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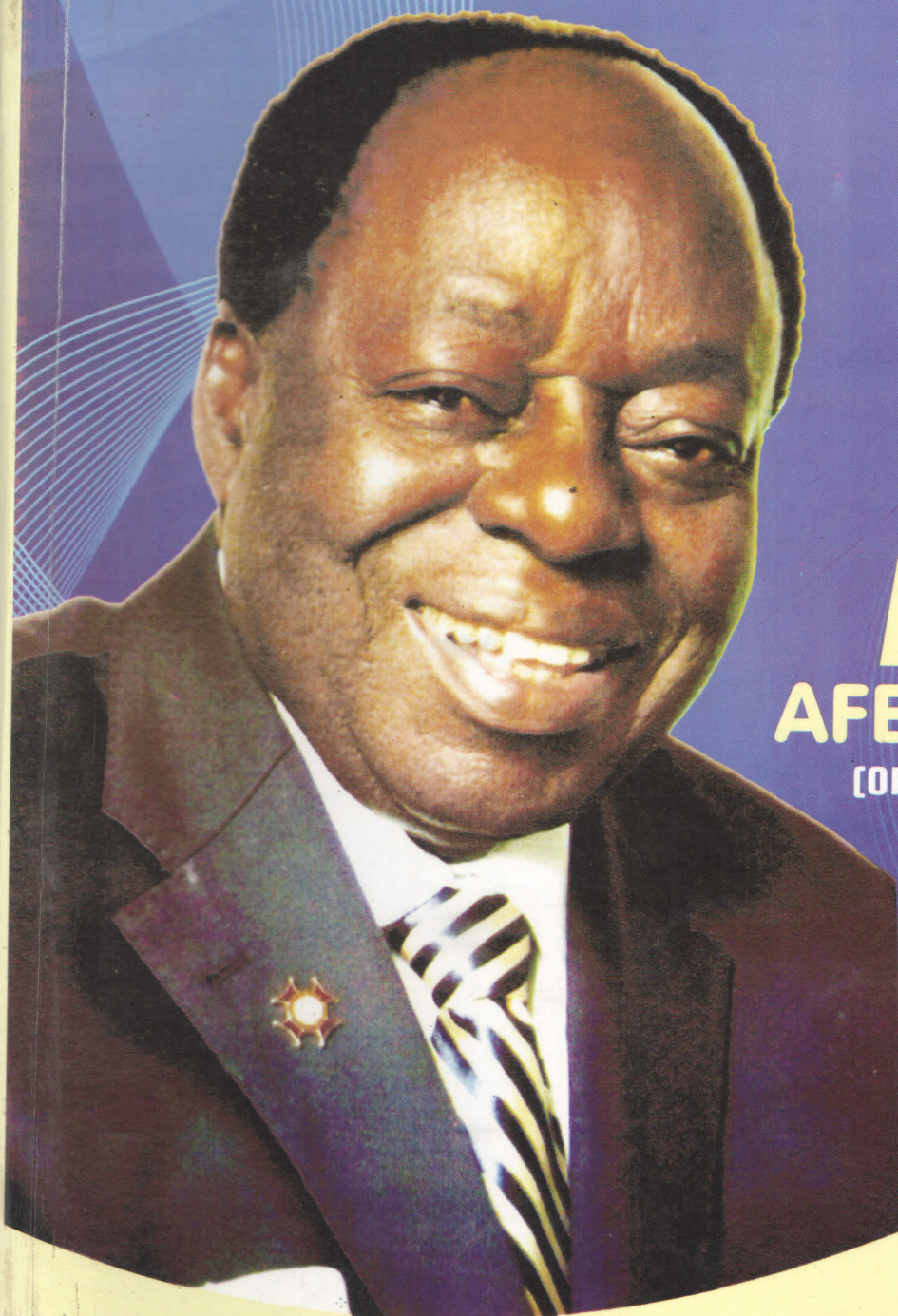
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CHAPTER 1

THE IMPACT OF UNIFIED MONETARY SYSTEM ON AFRICA**

Abstract

*"The harmony and happiness of man
Yields to the wealth of Nations."*

Percy Bysshe Shelley (1792-1822) in his book, "Queen Mab" when saying the afore-quoted phrase had most probably reasoned that the harmony of man which leads to his happiness is one which culminates in the increased wealth of nations. The above, if properly understood could be said to resonate around the idea that the harmony of men and countries, especially economically, would foster the economic growth of the harmonized nations.

