Forum: ECOSOC

Issue: Creation of an African Currency Union

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Introduction

Nearly fifty years have passed since the beginning of decolonization in Africa and in many regions the hopes of rapid development have not become a reality. Africa has not benefitted from the augmentation of prosperity which results in trade expansion and globalization, as seen in other parts of the world, especially in Europe. Africa's poor development can be attributed to policies that do not foster growth and serve as obstacles to trade, the policies which have kept dictators in power for over thirty years and the ongoing conflict between tribal and ethnic groups which result in war. According to Drummond, although there are existing monetary unions in Africa which aim to promote the economies of scale in production and distribution; these unions have not seen rapid growth or expansion in the economies.

Overtime, African leaders have brought up the need to amend the structures in their regions in order to foster the success of economic policies which will create more sustainable and developed regions. This report tackles the issue of the creation of a single African currency union, the obstacles which are prevalent in the efforts to create it, and how they can be overcome.

Definition of Key Terms:

Asymmetric shock

A change in microeconomic conditions that affects the different countries of a region or parts of a country. Asymmetric shocks are a source of difficulties for countries that share a common currency e.g. The Euro Zone. Weaker countries are usually hit by slow growth, low labour productivity and lack of competitiveness, whereas stronger economies experience higher labour productivity and more competitiveness.

Currency Union

The sharing of a common currency by two or more groups in order to maintain the value of their currency at a certain level. The main aim of the creation of a currency union is to synchronize and manage each region's monetary policy. It can also be referred to as a, '*monetary union*.'

Optimal Currency Area (OCA)

A geographic area in which a single currency would create the greatest economic benefit. The viability of an optimal currency area as stated by Robert Mundell depends on the following factors:

i. A currency risk sharing system which will distribute money to regions experiencing economic difficulties.
ii. Increased labour mobility throughout the area
iii. Maintenance of a balanced economic system by allowing financial resources to move between areas that trade frequently with each other. The market forces of supply and demand then distribute money to where it is needed most.
iv. The creation of similar business cycles so that economies are shared, and the OCA's central bank can diffuse economic recessions by promoting growth and containing inflation.

WAEMU: West African Economic and Monetary Union – Benin, Burkina Faso, Côte d'Ivoire, Guinea- Bissau, Mali, Niger, Senegal and Togo

CAEMC: Central Africa Economic and Monetary Community- Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon

ECOWAS: Economic Community of West African States
ECOWAS is a group of 15 countries with the mandate of promoting economic integration in all regions of the consulting countries. It has the vision to create a borderless region which will allow the population access to abundant resources and promote the free movement of labour.

CMA: Common Monetary Area – Lesotho, Namibia, South Africa and Swaziland

CFA: Communauté Financière Africaine
The CFA franc is used in 14 African countries and it follows the same monetary policies set by the European Central Bank and has a fixed exchange rate to the Euro. The currencies policies are therefore executed by the Central Bank of West African States and the Bank of Central African States respectively.

EAC: East African Community- Kenya, Burundi, Tanzania, Rwanda and Uganda
It is one of the fastest growing economic blocs in the world and it continues to deepen its cooperation with partners around the world, politically, economically and socially.

RECs: Regional Economic Committees
Eight sub regional bodies which are the building blocks of the African Economic Community established in the 1991 Abuja Treaty. They are key actors in the collaboration with the AU in ensuring peace and stability as well as the establishment of economic integration.

Countries and Organizations Involved

Nigeria

The AU is taking steps to establish a central African bank in Abuja Nigeria. According to the Daily Nation, discussions are currently ongoing with Nigerian authorities to "sign a memorandum for hosting a technical steering committee to undertake the implementation of this bank." Former Nigerian president Olusegun Obasanjo called on ECOWAS to introduce the "eco," a single currency for West Africa. The ECOWAS Commissioner for Industry and Private Sector Promotion, Kalilou Traore, announced in 2015 that the commission aims to implement a single West African currency by 2020.

Kenya

Kenya has a strong interest in improving exports and regional cooperation. The nation is economically stable and is a driving force in the EAC. In 2005, Kenya imports were worth $3.5 million and her exports were worth $5.8 million, according to the EAC. In 2014 her imports doubled and her exports tripled.

General Overview:

The goal to create an African Currency Union has been the symbol of strength since the creation of the Organization for Africa Unity (1963). Regional economic integration is becoming increasingly prioritized in African countries. At this point the AU is reliant on monetary unions in the five RECs in Africa. The AU hopes that these regions will eventually merge to form a single African Currency Union which would allow for the closer integration of capital markets and facilitation of trade.

The formation of an African Monetary Union has been motivated by the need to change the negative pre-conceived notion of Africa as weak; economically and politically. If a monetary union is ill-managed, the region may be subject to depreciation, which will not stimulate economic growth. Robert Mundell states in seminal article (1961) that, "a country abandoning its own currency gives up the

ability to use national monetary policy to respond to asymmetric shocks." Countries which have to give up their national monetary sovereignty are able to adapt to these shocks through wage and price flexibility, fiscal transfers and labour mobility.

