

A Critical Review of the Theory of Optimum Currency Areas: Perspectives for a West African Single Currency

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ABSTRACT This article presents a perspective on the driving force between economic and political judgement in the formation of a single currency union. West African rulers have long desired to form a single currency union but have for reasons of political instability within the region shied away from making this happen. In recent years however, the call for single currency in the region has indeed heightened as a result of indications of success within the Euro zone. This article critically reviews theoretical perspectives forming the macroeconomic guidelines for the successful implementation of single currency unions as a framework for the benefits for the strength of political will in the formation of a single currency union.

1.0 INTRODUCTION

This article critically reviews the theory of optimum currency areas and the overriding judgement between political and economic will to form a single currency area. The article contributes to existing literature on monetary unions by its examination of the borderline between economic and political reasoning in the determination of the criteria for economic integration. The article integrates views from the original ideas on the economics of optimum currency areas based on Mundell (1961), McKinnon (1963) and Kenen (1969) as well as views from more recent analysis such as Mongelli (2008), Dellas and Tavlas (2009) and Tavlas (2009) to argue that a political as well as an economic rationale is essential for the full monetary integration of member states in a single currency union. Mason and Patillo (2005) and Debrun et al. (2009) specifically reject the overriding political rationale governing the formation of the proposed West African single currency in favour of a more economically led rationale. This article seeks to demonstrate that single currency unions require as much political integration as they require economic integration (see Krugman and Obstfeld 2009).

As far back as 1975, the Economic Community of West African States (ECOWAS) was made functional to promote greater integration and trade amongst both the Anglophone and Francophone countries of West Africa. This involved free access of labour and capital across the borders of these different countries (Masson

and Patillo 2005). In another sub-regional meeting in 1987 (Abuja, Nigeria), the need for further integration was anticipated leading to the creation of the ECOWAS Monetary Cooperation Programme (ECMP). Under this programme, member states were required to follow a set of convergence criteria leading to the eventual adoption of a single currency for the sub-region. Four key convergence criteria were set to be achieved by the end of 1999 as follows (Bawumia 2002):

1. A ceiling on Central Bank financing of budget deficits to 10% of the previous year's tax revenue by 1998.
2. The maintenance of a single digit inflation rate by the end of 1998 for all the countries and for Liberia and Sierra Leone, compliance by the end of year 2000.
3. A restriction of the budget deficit to GDP ratio of no more than 5% by 1998 and then a maximum of 3% thereafter.
4. Countries with floating exchange rates to reduce variability of nominal exchange rates to less than 10% by the end of 1998 and less than 5% by the end of 1999; while countries with fixed exchange rates to eliminate any overvaluation by 1998.

In the face of difficulties involved in appealing to the existing CFA monetary union member states in West Africa to go into a single currency union with the rest of the sub-region, it was decided to follow a two tier approach to eventual single currency. In a meeting held in Lome, capital city of Togo Republic, tagged the "The Lome Agreement" it was decided that Ni-

geria, Ghana, Guinea, Sierra Leone and The Gambia should establish a single currency monetary union to later merge with the West African Francophone (CFA) countries. The key Institutional characteristics were to be as follows (Bawumia 2002):

1. An independent supranational central bank to direct and set monetary policy for the member states to be known as The West African Central Bank (WACB).
2. Prohibition of the public sector from receiving monetary financing.
3. The pooling of foreign exchange reserves.
4. Establishment of a stabilization and co-operation fund from which member states can draw to cushion against temporary balance of payment disequilibria.

To qualify for membership, certain convergence criteria were set as follows (Bawumia 2002):

1. A floor on foreign exchange reserves of at least three months of imports by year 2000 and six months by year 2003.
2. A ceiling on central bank financing of budget deficits to 10% of the previous year's tax revenue.
3. A limit of the annual inflation rate to a single digit by year 2000 and 5% by year 2003.
4. A restriction of the budget deficit to 5% of GDP by year 2000 and 4% by year 2002.

