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Outline

Charles Leyeka Lufumpa
Chief Economist Complex (ECON)
c.lufumpa@afdb.org
+216 7110 2175

Abebe Shimeles
Ag. Director, Development Research Department (EDRE)
a.shimeles@afdb.org
+225 2026 2420

Bernadette Kamgnia
Ag. Director, African Development Institute (EADI)
b.kamgnia@afdb.org
+225 2026 2109

Adeleke Salami
Coordinator, Development Research Department (EDRE)
a.salami@afdb.org
+225 2026 2551

Why and when to introduce a single currency in ECOWAS

Ferdinand Bakoup et Daniel Ndoye[1]

Summary

This paper seeks to inform the discussion on the introduction of a single currency in West Africa in an uncertain economic context disrupted by the Euro zone crisis. Far from slowing down monetary integration, the recent experience of the European single currency demonstrates the importance of hastening the introduction of a single West African currency in the Economic Community of West African States (ECOWAS) space. In fact, no country in this zone is able alone to resolve the serious externally-created monetary problems confronting ECOWAS, not even Nigeria, the continent's new economic giant, which lately became the leading African economy by virtue of the size of its gross domestic product. It will be recalled that international monetary cooperation mechanisms do not operate in an all-too perfect manner. So, introducing a single ECOWAS currency in this delicate global context will be a splendid opportunity for West African countries to pool their monetary resources and work for common objectives, while pursuing individual goals.

Today, it is common knowledge that the decision to institute a single common currency is guided by both economic policy and political economy. The main challenge for West African countries is then to facilitate ownership of this project by the parties involved. In our opinion, the support of the key players of the West African dynamic – Cote d'Ivoire, Ghana, Guinea, Nigeria and Senegal – is crucial because such ownership will help to nurture much-needed resourcefulness and creativity in the formulation of policies expected from West African decision-makers in this momentous project.

Classification JEL: E52 ; E58 ; F15 ; F42 ; F44 ; F59 ; N17.

[1] Ferdinand Bakoup and Daniel Ndoye are respectively Lead Economist and Resident Country Economist in Benin of the African Development Bank. The study benefited from the comments and suggestions of colleagues at the West Africa Region Department and West Africa Region Team. Although not wanting to involve them, the authors are also grateful to colleagues at the Chief Economist Vice-Presidency Complex and Frank Perrault, Director at the Vice-Presidency, Operations I: Country and Regional Programmes and Policy, for their very useful remarks and comments. The peer reviewers were Cédric Mbeng Mezui (Financial Sector Development), Pascal Yembiline (West Africa Region), Claude Nkodia (Central Africa Region), Mouhamadou Sy (Development Research) and Gabriel Mougani (Trade, Regional Integration and NEPAD), and Gilbert Galibaka (Development Research). The authors also thank Professor Mohamed Ben Omar Ndiaye, Director-General of the West African Monetary Agency for his discussions, remarks and information made available to them. Opinions expressed in this study are those of the authors and do not necessarily reflect the views of the African Development Bank or the persons mentioned. Comments and suggestions to: f.bakoup@afdb.org or d.ndoye@afdb.org.

Key Messages

- The creation of a single currency in West Africa remains a timely and relevant project, despite post Euro zone crisis uncertainties and the postponement, for the fourth consecutive time, of the introduction of a single currency in member countries of the West African Monetary Zone (WAMZ).
- In today's international monetary context, a single currency in ECOWAS will offer West African countries the opportunity to pool their monetary resources in order to pursue their common and individual objectives. In fact, the member countries of ECOWAS have serious externally-induced monetary problems that no country alone can resolve.
- West African authorities have adopted a roadmap which provides for the introduction of a single currency in ECOWAS in 2020, a timeline which seems tenable, judging from progress already made and prospects of economic convergence. To reduce the likelihood of a new postponement which could dent the credibility of this important project, the authorities should prioritize the Big-Bang option in 2020, consisting in all ECOWAS member countries adopting the single currency as from 2020.
- West Africa's heavyweights, namely Cote d'Ivoire, Ghana, Guinea, Nigeria and Senegal, could assume a leadership role and encourage all stakeholders to take ownership of the project.
- The contribution of this study to the existing literature lies in its explicit consideration of monetary problems, especially those stemming from the current failings of the international monetary system. It argues that only monetary union can contribute to solve them in the member countries of ECOWAS. In fact, inspired by the theory of optimum currency areas, existing analytical frameworks focus on the differences among these countries and the loss of national monetary sovereignty, a thing that became illusory a long time ago. The approach adopted here is to conceive of monetary union for economically similar or dissimilar countries as a means of collectively adressing the monetary woes arising from globalization rather than just a tool at the service of countries that are already alike (as implicitly assumed in the optimum currency areas theory).

1 | Introduction

1. In 2000, the countries of West Africa[2] expressed their desire to speed up the process of monetary integration initiated in the early 1980s, crystallized in a project for the two-phased creation of a single currency in West Africa. Under this plan, in its first phase, a single currency called ECO was to be launched by Member States of the West African Monetary Zone (WAMZ)[3] in January 2015. In the second phase, WAMZ was to merge with West African Monetary Union (WAMU) to create a single currency in all fifteen ECOWAS Member States in 2020. After three postponements in 2003, 2005 and 2009, West African authorities finally in July 2014 gave up launching ECO in January 2015, due to insufficient preparation and economic convergence among Member States of WAMZ. On that occasion, they also decided to change strategy, abandoning the interim stage of 2015 with a single currency in WAMU and rescheduling for 2020 the creation of a single currency in the whole ECOWAS.

2. Non-compliance with the 2015 deadline for launching the single currency in WAMZ and three successive postponements fuelled the debate on the single currency in West Africa. Is the new 2020 deadline realistic, given the project's recent setbacks? Is there still political will in all member countries of ECOWAS to create a single currency? How credible is the West African authorities' commitment to this project? Will West African authorities end up throwing in the towel once and for all? These are questions that can be legitimately asked.

3. It should also be remembered that the discussion on the West African single currency was intensified by recent economic developments in Europe, especially the European sovereign debt crisis and its impact on the European single currency, the Euro. Today, many doubt the rationale of the decision taken nearly two decades ago to create a single currency in Europe[4]. It may be still too early to tell, but the Euro crisis has probably revived the discussion on the timeliness of a single currency in ECOWAS. With the approach of the 2015 deadline, several West African officials' political declarations tended more to highlight obstacles than enthusiasm for a single currency. A recent study[5] on lessons learned from the Euro crisis also seems to recommend that ongoing monetary union processes in East and West Africa should be halted.

