed out that an arrangement in which credit is linked to the incidence of intra-regional imbalance is open to the objection that in so far as the mutual deficits and surpluses result from fundamental differences in structural economic and financial distortions and comparative costs, insistence upon the elimination of these imbalances would lead to a less efficient allocation of resources with little impact on intra-regional trade expansion. However, it

may be argued that the impact on such credit arrangements on the volume of West Africa's mutual trade which is presently conducted under highly restrictive conditions may be improved if provision is made for the balancing of incremental rather than total trade. This provides an additional incentive for participation in mutual trade. The review of the experience of West Africa's intra-regional trade flows implicitly recognises that member countries incurring persistent regional deficits may be unwilling to go very far with liberalisation of such trade if reciprocity in the form of balancing the growth in their imports resulting from their own liberalisation against the growth in exports attributable to liberalisation by other countries is not judiciously achieved.

At the same time, a country contributing reserve assets to the working capital of any credit arrangement will almost certainly require automatic access to at least an equivalent amount of credit, and an additional degree of automaticity might be in order. How far such automaticity should go is a matter for judgement and negotiation in each case, and should depend on such factors as the standards of monetary discipline of member countries, their confidence in one another and the quality of their experience in working together. Obviously, the more certain a country is of access to substantial credit facilities, the more inclined it will be to risk the balance of payments consequence of reducing restrictions on imports from other members of the group.

It should be noted also that while the initial problem with the credit proposal is the required mobilisation of the capital endowments amidst the currently depleted foreign reserve positions, the seriousness of the balance of payments implications of intra-

regional trade for the majority of countries relates not so much on that trade which is officially recorded but, more significantly on that which goes through unrecorded, and is substantially on the black market. There are as we have noted no estimates available on unrecorded intra-West African trade but it is undoubtedly of considerable importance as the goods involved are generally re-exports and are transacted in the relatively more convertible regional and foreign convertible currencies. However, strictly on the basis of the intra-regional trade imbalance positions revealed in our analysis, a credit facility to support this trade would automatically imply placing a disproportionate burden on the surplus countries - Nigeria, Ivory Coast, Senegal and Liberia, but such a reasoning is merely theoretical because of the equally worsening balance of payments pressures in these countries.

As far as the travellers cheques and currency notes repurchase proposals are concerned the greatest worry is that, because of the wide disparities in the degree of convertibility among the West African currencies, these mechanisms if instituted would seriously aggravate the 'conduit effect' and its consequent adverse implications for the balance of payments of the less convertible countries. It is too apparent that for a start a traveller from Sierra Leone, for instance, would purchase WAUA denominated traveller's cheques or leone notes. On arrival in Liberia he would then encash them into dollars, either through the banking system or at a discount in the parallel market. The dollars would later be exported illegally to Sierra Leone to finance both commodity smuggling and black market currency activities; and the vicious circle starts again. Until currency convertibility differentials

are eliminated through the introduction of a uniform currency or narrowed down through some fixed exchange rate arrangement, instituting these proposed facilities would only institutionalise at the regional level those black market and parallel market activities which in most countries are already deeply entrenched within the overall economic system.

On the foregoing, the idealised picture of the role of WACH that was drawn in the Articles of Agreement is thus evidently far from reality. As was envisaged before its inception the Clearing House has functioned without interfering in any way with the member central banks' autonomy in the choice of exchange regimes or in the application of national monetary and fiscal policies. Since exchange rates were not fixed within the mechanism, they too have continued to fluctuate widely against each other, reflecting, among other factors, the absence of harmonisation in monetary and fiscal policies. In essence, the Clearing House has done little to support economic integration in that it has operated over the years without making any impact on liberalising and expanding mutual trade and on improving regional convertibility. Indeed, the potential importance of its consultative mechanism, which have been evident among the member central and commercial banking systems, cannot be ignored, at least, if only to complement the transitional framework towards monetary union.

### **9.3.2 The West African Monetary Union (WAMU or UMOA)**

The WAMU model provides the closest conceptual example of a full monetary union in that throughout its existence, the union has operated with a common currency and union-wide central bank; foreign

reserves of the member countries are pooled at the union level; there is a broad uniformity in the application of monetary policy; and convertibility (the permanent absence of all exchange controls on current and capital transactions) is maintained among member states. In these respects, the WAMU largely satisfies both Corden's (1972) and Machlup's (1976 and 1977) definitions of complete monetary integration.

Significantly, however, the model has not evolved around the deliberate observance of the optimum currency area criteria in that inflationary tendencies have differed among the members and product diversification is limited only to 1-3 primary products with a high degree of non-complementarity even in the equally limited industrial activities. As in most developing countries, the only surplus labour at the disposal of the WAMU countries is unskilled so that apart from the border movements encouraged largely by historical and ethnic traditions, there is little mobility of complementary labour. Similarly, there is hardly any capital movement between the WAMU countries, which reflects the lack of adequate domestic savings and the non-complementary financial and monetary structures in the union. Economic openness, reflected mainly in terms of the high degree of trade and financial transactions with the outside world, is profoundly structural.

It should be emphasised that at the time of its formation in 1962, no special provisions were originally incorporated within the WAMU to invite economic integration by directly encouraging intra-union trade, mobility of factors of production, or by some central allocation of investment between member states, to foster complementary investment. In theory a free movement of labour and

capital between member countries is allowed in the Union but, as is widely the situation among ECOWAS countries, most of the WAMU countries only dispose surplus unskilled labour so that, apart from border mobility of labour encouraged by historical and ethnic traditions, there has been little mobility of complementary labour. Similarly, despite the free movement of capital, each of the WAMU countries, like virtually all other ECOWAS countries, suffers from a shortage of savings and a significant intra-regional mobility of capital could not be expected. Thus, economic integration in these circumstances could only arise from a free, and increasing movement of products, enhanced by an inflow of complementary external capital and skilled labour. The important point here is that the creation of WAMU was originally not an integral part of a consciously designed policy of economic integration among the member states.

It is evident however that while the WAMU has worked and endured for over two decades, its member states have represented the most active participants in the emerging economic integration schemes in West Africa. In addition to the CEAO in which they are all members, it has been observed (see Table 3C) that all integration schemes in West Africa, except the MRU, are evolved around WAMU countries. Although monetary integration is justified in large part because it promotes economic integration, the experience of the WAMU shows that there is hardly any established conceptual relationship between the two types of integration efforts.

As was discussed in Chapter 2, WAMU countries share similar production and trade profiles, producing competitive primary commodities typically for export and importing the bulk of consumer



and intermediate goods and services. Economic developments in these countries since the early seventies have shown a mixed picture that has been greatly influenced by a number of exogenous factors, notably, the oil price increases and the depressed demand conditions in the international primary commodity market. As a result, their overall economic picture, especially in the more recent years, has equally been one of rising severity in problems of international liquidity, represented by growing current account deficits, mounting external debt-service obligations, falling reserve balances, rising levels of monetary aggregates, strong inflationary tendencies and an unimpressive degree of financial intermediation.

The union represents about a fifth of total ECOWAS population, growing at around an average of 3 per cent per annum during the last decade. Per capita incomes among the member states may be diverging but are equally close and low compared with the other West African countries (except Nigeria). Niger and Senegal had negative growth in per capita incomes during the period. In growth terms, WAMU countries (except Senegal at 2 per cent) grew at over 3 per cent per annum with Ivory Coast growing at 6.2 per cent (the highest in West Africa). These growth rates compare with an average rate of 2.7 per cent for the ECOWAS as a whole in the 1970-80 decade.

As one looks back upon the discussions on monetary union, there is general agreement that the key factors on which the performance of such a union is assessed should include the nature and stability of the exchange rate and/or currency arrangements, the trade patterns of the member countries, and the price differentials at home and abroad. The conditions under which the fixed exchange rate system which characterises the monetary union is superior involves a

complicated weighting of these key factors, making generalisations difficult. However, in assessing the experience of the WAMU model and its implications for an ECOWAS monetary union, emphasis is placed on examining the integration of the member countries of the union with each other, their interaction with France and the union's performance in monetary policy compared with the rest of the West African countries, notably the FSA countries. In this respect three key questions are asked:

- (a) is intra-WAMU trade improving?
- (b) are WAMU monetary policies and performance more disciplined and converging?
- (c) is the special relationship between WAMU and France inhibiting for achieving ECOWAS monetary union?

#### 9.3.2.1 Intra-WAMU Trade

The picture in Table 9G reveals that intra-WAMU trade has not grown and is on average below 6 per cent (except Burkina, with an average of over 20 per cent) of total trade. While this trade represents over 50 per cent of the member countries' trade within ECOWAS, it also accounts for over half of the Community's total mutual trade. These two ratios, however, demonstrate both the degree of trade concentration within the WAMU as well as the relative importance of the Union's involvement in intra-ECOWAS trade. If one were to compare the mutual trade performance of the WAMU with that of the three countries that withdrew from the union - Guinea, Mali and Mauritania (although they have never been integrated to each other) - and of the rest of ECOWAS, the evidence is that the WAMU countries have at least not done any worse than

Table 96 Trade/Inflation Performance of WAMU Member Countries Compared with Ex-Franc Zone Countries

	Intra-WAMU in World Trade (%)			Intra-WAMU in Intra-ECOWAS trade (%)			WAMU in Intra-ECOWAS Trade (%)			France in WAMU World Trade (%)			Inflation (% Annual Increase in Consumer Prices)				
	1970-75	1976-80	1983	1970-75	1976-80	1983	1970-75	1976-80	1983	1970	1975	1980	1983	1970	1975	1980	1983
Benin	7.3	3.4	4.0	67.3	66.2	82.8	3.6	1.8	1.8	40.9	28.4	19.1	19.0	-	-	-	-
Burkina Faso	22.6	23.6	26.3	81.3	91.5	93.7	7.3	5.9	6.0	34.8	37.9	32.3	25.6	1.7	18.8	12.3	8.4
Ivory Coast	3.7	3.2	5.4	52.5	50.0	55.6	22.9	21.2	25.6	38.8	33.2	32.8	26.5	9.4	11.5	14.6	5.9
Niger	5.5	5.9	5.7	26.9	56.4	25.5	5.8	4.2	9.2	46.1	46.4	49.3	45.4	0.9	9.2	10.3	-2.5
Senegal	4.2	4.8	5.2	43.9	40.4	43.6	12.7	11.7	11.5	52.7	44.5	33.2	37.2	2.9	31.8	8.8	11.7
Togo	2.3	3.0	3.1	52.1	27.6	53.0	1.8	4.9	2.9	28.7	36.8	21.5	17.5	4.3	18.1	12.4	9.4
WAMU	4.9	4.4	5.9	52.6	51.6	53.1	54.1	49.7	57.0	41.4	36.7	32.6	28.6	3.8	17.9	11.7	6.6
Guinea	0.1	-	-	9.8	0.1	-	0.5	0.3	0.8	16.5	14.7	18.8	20.2	-	-	-	-
Mali	0.4	-	-	1.3	-	-	8.9	7.1	7.1	29.0	29.9	28.9	22.2	-	-	-	-
Mauritania	-	-	-	0.5	-	-	3.5	-	2.0	25.1	45.8	37.4	17.6	6.6	11.9	10.8	0.9
Total <sup>a</sup>	-	-	-	1.5	-	-	12.9	7.4	9.9	22.8	29.5	26.9	19.7	6.6	11.9	10.8	0.9

Sources: Tables 4L, 5D and 6B

Notes: a Analysis is with respect to trade between the three countries  
 - Non, negligible or not available

they and a few have in fact done better. The balance of trade is significantly in favour of the Ivory Coast and Senegal in the union just as it is in favour of Nigeria in the rest of the ECOWAS. There is hardly any meaningful trade relation between Guinea, Mali and Mauritania since much of Mali's intra-regional trade is with the WAMU. Because of the deep-seated structural pattern of the West African countries' trading relations, as Chapter 4 showed, it is not surprising that the WAMU should have very low impact on trade among its member states.