In spite of all these guidelines evidence from Mason and Patillo (2005) and Debrun et al. (2009) show that the countries proposing to form the West African Monetary Union exhibit low trade linkages as well as high fiscal asymmetries thereby dashing any hope of savings in transaction costs, one of the key benefits of monetary unification (Mundell 1961). In addition to this, Masson and Patillo (2005) and Debrun et al. (2009) concluded that Nigeria with its high level of fiscal indiscipline will put upward inflationary pressure on the rest of the countries in the union. In spite of the vast amount of macroeconomic evidence against the economic sense of the West African Monetary Zone (WAMZ), there continues to be a strong clamour by West African political leaders particularly Nigeria and Ghana to go into a single currency union possibly due to the initial success represented by the Euro zone and the continued survival of the CFA single currency union in West and Central Africa.

This article explores various schools of thought in macroeconomic reasoning as the basis for the provision of evidence to support the formation of single currency areas, arguing that political reasoning plays as vital a role in the judgement call as macroeconomic reason does. The article contributes to the vast body of literature seeking to better understand the monetary and fiscal interactions playing out within a single currency union. In addition to this, the article provides compelling evidence to suggest that a political rationale to ensure fiscal integration as important if not more important than an economic rationale in the decision to form and sustain a single currency union.

Section one introduces the basis of the argument presented throughout the article, section two looks at various theoretical perspectives, section three discusses the theoretical perspectives raised in the context of the monetary geography of Africa and section four summarises the arguments and draws a conclusion.

2.0 THEORETICAL FRAMEWORK

2.1 The 'Orthodox' Theory of Optimum Currency Areas

The original theoretical framework that attempted to define the corollaries of Monetary Integration emerged from the seminal article of Mundell (1961). He put forward his argument on the premise of optimality of a monetary area defined by the boundaries of flexible exchange rates (relative to other currency regions), internal factor mobility and external factor immobility against a case for national currencies, with fixed exchange rates (relative to other national currencies), internal factor mobility and external factor immobility. Put quite simply, Mundell elucidates his claim by describing a scenario whereby two countries operating separate national currencies, full employment and are in balance of payment equilibrium engage in bilateral trade; country one (C1) experiences an upsurge in the demand of its national output by country two (C2); he assumes that inflation targeting is in effect and short term changes cannot be made to price levels and wage structure. On the basis of this assumption, Mundell illustrates that the shift of demand of output from C2 to C1 will be accompanied by a rise in price in C1 causing inflation in C1 and a decline in

output and employment in C2; because C1 maintains its own currency, which it will not allow to float against that of C2, and because inflation targeting is in place, the Central Banking Authorities in C1 will move to contract monetary policy in order to stabilize price levels thereby rolling the bulk to C2 causing a reduction in real income and employment in C2. If a regional Central Bank was functional under a single currency regime, internal factor mobility and external factor immobility, the changes in the terms of trade would have been smoothly aligned by increasing money supply to maintain full employment in C2 and finance the increased activity due to factor mobility to C1. Such an area in which a Supranational Central Bank can operate to its full monetary capacity, Mundell referred to as an Optimum Currency Area. Mundell also emphasises that the concept of single currency is an economic concept which is not feasible without close political ties of national governments, an indication, not only of strong political will but fiscal integration and cooperation. This view of fiscal integration is upheld by Mundell in his emphasis that countries with symmetric trade shocks are in a more suitable position to integrate monetarily with less need for exchange rate adjustments to balance of payment disequilibria. Kenen (1969) on another hand proposes the use of regional fiscal transfers as a means of overlooking fiscal asymmetries. Aksoy et al. (2002) conclude that asymmetries in the European Monetary Union can be taken care of by the setting of interest rates that reflect the economic perspective of the entire euro-land. In carrying out their analysis [using “the optimal feedback rules proposed by Rudebusch and Svensson (1999)”] they admit neglect of the effect of real exchange rates on output and inflation thereby deviating from Mundell (1961). Going by Mundell’s assertion of the importance of political union there is a direct implication of the expectation of some sort of fiscal transfer from one region in a single currency area to another (Kenen 1969; Robson 1987; Weber 2011). Mintz (1970:33) argues that the most concrete factor driving the formation and success of a monetary union is the political will to do so. McKinnon (1963) attempts to deconstruct Mundell’s argument of optimality by arguing that the concept of optimality is complex and is not as easily identified as Mundell has put it; he stresses that Mundell’s model of