In the face of growing uncertainties as to the relevance of a single currency in West Africa, this study aims to contribute to the debate by considering in Section II, the monetary difficulties of West Africa and by assessing in Section III, the role of monetary integration in the search for efficient solutions. This section also affirms the importance of adopting a regional approach to the

[2] West Africa currently covers fifteen countries with eight currencies, namely the Cedi (used in Ghana), Dalasi (Guinea), Liberian Dollar (Liberia), Escudo (Cape Verde), Guinean Franc (Guinea), Leone (Sierra Leone), Naira (Nigeria) and CFAF Franc (used by 8 member countries of the West African Monetary Union: Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo).

[3] The member countries of WAMZ are The Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone. Although not yet participating, Cape Verde reportedly expressed the wish to join this monetary zone.

[4] See for example, Thomas Piketty (2013), Le Capital au XXIe siècle.

[5] See Gabriel Mougani (2014), "Challenges of Regional Financial Integration and Monetary Coordination in the West African Monetary Zone and in the East African community: Analysis and Recommendations", Regional Integration Policy Paper N° 003, African Development Bank, July 2014.

monetary difficulties of West Africa, the solution of which cannot be provided by any of the region's countries alone, including the giant, Nigeria, today Africa's leading economy by virtue of the size of its GDP. Next, Section IV proposes an overview of various monetary integration options which will enable us to demonstrate in Section V that creating a single currency is the most advanced form of integration, and the best response to West Africa's current monetary problems. Lastly, Section VI presents a summary of the main findings of this study.

2 | West Africa's monetary problems

4. Since it is natural for each country to have its own currency and monetary policy, the option of monetary integration with other countries should be an explicit choice of the public authorities. To be rational, this choice must primarily aim to solve one or more monetary problems[6], that is, problems the country faces in steering its monetary policy and which it cannot optimally solve by itself. Accordingly, the timeliness of monetary integration in West Africa needs to be assessed on the basis of a specific and in-depth analysis of the monetary difficulties countries of the region encounter individually and collectively. We will now look at the monetary problems of West Africa.

Constraints of the International Monetary System

5. The monetary problems facing West African countries and developing countries in general, are mainly attributable to the current international monetary system which does not effectively guarantee a reasonable multilateral exchange rates system. The monetary policies pursued by major industrialised countries, including some large emerging countries, can cause currencies in West Africa to appreciate in value. Two recent studies by African Development Bank economists have proven that economic and monetary policies applied in the rest of the world have a real impact on African economies. According to Gurara and Ncube (2013), quantitative easing policies implemented by industrialised countries generate inflationary pressures that favour raising and/or lowering exchange rates in African countries[7]. In their study on the trends of real effective exchange rates (REER) of the CFAF Franc between 1999 and 2011, Gnansounou and Verdier-Chouchane also concluded that the CFA Franc's misalignment curve closely correlates with the Euro/dollar exchange rate, except where the price of each country's main export commodity rises. In a more recent study, Guillaumont and Hua (2014)[8] also affirm that the pegging of some African currencies to major international currencies like the dollar or Euro – themselves sometimes over-valued relative to the Chinese currency – is an important factor of the appreciation of these African currencies against the Yuan.

Volatility of Capital Flows and its Negative Consequences on Monetary Management

6. Over the last few years, West African countries – especially Nigeria, Ghana and Senegal, considered frontier markets[9] of Sub-Saharan Africa – have, like emerging countries, registered progress in portfolio capital inflows, partly due to monetary easing in industrialised countries and diversification of the portfolio of investors from industrialised and emerging countries. Although most frontier markets in Sub-Saharan Africa were spared the difficulties encountered by emerging economies, fluctuations in monetary indicators were observed after the capital pull-out initiated by industrialised countries in May 2013. In Nigeria, after the first phase of massive sale in May 2013, the Naira depreciated slightly and yields on State bonds were stretched (see Graph 1). Ghana's currency also depreciated. According to Bank of Ghana, this was partly due to capital backflow in emerging and developing countries after the Federal Reserve decided to stop its financial stimulus programme.

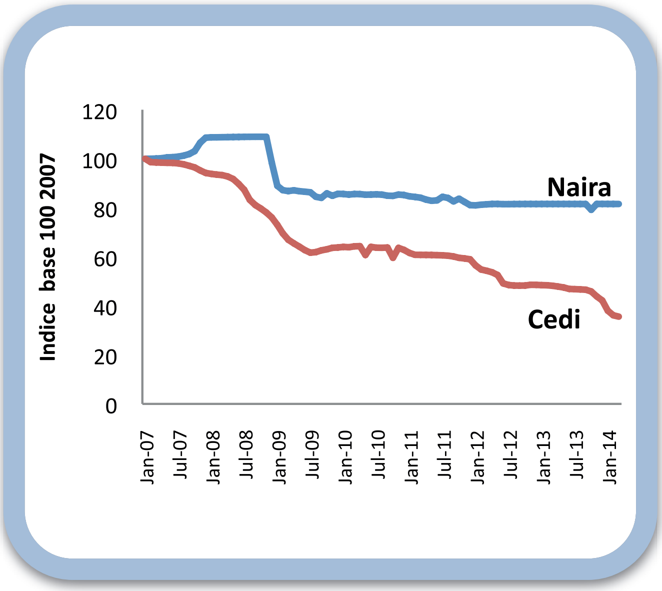
7. Although West Africa's integration in the international financial system is less pronounced than in emerging countries, international capital flows are observed to have a destabilising effect on the exchange rates and monetary policy, in general, of many West African countries. This is a serious problem which these countries must consider when assessing their monetary difficulties and the appropriate responses to be applied.