#### 9.3.2.2 Financial Efficiency in WAMU

The principal formal means of policy co-ordination in the WAMU involves the collective pegging of the 'national currencies' to a single currency - the French franc - at the same exchange rate - and the statutory limit on credit accorded to member governments by the BCEAO central banking system (ie, 20 per cent of the previous year's government domestic tax revenue). Comparative statistical tests are therefore carried out on whether monetary stability or convergence has been achieved by the collective exchange rate arrangements compared with the alternative unco-ordinated exchange rate policies adopted by the other West African countries.

In summing up the monetary experiences of the African countries, Mundell (1972, p 93) has argued:

'The French and the English economic traditions in monetary theory and history are different. At the risk of over-simplification the French tradition has stressed the passive nature of monetary policy and the importance of exchange stability with convertibility (within the

franc area); stability was achieved at the expense of institutional development and monetary experience. The British countries by opting for monetary independence have sacrificed stability, but gained experience and better developed monetary institutions'.

The conclusion along this view is that for the West African countries the choice in exchange rate arrangements implies a trade-off between monetary stability and development. Seeking explicit evidence along these lines is difficult because of the very close economic similarities between the countries. However the controversy about the costs and benefits of the WAMU exchange rate system or indeed, of the independent regimes maintained by the other countries merely reflects how the volatility of the French franc and the other intervention currencies have affected the West African countries in relation to the Mundellian monetary stability/development trade-off.

Since the 1970s, stability relative to one currency has meant instability in relation to other floating currencies so that fixing the exchange rate is no longer a valid option. Despite the French franc devaluations in the seventies and the early eighties, the annual variation in the exchange rates of West African currencies presented in Table 6C indicates that in contrast to non-WAMU currencies, especially the Ghanaian cedi and the Sierra Leonean leone, the nominal fluctuations of the CFA franc vis-a-vis the SDR and the US dollar have been of smaller magnitudes and less erratic. The overall average nominal variation of the CFA franc in 1970-83 was -3.52 per cent against the SDR (-3.45 per cent against the US

dollar) as against -12.87 per cent (-22.11 per cent) for the cedi and -8.27 per cent (-5.59 per cent) for the leone. It is also evident that the currency distortions which are imminent in many of the non-WAMU countries - represented by black market rates much lower than the official rates and with direct consequences for high incidence of smuggling and other illegal exchange activities - are generally non-existent within WAMU as the CFA franc indirectly enjoys the same convertibility as the French franc.

Mundell (1972) has suggested that the simplest test for the trade-off between monetary stability and development is the extent of development of money substitutes. There are generally no marked differences among the West African countries on the supra-national nature of the monetary and financial systems. No doubt the banking system in the former sterling area (FSA) countries is more diversified in terms of institutional arrangements although Nigeria and the Ivory Coast have the widest range of financial institutions. The discussion in chapter 6 of some of the indicators of financial intermediation suggests a blurring of the differences between the WAMU and the FSA countries in particular.

Table 9H provides evidence that although the degree of financial intermediation is generally improving in the region as a whole, the propensity to hold cash (ie the ratio of currency outside banks to money supply -  $M_1$ ) remains higher in the WAMU countries whose median propensity of 38 per cent in 1983 compares with 35.6 per cent in the FSA countries. The propensity to save (ie the ratio of quasi-money to money supply) is much higher in the FSA than in the WAMU states whose median propensity to save (24.7 per cent) in 1983 was lower than 36.3 per cent in the FSA. The table shows

however that in 1962-83, the propensity to save has increased much faster in the WAMU than in the FSA countries. Also, the level of liquidity (ie the ratio of money supply -  $M_2$  to GDP) has been much higher in the WAMU states. In 1982, it ranged between 20.1 per cent in Burkina to 43.8 per cent in Togo in contrast to a range of 17.3 per cent in Ghana to 37.2 per cent in Nigeria.

Trends in overall money supply and inflationary tendencies (Tables 5C, 5D and 9A) indicate that the WAMU states have had better performance over the non-WAMU countries in terms of having recorded lower growth in both aggregates. The relationship in inflationary and monetary stability within the WAMU and non-WAMU groups of countries was tested further by regressing the standard deviation of each aggregate to its rate of growth over 1970-83. The obtained equations for inflation were:

$$SD_i = 19.1 - 1.11x_i$$

$$R^2 = .72$$

$$N = 5 \quad (\text{for WAMU, excluding Benin})$$

and

$$SD_i = -2.44 + .90x_i$$

$$R^2 = .97$$

$$N = 6 \quad (\text{for non-WAMU}) \text{ (Gambia, Ghana, Liberia, Mauritania, Nigeria, Sierra Leone)}$$

The results suggest that even though inflation has been both rising and unstable throughout West Africa, the relationship remains less strong in the WAMU than in the non-WAMU states where the rates have remained relatively much higher and unstable. The differences between the two groups in the average rate of growth of inflation

Table 9H Financial Intermediation: WAMU Versus Rest of ECOWAS, 1962-83

	Propensity to hold cash <sup>1</sup>			Propensity to hold quasi-money <sup>2</sup>			Liquidity <sup>3</sup>	
	1962	1972	1982	1962	1972	1982	1962	1972
Benin	52.6	41.7	29.3	2.9	8.6	15.2	15.3	16.7
Burkina Faso	55.3	54.5	37.9	3.4	6.7	23.8	10.8	9.7
Ivory Coast	56.3	41.9	33.2	6.9	16.0	30.3	22.6	26.0
Mali	60.7	64.1	62.2	2.8	2.6	5.5	NA	NA
Niger	54.8	47.9	42.2	0.7	11.8	14.5	NA	NA
Senegal	50.9	38.5	32.2	3.4	8.7	28.0	21.3	15.7
Togo	61.1	39.2	46.3	1.4	15.0	23.1	11.5	15.9
Median (WAMU)	55.3	41.9	37.9	2.9	8.7	23.1	15.3	15.9
Gambia	61.7 <sup>a</sup>	55.2	44.0	13.5	15.8	31.3	21.0	24.9
Ghana	48.0	35.8	46.9	17.5	30.7	24.5	16.0	23.7
Liberia	NA	11.3 <sup>b</sup>	12.4	NA	40.2	51.1	NA	14.8
Mauritania	71.0	40.0	30.8	2.5	7.6	25.5	NA	13.8
Nigeria	48.0	32.0	25.3	24.0	38.0	39.8	13.2	15.6
Sierra Leone	51.1	43.6	28.9	18.2 <sup>c</sup>	31.1	39.7	11.8	15.9
Median (Non-WAMU)	51.1	37.9	29.9	17.5	30.9	35.5	14.6	15.8

Source: IMF, International Financial Statistics, (IFS)

- Notes: a 1964  
b 1974  
c 1981  
d 1980  
e 1963
- 1 Line 14a ) over lines 34 + 35 (M2)  
2 Line 35 )  
3 M2 over GDP



over the 14 year period was statistically significant ( $t = 2.785$ ,  $p = 0.05$ ,  $df = 152$ ).

In money supply, the derived simple regression equations for the period 1970-83 were:

$$SD_m = -4.38 + .90m$$

$$R^2 = .19$$

$$N = 6 \quad (\text{for WAMU})$$

and

$$SD_m = 14.3 + 0.23m$$

$$R^2 = .002$$

$$N = 7 \quad (\text{for non-WAMU}) \text{ (Gambia, Ghana, Liberia, Mali, Mauritania, Nigeria, Sierra Leone)}$$

These results suggest that the growth in money supply has been consistently higher in non-WAMU countries. The difference in the overall average growth in money supply between the two groups was however found not statistically significant ( $t = 1.225$ ,  $p = .05$ ,  $df = 175$ ). The causal relationship between inflation ( $I$ ) and the money supply ( $M$ ) was evidently stronger in the non-WAMU ( $I = -11.2 + 1.39m$ ;  $R^2 = .58$ ;  $N = 6$ ) than among the WAMU ( $I = 7.0 + 0.17m$ ;  $R^2 = 0.11$ ;  $N = 5$ ) countries. There has also been better budgetary control in the WAMU in terms of moderate deficit financing by the BCEAO but a higher growth rate of investment and modest balance of net foreign assets to short-term liabilities in non-WAMU countries.

There has also been some measure of cohesion in inflationary performance inside the WAMU, notably in terms of the standard deviation in the distribution of annual inflation rates around the WAMU average and the range from highest to lowest, especially after

1976. Inflation peaked in 1977 and the indicators of divergence reached their maximum within three years after the first oil price explosion in 1973. The differentials again widened sharply in 1981, shortly after the second wave of oil-price increases. Such convergence is hardly visible among the non-WAMU countries and the inflationary impulses of the two oil-price explosions were of relatively less comparable magnitude between the two groups of countries. It cannot be concluded whether or not this improved record of cohesion in the WAMU has been in line with expectations in the absence of any prescribed union targets. There can be little doubt however that the relatively more improved financial discipline and cohesiveness in the WAMU can be attributed to their collective monetary arrangements, albeit with close supervision from France.

In sum, the statistical results and conclusions obtained above and elsewhere in this study (see in particular, Chapters 5 and 6) on the comparative performance of the WAMU countries compare with those obtained by the ACMS (see ACMS, 1981). Both sets of analysis support the BCEAO group in connection with better control of money supply as well as inflation. Given its structure, vis-a-vis the rest of the central banks in West Africa, (especially the FSA banks) the BCEAO has by and large been more capable in resisting the financing of very large government deficits which accelerate the growth of money supply and therefore help to worsen the inflationary situation in a country. It is expected that the lower the ratios of currency in circulation to money supply the better, since they depict restraint from pressure to increase the proportion that the currency in circulation bears to the remaining components of the money supply.

The technique analysis of variance (ANOVA) (for one factor design for an unequal number of observations) adopted by the ACMS for comparison between BCEAO (six countries) and FSA (four countries), in particular, has observed no significant difference (at 95 per cent confidence level) between the two groups of countries in relation to several important money supply variables, eg growth of the ratio of currency in circulation to money supply, growth in money supply ( $M_1$  and  $M_2$ ), growth rates of total deposits of the banking system, commercial banks assets, domestic credit and credit to the private sector. Money supply is however observed to be consistently lower in the BCEAO. The difference between the BCEAO and FSA is found statistically significant in the currency ratio and money supply on the one hand, and the level of inflation on the other, in the FSA.

#### 9.3.2.3 WAMU and France

The strong caveat for the relatively better financial efficiency of the WAMU states has been the special role of France in supporting the international convertibility of their common currency through the Operations Account as well as in France's efforts to sustain its overseas franc area. The WAMU-France relationship is explained in the special treaty between the two parties:

'the BCEAO shall pay into the Operations Account the disposal funds that can be raised outside its zone of issue .... with exceptions' (Article 2).

In the event of a shortage of disposable funds in the account, the French Treasury may, in accordance with Article 5, grant overdrafts. Article 7 stipulates the conditions of payment of the debit or credit balances of the Account (see Omrana, 1980).

The main provisions of the revised statutes (1974) and the decisions subsequently taken by the WAMU states provide for:

- (a) new agreements with France governing economic co-operation and access to the 'operations account', which limit the union's liquid assets held in the Account to 65 per cent of total assets, lay down the principles for diversifying the remaining 35 per cent into other foreign exchange holdings, and provide for an exchange guarantee based on the SDR-French franc rate on the Operations Account deposits;
- (b) the establishment of an inter-bank money market managed by the BCEAO;
- (c) the harmonisation of union interest rates with international markets; and
- (d) the limiting of the liquid assets which banks and financial institutions could hold outside the Union to minimise working balances in order to avoid leakages.