Taking the foregoing into context, the benefits of the unified monetary system cannot be relegated to the background. This however is not the crux of this work but to evaluate critically the impact of the unified monetary system on the African continent. This article is more particularly important because of the exit of Britain from the European Union and the unarguable connection which most African countries have with Britain.

INTRODUCTION

A unified monetary system or monetary integration can be described as an aspect of economic integration that involves exchange rate unification and currency convertibility usually consisting of monetary union or a common currency area.¹ In the words of Max Corden, a monetary union involves two components which are "exchange rate union, that is, an area within which exchange rates bear a permanently fixed relationship to each other and currency convertibility which can be defined as the permanent absence of all exchange controls, whether for current or capital transactions within an area.² As a matter of fact, opinions abound on what constitutes a monetary union.³

From the definitions, some characteristics of a monetary union can be summarized as follows:

- A single money, or several currencies fully convertible at immutably fixed exchange rate;
- An arrangement whereby monetary policy is determined at the union level, allowing no national autonomy in monetary policy; and

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¹ Ojo, M.O, "The Rationale for Monetary Integration, Bullion, Volume 25, No.2, April/June 1-5.

² Corden, M.W, "Monetary Integration", Essays in International Finance, No. 93, Princeton, Princeton University Press, 1972

³ See Mason P, et al, *Monetary Union in West Africa (ECOWAS): Is it Desirable, How could it be achieved?* IMF Occasional Paper 204, Washington: IMF (2001); Allen, et al, *Organization and Administration of a Monetary Union*; Princeton Studies in International Finance, No. 38, Princeton University Press (1976); Mankiw, N et al, *Macroeconomics, 5th Edition*, New York, Worth Publishers (2003); Burda, M, et al, *Macroeconomics: A European Text*, 3rd Edition, New York: Oxford University Press (2001)

- A single exchange rate policy with a common pool of external reserves of members.

While these characteristics are not exhaustive of the features of a unified monetary union, when any or all of them exist in a monetary regime, it depicts quite patently the existence of features of a unified monetary regime.

Flowing from the foregoing, there are basically five (5) forms of monetary integration:

1. **Limited Currency Convertibility:** Under this, all exchange restrictions involving the use of the sub-regional currencies are removed. The implication of this is that the countries involved agree to harmonize their exchange rates and adopt a policy of uniform variation of these rates with the rest of the world.⁴
2. **Parallel Currency Union:** This allows for the circulation of a common currency alongside national currencies, which have defined and fixed relationship with the common currency.⁵
3. **Partial Monetary Union:** Under this, the participating countries agree to implement the same exchange rate regime (whether fixed or floating) and establish a fixed exchange rate between the currencies of the respective countries and the regional rate.
4. **Single Currency Model:** It involves the creation of a monetary zone with a single currency; one with a common pool of external reserve and a unified management of monetary, fiscal and other financial policies.
5. **Full Economic and Monetary Union:** The main feature of this regime is one of a creation of a monetary zone with a single currency and a common pool of external reserve. There is a single central bank while the management of monetary, fiscal and other financial policies is unified. While members have the freedom to determine their various fiscal policy operations, the central arrangements do have implicit influence on their respective domestic fiscal policies.

At this stage, it is important to consider the European Monetary System which is a model for the unified monetary system. The appreciation of this would lead to a further appreciation of the impact of this system on the African continent.

THE EUROPEAN MONETARY SYSTEM

The system came into being pursuant to an agreement made at Bremen, Germany in 1978 where European countries agreed to synch their currencies with a view to stabilizing inflation and stopping large exchange rate fluctuations.⁶

With the goal of establishing a common currency for all member countries of the European Union (EU), the European Monetary Union (EMU) was founded in 1999. The EMU's goal was to fix monetary exchange rates at the beginning of 1999 and replace national currencies such as French francs,

⁴ Mason P.R. *Exchange Rate Policy in a Monetary Union*;

in R.C Barth and Chong-Huey Wong (eds) "Approaches to Exchange Rate Policy Choices for Developing and Transition Economies," IMF Institute, International Monetary Fund, Washington DC (1992)

⁵ Crockett, A., "Financial Market Implications for Trade and Currency Zones: Policy Implications of Trade and Currency Zones," Proceeding of Symposium, Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, August 22-24, 1991

⁶ Available at "Definition of European Monetary System-EMS, available at <http://www.investopedia.com/terms/e/ems/asp> accessed on 23rd October, 2016

German deutsche marks, or Italian lire with a single currency known as the euro. The deadline was set at Feb. 28, 2002—after this date, national currencies of countries participating in the EMU would no longer exist⁷.