external factor immobility (flexible exchange rate with other regions) and internal factor mobility (price stability) is hypothetical. McKinnon argues that factor mobility or immobility is applicable not only to geographic boundaries as stated by Mundell but also to industrial boundaries so in determining an optimal currency area, it is imperative to consider the ability of factor to migrate from one industry to another within the same region or across regional boundaries (following the reduction in demand of the output of one industry relative to the other) as well as the ability of governments to replicate industries existing in other regions as a strategy to immobilise factor emigration. McKinnon’s case was for openness of the economy. With all the political will to go into part or full scale monetary integration, if there is no economic sense, what will be the eventual outcome? Going by Kenen (1969), can fiscal federalism sustain the economy? Orthodox literature in optimum currency as advanced by Mundell (1961), McKinnon (1963) and Kenen (1969) and summarised by Tavlas (1993), Tavlas (2009) and Dellas and Tavlas (2009) has it that where political union exists other key conditions must be met for optimality to exist between member nations viz: *similarity of inflation rates, degree of factor mobility, the openness and size of the economy, the degree of commodity diversification, price and wage flexibility, the degree of goods market integration, fiscal integration, and the need for real exchange rate variability*. See Weber (2011) for further views on market integration.

In summary, the orthodox theory of optimum currency areas is built around the pillars of exchange rate, inflation, output, unemployment and balance of payment. Credence is given to the use of exchange rate variability as a tool to maintain balance of payments between two countries or two regions. This school of thought generated a huge flock of followers in spite of the fact that the theory had no empirical proof (Schelkle 2001). Between 1961 and 1976, economists held onto these views more so in the presence of compelling evidence to the contrary (Lucas 1976), the view still held supreme. The Lucas Critique first of all appears to agree with the Mundellian flow of thought by its implication of endogenous growth influences on an economy as a result of internal macroeconomic policies applied to it. Schelkle (2001)

however demonstrates how the Lucas Critique debases the Orthodox view.

2.2 The 'New' Theory of Optimum Currency Areas

Goldberg (1999:8) refers to the Mundellian view of Optimum currency areas as dressed in Keynesian drag i.e. full scale demand results in perfectly elastic supply. Goldberg asserts that after over thirty years of revolution in macroeconomic theory, the basis of this assumption may no longer be relevant; she supports this assertion by citing Aizenman and Flood (1992) "supply side driven disturbances rather than the traditional Keynesian demand-side disturbances". Tavlas (1993) indeed with sympathy for the Mundellian School analyses some new criteria for the determination of optimality in addition to Mundell's view viz: *investor expectation, inconsistency in time, credibility of policy makers, uncertainty facing labour mobility and the process of determination of exchange rates*.

Brigham and Houston (2007:193) state that under the pure expectation theory in finance, investors trading in bonds and other financial securities establish bond prices and long term interest rates simply on the basis of expectations for the future direction of interest rates. Their expectation is hinged on their perception of the monetary authority's drive to combat short term inflation given that the central bank plays in the short term end of the market. This view can be used to query the Mundellian view of demand driven supply considering that investors (supply) will only react to market conditions (demand) if they felt that it would be in their interest to do so. This conviction must then come from the fiscal as well as monetary authorities in some form of policy driven action to gain full realization. This view is similar to the view of fiscal federalism held by Kenen (1969) albeit modifications with respect to its dependence on supply side expectations (Aizenman and Flood 1992). This view is further enhanced by Lawson (1995:271) which states that due to our occupation of an ever changing world subject to various policy upheavals affecting trade, political relations and consumer behaviours, how is it possible to model investors behavioural response to macroeconomic changes to importation, exportation, investment and production given the

different institutional, political, social, educational and cultural contexts these investors operate in; Lawson's view is a direct critique of the Mundellian school of optimality.