There are divergent views about the consequent costs and benefits of France's role in the WAMU for both parties. Omrana (1980) has argued that the system has two major advantages for France. Firstly, in the event of an excess of French imports of WAMU products over French exports to WAMU, the system enables France to settle its resulting trade deficit by simply crediting the Operations Account with the deficit value without an immediate

settlement involving actual transfer of foreign exchange. In this respect also there is loss of choice in the dominance of a settlement currency. Secondly, to the extent that any expected surpluses resulting from WAMU's trade with non-franc zone countries are instantly credited to the Operations Account in the union's favour, France should benefit from the temporary use of such reserve balances.

In practice, however, trade between WAMU and France has been on the decline. The share of France in WAMU's total trade dropped from 41.4 per cent in 1970 to 28.6 per cent in 1983 (Table 9G) while the trade imbalances between the two parties have widened considerably in favour of France (Table 9I).

**Table 9I WAMU: Net Trade with France (million dollars)**

	1970	1975	1980	1983
Benin	-13.98	-47.48	-135.51	-95.24
Burkina	-18.82	-57.42	-118.17	-68.45
Ivory Coast	-26.10	-120.20	-537.20	-140.20
Niger	-11.95	+27.07	+101.57	+116.44
Senegal	-16.34	-17.68	-210.96	-230.14
Togo	-3.59	-11.55	-86.71	-83.77
Total	-90.78	-227.26	-986.98	-501.36

Source: See Table 4H

As a group, WAMU's trade deficit with France has risen by more than tenfold between 1970-1980. This implies (on the merchandise trade side) persistently negative operations account with France. The overall operations account moved from a claim of CFAF 54.6 million on France in December 1979 to a liability of CFAF 13.2 million in March 1980 (de Macedo, 1985, p 32). The steep increases in the reserves of Togo in 1980-83 were offset by an even steeper decline in Benin, Ivory Coast and Senegal (Table 6H).

The extent of the French transfers - which have allowed the continuous sterilisation of the loss in reserves - cannot be neglected. But as de Macedo observes (op cit, p 35), the reversal in the increase in WAMU's money stock relative to France's in the last few years has been in line with France's emerging reluctance to continuously replenish the operations account. The implication is that in the future the monetary allocation of the transfer may become a central policy issue for the union's relationship with France and this could be aggravated by the readmission of Mali, another structurally deficit country.

Available statistics on the listed sources of financing indicate that French aid to WAMU rose from 40.5 per cent in 1974 to 44.1 per cent in 1976 of total financing. This was explained by a marginal drop in private investments especially between 1974-75, and the slow rise in public funds, the bulk of which was allocated to technical and cultural co-operation and equipment needs. The share of French aid in 1977 was marginally lower, at 39.6 per cent (Omrana, 1980, p 17).

The most obvious cost of the WAMU system to the member countries derives from the disadvantages associated with the loss of national autonomy in the use of the exchange rate as an instrument of policy as discussed previously. The fixed CFA franc/French franc rate has remained unamended since 1948 and there is little evidence of this arrangement being openly contested by any member country. Advantageously, the convertibility guarantee which is at the centre of the system has positive impact on the union both in terms of maintaining the confidence of investors and in the *inflow* of economic and technical assistance. The CFA franc is collectively less over-valued compared with currencies like the cedi and naira (Table 9E). The CFA franc's stable fixed relationship with the French franc makes it easier for foreign investors to plan and forecast their CFA franc obligations and the potential exchange risk by simply observing fluctuations of the French franc in the international exchange markets. It is however difficult to judge determinately the likely effect on the WAMU of the absence of such a convertibility as well as that of an overall withdrawal of French support for the WAMU system. Under such circumstances and judging from the experience of other ECOWAS countries, the WAMU countries would be more likely to retain their single currency system, implying that the costs associated with the France-WAMU relationship are more than offset by the corresponding benefits.

The fact, however, is that like all other West African countries the WAMU countries have not escaped the disastrous impact of the global shocks of the seventies. The economies have experienced widening trade deficits and a marked economic slow down. The low level of domestic savings has equally precipitated increased

foreign borrowing while economic and financial policies are increasingly expansionary with serious implications for inflation and the balance of payments. Intra-union trade remains marginal and complementary production and financial services are inexistent. The WAMU system, despite its relative political coherence, has had limited capacity to insulate the member economies from these constraints. This should develop greater enthusiasm for membership to an ECOWAS common currency arrangement, at least to moderate total dependence on France.

Unlike the existing situation in economic integration where ECOWAS co-exists with sub-regional groupings, it is much more complicated for the WAMU arrangement to co-exist with an all-embracing ECOWAS monetary union, especially if a new currency were to be created. For as long as France is willing and ready to sustain and support the WAMU agreement, it would be unrealistic to imagine that at least they would abandon the union in place of independent monetary systems without the implied feeling that they would be jeopardising their economic and political unity, thereby undermining economic confidence. Besides, the WAMU membership is increasingly likely to expand with the re-admission of Guinea and Mauritania and the new admission of Gambia and Guinea-Bissau. Moreover, the conduit effect of the CFA franc is becoming increasingly apparent in these countries as well as Ghana and Nigeria where the currency is already illegally traded widely since it is regarded just as valuable an exchange medium as sterling or the US dollar.



Finally, it may be difficult to attribute whatever performance or disparate levels of development obtainable among the WAMU states exclusively to the membership of the union. Even where some of the intra-union disparities may be severe, there is apparently no evidence - from the point of view of the members - that membership of the union has been gravely disadvantageous to them. This is what would count heavily - from the point of view of the WAMU members - against an ECOWAS monetary unification strategy that would either be completely different from the WAMU tradition or necessitate its complete structural dissolution or overhauling.

### **9.3.3 West African Monetary Unification and International Monetary Relations**

Monetary unification in West Africa on the scale envisaged also has important implications for the reform of the international monetary system. There is no problem in the IMF Articles of Agreement inhibiting the creation of a common monetary bloc in West Africa. There are provisions however that specify the rules with respect to exchange rate and intervention policy. From a formal point of view there is no problem to the transition; firstly, as the desired objectives of the pecuniary gains to West Africa from reserve saving, a more independent control over the West African money supply, the recovery of mutual trade and seigniorage to West Africa, the enhancement of regional convertibility and the availability of a new instrument to correct the West African balance of payments problem do not imply an abrupt demonetisation of existing international reserve and pivot currencies; and secondly, because monetary unification in West Africa is fully compatible with

the spirit of international co-operation that is sought for the reform of the international monetary system.

The latter implies directly making currency unification in West Africa subject to IMF guidelines - whether for exchange rate arrangements and surveillance; for drawings on the Fund; for the role of lenders/borrowers in the fund; for the respective roles of the common currency or unit of account and the SDR; or for payments and transfers. More specifically, in terms of the IMF Articles of Agreement, West African monetary unification is internationally acceptable to the extent that it promotes exchange rate stability, maintains orderly exchange rate arrangements among the countries and avoid competitive exchange depreciation (Article I); and it is compatible with Article IV, Section 26, which stipulates that Fund members may adopt 'co-operative arrangements by which members maintain the value of their currencies in relation to the value of currency or currencies of other members'. Against this background, monetary unification in West Africa becomes an integral part of the search for a new and stable international monetary system.

#### **9.4 EXCHANGE RATE UNIFICATION VERSUS COMMON CURRENCY**

##### **9.4.1 The Case for Common Currency**

ECOWAS has two policy options for achieving monetary union. The first is to establish some form of exchange rate unification among the member currencies, in which case the member states would have to establish firm commitment to accept and trade each other's currencies for all transactions within the region at some acceptable exchange rate conversion margins. The more irrevocably fixed the rates are the closer is the union towards the establishment of the

second option; namely, a full monetary union in which the member countries will share a single common currency and an autonomous central monetary authority. The choice between the two options has to be influenced essentially by the extent to which each is potentially more capable of achieving the required regional convertibility, sustain it and hence, insulate the economies against the social and economic costs associated with the marked disparity in the convertibility levels of the individual currencies.

In these respects, the obvious candidate is a single currency whose creation would eliminate the technical problem of maintaining fixed exchange rates among the currencies, and which, as Cooper (1973, p 230) puts it, 'would make irrevocability of parities really credible'. The single currency would, moreover, eliminate the problem of having to maintain a clearing system for the various currencies in a fixed rate arrangement. These and other differences between the two options have already been discussed, especially in Chapter 7. The main contention in this study is that exchange rate unification would appear a less viable policy option especially for less-developed countries such as the ECOWAS where the financial and monetary system is severely dependent, rudimentary and has very limited facilities to support such a system.

The interest in a unified exchange rate system derives in large measure from its utilisation as a step in a gradual approach towards having a common currency for the monetary union or, where the latter is found to be completely impracticable to attain exchange rate unification is considered a second best situation. A unified exchange rate system, where the rates are irrevocably fixed and convertibility is completely free, is for all practical purposes a

single currency, as the established rates are merely another way of expressing one currency against the other. If for example country A and country B were to adopt a unified exchange rate system, it matters not, as far as the concept of a single currency is concerned, where one unit of currency of A is defined as equal to one or half a unit of B. If the rates are fixed at B1 equal to A0.50, then B1 is merely another way of expressing A0.50 and vice versa. The implication however is that in the absence of a similar if not identical monetary policy between the two countries, a more than proportionate increase in the money supply in one member country would give it a greater claim on the goods and services of the partner country. This skewed situation can only cancel out through a reciprocal but proportionate increase in the money supply, otherwise the unified exchange rate system would rapidly degenerate to a situation where one country may be subsidising another.

These implications are further examined by Sohmen (1969a, 1969b) who stresses the necessity for the constancy of both 'spot' and 'forward' exchange rates and maintains that since governments today are far from being capable of pegging the exchange rates for all maturities, a single common currency must be preferred to secure the benefits of a currency area. Meade (1957), Johnson (1963) and Ingram (1969) have emphasised that exchange rate unification by itself would not lead to an acceleration of capital mobility and competition within the area since, in defence of the fixed exchange rate, governments may be obliged to resort to exchange controls, thus destroying convertibility. Fleming (1971) and Palankai (1977) argue that even though exchange rate fixation at a given date might have taken place according to 'balanced exchange rates', at a later

date the actual parity of currencies may shift mainly because, as Fleming sums it up, 'developments would occur ... that pushed the relative costs levels of the participating countries out of line' (p 468). The repercussions of such developments on the balance of payments, unemployment and inflation would necessitate adjustment, in the absence of exchange rate fluidity, through domestic expansionary or deflationary policies in the member countries. This may involve the attainment of one economic objective at the expense of the other, thus worsening the trade-off relationships between key economic policy targets for the countries subject to exchange rate unification.

As Palankai suggests, efforts aiming at the maintenance of fixed exchange rates and consequently of balance of payments equilibrium can create long-range problems for the member countries. The reason, according to him, is that in the longer-term of exchange rate unification, as parity shifts, it is highly improbable that the inflation of the national currencies will be of equal rate and extent, and this brings about the over-valuation and/or under-valuation of the currencies in respect to the price levels in the individual countries. On the other hand, the different development of effectiveness and productivity results in the same situation and this causes a change in the cost levels among the different countries. From the over-valuation and/or under-valuation of currencies there ensues an increasing and even cumulative tension both as regards the maintenance of fixed exchange rates and the equilibrium of the balance of payments.