The Maastricht Treaty on European Union, signed in 1991, laid out the basic plan to the effect that countries would surrender to a European Central Bank the right to make monetary decisions. Everyone would use the euro, and national coins and notes would go out of existence. Travelers in Europe could make purchases anywhere within the EU without having to change money or worry about exchange rates⁸.

To prevent such problems, the treaty set criteria to control inflation and bring the monetary policies of participating countries into convergence. For a nation to join the EMU it had to meet certain requirements: its budget deficit could be no greater than three (3) percent of its gross domestic product (GDP), its public debt could be no more than 60 percent of GDP, and its inflation and long-term interest rates could be no higher than 1.5 and 2 percentage points, respectively, above the average of the three best-performing states. Exceptions could be made for nations that were near the goal and moving in the right direction⁹. To meet these preconditions, most governments needed to reduce social programs drastically or increase taxes.

THE Euro has grown to be the world's second largest reserve currency and an integral feature of the global economy. It has facilitated to a large extent a more efficient distribution of resources and made prices for goods and services fully transparent across countries.¹⁰

THE IMPACT OF UNIFIED MONETARY SYSTEM IN EUROPE ON AFRICAN

It must be noted that arguably all African countries have different local currencies and are not dependent on each other in terms of currencies albeit there is on going effort to have one through Ecowas.. It is thus quite impracticable for African countries to have a unified monetary system. By extension, it thus brings to the fore what and how a unified monetary system in Europe would have any relevance on the African continent.

Opinions are divided over whether the introduction of the single European currency (euro) on 1 January 1999 will prove to be a boom or a bane for African economies¹¹. Two certainties for the foreseeable future are that the CFA franc used by 14 African countries will be pegged to the euro instead of the French franc to which it has been tied since 1948 and that 65 per cent of these countries' external reserves will continue to be kept in an account held by the French Treasury¹². Some of the impacts of a unified monetary system on the African economy are as follows:

⁷"European Monetary Union." Britannica Student Library. *Encyclopædia Britannica Student and Home Edition*. Chicago: Encyclopædia Britannica, 2011

⁸ Ibid

⁹ Ibid

¹⁰ A Blueprint for a Deep And Genuine Economic and Monetary Union: Launching a European Debate, available at http://ec.europa.eu/economy_finance/emu10/emu10report_en.pdf. Assessed on 22nd October, 2016

¹¹ www.africarecovery.org Varied impact on Africa expected from new European currency by Jacqueline Irving accessed 23rd of May 2016 by 8.00pm

¹² Ibid

1. FREER, GREATER FINANCIAL FLOWS

In the positive scenario for financial flows, exchange rate stability promoted by the CFA-euro link could lead to benefits such as greater inflows of direct investment from euroland countries, says a recent International Monetary Fund (IMF) report¹³. Other investment flows from Europe into the CFA zone could increase if European institutional investors such as pension fund and insurance companies decide to diversify their portfolios by moving some of their funds to CFA countries, another recent IMF report notes¹⁴.

Therefore, these benefits could be enhanced and reinforced by the improved access of CFA countries to euroland's financial markets. Borrowers in CFA countries would find that they could raise funds more easily and at cheaper rates in the deeper, more competitive financial markets expected to emerge in euroland¹⁵. BCEAO officials recently said that they expect the CFA-euro peg to attract more European investors to CFA financial markets, who will be notably more interested in the operations of the regional stock market in Abidjan, Côte d'Ivoire¹⁶.

However, there is a possible downside associated with the freer, greater financial flows expected between the two regions. For example, freer access to euroland financial markets could mean that many CFA borrowers would leave CFA financial markets altogether, hindering their development.¹⁷ In a different scenario, if the euro boosts productivity and growth in euroland and increases the relative attractiveness of euro assets, borrowing costs for CFA countries could actually increase. Thus, in the event of a crisis of confidence, if the euro gains so much strength that a devaluation of the CFA franc becomes necessary, capital flight from the CFA to euroland could be destabilizing. This risk is not new, however: the possibility of capital flight following a speculative attack also existed under the French franc-CFA franc link¹⁸.