Asymmetric shocks occur most often when there are differences in production and export structures amongst partners in the region. In contrast to the Euro- Zone which has technologically advanced communication structures, the African region will not experience the same gains as Europe due to the differing transport structures within the region. If countries in a monetary union undergo similar shocks, there is less likely to be any cost entailed over the loss of monetary autonomy.

Africa faces many institutional challenges that hinder the formation of a monetary union. Countries with their own currencies have experienced periods of high inflation, such as Zimbabwe in 2008, due to the alarmingly high public deficits which needed to be paid off at the expense of the social and environmental welfare of the region. The existing central banks in regions like this are usually not independent. It is important to question whether the creation of a regional central bank will indeed solve the problems that weigh heavily on these existing central banks.

In order to see whether this system works, one must take into consideration the CFA franc zone which is made up of the WAEMU, the CMA and the CAEMC. These monetary unions have not seen a dramatic increase in regional trade and policy coordination. Paul Masson and Catherine Pattilo's model aims to evaluate these issues in African monetary unions. The model, "integrates the idea of asymmetric shocks with the absence of institutions effectively able to insulate the central bank from pressures to finance deficits and undertake over-expansionary monetary policies." The model is based on the theory of the optimum currency and emphasizes the fact that countries will not be willing to join a monetary union with another country which is experiencing different shocks and has less disciplined fiscal policies.

The issue of creating monetary unions has not been given the attention it requires in order to make it a reality. The Euro- Zone worked extremely hard to achieve a high level of integration before establishing the Euro currency. However even the European Union which was then formed in 1993 has started to show "serious difficulties and major shortcomings," which is why an African monetary union needs to be discussed with careful examination of the collected research.

Leaders have debated about integration based on the political dimensions and pan-Africanism however, this debate needs to become more technical in order to give African countries the boost to diversify their economies and achieve a more structural and balanced society. *Carlos Lopes* insists that attention must be focused on, "an appropriate macroeconomic policy framework underpinned by a long-term

development strategy that facilitates transformation of economic and social structures, and ensures a positive feedback loop in the investment growth nexus." This can be achieved by five main points:

i. Scaling up public investment and public goods provision
ii. Maintaining macro stability to attract and sustain private investment
iii. Coordinating investment and other development policies
iv. Mobilizing resources and reducing aid dependence over time
v. Securing fiscal sustainability by establishing fiscal legitimacy.

Wider regional integration will undoubtedly assist Africa in negotiating favourable trade deals with either the EU or the United States. The integration will provide broad opportunities for African businesses and consumers within the globalizing world. It will encourage healthy inward competitiveness for investment and trade by stimulating more direct foreign investments in Africa. It is therefore essential that more emphasis is placed on the establishment of an African Currency Union, because lack of progress and detail in discussions will most certainly result in the existence of flaws in the system and with time, the collapse of the Union.

Previous Approaches to Solving the Issue

Abuja Treaty 1991: The Establishment of the African Economic Community under the AU. The treaty sought to create an African Central Bank, African Investment Bank and an African Monetary Fund. The treaty also proposed the enactment of the currency by 2028 with the African Central Bank being the sole issuer of the currency.

30 November 2013: Protocol for the Establishment of the EAC Monetary Union signed by Burundi, Rwanda, Kenya, Tanzania and Uganda.

25th AU Summit, June 2015: Representatives from 25 African nations signed an initial agreement to create a free-trade zone linking three economic blocs that would unite 57 per cent of the continent's population. The AU aims to have a common currency by 2025 and an African Monetary Fund.

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Appendix

Table 1 shows that Common Market for Eastern and Southern Africa and the Economic Community of West African States would benefit on average from a single African currency. The other regional economic communities with more disciplined fiscal policies would suffer net welfare losses on average.