The differences between systems of a single common currency and multiple national currencies pegged to each other may be great. Yet in view of the different conceivable stages of currency unification, it may seem an extremist position to claim that a single common currency must exist from the beginning and then to say that a common currency is not feasible in practice; and therefore that fixed exchange rates would lead to more problems. At least in practice, the experiences of both the EEC and the former East African Community are indicative of the difficulties and gross limitations of exchange rate unification as a strategy for achieving monetary integration. In the EEC, the 'snake' failed and there are still several 'hiccups' in the EMS as it tries to achieve its main objective of monetary stability in Europe. Eight EMS realignments have so far taken place since 1979.

In the defunct EAC, the exchange rate unification system under which exchange restrictions between the three member states - Kenya, Uganda and Tanzania - were liberalised, the three currencies - Kenyan shilling, Ugandan shilling and Tanzanian shilling - had full convertibility against each other on a one to one basis, and a par clearance of national currency notes was available; the system fell apart within four years of its creation. By this time (in 1970) economic policies had begun to diverge widely with money supply growing at different rates, different wage legislation enacted and different investment policies pursued. In fact full convertibility between the currencies was never restored even after the repulsion of the temporary reintroduction of exchange controls against each member country. The high degree of uncertainty that surrounded the exchange rate arrangement after these developments escalated the

divergences in the relative strengths of the member currencies as well as black market practices against each country. As these developments continued, showing an increasing awareness by each member state for foreign exchange shortage, it was obvious that the net benefactor in terms of both trade, investment and capital flows was Kenya whose national currency and economy became increasingly stronger in the Community; a situation which also influenced the final collapse of the Community in 1977.

In principle, an exchange rate unification scheme in ECOWAS may take the form whereby the 10 member currencies can be linked at exchange rates determined by cross rates vis-a-vis a reference currency or currencies in international markets. The more advanced form of exchange rate unification may also be adopted with rates irrevocably fixed, although this is a much harder policy to conceive of following the dependent nature of the member countries' exchange rate systems. Table 9J gives some indication of the cross-rate relationship between the currencies. The US dollar is used as reference currency. However, as long as varying margins and different currency pegs are used in the region, the cross rates of the member currencies will continue to exhibit more or less large daily fluctuations, depending on the movement of the intermediary currencies in the world markets. Table 9K shows the changes in the exchange rates of member currencies against each other in 1980 as compared with 1984.

The cross rates of West African currencies and their exchange rates in relation to foreign currencies will only become stable if they are pegged, with given margins, to a common currency. But this pegging would not be completely reliable as differing monetary and

Table 9J ECOWAS: Estimated Cross-Rates of National Currencies<sup>1</sup> (On 3 July 1985)

	CFA franc	Escudo	Dalasi	Cedi	Sylli	Peso	L-Dollar	Oygu'ya	Naira	Leone
CFA franc	-	5.18	120.84	8.73	18.77	3.14	462.83	6.89	514.26	77.14
Escudo	0.19	-	23.31	1.68	3.62	0.61	89.27	1.33	99.19	14.88
Dalasi	0.01	0.04	-	0.07	0.16	0.03	3.83	0.06	4.26	0.64
Cedi	0.11	0.59	13.84	-	2.15	0.36	53.00	0.79	58.89	8.83
Sylli	0.05	0.28	6.44	0.47	-	0.17	24.66	0.37	27.40	4.11
Peso	0.32	1.65	38.46	2.78	5.97	-	147.32	2.19	163.69	24.55
L-Dollar	0.002	0.01	0.26	0.02	3.04	0.01	-	0.01	67.16	0.17
Oygu'ya	0.15	0.75	17.54	1.27	2.72	0.46	67.16	-	74.62	11.19
Naira	0.002	0.01	0.23	0.02	0.04	0.01	0.90	0.01	-	0.15
Leone	0.01	0.07	1.65	0.11	0.47	0.04	6.00	0.09	6.67	-

Source: West Africa, 8 July 1985, p 1385

Notes: 1 Cross-rates are based on middle rates against the US dollar.  
Rates are in terms of currencies in the horizontal axis.



Table 9K ECOWAS: Changes in Cross-Rates, 1980-84 (Per Cent)<sup>1</sup>

	CFA franc	Escudo	Dalasi	Cedi	Syfi	Peso	L-Dollar	Ougutya	Naira	Leone
CFA franc	-	-3.82	9.63	84.52	-71.01	10.56	-126.98	-55.00	-56.08	4.67
Escudo	5.00	-	12.84	87.96	-64.73	14.29	-118.92	-48.39	-50.52	8.06
Dalasi	-	-25.00	-	85.71	-88.89	-	-151.16	-50.00	-72.52	-5.49
Cedi	-9.00	-8.00	-623.13	-	-1321.43	-635.00	-1718.18	-1133.33	-1150.00	-653.36
Syfi	44.44	40.00	-47.14	92.75	-	53.57	-32.74	9.76	8.73	44.27
Peso	-12.50	-15.00	-0.97	86.00	-91.57	-	-153.62	-74.62	-74.38	-6.52
L-Dollar	60.00	50.00	60.34	94.44	20.00	66.67	-	50.00	31.32	-57.89
Ougutya	36.36	33.33	41.63	91.91	-10.33	42.65	-46.57	-	-0.77	38.43
Naira	33.33	-	40.63	90.00	-	50.00	-45.45	-	-	38.46
Leone	-100.00	-50.00	4.92	86.84	-66.67	-	-138.10	-100.00	-63.87	-

Sources: IMF: IFS Year Book, 1984 and IMF Survey, February 1985, p 41

- Notes:
- 1 Based on rates against the US dollar as of 31 December each year
  - 2 Negative sign denotes depreciation and position change denotes appreciation of currency in the vertical axis against currency in horizontal axis
  - 3 - denotes no change in some cases

financial policies could generate pressures to alter prevailing rates or even force other member countries to withdraw. In this respect it is not enough to lift restrictions on foreign exchange in order to maintain cross-rate stability, although the situation could be worse, if exchange rate unification is pursued without exchange control liberalisation. Such a situation may further strengthen the already stronger CFA franc and Liberian dollar and, hence, encourage capital flight in favour of these currencies. It matters not that under exchange rate unification the rates are irrevocably fixed, for as other currencies become relatively weaker, everybody begins to anticipate the irrevocable to be revoked. The immediate consequence is a heightening of black market activities so that although the fixation of a common rate is maintained, it is achieved at the expense of the movement of commodities inside the region.

It should, of course, be emphasised that the tables have only shown theoretically equivalent cross rates between the member currencies. Real or actual nominal cross rates would have to reflect the extent of over-valuation, the difference between black market and official rates, and, most importantly, the ability of each economy to be able to support any derived rate. It is now evidently clear from the WACH experience that any exchange agreement that allows for freedom of choice as to the type of exchange rate arrangement by each country is hardly a realistic monetary integration framework for ECOWAS. At the minimum there has to be a form of irrevocably fixed exchange rate, which in turn means movement towards the common currency option. At the same time, the EMS system cannot be mirrored, especially its exchange rate margin mechanism. The EMS member currencies are already independently

convertible and each currency is in a relatively better position to withstand or protect itself against destabilising forces compared with any of ECOWAS' currencies. For ECOWAS, the most urgent problem is the achievement of regional convertibility and this can no longer be made wholly dependent on the prior complete liberalisation of trade via liberal exchange payments restrictions since this objective, on its own, can never be achieved (see Chapter 6 for some of the reasons).

#### **9.4.2 Common Currency Options**

The idea of creating a genuinely new West African currency can be realised in basically two ways: to adopt one of the existing national currencies or to create an entirely new unit of account. It may not be technically difficult to design a new currency, although it should be noted that the SDR is not an appropriate precedent in this case because even though it has become an increasingly attractive store of value (ie reserve asset in foreign asset portfolios), its use as a means of payment has still been very limited. Unlike the SDR, the West African currency is a claim to be held not by central banks alone but substantially by the general public as well. The main problem rather would be to gain public acceptance. To make it work, it would be necessary to make it conveniently available in adequate supply, create adequate demand for it and make it widely acceptable for all transactions within the region. It is inevitable that until the regional currency establishes itself fully, it would face stiff competition from the existing national currencies in domestic use and much stiffer

competition on the international scene for the settlement of international obligations.

Naturally in cases where small countries are involved in a monetary union, it is expected that the larger and most relatively developed partner is more likely to influence the choice of a common currency with the highest probability of its own currency performing this function. If one could abstract from political considerations, one of the most important factors to influence this decision is the strong assumption that technical facilities already exist in the dominant country for dealing with its currency. In such instances, the smaller countries would commence by pegging their currencies irrevocably to the currency of the dominant economy, and, thereafter, allow a smooth and complete replacement of these currencies by the dominant currency. The most obvious factors that would tend to inhibit the use of a particular national currency as regional money originate from either the seigniorage problem or from political considerations of national prestige and a sense of fairness therefore calls for some form of compensation.

Among the 10 West African currencies, three may emerge for this enlarged role. Firstly, in terms of convertibility, the Liberian dollar, which is the same as the US dollar, competes with the CFA franc, currently circulating in seven of the 16 member countries but with strong indications for the zone to expand to 11 countries. The other feasible alternative to these two currencies would be the Nigerian naira, for which the absence of experience of technical advantages available to the CFA franc in particular from the point of view common currency management in a monetary union might be more than outweighed by size, political and economic considerations,

especially the huge oil revenues which, with prudent management would yield large external savings (attested by the potential currency account surplus). Compared with both the CFA franc area and Liberia, other countries (including Nigeria) with varying degrees of inconvertible currencies have to implement measures which would lead to their currencies being convertible. Most of these countries have over issued currency in order to finance the persistently rising budget deficits and, in addition, their external reserves are relatively more depleted. In the final analysis, it is the speed with which the problem of basic adjustment is solved in these countries as well as their readiness also to observe monetary discipline that is the crux of their monetary union membership.

It can be argued that the logical candidate for the enlarged role of a West African money is the CFA franc, which means that the other West African countries would have to join the WAMU and thus allow a denigration of their national currencies. This appears to be the easiest and fastest route to the creation of a West African currency. Apart from the general experience already obtained by seven of the 16 countries in the region on monetary union affairs, important institutional facilities already exist in the CFA franc area for dealing with a common currency and these could be upgraded in terms of the ECOWAS monetary union. In particular, the BCEAO, already a supra-national central banking institution for over two decades, could be functionally enlarged to enhance the issue and distribution of the new enlarged CFA franc as well as the co-ordination of monetary policies. The Stock Exchange market in the Ivory Coast and the inter-bank money market being managed by the BCEAO would all be expanded to provide a sizeable money market in

the region, whereas the West African Development Bank of the CFA franc area would facilitate the rationalisation of common industrial and agricultural investment programmes. It must be reiterated that in the light of the conspicuous failures by several countries, regionalising agricultural and industrial policies has to be a strategic feature of an ECOWAS monetary union if it is to succeed otherwise there can be little change in the magnitude of the development constraints - eg savings, foreign exchange, balance of payments, etc - of the region even if a single common currency is successfully launched.

An equally important consideration is how to acquire external convertibility for the 'new CFA franc'. It is not likely that on her own France would be in a position to provide for the new franc the special convertibility guarantee which it does for the existing franc because of the possible pressure which a larger group might pose on the French balance of payments as well as on the French franc in both the EMS and in the international money markets. It is however not proposed in this study that acquiring a similar convertibility guarantee must be a sine qua non for the common West African currency.