Weak Financial Management Capacity

8. Weaknesses were noted in the definition of objectives, the organisation of financial markets and the management of bank liquidities. With the emergence of cross-border banks in

[6] Monetary problem means a situation reflected in the failure to implement one of the final or interim/operational monetary policy objectives or in an inappropriate operation of the instruments or links of the monetary policy transmission chain.
[7] See Gurara, D.Z & M. Ncube (2013), "Global Economic Spillovers to Africa: A GVAR Approach"; Working Paper No. 183, African Development Bank, September 2013.
[8] Sylviane Guillaumont Jeanneney & Ping Hua (2014) "China's African Financial Engagement, Real Exchange Rates and Trade between China and Africa", Journal of African Economies, 2014, 1-25, doi: 10.1093/jae/eju020, Oxford.
[9] "Frontier market" refers to a group of emerging markets which although having a not-so-developed financial sector are relatively open and accessible to foreign investors.

Graph 1 Trend of the Value of the Naira and Cedi against the US Dollar



Sources: Central Banks of Ghana and Nigeria

the sub-region, it has become a real challenge for West African monetary authorities tasked with preserving financial stability to supervise these institutions. Memoranda of understanding have been signed by various supervisory authorities in the sub-region, but their implementation remains inadequate.

Problems of Institutional and Operational Independence of Central Banks and Monetary Policies

9. The lack of Central Bank independence tends to affect the credibility and hence the effectiveness of monetary policy and its impact on the economy. The Central Bank Independence Index[10] calculated by Arnone, Laurens and Segalotto (2009) for West African countries gives the following scores: 0.69 for BCEAO; 0.63 for Guinea; 0.50 for Ghana; 0.44 for Nigeria, against an average of 0.47 in Africa.

Non-Convertibility of Currencies

10. Most of the eight currencies used in the 15 countries of the West Africa region are not convertible. Convertibility is defined as the possibility to freely exchange a country's currency for foreign currencies, thereby fostering better integration in the world economy. Exchange rates in the region are relatively volatile (effective exchange rates unstable within the WAEMU area even if these countries have a fixed nominal bilateral exchange rate against the Euro; but effective bilateral exchange rates unstable in the other non-WAEMU countries,). Restrictions on international payments help to drive trade through informal channels as well as parallel exchange markets in West Africa. Monetary integration will help to address the issue of multiple currencies and exchange rate fluctuations that affect intra-regional trade.

Undeveloped Financial and Payment Systems

11. The financial system is the main means of monetary policy transmission. West African countries have the least developed financial sectors in the world. The ratio of bank credit to GDP therein is low. Financial markets that can serve as a powerful transmission channel for monetary stimuli are not so developed. In 2013, market capitalisation was 13% of GDP for WAEMU, 8.5% of GDP for Ghana and 21% for Nigeria, against an average of about 65%[11] for Sub-Saharan Africa. Payment and settlement systems in several West African economies are still marked by the predominance of checks in noncash payments.

Inadequate Effectiveness of Monetary Policy Transmission Channel

12. The transmission of monetary policy decisions to final objectives remains inadequate. Sodokin and Gammadigbe (2013)[12] argue that BCEAO leading rates do not influence the trajectory of lending rates of commercial banks within WAEMU due to structural over-liquidity of the banking system and the uncompetitive structure of the WAEMU banking industry[13]. In the case of Ghana, Buchs and Mathisen (2005)[14] considered the lack of competitiveness of the banking sector as a handicap in steering monetary policy. Saxegaard (2006)[15] had already proved that, in a context of excess liquidity, monetary policy innovations had a weak impact on production and inflation in Nigeria.

Currency Mismatches

13. There is a noted currency mismatch among currencies when exchange rate fluctuations have a significant impact on the

[10] This involves a combination of political independence (Central Bank governor and monetary policy autonomy from Government) and economic independence (in particular, absence of direct advances to State). The index calculated for 2003 ranges from 0 to 1.1, corresponding to the highest level of independence, in a sample of 163 countries selected by the authors.
[11] Source: World Bank database.
[12] Koffi Sodokin and Vigninou Gammadigbe (2013), "In search of the pass-through dynamic of interest rate in WAEMU", June 2013.
[13] In WAEMU, close to 70% of bank assets are held by a quarter of banks (2013 Report of the WAMU Banking Commission).
[14] Buchs and Mathisen (2005), "Competition and Efficiency in Banking: Behavioral Evidence from Ghana", IMF Working Paper No. 05/17.
[15] Saxegaard (2006), "Excess Liquidity and Effectiveness of Monetary Policy: Evidence from Sub-Saharan Africa", IMF Working Paper No. 06/115.

net assets or revenue of economic agents. Various indicators are used to measure this imbalance. Morris Goldstein and Philip Turner have proposed a system of measurement with three components: net foreign currency assets; share of external debt in foreign currency; and imports of goods and services. Although calculations made within ECOWAS zone using this method revealed no significant imbalance since the indicator was regularly positive, the recent spike of foreign currency-denominated debt observed in a number of countries calls for some vigilance on this problem.

3 | Monetary integration: solution to West Africa's monetary problems?

14. In this part, we will first explain why no country, not even giant Nigeria, is able all alone to resolve the monetary problems of West African countries. Next, we will demonstrate that regional monetary integration will contribute significantly to the search for solutions, especially in view of the failings of international monetary cooperation mechanisms, which can justify rolling out a process of region-wide monetary cooperation.

West Africa's monetary problems are such that no country alone can resolve them

15. A close scrutiny of the situation confirms that West Africa's monetary problems can be grouped into two broad categories: the first category concerns problems that to an extent can be effectively resolved as part of national efforts made by each country taken individually. These include inadequate capacity or the strengthening of channels of monetary policy transmission. The second category has to do with other more complex problems like the independence of monetary authorities or difficulties that have international ramifications and require a supranational approach to be effectively solved. The operational shortcomings of the international monetary system, the destabilising effects of international capital flows or the monitoring of cross-border financial flows fall under this second category. In today's context of globalization, where cross-currency exchange rates constitute an extremely important factor of economic competitiveness and performance for countries, the second category of problems identified above is evidently important in determining overall monetary policy effectiveness. Resolving monetary problems and, hence, enhancing monetary policy effectiveness are matters that are supranational in nature.

16. The role of monetary integration in resolving problems linked to the international monetary environment has hardly been highlighted in the documentation and decisions of economic policy officials. In fact, only impact in terms of lowering transaction costs, facilitating payments, and hence trade, are presented as the expected benefits of monetary integration.