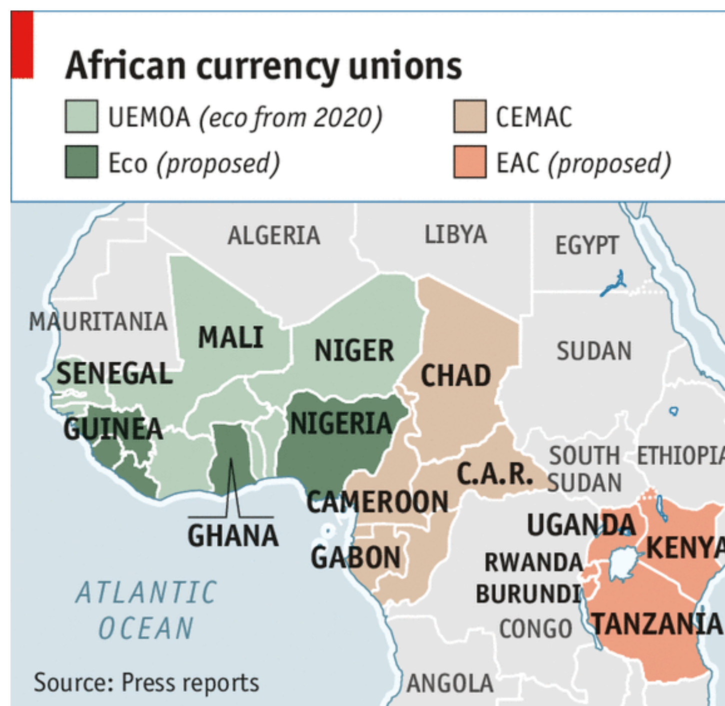
	Average net welfare gain[1]	**Trade with the rest of the AU[2]**	**Proportion of countries gaining in regional economic community**
Arab Monetary Union	-0.11	0.21	0/3
Common Market for Eastern and Southern Africa	3.95	0.28	7/7
Economic Community of Central African States	-1.28	0.86	0/4
Economic Community of West African States	11.25	1.35	13/13
Southern African Development Community	-7.39	0.91	1/12
Overall net gain	-0.45		

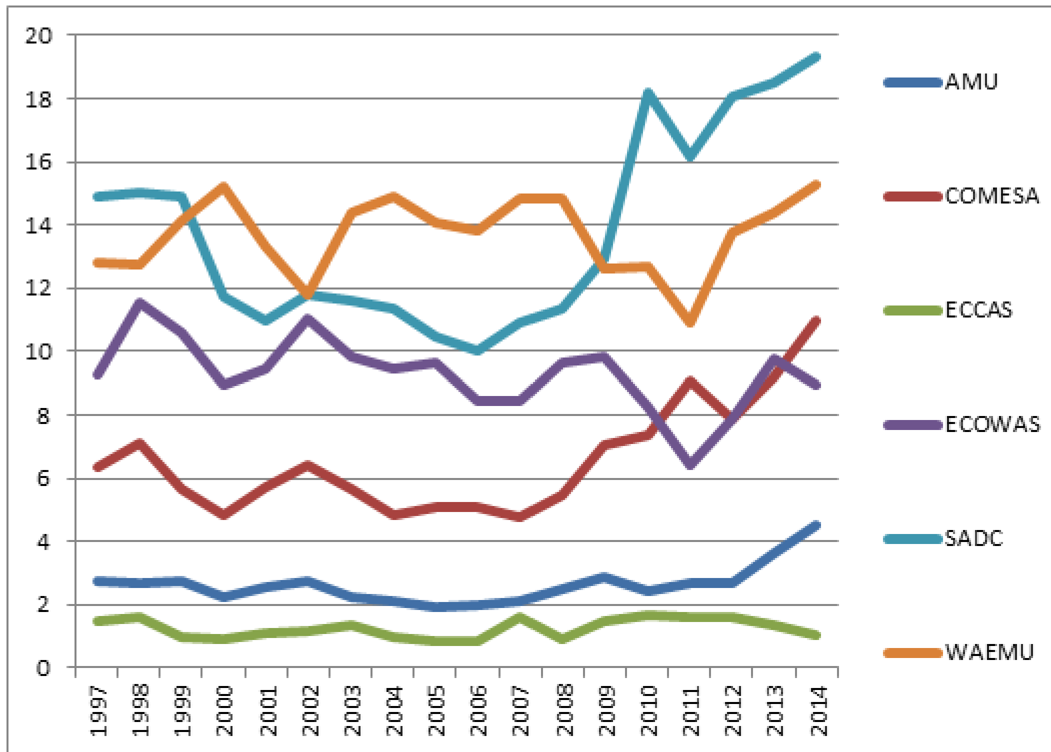
Source: *Masson and Pattillo* (2004)
[1]As a percent of GDP –equivalent
[2]As a percent of regional economic community GDP

Table 2 shows that some economies would benefit and others would lose from the proposed African regional and sub-regional monetary unions. Full monetary union among either West African Monetary Zone or Economic Community for West African States' members would be undesirable for most members.

	Gainers	**Significant losers[2]**
Common Market for Eastern and Southern Africa	Angola, Ethiopia, Malawi, Seychelles, Sudan, Zambia and Zimbabwe	Egypt, Kenya, Madagascar, Mauritius, Namibia, Swaziland, Uganda
East African Community	Kenya	
Economic Community of Central African States	The Gambia, Ghana, Nigeria, Sierra Leone	Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo
Southern African Development Community	Angola, Botswana, Democratic Republic of Congo, Malawi, Mozambique, Seychelles, Tanzania, Zambia, Zimbabwe	Lesotho, Namibia, South Africa, Swaziland
West African Monetary Zone	Nigeria	The Gambia, Ghana, Guinea, Sierra Leone

Source: *Masson and Pattillo* (2004)
[2]Welfare losses greater than 1 percent of GDP-equivalent





Intra-Regional Exports As A Percent Of Total Exports, Selected African RECS