This problem is related to the problems of choice in an exchange rate regime, and this as was discussed in Chapter 6, has gained wide currency in the literature. With the collapse of the Bretton Wood System in March 1973, it has no longer been possible for small open economies to adopt a fixed exchange rate. At best, they can peg to a major currency (or basket of currencies including the SDR) and thereby float (or live dangerously) with respect to others, or they may adopt a crawling peg rule, either active or

passive. Until very recently, pegging arrangements in most West African countries have been modeled more along the lines of historical political considerations. In the light of the pegging experiences of the member countries especially now that the 'floating' of the major currencies which would normally qualify as pegs is a fact of life, it is of utmost importance that the choice of an optimum peg for the West African money is cautiously contrived. Regional convertibility is required but certainly not at any price. This aspect of the common currency arrangement needs further elaborate analysis because of its theoretical and practical complexities. In essence, however, emphasis must be placed on designing a peg that should:

- (a) stabilise export earnings;
- (b) insulate the economies from international monetary shocks;
- (c) promote confidence in the regional currency;
- (d) provide a restraint against the over supply of domestic money; and
- (e) enhance overall monetary stability, especially where monetary stability is characterised not only by the rate of inflation but also by stability in the rate of inflation (Benjamin, 1976 and 1978).

Because of the openness of the West African economies, the choice between the two broad alternative pegs - a single currency versus a basket peg - can be modeled in light of the extent to which these objectives are achieved.

Specifically, the choice can be determined by three major factors:

- (a) the region's desired rate of inflation and its variance;
- (b) monetary policies in each of the economies of the five competing industrial currencies - the US dollar, the mark, the French franc, the yen and the pound; and
- (c) the regional pattern of the member countries' international trade and other financial transactions and the extent of deviations in exchange rates from purchasing power parity movements (for other alternative approaches see for example Black (1976), Connolly (1982), Lipschitz (1979) and Williamson (1982)).

**Table 9L ECOWAS: Estimated Share of Trading Currencies in Total Merchandise Trade**

(Per Cent)

	US Dollar		French franc		Pound sterling		ECU <sup>1</sup>	
	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp
1980	32.8	7.4	12.5	16.1	2.6	14.5	41.2	54.5
1981	36.7	8.7	9.9	15.0	2.5	14.6	34.9	53.8
1982	31.6	8.3	11.8	14.9	3.6	11.7	37.2	48.5
1983	20.6	8.2	13.9	16.5	4.0	9.8	44.5	46.6

Source: Tables 4H and 4I

Notes: 1 European Currency Unit is assumed as trading currency for trade with the EEC

(Exp) Exports

(Imp) Imports



The major focus of the choice of a peg therefore should be on the level of influence which each of the industrial countries has on the trade and financial transactions of the region as a whole as well as on the quality of each country's monetary policy, its economic performance and the position of its currency in the world financial markets. While one does not know the future conduct of monetary and economic policies by the various industrial countries, there is a long record from which lessons can be drawn.

Meanwhile, in terms of a single currency peg for the 'new CFA franc' (with a new 'convertibility guarantor' it may be necessary to change the name of the currency - call it the WAC meaning the West African currency or the SHELL denoting the cowrie shell; this will be politically logical in view of the changed situation), there are two main candidates; the US dollar and the French franc. As shown in Table 9L (in terms of country trade stress), the dollar accounts for over a fifth of total exports but less than one tenth of the total import value. The share of the French franc on the other hand is more evenly distributed, accounting for 10-14 per cent of total export value and 15-17 per cent of import value. The skewness in the direction of trade with the USA is a reflection of Nigeria's oil exports. The French franc is a peg in seven of the 16 member countries, while the dollar too is the intervention currency in seven countries. From an inflationary point of view, the US rate of inflation over 1970-83 was on average lower than France's (7.4 per cent versus 9.8 per cent), although as measured by the standard deviation, France's rate of inflation has been more stable (2.8 per cent versus 3.2 per cent). Comparative rates over the 14 year period were 4.9 and 1.4 per cent for Germany; 12.1 and 5.5 per cent

for the UK; and 7.7 and 5.7 per cent for Japan. Strictly on the basis of this inflationary performance and its likely impact on imported inflation in West African countries, a hypothetical US dollar peg for the common currency would be less inflationary than a French franc peg but more inflationary than a mark peg. The most inflationary would be a sterling peg. In contrast, a French franc peg would provide a more stable peg than a dollar peg in terms of the standard deviation in the pegging country's inflation rate. A mark peg is the most stable compared with a yen peg which is the least stable.

Alternatively, there are three options for a basket peg, a trade-weighted peg, an SDR peg or an European Unit of Account (ECU) peg. In essence basket pegs have characteristics in common, since they are all expected to shield a country from disturbances to the domestic rate of inflation due to deviations in exchange rates from purchasing power parity movements than a single currency peg. The choice between them must essentially be influenced by the extent to which each basket of currencies reflects the regional structure of the bulk of the region's international trade and other transactions. Often because of the complex and discrete nature of non-trade transactions between the West African countries and their overseas partners, it is practically difficult to diversify total transactions by currency of commitment. However, in terms of merchandise trade as discussed in Chapter 4, the region's major trading partners - the UK, France, the USA, West Germany, Japan, the Netherlands, Italy and Spain account for over 60 per cent of total trade (see Table 9M). It should be noted nonetheless that in practice most invoices especially for trade with countries like

Japan, Netherlands, Italy and Spain, are prepared and settled in US dollars. Consequently, a trade-weighted basket may not necessarily reflect as a whole the national currencies of the trading partners. An SDR peg on the other hand (constituting the US dollar, mark, French franc, sterling and yen) would reflect around half of the region's total merchandise trade, although this percentage would rise substantially with the inclusion of SDR-denominated IMF transactions (see Table 9N). From Table 9L, it can be observed that an ECU peg would reflect a little over 40 per cent of total trade, but this percentage should rise to around 50 per cent with the admission of Spain and Portugal into the EEC, as both countries are increasingly becoming important trading partners for several countries in the region. Spain's share in particular has risen from 0.5 per cent of total imports (2.3 per cent of exports) in 1970 to 1.8 and 3.6 per cent (1.6 and 2 per cent) in 1980 and 1983 respectively.

**Table 9M ECOWAS: Combined Share of Eight Currencies<sup>1</sup> in Total Merchandise Trade, 1970-83 (Per Cent)**

	Exports	Imports
1970	77.7	71.9
1975	75.5	71.9
1980	73.9	66.7
1983	64.4	60.5

Source: Table 4I; World Bank, Direction of Trade Statistics

Notes: 1 US dollar, sterling, mark, French franc, yen, Dutch guilder, lira and Spanish peseta

Table 9N ECOWAS: Combined Share of SDR-Basket in Merchandise Trade, 1970-83 (Per Cent)

	Exports	Imports
1970	53.8	63.3
1975	61.0	62.0
1980	59.2	55.3
1983	50.3	46.3

Source: Table 4I

Though an SDR peg would be relatively easier to pursue and from an IMF perspective, the most favoured, a trade-weighted basket has the advantage of reflecting the true currency weights of the region's trading and other transactions. An ECU peg on the other hand has the advantage of reflecting and strengthening the region's trade and financial relationships with the EEC especially as are indicated in the ACP/EEC pact. It might even be easier to work out a special 'convertibility guarantee' deal under this peg. The ECU however has the disadvantage of totally excluding the dollar and yen.

The second method of creating a common currency in West Africa is the launching of an entirely new unit of account which, during a transitory period that should not be far too long, would co-exist with national currencies before displacing them finally as the region's only currency. In this respect, the most logical step would be to redefine the West African Unit of Account (WAUA) and possibly change its name to the West African Currency Unit (WACU). Originally the share of the individual currencies in the basket would be fixed in accordance with the respective countries' shares in intra-regional trade, national product and quotas in a

transformed West African Clearing House or the ECOWAS Secretariat support mechanisms. As fluctuations in exchange rates occur the relative weights of the component currencies in the basket are subject to constant adjustment.

The WACU approach is certainly a more difficult and complex strategy in the light of the dependent monetary and financial systems in the region. Making it work in terms of both public and private sector transactions involves many complications including:

- (a) choosing it as a numeraire for expressing central parities;
- (b) creating its supply and demand conditions; and
- (c) making it an acceptable worldwide monetary unit.

In these respects there are certainly several lessons to be learnt from the experience of the EEC in establishing the ECU as a fully convertible monetary unit. While in the EEC obstacles to the further development of the ECU and, hence the EMS, have included Britain's opposition to becoming a full member of the EMS, West Germany's ban on domestic use of the ECU, the special status of the Italian lira, and controls on capital movements in Italy and France (see The Times, 15 April 1985, p 21), in West Africa the key problem for the WACU is the rudimentary nature of the monetary and financial markets and the high propensity of foreign-currency related transactions. Indeed, to launch the WACU or any other common currency successfully in the region, it must be reiterated that it would be necessary not only to solve the problem of basic adjustment within the region, but also to denigrate existing national currencies; a high degree of equality in the distribution of gains and losses in the system must be ensured; and, finally, member

countries must be involved operationally to the extent that all legal, political and monetary constraints for the proper working of the system are removed.

## 9.5 CONCLUSIONS

Building on the analysis in previous chapters, this chapter has further analysed the problem of common currency, its process and meaning for West Africa. We have argued that having a common currency means that *West Africa as a whole can exploit the economic and political potentialities of the member countries more efficiently*. The benefits would appear as a result of reserve saving and concerted effort at tackling the balance of payments and development constraints. To the extent that monetary co-operation for West Africa is envisaged in this broader perspective, the operational limitations of the existing Clearing House arrangement have been analysed.

In addition, the chapter has also described the implications of the West African Monetary Union for achieving monetary unification in the region. One of the key transition problems for achieving ECOWAS monetary union is the apparent loss of a WAMU autonomy that has existed for more than two decades. The analysis of the WAMU experience indicates that the influence of France in sustaining the union cannot be easily ignored. It can be argued however that in the light of existing circumstances, the WAMU members can be better off within the wider ECOWAS monetary union.

Finally, the chapter has argued that a simple exchange unification (or realignment) strategy would not be beneficial to West Africa since this would not eliminate the disparate levels of currency inconvertibility and hence, the consequent 'conduit effect' and related black market operations. The development nature of West African currencies means that a simple exchange rate arrangement would not ensure the gains that may result from simplification of international transactions nor will it eliminate exchange risks and the banking costs of currency conversion. However, for pegging the common currency, comparison was made between a single currency and basket pegs. A more independent and relatively flexible collective exchange rate policy is more gainful compared with a single currency fixed peg.

Mundell (1972, p 55) has argued:

'... For African attempts to integrate in the 1970s present a far greater chance for success the sooner they are begun. If time is allowed to cement vested interest in the status quo at the present tierage of authority, Africa's problems will increase not diminish. Integration should proceed from the top down, not from the grass roots up'.

and has then stressed that 'Africa needs a currency of its own' as 'Partial substitutes for it are bound to do more harm than good by occupying space and preventing ultimate reform later. An arrangement imitating the European Payments Union is neither necessary nor desirable because the level of intra-African trade is insufficient. It would only get in the way of the ultimate goal later on'.

## CHAPTER 10

### SUMMARY AND CONCLUSIONS

Monetary unification in West Africa (in terms of full monetary union) is clearly not a panacea and it is unlikely alone to provide the perfect solution to the multifarious socio-economic problems that have severely constrained the member countries' economic growth process since the achievement of political independence in the later 1950s and early 1960s. As in most other developing countries, West African's economic problems have derived in part from the structural disposition of the national economies and, more importantly, from the apparent lack of disciplined, prudent and realistic overall economic management.