The time inconsistency criteria in today's macroeconomic world of inflation targeting can be viewed from a different angle from that intended by the Mundellian School. Their view was that in the maintenance of flexible exchange rates between two countries, monetary policy in these countries had to be directed towards targeting inflation resulting in similar inflation rates in these countries (Tavlas 1993; Dellas and Tavlas 2009). The new theory of optimum currency areas is, however, of the stand that this criterion of similar inflation rates is more realistically achieved as an aftermath of monetary integration rather than a requirement for monetary integration (Tavlas 1993). Tavlas based his argument on the fact that monetary integration between two countries, one with a time consistent history of inflationary monetary policies and another with a history of low inflation will result in the inflation prone country being usurped of some of its autonomy in carrying out its inflationary monetary policy. A similar view is also held by Krugman and Obstfeld (2009:569) and Debrun et al. (2009). Debrun et al. however argue that the benefits of low inflation would be shadowed by high levels of output shock asymmetry and fiscal disparities amongst the countries proposing to form the union.

Under the Mundellian School, there is an outright assumption that labour will migrate from areas of high demand to areas of high supply to fill the employment vacancies created by high supply elasticity. The new theory of optimum currency areas is however of a slightly different view as regards the degree of labour mobility. Tavlas (1993) elucidates that uncertainty in the cost of migration may act as a deterrent to labour mobility.

2.3 An Overview of the Lucas Critique

Lucas (1976) identifies a key constraint in the use of econometric data as a yard stick for predicting factor reaction to policy changes; Lucas points out that whenever a change in government policy occurs, existing econometric relationships are no longer sufficient to truly model factor reaction. In spite of this obvious lapse in the econometric models used to fore-

cast behaviour, Lucas points out that econometricians remain indifferent to their inadequacies. Lucas made a set of inferences as follows: firstly, he addresses the issue of optimality of factors modelled in econometric relationships as being based on the immediate circumstances of those factors (that is, rules governing demand and supply such as monetary and fiscal policies). Factor reaction to changes in policy will be subject to the environment in which these factors operate as well as past, present and future expected changes to their environment. Secondly, Lucas argues that the degree of optimality of policy changes will be determined by the degree of rational expectations of the factors affected by these 'optimal policies'; again, this will be subject to, in my view, past and present changes to the factors operational environment. Thirdly, Lucas infers that if there had been changes to the factors environment due to past changes in optimal policy regimes then further changes in optimal policy status will result in inconsistencies in the relationship between factors and agents of policy (Lucas 1976: 25).

Going further, he shows that the parameters (F, θ) representing demand and supply functions are not easily determined (in the equation below).

$$y_{t+1} = F(y_t, x_t, \theta, e_t)$$

Even though Lucas asserts that there is no rational likelihood that (F, θ) will be easily determined, he points out that the assumption of optimality, the cornerstone of the theory of economic policy (with no direct reference to Mundell 1961) is based on a faulty estimate of these parameters. Whenever there is a change in monetary and/or fiscal policy, the variables y_t, x_t (endogenous and exogenous variables) are expected to change but if the values of (F, θ) deviate significantly from their previously estimated values, then the implication is that the result of the models do not correspond statistically with their theoretical basis of a known value of (F, θ) .

Mundell (1961) on the other hand implies that when there is a change in policy (monetary or fiscal), an increase in demand will result in perfectly elastic supply (echoed in Goldberg 1999 as erroneous). Lucas (1976:25) maintains that between policy changes, the demand and supply structure should not vary significantly. This however is not the case in reality.

Lucas laid the solution to this problem at the doorstep of the policy maker saying that the policy maker had to announce the changes to those affected prior to implementing them. Mathematically speaking however, this view of Lucas may seem like working from the solution backwards to the question. Lawson (1995) strongly criticised Lucas's approach to solving the problem by rolling the bulk to the policy maker rather than to the econometrician. He purports that the inadequacy of an econometric solution to the problem is in itself an insinuation that econometrics may not after all be viewed as a rational science. With this assertion, we are prompted to redefine the word 'optimal' as it relates to economics, econometrics, and international finance. Optimal is derived from the word optimum which is derived from the word Optima defined by the Oxford Advanced Learners Dictionary as *the best or most favourable*. Given changing conditions, 'the best', a qualitative description/social construct can often shift position. In mechanical terms, automobile engineers defined the optimum speed for efficient fuel consumption for an automobile to be 60mph but with revolutionary changes in the capacity of automobile engines, this optimum speed can now be easily used up by the first gear only making us desirous for change in the definition of what we consider optimum speed for fuel efficiency, *ceteris paribus*. Lawson points out that in view of Lucas's position with the policy maker, that the hypothesis of rational expectation has come under the lime light causing extreme schools of thought such as Sims (1982) on one side [economic theory does not have the capacity to provide a basis for rational econometric relationships] and Sargent (1986) on the other side [Economic theory can provide a basis for rational econometric relations to hold]. Hendry (1995: 202) describes the concept of rational expectations as a somewhat jocular concept "*an abuse of language has crept into professional discourse since it might be irrational to form a rational expectation*". Muth (1961, cited in Hendry 1995) "*defines expectations to be rational if they were formed according to the economic model underlying the behaviour*".