Multilateral Monetary Cooperation Frameworks: Variable Levels of Effectiveness

17. Monetary problems have frequently been resolved by the international community at the supranational level. Meanwhile, a close look reveals that multilateral frameworks of international monetary cooperation were weakened after the collapse of the Bretton Woods monetary system[16] in 1971. This led to a gradual fragmentation of international efforts to ensure international monetary cooperation. Various frameworks emerged that were regional, bilateral or bringing together countries that have certain affinities and decide to establish a monetary cooperation framework. Apart from the fragmentation of multilateral monetary cooperation frameworks, there is a predominance of bilateral frameworks in which dialogue to resolve monetary disputes takes place in an essentially bilateral framework – the outcome depending on the diplomatic and economic clout of the protagonists. The monetary debate pitting China and the United States and, to an extent, China and the Euro zone countries[17], is an example. In fact, a re-evaluation of the Yuan by the Chinese authorities remains a key objective of the international economic policy of the US Administration and several European Governments.

18. Today, international monetary cooperation is characterised by mechanisms that create an environment where national monetary practices differ from what they could have been if the rules of good neighbourliness were observed. In such an environment, small countries find it difficult to preserve a value of their currency that is commensurate with their national growth and job-creation objectives, unlike countries or groups of countries with significantly more economic and diplomatic weight.

19. If international monetary cooperation functions so imperfectly, what then would be the picture at the level of Africa? Can West African countries count on the monetary cooperation programme established by the African Union to find solutions to their monetary problems?

[16] This happened in 1971, when US President Richard Nixon declared the end of the convertibility of the dollar, and de jure in 1973, when the Kingston Accords, in Jamaica, officialised floating exchange rates.

[17] Even if the United States has often been critical of the value of the Yuan, Euro zone officials have often aligned their positions, albeit more discretely than US officials.

African Monetary Cooperation: a Project in Development

20. The goal of monetary integration in Africa, enshrined in the African Union Constitutive Act of 1963, was formalised in the Abuja Treaty in June 1991, and implemented under the monetary cooperation programme in Africa. The latter aims to harmonise the monetary cooperation programmes of the various sub-regions to achieve the final objective of a single zone, a single currency and an African central bank. The institutional framework of Africa's cooperation programme has been established and convergence criteria defined. However, slowness in owning and implementing programme guidelines in the sub-regions and the multitude of overlapping regional communities make its implementation difficult. In that regard, the process of monetary cooperation in ECOWAS – one of the most advanced on the continent – can serve as an example and contribute to further drive the programme at the continental level.

Contribution of Monetary Integration in Solving Monetary Problems in West Africa

21. All these developments point to the limitations of current international monetary cooperation mechanisms. In a context where international political and diplomatic clout weight in the game of international monetary cooperation, regional monetary integration can offer West African countries an opportunity to strengthen their individual and collective positions in international cooperation. This vision – founded not on contribution to resolve internal monetary problems but perceived as an instrument for managing external monetary shocks – has not been adequately recognized and analysed both in theoretical literature and in political decision-makers' considerations. Better consideration of this dimension can help guide the monetary integration debate in the right direction: that of rapid progress towards the single currency. Besides, it was partly to address the disintegration of the Bretton Woods-inspired international monetary system that Europe launched its process of integration to collectively withstand the more unstable and more elusive new global monetary environment.

22. In the face of international monetary system fluctuations, monetary integration can also play a stabilising role upstream and downstream. Upstream, control structures and prudential arrangements at the supranational level can prove stronger and reduce the risk of exposure. This is particularly true of small countries like those of West Africa. The analysis of the impact of the 2008 financial crisis on WAEMU countries revealed that the impact on the financial sector was weak. This is due to poor interconnection with international markets, as well as to the Union's prudential rules and banking sector risk supervision mechanism that made WAEMU economies less vulnerable to the toxic financial assets which caused the financial crisis (BCEAO Report on the impact of the financial crisis). Downstream, the principle of solidarity, which is essential for monetary integration, sets in case of shocks, especially monetary, to mitigate its impact on the most affected countries and preserve the common currency, where necessary. In the European Union, the European Financial Stability Facility (EFSF) helped to resolve the sovereign debt crisis in 2009. Within WAEMU and CEMAC, the principle of centralisation of external reserves allows countries affected by a shock on their external payments to temporarily benefit from the resources of the other countries.

23. The contribution of monetary integration to addressing monetary issues in West Africa can also be seen in monetary management and bank supervision. In West Africa and other regions in the world, bank groups and conglomerates as well as cross-border financial flows have developed and can only be monitored by crossing national borders. Difficulties encountered here stem from differences in the quality of supervision, reporting and information available. It is, therefore, important for bank supervision to become regional in nature to ensure a holistic assessment of the situation of the financial sector and strengthen the crises management and resolution arrangement. In fact, the debates that ensued after the Euro zone sovereign debt crisis highlighted the importance of regional coordination for financial sector supervision. This is what pushed European countries towards the banking Union.

24. Last but not least, monetary integration also contributes to developing financial systems and payment facilities. Interconnecting the sub-region's financial sectors offers an opportunity to strengthen their efficiency with broader avenues for investing liquidities and sharing best practices and financial infrastructure. This will help to upgrade least developed financial systems.

25. In conclusion, third section of the brief underlines the essential role of regional monetary integration in the search for solutions to West Africa's monetary problems. This role derives mostly from the predominance of externally-caused monetary problems in the region, the limited contribution of international monetary cooperation to resolving these problems, and the still inadequate progress of African monetary cooperation.

4 | Various monetary integration options

26. Whereas regional monetary integration can be a key tool in the quest for solutions to the monetary problems of West

Africa, what form of monetary integration does this region need? This is the question we will try to answer in the fifth section of this brief. But we will begin by considering in greater detail the various options of monetary integration.

Monetary Integration, a Variable-Geometry Process

27. It is important to begin by recognizing the difficulty of examining various possible forms of monetary integration in the absence of well-conceived theories on monetary integration milestones, comparable in sophistication and clarity to the theory of trade integration. Although the literature is silent on a theory of monetary integration stages, we need not necessarily start from scratch[18]. Elements can be identified in the literature and monetary authorities' practices that can help to construct such a theory[19]. Based on Table 1 below, the identified stages range from the lowest level of monetary integration to the highest which without doubt corresponds to the creation of a single currency and adoption of a single monetary policy for all member States of the monetary union considered.