At the national level, West African countries are currently faced with a severe liquidity strain, low levels of success in adjustment policies, rising inflationary tendencies, low growth rates and a high incidence of political fragility. Undoubtedly, the severity of these problems has also had its background from the collapse of the international monetary system with the advent of obvious and grossly unexpected variability of the major currencies' exchange rates; from the oil price crises; and from the depressed state of the economies of the developed industrialised economies. But in some countries like Guinea, Sierra Leone, Ghana and Nigeria, socio-economic problems in more recent years have been worsened by the waning confidence in national monies as the general public shifts rapidly away from them towards foreign money - as store of value, unit of account and as *medium of transactions*.



For the region as a whole, the co-existence of several national currencies with varying convertibility and over-valuation levels has provided a firm base for the so-called 'dollarisation' process. As a concept 'dollarisation' applies generally to the increasing use of any foreign money (Fischer, 1982, p 295). In West Africa and in the context of this study, dollarisation explicitly refers to the movement towards the dollar in Liberia and the CFA franc in the WAMU group of countries. The resulting 'conduit effect' has had more serious economic implications for the more inconvertible currencies although even the corresponding advantages to the economies of the two most convertible currencies are arguably not so clear-cut. Added to this problem has been the low degree of socio-economic complementarity and interdependence among West African states.

This study has nevertheless attempted to enquire into the reality of and potential benefits which monetary unification holds for West Africa - within the institutional framework of ECOWAS, given the basic a priori reasoning that there is an important role for monetary integration in general in the process of political unity, economic growth and development. At the national level, the role of monetary unification is assessed in terms of finding an alternative but very realistic policy approach (need not be wholly national) that would enhance further development in some economies while in many others, the essence is to rehabilitate or revive overall performance trends, and instill comparable financial stability and discipline. In the context of ECOWAS, the question arising is whether the objective of economic integration - maximising the potential static and dynamic resource allocation gains - is best served by the establishment of full monetary union.

The main trend of thought in this study is that in both respects, monetary unification now provides the most viable (if not the only available option for most countries) alternative towards monetary co-operation. As the literature review reveals, this hypothesis is formulated against the considerable concern that a full monetary union is neither a practical proposition for developing countries (Kafka, 1969, p 135) nor is a common currency in particular regarded as a pre-requisite for effective economic integration (Johnson, 1973, p 195). Johnson argues that it is merely an 'outward symbol' of effective economic integration. Alternatively, Mundell's view (1972, p 54), is that 'Africa needs a currency of its own' as partial substitutes for it are bound to do more harm than good by occupying 'space' and preventing ultimate reform later.

Moreover, the question as far as the required fixity of exchange rates within the full monetary union is concerned is asked not with the general implications of fixed or floating rates for developing countries, but with the specific implications of the two alternatives for the process of economic integration. From this narrower but extremely critical point of view, the answer must depend first on the effects of the two alternatives upon the relative prices of an integrating country's products with respect to those of its partners as well as the relative costs of intra-union factor mobility. And secondly, once the union is formed, the fundamental concern is to let the collective exchange rate co-exist with other international currencies with minimum adverse impact on both the union and the rest of the world. Indeed, in the context of the varying rates of inflation both within and outside the union,

the more relevant consideration is not variations in the nominal parity rate but rather variations in the 'real' rate of exchange since changes in this rate appears to denote more clearly changes in the international competitiveness that result from disparate movements in domestic prices and exchange parities.

For the ECOWAS specifically, Robson (1983, p 143) has referred to the optimum currency area criteria as well as the dependent and disparate structural pattern of trade, monetary, and financial policies of the member states to object any immediate move towards full monetary union in the Community. Similarly the scope and final positions taken by the three most authoritative studies that have emerged so far since the inception of the WACH on how to improve the process of monetary integration in the Community have concentrated on two broad options:

- (a) the achievement of 'limited' currency convertibility (IMF, 1980; and Cincin-Sain and Marshall, 1983) and
- (b) the establishment of intra-ECOWAS financing mechanisms to expand the West African Clearing House operations and for balance of payments support (Frimpong-Ansah, 1983).

The substance of the partial convertibility which each of the studies (all of them were under the auspices of the Committee of Central Bank Governors of ECOWAS) has tried to achieve relates to a firm commitment by member states to co-ordinate and liberalise national exchange arrangements and restrictions with a view to expanding intra-regional trade.

Accordingly, the IMF study, for instance, proposes a 'convertibility agreement' that would allow the free inter-change of national currencies without interfering with on-going flexibility and national autonomy in exchange arrangements. The study regards any form of monetary integration towards a common or a set of fixed exchange rates system only as a 'longer term' prospect for ECOWAS. Similarly, the Cincin-Sain/Marshall study which is substantially a follow up to the IMF study, recommends the application of preferential treatment to intra-regional payments that would allow the elimination of exchange restrictions on current transactions (Stage I) and on capital transactions (Stage II). This study also concludes that the establishment of a monetary union within ECOWAS - ie maintaining a common currency characterised by a rather high degree of convertibility with outside currencies - cannot be achieved within the foreseeable future. There is no conclusive timing of either the 'longer-term' or the 'foreseeable future'.

Although closely linked to the partial convertibility studies, the Frimpong-Ansah study specifically examines the modalities for the possible expansion of the Clearing House into an effective clearing mechanism with a view to arriving at a financing scheme that would minimise the hardcore debtor /creditor imbalances as well as the level of settlements in convertible currencies. Accordingly, the study has proposed the upgrading of WACH to a Settlement Institution, eg 'Bank for West Africa Settlements'. On the balance of payments, the study has also recommended the setting up of a monetary institution to supervise exchange rate and balance of payments conditions in member states as well as provide members with

balance of payments support aimed at correcting payments disequilibria.

In large measure, these three studies have generally stressed, as one of a number of impediments to the development of intra-ECOWAS trade, the existence of widespread controls and restrictions on exchange transactions which render most of the 10 member currencies inconvertible. The need therefore to achieve convertibility in terms of liberalisation and/or co-ordination in these arrangements is viewed as the most viable and urgently required form of monetary integration in the ECOWAS. There is no doubt room within this proposition for achieving greater regional convertibility. Albeit, it broadly reflects the so-called 'economists' strategy which is the antithesis of the 'monetarists' approach towards monetary integration.

The basic limitation however is that in the light of existing socio-economic realities in the member states, limited convertibility even if it were fully achieved would lead to substantial 'leakages' within the sub-region and out of it. There is little scope for it to provide any meaningful answer to the intra-regional trade and payments problems. It need not be emphasised that the 'leakages' problem has posed one of the most serious threats to domestic monetary and fiscal policies in many ECOWAS countries. 'Leakages' cannot therefore be avoided or stopped by mere administrative measures aimed at fiscal and monetary control or surveillance since in the last resort the substantial profits to be gained in the 'illegal transactions' involved would be overwhelming, and would be more than sufficient to overcome the physical obstacles and legal penalties imposed by governments.

On the other hand, the proposed financing mechanisms, in particular, raise the issue of assuring resource transfers mainly to the poorer members of the Community. This issue emerged in the initial stages of the European Monetary System as Italy and Ireland joined the System with resource transfers from the core countries (Germany, France, Benelux and Denmark) for whom the advantages of such monetary integration were regarded as most clear-cut at the time. In the context of the ECOWAS, the greatest difficulty with financing mechanisms is their funding. Besides, apart from the limited reserve base capacities of virtually all member states, except Nigeria, another important scepticism is whether the institutionalisation of financing mechanisms without full convertibility would make any meaningful impact on the structurally skewed pattern of intra-regional transactions and the overall balance of payments disequilibria. Obviously the future of monetary integration in the sub-region must expand beyond that of providing short-term to medium-term credit alone. At the same time the extent to which such financing facilities will be able to influence even the policies of the most likely non-borrowing member countries - Ivory Coast and Nigeria - is definitely an open question.

As indicated in Chapter 1, the context against which monetary integration is considered in this study for ECOWAS is much wider. The role of monetary integration is viewed here in terms of providing a firmer and new form of monetary stability on which national and regional policies can be based with the hope of achieving currency confidence within and outside the sub-region and, hence, inducing complementary resource and factor mobility both within and to the sub-region. Indeed, the external motivation for

monetary integration in ECOWAS is to rationalise and/or lessen the degree of monetary and financial dependence and to enhance the Community's own general economic independence. These challenges can and must be considered more seriously if national economic recovery and economic integration are to be strengthened and sustained.

In this respect, this study has examined the case for monetary unification. In particular, its theoretical foundations, some of the problems it will encounter, and some of the doubts it evokes for West Africa are investigated. The position taken is conceptually 'monetarist' in the sense that the adoption of a common currency at the initial stage is expected to lay better and more realistic foundations in the search for a solution to the problems of liberalisation of payments restrictions, management of exchange rates, monetary and fiscal policies and balance of payments. This view compares with that held by France and other members of the 'monetarist' group on European monetary integration and is strongly supported in this study by the results of our analysis of West Africa's economic problems which have escalated unabated since the early 1970s.

The evidence presented in Chapter 2 discusses the natural economic and geo-political and other structural features of the West African economy and shows its structural dependence and the apparent disparities that exist between the member economies. Economically the sub-region is endowed with some of the richest mineral deposits in Africa, eg diamonds, gold, iron ore, crude oil, uranium, bauxite, etc - and exportable agricultural resources. The resource potentials are such that with an improved rate and form of exploitation, West Africa as a coherent economic unit can become

substantially self-dependent. It hardly needs to be said that the disparities which have existed between the countries in their socio-economic historical and political developments over the years as well as their geographical features pose substantial difficulties for the process of monetary unification. The backwardness of most countries stems not so much from the lack of natural resources or even from trends in the international commodity markets for most of these resources. Virtually all West African economies have exhibited incomplete or rudimentary sectoral interdependence. This situation reinforces the underdeveloped international division of labour whereby they continuously specialise in producing raw materials or primary goods for export. These features are compounded not only by the rudimentary state of economic infrastructures and of the commodity-money relationship in these economies but, also, by the high incidence of political instability or fragility in all countries except to a lesser extent, Ivory Coast and Senegal.

Chapter 2 shows further that politically leadership is militarised in 11 of the 16 member countries. Of the remaining 5 countries, there has been successful or abortive take-over attempts in all except Ivory coast and Senegal. Ghana and Nigeria are proved undoubtedly the most politically fragile with each country having experienced over five changes of political leadership in form and personality (including a major Civil War in Nigeria) since independence. In terms of economic growth and overall performance, the francophones have, as a group, performed a lot better than the rest of the countries, especially the anglophones. But what has greater implication for ECOWAS monetary integration efforts is the



fact that the francophones have remained very closely linked together both economically and politically. Even more critical is their continued undisturbed relationship with France.

As between individual countries, the chapter illustrated the initial importance of Ivory Coast (in terms of overall political and economic performance and apparent leadership among the francophones) and Nigeria (in terms of geo-political size and crude oil resources). The Ivorian economy is practically the most economically diversified and has grown fastest (at an average annual GDP growth rate of 6.2 per cent in 1970-81 - one of the highest in the world). Nigeria, on the other hand, commands around 57 per cent of ECOWAS' potential market of around 153.4 million people (mid-1981) spread over an area of 6,143,000 square kilometres. At the other extreme, are the smaller and poorer countries like Cape Verde, and Guinea-Bissau whose growth rate together with that in Ghana, Liberia, Mauritania, and Sierra Leone has deteriorated sharply to less than 2 per cent during the last decade. While growth problems in some countries like Ghana, Nigeria and Sierra Leone have been induced largely by undisciplined and inappropriate macro-economic planning and management, in others, notably Cape Verde, Mali, Mauritania and Niger, economic performance has, despite the resource potentials been seriously affected by persistent drought, desertic conditions and the fact that some are geographically landlocked.