According to Hendry, the relationship between an expectation and a consistent underlying economic model is given by:

$$z_t^e = E_{\text{model}}[z_t] \text{ model of } z_t$$

Where z_t is the policy expectation of a set of policy changes shown by the left side of the equation. Going back to the Lucas critique, Lucas proposes that the expected outcome z_t of a future policy should be made known in advance so that econometric models (left hand side of the equation) to analyze the outcome or set of outcomes can be made available. Lawson (1995) is however critical of this approach saying that the inability of the left hand side to predict z_t is in itself an indication that the integrity of econometric modelling may be subject to question. In predicting future expectations, Hendry as well as Lawson agree that there is a strong need to identify structures that remain constant with every changing policy in order to build the bed rock of predictive econometric models around these structures. In proposing an econometric solution to the problem highlighted in the Lucas critique, Lawson drives for a review of the ontology of science from one of empiricism (acceptance as the status quo based on replicability of experience) to one of transcendental realism to which he arrogated three domains of reality viz: *“empirical (experience and impression), the actual (actual events and states of affairs as well as experience) and the non-actual or, metaphorically, ‘the deep’ (structures, mechanisms, powers and tendencies)”*. In driving home this argument, he leverages his reference on Bhaskar (1978). Going by Hendry (1995:9) *“Science is a public approach to the measurement and analysis of observable phenomena. Its essential aspects are that it is a systematic study of empirical evidence, with accumulated evidence consolidated and unified in theories, which are evaluated in turn against further observation statements”*. Lawson’s is a significant deviation from what is ordinarily accepted as science and therefore by default necessitates a re-definition of econometrics in terms of its rationality or otherwise. The traditional view of theorizing in science follows a deductive process (Hendry 1995) but Lawson proposes a retroductive or abductive reasoning technique strongly criticized in Parker (2002a, b and c) as a ‘common sense approach to doing things’. In conclusion, Lawson is of the view that the positivistic assumptions on which economics is projected as a science should be rejected for a transcendental realist alternative. This view of rejection of positivism is however rejected by Mackenzie (2001) where he analyses and draws

close similarity to the relationship between physics and finance as world makers and not just descriptive subjects. Mackenzie is of the view that an end should be put to the rejection of finance and financial engineering as a science; he asserts his opinion by a detailed description of N and S terms in physics and finance and shows that both subjects contain both N and S terms but to varying degrees due to the purpose they serve in society. In his description of finance, Mackenzie refers to the subject as a derivative of economic theory.

2.4 New Views of Optimum Currency Areas

Schelkle (2001) argues that the Optimum Currency Area (OCA) framework proposed by Mundell (1961) may have become obsolete; he supports his argument with two key views, the first being that expressed in Lucas (1976) which unequivocally highlights a problem in the area of determining stable econometric relationships that will address the problem(s) posed by ‘the same variables’ under changing policy regimes. Schelkle is of the view that monetary integration is by all ramifications, a change in policy regime and thus attacks Mundell (1961) using the Lucas critique even though the critique made no mention of Mundell or even monetary integration. He builds his argument around the point that following new light shed on the OCA literature by Tavlas (1993) and the 1999 Nobel Prize awarded to Robert Mundell for his innovative work on the OCA framework, research into monetary integration has simply lent credence to the original framework rather than attempt to test its validity. Going by Lucas’s recommendation that effective econometric modelling of the impact of change in policy on factor behaviour can only be effectively done if the affected population have received adequate guidelines as to how their behaviours are expected to change to conform to the policy change, Schelkle concludes that the OCA guidelines as a precondition to monetary integration specified by Mundell (1961) can be better achieved ex ante (after monetary integration rather than before) if effective channels of communications are used to carry along factors of production and their agents.