2. SPURRING REGIONAL INTEGRATION

One potential benefit of the CFA-euro peg is of the maintenance and strengthening of a common currency acts as a spur to broader economic integration in West and Central Africa. Because maintenance of the common currency requires harmonization of policies including fiscal and trade policies. It's a strong incentive to do the right thing to build a bigger base for regional integration¹⁹. In West Africa, for example, CFA countries form half of the 16-nation Economic Community of West African States (ECOWAS). Assuming the CFA countries continue to enjoy low inflation, strong growth and improved economic stability through the macroeconomic policies associated with the euro peg, the "ECOWAS region as a whole will benefit from the spillover effects, Mr. R.D. Asante, who heads the Money and Payments Division of the ECOWAS Secretariat, told *Africa Recovery*²⁰. Mr. Asante refers to the euro as an incentive to non-CFA, ECOWAS countries to work towards greater harmonization of monetary and financial policies with the CFA. "And now there is talk of having a dual monetary zone in Africa because of what is happening with the euro," he adds²¹.

¹³www.africarecovery.org Michael T. Hadjimichael and Michel Galy, *The CFA Franc Zone and the EMU*, IMF Working Paper, No. WP/97/156 (Washington, DC, November 1997) accessed on 22nd October, 2016

¹⁴www.africarecovery.org John Green and Phillip L. Swagel, "The Euro Area and the World Economy," *Finance & Development*, Volume 35, No. 4 (December 1998). Accessed on 23rd October, 2016

¹⁵ Ibid

¹⁶ Ibid

¹⁷ Ibid

¹⁸ Ibid

¹⁹ Ibid

²⁰ Ibid

²¹ Ibid

Other economists and public officials predict renewed impetus for regional integration throughout Africa. The euro is likely to "reinvigorate the current slow pace of economic integration in Africa, particularly in non-CFA Africa,"²² Mr. Maurice Kanga, Chief Economist at the Central Bank of Kenya, says. He went on to declare that "it will be beneficial, from an economies of scale point of view, to unify the many [African] currencies to face the euro."²³ Echoing this view, Mr. J.E.O. Mwencha, Secretary-General of the Common Market for Eastern and Southern Africa (COMESA), told *Africa Recovery*: "Strong regional trading blocs are taking shape and we see this as a call for the countries in Africa also to integrate their economies."²⁴

3. INCREASED EXPORT SALES

Trade links between euroland and African countries, particularly in the CFA zone, are already tight. Trade with euroland accounts for 40-50 per cent of total African trade, according to IMF figures²⁵. The figures are generally at the higher end of this range for CFA countries (although CFA trade with the European Union countries has declined quite steeply in recent years²⁶. If the euro regime leads to an economic upswing in euroland, it could boost that region's output and demand for imports. In turn, this could benefit the economies of euroland's African trading partners. For companies in CFA countries trading with companies in the European countries sharing the euro with France, the shift in the currency peg from the French franc to the euro would also mean lower commercial and currency transaction costs²⁷.

Central bankers of the mainly francophone West African Economic and Monetary Union (WAEMU) are optimistic. The CFA franc-euro link "will give a new impulse to trade and financial flows" between WAEMU and European countries, offering "new opportunities to the economies of WAEMU and new markets to European countries," said an official of WAEMU's Central Bank of West African States (BCEAO)²⁸. The link should also offer to WAEMU's eight members the distinct advantages of "more commercial outlets, [the ability to] attract more European investors and access to the European financial market." But WAEMU officials also note that among the challenges posed by the euro link is the continuing obligation that WAEMU members "implement sound and convergent economic and financial policies."²⁹

However, some economists are more dubious about the extent to which the euro's introduction will have positive trade effects for any countries, including those in the CFA zone. "I don't believe that there is going to be much benefit in terms of trade to any partner of the euro zone, including the CFA," says Mr. Yilmaz Akyuz, Chief, Macroeconomic and Development Policies of the UN Conference on Trade and Development (UNCTAD)³⁰. He acknowledges that reduced transaction costs and the elimination of exchange rate uncertainty within Europe following the euro's introduction could boost euroland's income levels and demand for imports. But citing recent economic forecasts, Mr. Akyuz opined out that, in the period to 2010, total income for all euroland could rise just 3 per cent and

²² Ibid

²³ Ibid

²⁴ Ibid

²⁵ www.africarecovery.org/impact of unified European monetary system on African economy accessed on 21st of October, 2016

²⁶ Ibid

²⁷ Ibid

²⁸ Ibid

²⁹ Ibid

³⁰ Ibid

³¹ Ibid

increased trade with euroland would lead to a rise in developing countries' GDP of just 0.3 per cent over the same period³¹.