28. Of all the monetary integration options mentioned in Table 1, only the single currency guarantees that countries implement reforms necessary for the sustainable operation of the monetary integration project. In fact, in the other forms of integration, each country keeps its national currency, knowing that in case of absolute necessity, it can opt out of the

Table 1 Various Monetary Integration Options

Integration Options	Description
Exchange of information and experiences between national monetary authorities	Strengthening of exchanges of information and experience between the countries' monetary authorities, which may be in the form of an exchange of personnel, skills and data.
Establishment of payment and clearing mechanisms	Creation of mechanisms between States with different currencies to periodically clear any exchange balances between them.
Currency swaps arrangements	Central banks swap their respective currencies for specified periods. Between 2007 and 2010, the US Federal Reserve established a currency swap arrangement with several central banks including the Central bank of Brazil, the Bank of England, and the European Central Bank. Although each country maintains its currency and full independence to define and steer its monetary policy, these swaps are an advanced form of cooperation since they help countries to collectively resolve, through cooperation, such important issues as the excessive fluctuation of exchange rates linked to factors that the economic fundamentals of the country do not justify.
Parity agreement between national currencies	This is an advanced stage of monetary integration which allows countries to fix the exchange rates of their currencies or define the range of exchange rates fluctuation. The European serpent currency established from 1972 to 1979 and its successor, the European Monetary System (EMS), before the coming of the Euro in 1999, constitute to this day the finest examples of this type of monetary integration. This type of integration effectively closes the gap between the monetary and macro-economic policies of member countries since the commitments to be respected and the exchange rates agreed upon impose a degree of discipline even if responsibility for these policies still reverts to the national authorities. Also found in this category is the pegging of a national currency to a benchmark currency, like the CFA Franc or Cape Verde's Escudo to the Euro.
Agreements of circulation of national currencies	Agreements giving free rein to partner countries' currencies throughout their territories. East African countries (Kenya, Rwanda, Uganda, Burundi and Tanzania) recently opted for this mechanism which is part of overall efforts to set up the East African Monetary Union. Also found in this category is the Common Monetary Area (CMA), bringing together South Africa, Namibia, Lesotho and Swaziland, whose reference currency is the South African Rand. The most extreme form of this type of monetary cooperation is the unilateral adoption of another country's currency, without this being formally materialized in an agreement. The most common cases concern the use of the Dollar or Euro, termed as dollarisation or euroisation.
Monetary Union: creation of a single currency and adoption of a common monetary policy in participating States	Creation of a single currency in several countries, representing the most advanced form of monetary integration. Countries renounce having a currency and a central bank. A single common currency is shared with the other member countries alongside a supranational central bank. In this form of monetary integration, countries are compelled to harmonise their position in order to speak with one voice during international monetary discussions.

[18] Some may think of the optimum currency areas theory, but it concerns the conditions of monetary union rather than the different forms of monetary integration.
[19] A precise definition of the very concept of monetary integration will be useful to identify monetary integration milestones. To that end, we will define it as a process whereby two or more countries embark on measures of rapprochement of monetary conditions. The index of monetary conditions is calculated by the weighted average of an indicator measuring interest rates variation and an indicator measuring the exchange rates variation.

monetary integration agreements. This possibility makes monetary integration less credible.

5 | A single currency for ECOWAS?

29. Since the start of the 2000 decade, West African countries seem interested in having a regional monetary integration policy despite slow progress and doubts (partly fuelled by the Euro zone crisis) about the timeliness of a single currency in the region. In this context, the question that readily comes to mind and which legitimately bothers decision-makers in the region, is whether, like some are suggesting (see introduction), the recent Euro zone crisis has demonstrated the need for a more cautious approach to the single currency for West Africa region? In that case, what form of monetary integration would be more appropriate in the West African context? In this section, we will attempt an answer to all these questions.

30. We hold that the main lesson learned from the recent Euro zone crisis for West African countries is the need to accelerate the introduction of a single currency in ECOWAS by 2020, as planned in the roadmap. This section will consider other frequently mentioned obstacles and explain that they can be overcome.

Without a single currency, monetary integration in West Africa will be incomplete and unsustainable

31. For a long time, West African countries have been making efforts towards monetary integration. Several stages mentioned in the preceding section have already been crossed[20]. If the real intent is to pool their monetary resources to resolve their monetary problems, in particular those originating externally, only a single currency can contribute to this. In today's international monetary environment, characterised mainly by the absence of unanimously accepted rules of good monetary conduct, West African countries – like most other developing countries – are not immune to monetary shocks caused by policies implemented in the rest of the world. In such a situation, only the single currency can offer West African countries the chance to put up a collective and effective front against these disruptions and especially enable each country to have a single currency whose value relative to other currencies can better support its growth and job-creation objectives. During international monetary dialogue, which plays a decisive role in currency value today, such a currency would benefit from the economic and diplomatic clout of the entire West Africa, which far exceeds the weight that each country of the region can pull individually.

32. The other monetary integration options examined earlier offer a degree of flexibility and are considered more cautious in several respects. However, this flexibility can in and by itself constitute a disadvantage since commitment to implement necessary reforms to build stronger foundations for a single currency requires some firmness on the part of States. In fact, so long as each State continues to have its currency, the temptation to "go it alone" is great whereas this alternative is less favoured. In zones where they have been implemented, the other options appear as transitional stages towards monetary union and a single currency, except where ambition for integration is limited. Considering Nigeria's economic weight, one wonders legitimately whether the Common Monetary Area (CMA) in Southern Africa cannot be replicated in WAMZ with the Naira playing the anchor role. Two difficulties stand in the way of this possibility. First, Nigeria's volume of trade with the other WAMZ countries is far less than that of South Africa with CMA countries[21]. Second, the Naira is neither freely convertible nor present on exchange markets, necessary elements for conferring on it a role of reserve currency, contrary to the Rand in CMA.