Based on the above disparate historical, political and economic orientations of the member countries, the comparative analytic methodology basically adopted for the study has been to divide the sub-region into two: the francophones (of which the seven members of the CFA franc zone - Benin, Burkina, Ivory Coast, Mali, Niger,

Senegal and Togo are stressed) and the four anglophone countries (Gambia, Ghana, Nigeria and Sierra Leone) which were all members of the former sterling area. In between, comparisons are extended to the rest of the region especially Liberia because of its perfect links with the United States dollar. There is no doubt that the viability and success of monetary unification in ECOWAS depends substantially on the extent to which these apparent structural disparities can be realistically reflected in the scheme.

The review in Chapter 3 showed the extent to which these structural elements have already impeded or threatened further progress in the process of economic integration in the region. The francophones are the most economically integrated as they have, collectively or separately, participated in practically all of the 30 or more inter-governmental economic organisations that have emerged so far in West Africa. Their all-embracing CEA0 poses, perhaps the most serious threat for the existence of ECOWAS. It has to be emphasised however that the process of West African economic integration is slowed down mainly because it conceptually lacks a concrete financial, development and industrialisation strategy to enhance its objectives. As pointed out in Chapter 3, these objectives are more or less formulated strictly within the static considerations for the trade creation and trade diversion elements of the conventional customs union theory.

Moreover, apart from the inherent political, financial and general economic difficulties across the region, West African economic integration is also impaired substantially by a high incidence of inter-personal suspicion and mistrust between the political leadership and also by waning interest. Indeed, part of

this mistrust has its historical origins in the genesis of ECOWAS. Financially, total arrears on the Community's operational budgetary contributions have grown by more than 118 times since its inception. Liberia's arrears date as far back as 1978 and currently represent 21.2 per cent (Ghana 15.9 per cent) of total arrears outstanding in 1985. In most countries arrears have accumulated since 1980, while only in three countries - Guinea, Ivory Coast and Nigeria - are arrears with respect to 1985 contributions only.

The limitations and apparent failures of ECOWAS are demonstrated not only in the grouping's low success rate at its trade liberalisation programme but also in its zero impact on improving intra-regional trade whose pre-integration level of less than 5 per cent of either exports or imports remains unchanged. Nearly two thirds of this trade is still by and between the francophone states. Nigeria's share in this trade is basically in terms of petroleum exports. Besides the lack of basic physical, monetary and financial infrastructures, it has been emphasised in Chapter 4 that the most important determinant of the low level of intra-regional trade is the profiles of resource endowment, general production, trade and consumption of the member countries between which there is a high incidence of non-complementarity.

The profiles of international trade indicate the general persistence of colonial trade relationships although there has been increasing importance in relations with non-traditional partners, especially Germany, Japan and the United States. Especially in the early 1980s, the level of exports in most countries has declined almost continuously thereby forcing a compression of imports which in turn, with all its unfavourable consequences, has mainly been

responsible for some semblance of improvements in the overall balance of payments position in some countries. In the face of an increasingly difficult foreign exchange situation over the last few years, imports have declined steadily from around \$26 billion (exports \$35 billion) in 1980 to \$18 billion (exports \$21 billion) in 1983. Faced with this reality, the question that arises is the extent to which imports can be compressed further in economies with a high import content in all expenditures. Crude oil imports alone have accounted for almost a third of total imports in several countries, notably Ghana and Sierra Leone. At the same time there is need for substantial increase in export earnings through official channels.

In response to trade problems, several of the most affected countries have resorted to excessive monetary and fiscal expansionary policies as well as the imposition of tighter exchange controls and payments restrictions. The results in Chapters 5 and 6 showed that domestic money supply has on average grown between 9.2 per cent in Liberia and 33.4 per cent in Ghana in 1970-83. Correspondingly, the average annual rate of inflation has ranged between 8.4 per cent (Liberia) and 50 per cent (Ghana). The pressures on international reserves are such that except Mauritania, to a lesser extent, current balances can hardly finance three months level of imports in most countries. The group differences in these developments between the WAMU states and the rest of ECOWAS were statistically tested and the results indicate that they cannot be ignored (Chapter 9). There are obviously serious implications for the convergence process. The general conclusion from the analysis of monetary and financial development in West Africa is that the

rudimentary and relatively underdeveloped monetary and financial institutions presently existing must be made capable of adaptation and growth and must possess flexibility of reflection and initiative if they are to be more useful to the region. These policies apart, many countries have resorted to relatively unsuccessful wider margins of exchange rate depreciation (discrete and/or official) (Table 6K and Figure 6.1).

The literature review in Chapter 7 and 8 focuses on the conceptual role and modalities of the various forms of monetary integration in general. Unfortunately there appears to be no agreeable situation or firm basis on which firm monetary integration can be best suitable for a given group of countries. The most difficult problem, and the one about which this study is undertaken is on the factors which make countries better or worse candidates for joining together to form a currency area. These include both systematic tendencies in the size, nature and source of the socio-economic disturbances countries face and the factors influencing the ease of monetary unification, such as factor mobility, openness, diversification and inflation differentials. In Chapter 8, the ECOWAS subregion was tested against these various criteria and was found to be substantially unfeasible as an optimum currency area. The analysis provides nonetheless a clear indication of some of the major areas for policy consideration for beneficial currency unification.

The economic benefit for currency unification was clearly analysed in chapter 9 as well as the unfeasibility of an exchange rate co-ordination strategy.

With the long-established WAMU and the more recently established WACH as the actual post-independence experience of monetary co-operation in West Africa up to the present time, the analysis has also shown the severe limitations of both institutions for improving the member economies or enhancing the performance of the ECOWAS. It was found that both institutions have had very little influence on the expansion of intra-region transactions or on the elimination of the 'leakages' problem. Although the absolute value of transactions passing through the clearing house had risen since its commencement in 1976, this has represented less than 10 per cent of the intra-regional trade which itself, as already shown, is also less than 10 per cent of total external trade. In many respects, the failure of the clearing house to stimulate regional growth, development and integration is fully recognised in this study and the arrangements are seen simply as a euphemism of laxer monetary integration or no integration at all. Its failure means that it has also not bridged the crucial gap between francophone and anglophone relations but simply created a more brazen kind of regional unity.

As the foregoing analyses have shown, the practical implementation of a common currency for any group of countries with disparate socio-economic orientation is obviously a very lofty proposition with serious transitional adjustment pressures on monetary expansion, deficit and inflationary financing, exchange rate variation and reserves mobilisation policies, as well as on the overall balance of payments management. Basically, these pressures are related to the extent to which member countries are prepared to give up national for regional autonomy. The common currency

arrangement is consequently bound to be subjected to strain unless member states' policies can be co-ordinated more closely than heretofore.

In West Africa, countries within the convertible CFA franc zone, and Liberia, which uses the US dollar, have less difficulty in terms of convertibility. No doubt the pressures of transitional adjustment have to be more on the other countries with varying degrees of inconvertible currencies. It is however clear that by now such countries as Guinea, Ghana, Sierra Leone and Nigeria which have been prone to the most frequent and more serious devaluations and revaluations (Nigeria), currency changeovers, as well as to expansionary fiscal and monetary programmes should have come to appreciate that erratic exchange rate movements and undisciplined monetary and fiscal policies must form part of the reasons for their deterioration in their national monies (in terms of both internal and international exchange values) and their economies are constrained to sub-optimal performance. Indeed, the divergent exchange rates have in part exacerbated divergent inflationary tendencies in the region, thus making well-nigh impossible to identify or control any business cycles.

This is mainly because emphasis on exchange rate policies has been more on the fluctuations of national currencies against hard currencies than on reducing the intra-regional conduit effect or attaining positive gains to their economies from maintaining stability among currencies. Yet, as the study has shown, the structural dispositions and interests of the West African states are not so divergent that economic disturbances have created circumstances in which the region cannot strive towards a currency

area or in which it is preferable for some countries to collectively hold exchange rates and other socio-economic policies steady and for others to let them vary independently. The main concern is the speed with which transitional adjustment is undertaken and monetary and financial discipline is improved.

It was indicated that once a common currency is preferred as against a more unrealistic exchange rate co-ordination scheme in which members retain their independent monies and exchange rate policies, the most logical step would be to refer to the existing CFA franc and EMS arrangements for guidance on the implied operational technicalities. While an automatic expansion of the CFA franc zone requires very substantial transitional adjustment for the members, especially the anglophones, a more crucial modification is with respect to France's special role in guaranteeing the convertibility of the existing CFA franc. As was pointed out, where this crucial element is to form part of an ECOWAS common currency, France may not on her own be in a position to guarantee convertibility because of the possible pressure which such large group might pose on the balance of payments and the French franc's position in the EMS. It may thus be necessary in this case to seek the concerted assistance of the EEC and/or the United States. With a new guarantor then, it may be politically logical and necessary to change the name of the currency (eg the SHELL or West African DOLLAR). Of course it is also believed that a more practical strategy would be to allow the new currency to obtain its international market value independently. This eliminates the dependence risks that are apparent in existing national monetary policies.



Reference to the EMS on the other hand provides guidance for instituting an in-built flexibility and an 'early warning system' within the concerted currency system. The system must be stable but at the same time flexible enough and in time to tolerate further adjustments of parities and objectives and allow member states to survive the tumult in their exchange rates, monetary and fiscal policies and overall economies, especially in the initial years. This requirement clearly indicates that the implications of entry to monetary unification at the 'wrong rate' cannot be underestimated. It would be a fundamental mistake for member countries to enter or continue to operate in a monetary union at the wrong exchange rate or wrong adjustment policies. In the event this happens, it would make their economies uncompetitive, widen the economic disparities and in the end set up tensions in the union. And the worst results would be for members to come in and then drop out (as it happened in the European Snake).

It has to be recognised on the other hand that it is never possible or easy enough to pick the best moment for each potential member country for joining the monetary arrangement in advance. As in the case of the EMS, countries may stay out (temporarily or indefinitely) because of the fear that their economies may be weak compared with others. Yet the proposition that is envisaged for West Africa in this study is not exactly in the same time-frame as the Lagos Treaty's 15-year programme for the detailed break-down of national barriers to labour and trade in goods and services, neither is it in complete harmony with the IMF's (1980) or Cincin-Sain/Marshall's (1983) limited convertibility first step action.

Eventually, a true regional market must be enhanced by the initial availability of a common currency.

Furthermore, it would be difficult for member states to enter the monetary union at anything other than the prevailing market rates against each other. But for West Africa in particular, the exchange rate matrix presented in Chapter 9 (Table 9J) merely indicates the theoretically equivalent values of the member currencies. It has been indicated that the so-called 'market' rates for these currencies diverge considerably and violently with the officially quoted rates. Market exchange rates of national currencies in the region substantially reflect black market exchange practices which have given rise to exchange rates that are practically between 2-3 times the officially quoted rates. These market rates are directly influenced by over-valuation, multiple exchange rate policies many of which are more generally in favour of private monopolies, as well as by the shortage of official international reserves. All of these provide the firm foundations for illegal commodity and currency practices.

It is recognised also that the disparity between the CFA franc zone and Liberian dollar exchange rates on the one hand and those in the other countries on the other are not seemingly entirely justified by the differences in economic performance or structural distortions. The most noticeable feature nonetheless is that while payments and exchange restrictions in the CFA franc zone and Liberia are more liberalised than in the rest of ECOWAS, the latter's exchange rate policies appear for less dependent than the former's. It is a fact that the true market rates in the CFA franc zone and Liberia are hidden within their fixed exchange rate systems and are

not entirely reflected in their national economic performances or in their apparent leakage problem. In this respect therefore the main thrust of a transitional exchange rate policy for monetary unification would be the prompt and concerted adoption of an unmanaged dual exchange rate system in each country with respect to a nominated numeraire (eg the French franc or US dollar). In such a circumstance the burden of adjustment would fall equally on the CFA franc zone and Liberia as it would on the other ECOWAS member states. For each member country however, the most important area of concern at the very initial transitional stage would be an improvement in reserve mobilisation which in turn requires improved and stricter enforcement of foreign exchange surrender obligations.