In his second argument, Schelkle goes to pull down another corner stone of the OCA framework using the modern theory of exchange rates,

another framework where Mundell received considerable credit for his contribution. He raises an enquiry as to the ability of capital market integration to undermine the use of exchange rates as absorbers of systemic shocks but puts this beyond the scope of his research. Capital mobility across national borders may lead to monopoly of firms in regions of a monetary union (Ricci 1998).

3.0 DISCUSSION

3.1 In Context with the Monetary Geography of Africa

Masson and Patillo (2005) have drawn on the principles of established Optimum Currency Area theory to suggest that the proposed West African Monetary Unification will on balance provide negative economic benefit. The trail of this literature review has adapted a critique to re-examine not only the findings of Masson and Patillo but also the current validity of the theory upon which they based their assertions on. Substantial evidence of critiques (direct and indirect) exists to show that their assertions may have become obsolete or is in fact at the brink of becoming obsolete (Dellas and Tavlas 2009; Tavlas 2009). If this is the case, can it be assertively said that the monetary unification in West Africa will be a success, in other words provide net positive economic benefit? Evidence from Goldberg (1999:7) on issues of re-engineering suggest that the key problems highlighted in Masson and Patillo (2005) still need to be addressed for positive economic benefit to exist particularly in the case of Nigeria, a potential candidate for the hegemon. Further evidence given in Krugman (1993) cited in Schelkle (2001:8) suggests that a monetary union formed after satisfying all the relevant OCA criteria according to Mundell (1961) could become sub-optimal due to factor migration and concentration in specific areas of the union. This would lead to regional differentiation of factors of production due to economies of scale, thereby deepening asymmetries between this region and other parts of the monetary union. Kenen (1969) however argues that with the effective mobilization of fiscal transfers, these economies of scale could be decentralized thereby debunking ex-ante sub-optimality.

Masson and Patillo (2005:112) are somewhat sceptical of the logic of political drive surpass-

ing economic drive in the formation of a monetary union, arguing specifically in the case of the proposed West African Monetary Union that fiscal and export produce related asymmetries are overwhelming as well as bi-lateral trade volumes being insufficient in the region. Countries with symmetric trade shocks are more suited to monetary integration with less need for exchange rate adjustments to balance of payment disequilibria (Mundell 1961). Evidence however exists to the contrary. Kenen (1969) demonstrates that regional fiscal transfers can effectively resolve fiscal asymmetries. Aksoy et al. (2002) show that a balanced approach to monetary policy setting can see the use of interest rate as a tool to smoothen out such asymmetries (evidence from the European Union, see Krugman and Obstfeld 2009). Schelkle (2000:4) argues that monetary unification is not primarily targeted at reducing transaction costs but reducing asymmetries in fiscal positions as well as smoothening differences arising from variable exchange movements.

The argument of time consistency (Tavlas 1993) forms a part of the basis of the position taken by Mason and Patillo (2005) of Nigeria's unsuitability for monetary unification in the proposed West African Monetary Union due to their time consistent inflationary trends. Changes in the nature and operations of monetary and fiscal institutions bring about change in time consistent trends resulting in credible reputations being built for countries with hitherto poor credibility (De Grauwe 1992a:450). Social perception is not only dependent on human action but is also an act of human endeavour; it is therefore possible to change the culture of society (inflationary trends, fiscal indiscipline etc.) by changing people's conception of the goals of policy makers (Lawson 1995). Mason and Patillo (2005: 96) make a case for Nigeria as the 'hegemon' in the proposed West African Monetary Union by asserting that 75% of the Unions GDP would be generated by Nigeria however amidst scepticism they declare that Nigeria's candidacy as a nucleus for the central banking structure is greatly undermined by a 'time consistent' history of inflation and inconvertible Nigerian currency. They go further albeit in slight contradiction of the inconvertibility problem to suggest that credibility may be obtained by putting forward a system of institutional surveillance (p. 112) and abandon-