33. A peculiarity of the West Africa region is also the existence of the West African Monetary Union (WAMU) which operates rather satisfactorily. Although improvements can still be made, this monetary union has unquestionably contributed to the macro-economic stability and economic integration of its members, especially given their resilience to external and internal shocks and cognizant that the level of trade and financial flows within WAMU alone exceeds the average of all intra-African trade. Therefore, it seems hard to believe that a less complete model of monetary integration in West Africa will be appropriate for them. In light of these economic and political considerations, the approach adopted by West African countries to move directly towards monetary union can be justified. Through this process, progress was achieved in terms of economic convergence and harmonisation of policies as stated above, but additional efforts are still necessary. Moreover, this approach which is fully consistent with the vision of monetary integration charted at the level of the African

[20] West Africa already experiments with information swaps between central bank, exchange rate agreements and payment and settlement mechanisms between central banks as well as with monetary union and a single currency among the eight CFA Franc member countries. The West African Monetary Agency headquartered in Freetown, Sierra Leone, is the institution mandated by West African countries to promote monetary cooperation in the sub-region.

[21] South Africa is the first partner of the three CMA countries, from which originate over 80% of imports from Lesotho and Swaziland, and 62% of imports from Namibia in 2014, whereas Nigeria's share in the trade of WAMZ countries is below 3% (Source : Statistical database of the World Trade Organisation; http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E).

Union, can serve as example and catalyst for the continent-wide monetary union project.

34. After explaining why the single currency remains the most suitable form of monetary integration, we will now consider in the next paragraphs a few obstacles that are frequently encountered during implementation of this project.

Is there real political commitment?

35. Progress has been made in implementing the ECOWAS single currency road map adopted in May 2009. Ongoing works must strengthen payment systems[22] and harmonisation of statistics. The recent adoption of a common external tariff for ECOWAS, effective since January 2015, also contributes to the creation of a common market. That notwithstanding, ECOWAS officials again noted in July 2014 six months to the 2015 deadline, that progress was inadequate in terms of convergence and institutional readiness to launch ECO in WAMZ. As can be noticed, a major challenge for the monetary integration process in West Africa will be to consolidate gains made and secure the necessary bases for establishing the credibility of commitments taken at the institutional level.

36. Political commitment to institute a single currency in West Africa exists and has often been reaffirmed, including at the highest level of State. The creation of a Presidential Task Force to monitor the single currency creation process, headed by the Heads of State of Ghana, Nigeria and Cote d'Ivoire and the Committee of Central Bank governors, is a glaring illustration. The importance of a single currency seems to have been understood in West Africa and political commitment is affirmed. What now remains is to transform this commitment by accelerating the implementation of reforms to help achieve this objective.

Is economic convergence sufficient?

37. Economic convergence is often presented in the literature as an essential condition for a successful monetary integration process. The importance of convergence is sourced in the optimal currency arrears theory propounded by Canadian economist R. Mundell. According to this theory, several factors can impede the viability of a monetary union – a powerful asymmetry of shocks, low factor mobility in the zone and the absence of transfer mechanisms, with member States losing the use of their monetary policy as an instrument of adjustment to shocks.

38. Assessments conducted[23], therefore, seem to conclude that West Africa is still far from the required convergence for the introduction of a single currency. Inadequate level of convergence within the West African Monetary Zone has been raised to justify the decision of ECOWAS to suspend the introduction of ECO in January 2015. Delays are often observed in incorporating regional commitments into national laws. In a nutshell, the main argument for slowing down the march towards a single currency remains the inadequate convergence of West African economies.

39. The argument for suspending the introduction of a single currency in West Africa on grounds of absence of convergence does not stand up to a strict analysis of convergence in West Africa and its role in the success of the single currency project. We will first look at the status of convergence in West Africa. The table attached as Annex 1 shows that virtually all ECOWAS member countries have met the primary criterion of Central Bank financing of deficits. Most countries (53 %) have also complied with the primary criterion concerning the level of budget deficit and inflation. With respect to secondary criteria, overall performance also seems to be on the right track.[24] Contrary to arguments developed in some documents about the role of convergence, we hold that the convergence of economies does not need to be a strict condition for a country's participation in the single currency for two practical reasons. First, optimum currency areas do not really exist. In fact, experience has shown that optimum currency areas as defined by a Mundell (1961)[25] have never really existed and probably never will. The reason is simple: except in exceptional circumstances, there will never be concordance between a political territory having a single currency issued by a sovereign political authority, and a homogeneous economic territory (which is appropriate for a single currency). In the world in which we live, including West Africa and other regions, national currencies are used within a geographic territory with different economic contexts by region. In Nigeria, which has a single currency, the situation in the oil-rich Rivers State certainly differs from that in Sokoto, in the North of the country. In the United States of America, major differences are observed in the economic situations and structures of the respective States. The

[22] The harmonisation of convergence criteria and strengthening of payment systems benefited from the financial support of the AfDB.
[23] For example, Debrun, W., Masson, P., Patillo, C., (2010) "Should African Monetary Unions Be Expanded? An Empirical Investigation of the Scope for Monetary Integration in Sub-Saharan Africa", IMF Work Report 10/157.
[24] ECOWAS in July 2014 decided to simplify and streamline convergence criteria, reducing them from 11 to 6 criteria.
[25] Mundell, R.A. (1961), "A Theory of Optimum Currency Areas", American Economic Review reproduced on Blejer, M.I., Frenkel, J.A., and Leiderman, L., and Razin, A. (1997) eds, in cooperation with D.M. Cheney, Optimum Currency Areas: New Analytical and Policy Developments", International Monetary Fund.

employment growth rate over the last five years ranged from -0.3% in Wyoming to +34.8 % in North Dakota[26]. In West Africa, economic disparities are also observed by region. In WAEMU where a single currency exists, member States are still far from complying with the convergence criteria adopted.

40. Second, the convergence of economies must not be a strict necessary condition for a country's participation in the single currency: efforts at convergence can only produce limited results. Real convergence – the one that makes situations homogeneous – is structural convergence, the convergence of the structures and cycles of activities of economies. Now, this convergence is way beyond reach because the task of modifying structures of the real sector of an economy requires a lot of time. That is why in the process of integration targeting a single currency, it is nominal convergence or the convergence of macro-economic aggregates that is sought.

41. Additionally, some authors have questioned the static nature of the convergence criteria generally adopted, arguing that monetary integration can also contribute ex post to strengthening convergence among member States. The latter should be seen as an ongoing objective and not as a pre-condition for joining a monetary union.[27] According to Tsangarides, Ewenczyk and Hulej (2006), apart from inducing net creation of trade and stabilising exchanges (factors of progress towards an optimum currency area in the sense of McKinnon (1963)[28], monetary unions foster the correlation of price movements. Rose (2000) and Tapsoba (2009) also affirm that membership in a monetary union enhances trade and the synchronization of cycles of activities.