Moreover, Mr. Akyuz speculates that euroland's growth may not even reach three (3) per cent as a result of costs associated with member countries' obligation to meet tight fiscal and monetary policy targets. And even if the overall effects on African trade are positive, the euro regime could have a negative impact on certain businesses, sectors and/or economies in Europe. In turn, this could slow export growth in certain sectors of African economies³².

PERCEIVED NEGATIVE IMPACTS

1. Neo-Colonialism

It is the view of **Nnamdi Azikwe** that a major factor inhibiting African unity is the 'vestigial attachments of African States with their former colonial rulers. These attachments are so deep-rooted that they affect the whole personalities of these budding political personalities. Since imperialism is all-pervading in its operations it envelops in its totality the very atmosphere of these former colonies. Consequently, their political, economic, social, educational, spiritual, cultural and religious institutions have been subjected to a terrific impact from which they may never recover.'³³

Some analysts think that the shift in the currency peg from French franc to euro might weaken French influence in the CFA region. "To the extent that the French influence over the [euro-zone] exchange rates is less than the French influence over the French franc the political link between France and the CFA countries may be expected to weaken a bit," says Mr. Akyuz.³⁴ But on the other hand, France becomes the main country within the euro zone that takes care of the interests of the CFA countries.

2. STRONG OR VOLATILE EURO POSES RISKS

Exploring possible negative aspects of the CFA-euro link, some analysts warn that either a strong or a volatile euro could harm CFA economies. Among the main risks associated with the euro peg "could be the potential appreciation of the real effective exchange rate of the CFA franc zone countries"³⁵ which could undermine the competitiveness of CFA countries' exports, says Mr. Cornelius Mwalwanda, Senior Economic Affairs Officer with the UN Economic Commission for Africa³⁶. Heightened volatility of the euro in terms of other major currencies, "both in the transition and early years as well as over the long run" would also hurt CFA countries' trade performance, he adds³⁷. Such risks, said Mr. Mwalwanda, were among the many issues raised at a November 1998 symposium on the future of the CFA franc zone, held by the Council for the Development of Social Science Research in Africa (Codesria) in Dakar, Senegal³⁸.

³² Ibid

³³ Azikwe N, *The Future of Pan Africanism* available at <http://www.blackpast.org/1962-nnamdi-azikwe-future-pan-africanism> assessed on 24th October, 2016

³⁴ Ibid

³⁵ Ibid

³⁶ www.africarecovery.org: Mr. Mwencha expresses his view on: CFA economies will not benefit from euro peg unless there are some reforms of functioning of the CFA franc zone

³⁷ Ibid

³⁸ Ibid

While it is conceded that it has increased to a large extent economic partnership agreement between the European Union and African countries and increased the humanitarian aid which the European Union provides for the African continent, the down side of this is that if the European Union suffers an economic crunch, then it implies a decrease in economic aid for the African continent.³⁹

The exit of a country like Britain as was done recently could also signal adverse economic challenges on countries whose apron strings are tied to the British empire. For instance, the British commonwealth has many African countries in its membership and these African countries depend hugely on the Commonwealth economically. A withdrawal from the European Union could thus signal the death knell of many African countries economically.

CONCLUSION

*In order to understand present economic conditions in Africa, one needs to know why it is that Africa has realized so little of its natural potential, and one also needs to know why so much of its present wealth goes to non-Africans who reside for the most part outside of the continent.*⁴⁰

These famous words of Rodney in the now notorious book of 'How Europe underdeveloped Africa' depict quite aptly the prevalent economic situation of the African continent. This is not unconnected to its dependence on the European Union economy as unified by the Unified Monetary System. Thus, it would be of great importance for the African continent to look within and have its own unified monetary system which would reduce its undue dependence on the economies of the European world. This is further brought to the fore by the unguarded rate at which recession is crippling the African economy.

³⁹ Impact of Poor Economic Conditions in Europe on Africa available at <http://comtrade.un.org/pb/default.aspx.com> assessed on the 16th October, 2016

⁴⁰ Walter Rodney (1973) How Europe Underdeveloped Africa, Published by : Bogle-L'Ouverture Publications, London and Tanzanian Publishing House, Dar-Es-Salaam 1973, Transcript from 6th reprint, 1983