It may be important in this concluding chapter to examine more closely another important aspect of the costs and benefits of using a local currency at the national level as opposed to a foreign currency as in the case of Liberia. The emphasis here is on the seigniorage foregone by using a foreign money. As already noted, in countries with rising rates of inflation, there is typically movement away from the use of the domestic currency towards a foreign money (ie dollarisation). This process is increasingly the case for most West African currencies. Even if it should be desirable for a country to fix its exchange rate, it still loses seigniorage if it does not use its own money. The case for using a foreign money then turns largely on the superior discipline imposed on domestic policymakers by removing their control over money supply.

There are nonetheless some implications for domestic government finance, the balance of payments, the banking system, and economic policy. The most important autonomous taxing power the government gives up is seigniorage. The right to print money is peculiarly important in the West African economies in providing most governments with a ready source of finance following the narrow tax base, low tax effort and a wide range of subsidies. On the other hand, a country using foreign money has, on average, to run a balance of payments surplus to import the high-powered money needed for domestic use. The size of the required surplus depends on the nature of the banking system as the domestic banks, including the central bank, would have to hold foreign currency assets and issue corresponding liabilities. There should thus be a strong incentive for the banking system to operate efficiently, treating high-powered money as a scarce resource. An extremely vital consideration is that the choice between a floating rate regime in which the government collects seigniorage and a fixed rate system in which the government collects seigniorage but at a rate determined by the foreign country's inflation rate, or elects to pay seigniorage to the foreign country (ie where the fixed exchange rate regime implies the complete use of a foreign money) is made on the basis of a cost-benefit analysis in which the loss of control over the country's rate of seigniorage collection and domestic policy instruments that have to be directed to maintenance of a fixed exchange rate are balanced against the benefits of having a fixed exchange rate. There is no absolutely guaranteed way of providing discipline for governments determined to avoid the misuse of external reserves or high-powered money. But the discipline imposed by use of a foreign

money appears greater than that imposed by fixity of the exchange rate, which is greater than that imposed under a flexible rate system.

Estimates of the amount of seigniorage raised by a number of West African governments are presented in Table 10A. The evidence shows that several governments have made substantial use of seigniorage in recent years. For the twelve countries for which data is available, the ratio of the change in high-powered (or 'Reserve Money', Line 14 in the IMF's International Financial Statistics) to nominal GNP or GDP is calculated, representing the command over resources as a ratio of the GNP or GDP that government obtained by creating high-powered money. Also shown in the table is the ratio, for each country of seigniorage use to total government revenue (including seigniorage). The rate of high-powered money creation relative to GNP is typically greater for the anglophone and higher inflation countries. In Nigeria for instance, it peaked 6.1 per cent in 1980 and ranged between 3 and 5 per cent in Ghana in 1975-83. By contrast, the ratio has, with the exception of Togo, generally fallen below 2 per cent in the CFA franc zone countries in 1970-83. Correspondingly, there are a number of countries for which seigniorage has constituted over 10 per cent of total revenue on average. In Ghana, for example, this ratio rose from 6.4 per cent in 1970 to 31.3 per cent in 1980. Seigniorage is thus *only* not a major factor for West African governments but the disparate rates of seigniorage between them also indicate a crucial problem for policy co-ordination in monetary unification.

Table 10A ECOWAS: Seigniorage Rates, 1970-83

	Change in high-powered money as a ratio of GNP (or GDP) <sup>a</sup>				Change in high-powered money as a ratio of change in high -powered money plus Government revenue <sup>b</sup>		
	1970	1975	1980	1983	1970	1975 <sup>c</sup>	1983 <sup>d</sup>
Benin	.009	.018	.015	-.012	-	.059	.113
Burkina	.002	.019	.006	.033	.100	.148	.118
Gambia	.028	.010	.013	.057	.115	.065	.150
Ghana	.014	.054	.033	.037	.064	.260	.313
Ivory Coast	.021	.015	.001	.006	-	-	.005
Mali	-	-	.007	.013	-	-	.055
Mauritania	.008	.009	.006	-.003	-	-.046	.104
Niger	-	-	.012	-	-	.123	.059
Nigeria	.022	.040	.061	.005	.196	.114	-.021
Senegal	.014	.006	.017	.003	.077	.030	.068
Sierra Leone	.007	.006	-.010	.040	-.052	.033	-.060
Togo	-	.021	.020	.027	-	-	.062

Source: IMF, IFS and GFS

- Notes:
- a High-powered is 'Reserve Money', Line 14 in the IMF, International Financial Statistics
  - b 'Total Revenue', Line 2 in the IMF, Government Financial Statistics
  - c 1976 for Benin and Niger
  - d 1978 for Gambia and Nigeria; 1979 for Benin, Burkina and Mauritania
  - Data not available

Fischer (1982) argues that to the extent that high-powered money is backed by foreign currency reserves, the assumption is that the reserves are invested in interest-bearing assets and do not represent any offset to the seigniorage effects of creating high-powered money. A major obstacle for the West African monetary

systems whose rates are practically pegged to hard currencies has been the widespread shortage of foreign exchange reserves and their fixed parity systems have increasingly been vulnerable to a crisis of confidence because speculators cannot lose. With the corresponding balance of payments crises, many fixed rate systems have been forced into adjustable peg regimes. The problem then is how can discipline be enforced in such fixed-rate regimes to ensure smooth transition towards monetary unification.

Fischer (1982, pp 299-300) asks the question 'How, in other words, does the system ensure that the exchange rate regime remains fixed rather than becoming an adjustable peg?' In so far as the difficulty of maintaining fixity of the exchange rate stems from the possibility of balance of payments crises, fixity of the exchange rate could be preserved by holding at least 100 per cent reserves. If such reserves were maintained, there would be no risk that the monetary authority could not meet demands for foreign money. Further, since reserves can be borrowed and reinvested, the costs of keeping 100 per cent reserves would be small. Much larger holdings of reserves would be needed to guarantee 100 per cent convertibility of currency and commercial bank deposits. Curiously, however, with such large holding of reserves, little need be used. With confidence, small holding of reserves would suffice. In the current context, however, there is little confidence in the ability of practically all West African countries to maintain fixed or even active crawling pegs. what would be needed would be large-scale loans of reserves from overseas. Indeed, if such loans were made in order to guarantee exchange rate fixity and stability, and to restore currency confidence, they could instead be extended towards

the maintenance of a collective exchange rate system. Such a move would more meaningfully enhance regional confidence and stability.

A final point of consideration is the political argument for monetary unification in West Africa. Throughout the analysis, the study has managed to skip - not with any contempt or underestimation - the purely political motivations that may contribute to blocking any agreement or positive movement towards monetary unification. A monetary union, along with the technical procedures designed to achieve it, will require much enhanced political co-operation among member states. The political commitment needed to make the union work is very far-reaching, extending as it does into issues usually considered to be rigorously domestic in nature. The central question is: Are the governments ready to take the hard decisions and carry out the politically charged policies that could give stability to a common currency arrangement?

In West Africa, the divergent political orientations of the member states are not so sharp and intense that they alone should be allowed to dictate the pace of monetary unification. Economic considerations are far more important. There are notwithstanding tremendous odds to be overcome particularly the difficulties of reconciling national views and interests, of shaking the traditional inertia of bureaucracies, of minimising the incidence of recurring border closures and disputes, and of accepting the political risks entailed in such bold attempt to reshape the socio-politico-economic future of ECOWAS. In this case the real problem is harmonising the more politically coherent francophones with the more politically disparate anglophone states. As far as the existing Lagos Treaty



provisions are concerned it has to be sensibly conceded that some alterations are required, at least, to set monetary integration as a general objective. In particular, there is need for agreement on a new preamble or provision to the Treaty referring to the ultimate goal of an economic and monetary union and implying institutionalisation of a common West African currency.

While the requisite political will cannot be underestimated, there is also the fear that in circumstances like this, it may be overestimated, thereby giving the feeling that politicians too are not human and therefore cannot feel the pinch of economic crises. What is certain is that the transition period under which their feelings matures may be much longer than that of economists and other non-politicians. This makes the achievement of a monetary union in West Africa still a long waiting game which for the benefit of the unconverted politicians is bound to hide behind the unproven proposition that a monetary union is a non-starter for developing countries. The question, however, is how long can the ECOWAS afford to wait, at least, in the light of the foregoing analysis?

## APPENDIX 1

### ECONOMIC COMMUNITY OF WEST AFRICAN STATES

Memorandum on monetary co-operation studies and the decision of heads of states and government on the creation of an ECOWAS monetary zone (ECW/COG/R/4/2, Lagos, July 1983).

#### STUDY ON THE CREATION OF AN ECOWAS MONETARY ZONE

Item 5 on the provisional agenda addresses itself to an outline of possible studies to be undertaken in accordance with the decision of the Authority of Heads of State and Government to create an ECOWAS Monetary Zone.

These studies are listed as follows:

- (a) Economic implications and pre-requisites for the creation of an ECOWAS monetary zone
  - the case for a monetary zone within the overall context of economic integration of the sub-region
  - sub-region as optimum currency area advantages and disadvantages
  - necessary preconditions, etc ...
  
- (b) Analysis and critical evaluation of UMOA, experience and its relevance to the creation of an ECOWAS Monetary Zone
  - appraisal of UMOA model
  - possibilities for expansion
  - conditionalities for accession
  - possible modifications and adaptation needed, etc ...

- (c) The framework of a management system including institutional arrangements for an ECOWAS Monetary Zone
- the design of a viable model of an ECOWAS monetary zone
  - review of existing regional institutions
  - appropriate regional institutions to be created
  - examination of rules and procedures for membership
  - external relationships and convertibility guarantee, etc ...
- (d) Country studies of ECOWAS member states to determine the relevant policy and adjustment measures required for their successful membership of the proposed ECOWAS Monetary Zone.
- assessment of costs and benefits to individual member countries
  - policy measures to be adopted
  - institutional measures to be taken at national and community level, etc ...

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of WACH transactions are actually due for settlement in foreign currencies.

Another critical feature of the WACH's operational experience is shown in Table 9D in that the pattern of clearing transactions and settlements have merely reflected the pronounced mutual trade imbalances as were shown in Chapter 4. In particular, the skewness is between the francophone countries as a group and the rest of ECOWAS. The Table indicates the predominance of the WAMU countries (BCEAO as central bank) as net creditors in the clearing system as against persistent debtor positions by such countries as Ghana, Guinea and Mauritania. Inclusion of oil payments for WACH clearing would not only greatly augment the overall volume of transactions cleared, it would also reverse Nigeria's chronic debtor position.

Payments (or receipts) in favour of the BCEAO, as a proportion of total WACH transactions, increased from 68.98 per cent in 1976/77 to 82.80 per cent in 1981/82, while the proportion of the corresponding payments it has had to order has dropped consistently. In general, the WAMU states as a group have not manifested any significant utilisation of the clearing facility, although this is also true for most countries in the ECOWAS. Although it may appear that some of the countries with the more highly inconvertible currencies, owing to stricter exchange restrictions (eg Ghana, Guinea and Nigeria) have channelled an increasing proportion of their payments for intra-regional transactions through the WACH, Ghana's participation has been steadily declining. Liberia, the most liberal in terms of trade and payments restrictions, Guinea-Bissau which joined the WACH only in 1978/79 and Sierra Leone, with