42. All these practical considerations lead us to conclude that although economic convergence is sought in a monetary integration process aimed at creating a single currency, its absence must not become an absolute obstacle. Countries must therefore learn to live with the single currency while accepting a reasonable level of divergence in their economies. Solidarity among member countries which depend on inter-state transfers, can mitigate, if not totally eliminate the impacts of such divergence. Furthermore, the relatively advanced level of integration and factor mobility observed in West Africa predisposes this region to a single currency.

Will the new January 2020 deadline be respected?

43. After giving up the idea of introducing a single currency in WAMZ (West African Monetary Zone) countries in January 2015, ECOWAS member countries set for themselves the objective of instituting a single currency in 2020. During an inaugural meeting organised in Niamey in February 2014, the Presidential Task Force, set up by the Heads of State and Government of ECOWAS member countries to accelerate the pace of introducing the single currency, recommended the adoption of the Gradual Option (Option 2) after considering three options. This option essentially articulates that member countries that comply with the primary criteria of convergence before 2020 will participate in the single currency[29]. Although it appears more prudent, Option 2 also entails risks and especially the likelihood that the 2020 deadline for launching the single currency will not be respected. In fact, the four possible scenarios in 2020 are summarised in Table 2 below.

Table 2 Possible Scenarios for Introducing the ECOWAS Single Currency in 2020

Convergence Scenarios	Qualified Countries	Result
Scenario 1	WAEMU countries	Current status quo. Possibility of fresh postponement of the ECOWAS single currency
Scenario 2	WAEMU countries+ Nigeria + Ghana + a few WAMZ countries	Possible launching of ECOWAS single currency
Scenario 3	WAEMU countries + WAMZ countries without Nigeria and Ghana	Possibility of a fresh postponement of the ECOWAS single currency. An additional period could be granted to Nigeria and Ghana in order not to exclude these two economic heavyweights
Scenario 4	WAEMU countries + WAMZ countries	Possible launching of ECOWAS single currency

[26] United States Congress, "The US Economy by the Numbers", April 2015.
[27] Janine Rossouw (2006), "An Analysis of Macro-economic Convergence in SADC", cited in W. Debrun, P. Masson, C. Patillo, (2010), « Should African Monetary Unions Be Expanded?".
[28] McKinnon, R. (1963), "Optimum Currency Areas", American Economic Review 53, pp. 717–25.
[29] The two other options considered were Big-Bang (Option 1) and Critical mass (Option 3). In the Big-Bang option, all member countries participate in the single currency in 2020 and countries that fail to comply with the convergence criteria ex ante will do so ex-post. In the critical mass option (Option 3), the single currency will be launched in 2020 if the critical mass of countries representing at least 75% of the GDP of ECOWAS respect the convergence criteria. Options 1 and 3 were rejected because the Task Force deemed that the macro-economic instability related risks were too high. See ECOWAS Commission (2014), "Inaugural Meeting of the Presidential Task Force on the ECOWAS Monetary Cooperation Programme, Niamey, 20-21 February 2014", Final Report, 21 February 2014.

44. Although it may be hard to determine which scenarios translate into reality, the launch of the ECOWAS single currency in 2020 could again be postponed. To prevent this risk, we would have wished that the Big-Bang option (Option 1), recommended on the basis of our present analysis, should be selected. Since the distribution of tasks among key actors can also be a factor of delay, more responsibility should be given to the central banks of the region to implement critical actions. Such an approach will allow these banks, which are at the heart of this process, to further own these tasks.

45. For the 2020 deadline to be met, three critical measures, not adequately addressed hitherto, should be fully implemented: (i) preparation of a strategy and procedures of the future single currency of the ECOWAS monetary union; (ii) drafting of a treaty establishing the monetary union between ECOWAS member countries and its ratification by all member countries; and (iii) design, adoption and ratification of the future ECOWAS Central Bank's articles of association in all member countries. Ideally, these tasks should be completed before 2017 for the single currency to be launched in 2020. In the following paragraphs, we will consider in greater detail a few questions and challenges that require special attention in this process.

What Exchange Regime for the Single Currency in West Africa?

46. The issue of exchange regime is not a simple one given the diversity of monetary regimes in force in West Africa. They vary from WAEMU's fixed exchange regime pegged to the Euro to the flexible regime in WAMZ countries, having the dollar generally as reference currency. Under the ECOWAS single currency roadmap, exchange rates are expected to stabilise in 2018, two years before the single currency is launched as scheduled in 2020. But several questions remain unanswered. Are we heading for a fixed or flexible exchange regime? Will it be pegged to a reference currency or a basket of currencies? What internal anchoring will the common monetary policy have? What adjustment mechanism will help address the impossibility for countries to individually use the exchange rate as variable for adjusting idiosyncratic shocks? Answers to these questions, which require quick in-depth analysis by ECOWAS authorities, will be crucial to the success of the single currency. Some studies have been devoted to this question, but did not indicate the most relevant choice. For example, Dufrénot and Sugimoto (2009)[30] conclude that no reference currency is absolutely appropriate for all ECOWAS countries to preserve their competitiveness. The roadmap must include a schedule of activities to be undertaken in this context and enable the authorities to decide at the earliest on the choice of exchange regime – a decision which is ultimately political one. Nevertheless, a degree of exchange rates flexibility is needed if the future single currency is to serve as an instrument of competitiveness for these economies, especially in today's international monetary environment and the risks of uncertainty dealt with at length in the preceding sections.

The Challenge of Common Management of Exchange Reserves

47. This important question calls for strategic reflection since some countries may be worried that their reserves could possibly be used to finance other countries' external commitments. There are generally two management methods: centralised management and decentralised management. In the first method, member countries' external reserves are managed by the common central bank (for example, WAEMU and CEMAC zones). In the second, the common central bank has reserves which serve in particular to intervene in the financial market, but national central banks manage their own reserves, meant especially to pay for external transactions (for example, in the Euro zone). Based on member States' configuration in relation to the currency, the easier option seems to be decentralised management. Two important principles must be borne in mind in a monetary union: the principle of equity and the principle of solidarity. The management framework must in fact ensure that each country benefits from reserves it has been able to build. But, it should also have mechanisms whereby countries with serious difficulties can temporarily access the reserves of other countries to assist them, while, however, avoiding any repercussion on the common currency as illustrated by the case of Greece in the Euro zone.

Can the Political Economy of the West African Single Currency Favour this Project?

48. The decision to create a single currency in West Africa is very rational. At the same time, it raises very complex questions at the level of political economy not only among West African States but also between these States and the external world.

[30] Gilles Dufrénot and Kimiko Sugimoto, "Pegging the future West African single currency in regard to internal/external competitiveness: a counterfactual analysis", The William Davidson Institute, December 2009.

Internally, the question of the single currency should not be limited to elite political and economic circles. It is important to widely inform the populations of the stakes of the project so as to gain their full support and make policy choices linked to the introduction of the single currency that will inevitably involve lifestyle changes and adaptations on their part. National and community parliaments should also be regularly informed of the conduct of the process so that they should also serve as relays to the populations and facilitate the adoption of legal and institutional frameworks linked to the single currency.

49. It is also important for the leading political and economic powers of ECOWAS, namely Cote d'Ivoire, Ghana, Guinea, Nigeria and Senegal to assume leadership and create the necessary synergy to accelerate the establishment of the West African Monetary Union. Nigeria, the first economic power of West Africa and principal market of the region, must play the role of catalyst in this process. It must further open its market to regional exports, but especially broaden its outlook by viewing neighbouring countries as partners and not as mere clients[31]. Through this monetary union, WAEMU countries which have sixty years of experience in common currency management, should explore the possibility of widening their economic and financial space to the whole of West Africa, while preserving their macro-economic stability.

50. Special attention should also be paid to the political economy implications for the rest of the world. When delivered, the West African single currency will replace all currencies in force in this part of the continent, including the CFAF Franc, currently tied to the Euro under agreements concluded between countries using it and France. Needless to say that economic considerations involving mostly France assume considerable importance. This aspect also concerns the international impact of the West African single currency. With these external stakes in mind, it is worth noting that the adoption of a currency is primarily a sovereign decision. Therefore, the creation of a single currency in West Africa should first depend on the desire of member States and the support of their populations.

6 | Conclusion

51. We have demonstrated in this brief that the finest form of monetary integration in West Africa is the establishment of a single currency. It remains timely and relevant, despite uncertainties that appeared recently with the Euro crisis and failure to meet the 2015 deadline for launching the single currency in WAMZ. The single currency is a chance to more effectively address the many monetary issues currently confronting these countries. In a context where West African countries experience serious externally-created monetary problems which none of them can single-handedly solve and where international monetary cooperation mechanisms operate imperfectly, the single currency is an opportunity for them to pool their monetary resources – an indispensable condition for pursuing their individual and collective monetary goals in the current international context.

52. The option adopted by West African countries to go directly towards monetary union in ECOWAS, while discarding the intermediate stage envisaged for WAMZ countries, seems more suited to the economic and political context of the region. In that regard, it seems that to reduce the risk of a new postponement that can hurt the credibility of the process, the authorities should prioritize the Big-Bang option in 2020. In other words, all member countries will participate in the single currency in 2020, and those which will not have complied with the convergence criteria ex ante will be able to do so ex post. Of course, the efforts made by the governments should be maintained in order to comply with the convergence criteria by 2020.

53. To satisfactorily implement the road map of the ECOWAS single currency agenda, it seems necessary to rapidly complete not only studies that should lead to the choice of the monetary and exchange policy framework but also the articles of association of the future ECOWAS Central Bank by 2018. In that connection, the region's central banks should be further involved and empowered to steer these reflections and implement actions that are critical for introducing the single currency. Communication and information on the monetary integration process should be strengthened in the direction of the populations, parliaments and private sector to consolidate support for the single currency. The Technical and Financial Partners, including the AfDB, should support this process by encouraging countries to continue economic reforms, conduct technical studies on the institutional and legal framework and engage dialogue for greater ownership of the process by West Africa's populations and leaders.

[31] African Development Bank (2014), "Combined Mid-Term Review and Regional Portfolio Performance Review of the Regional Integration Strategy Paper for West Africa, 2011-2015".

Annex 1: Trend of Number of Countries having Respected each Criteria between 2011 and 2013

		Standard	2011	2012	2013
Primary Criteria					
1	Fiscal deficit, including grants (commitment base)/GDP ratio	≤ 3%	8	7	8
2	Average annual rate of inflation	≤ 5%	9	8	9
3	Central bank fiscal deficit financing	≤ 10%	14	15	14
4	Gross external reserves	≥ 6 mois	10	1	9
Secondary Criteria					
5	Domestic default payments	≤0	7	6	9
6	Tax revenue/nominal GDP ratio	≥ 20%	1	1	3
7	Total wage bill to tax revenue ratio	≤ 35%	3	3	4
8	Internally-funded public investments / tax revenue ratio	≥20%	7	9	9
9	Public debt/GDP	≤ 70%	14	13	13
10	Nominal exchange rate	± 10%	13	14	14
11	Real interest rate	> 0	9	13	10

Source: WAMA Technical Notes in the context of the single currency, February 2014.

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Acronyms and abbreviations

ADB	African Development Bank
BOAD	West African Development Bank
BRICS	Brazil, Russia, India, China and South Africa
BCEAO	Bank of West African States
CEMAC	Central African Economic and Monetary Community
CET	Common External Tariff
CFAF	Franc of African Monetary Community
CMA	Common Monetary Area
ECB	European Central Bank
ECOWAS	Economic Community of West African States
EFSF	European Financial Stability Facility
EMS	European Monetary System
FED	Federal Reserve of the United States of America
FSAP	Financial Sector Assessment Programme
GDP	Gross Domestic Product
IMF	International Monetary Fund
MCP	Monetary Cooperation Programme
MDG	Millennium Development Goals
NGO	Non-Governmental Organisation
REER	Real Effective Exchange Rate
RTGS	Real Time Gross Settlement System
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TFP	Technical and Financial Partners
UA	Unit of Account of the African Development Bank
UNDP	United Nations Development Programme
VAT	Value Added Tax
WAEMU	West African Economic and Monetary Union
WAMA	West African Monetary Agency
WAMI	West African Monetary Institute
WAMZ	West African Monetary Zone