ment of external targets (exchange rate pegs or other forms of monetary linkages to other convertible currencies) in favour of endogenous monetary policy objectives such as inflation targeting (consistent with Lucas 1976). The similarity of this view to that of Lucas is in itself an inconsistency with the Mundellian School. Krugman and Obstfeld (2009:575) further demonstrate how a high inflation prone country can gain credibility by entering into monetary union with a disciplined country. Fratianni and Von Hagen (1990a) are of the view that if the hegemon pursues inflationary monetary policies, the effect in a single currency area would be a dispersion through out the union thereby causing the Philips curve of the hegemon to be flatter than it would have been had it maintained its own independent currency and monetary policy. The strength of this view for the hegemon put forward by Fratianni and Hagen is however questionable; how much would the hegemon increase money supply before the dissipated waves of inflation would eventually flow back to it in a ripple effect and thus incline its Philip curve along with that of the entire union? This is the extent of scepticism expressed in Masson and Patillo (2005). Can a time consistent inflationary hegemon provide a credible central banking nucleus for a single currency union? How can this time inconsistent credibility be achieved with the help of other smaller countries in the union? Is it possible that bullying of the smaller nations can occur by the hegemon and if so, what price will the smaller nations pay to exit the union? In the formation of the European Monetary Union, Germany acted as hegemon providing a strong and stable nucleus for the European Central Bank on the basis of its time consistent anti-inflationary monetary policy. Critiques of monetary integration continue to argue that the level of discipline and independence exhibited by the German Bundesbank cannot be rivalled in the near future (Marshall 1999). Going by this argument, Nigeria with her central bank still dependent on the Presidency has absolutely no chance at monetary integration unless of course the mantle of central banking supremacy is passed on to one of the smaller countries with less of a negative legacy amounting to a loss of Seignorage on the path of Nigeria. This loss of Seignorage described in Goldman (1999) may be counterproductive as in her view countries relying on Sei-

gnorage for monetary finance are traditionally those countries with an underdeveloped tax system. By implication, monetary integration in transition or emerging markets must be accompanied by institution building and re-engineering.

In the European Central Bank, credibility of policy makers was assured by the provisions of the Maastricht treaty (Marshall 1999) hinged on the Bundesbank tradition of monetary discipline. De Grauwe (1992a) emphasizes that for a country with previous poor credibility to abandon its autonomy over monetary policy either due to a political or economic motive is in itself a cause for credibility. In going into monetary unification with a low credibility hegemon, a treaty such as the Maastricht treaty can spell out limitations and penalties as a precondition to unification. Cohen (1993) in an empirical study of six monetary unions concludes that political will and drive tends to override economic logic in the formation of monetary unions. Given Masson and Patillo's conclusion that the proposed West African Monetary Union is driven more by political rather than economic logic, it is worth wondering if Cohen (1993) and Mundell (1961) hold any logical sense in theorizing for the supremacy of political will over economic logic.

Masson and Patillo, even though logically correct in their argument have put forward a case of an irreversible reaction for one which entertains reversibility as demonstrated in Goldberg (1999)

4.0 CONCLUSION

Emerging markets with specific behavioural characteristics distinct from developed and advanced economies results in the same policy objective yielding different outcomes. The uncertainty of econometric models widely demonstrated in the Lucas critique is sufficient evidence that the eventual behavioural response of policy can hardly be predicted. The succinct analysis of Masson and Patillo (2005) was based purely on recorded macroeconomic variables ignoring the vast amount of unofficial trade currently transpiring amongst West African countries.

It will be erroneous therefore to judge the viability of single currency union in West Africa purely on dogmatic macroeconomic reason-

ing ignoring key political instruments which are the main transmission mechanism for fiscal transfers embodied with the potential of smoothening out of fiscal disparities, a key constraint to the viability of monetary integration. This study has reviewed literature providing evidence that macroeconomic policy may not always yield the desired outcome and has further demonstrated that political will plays a strong role in the setting out and sustenance of a single currency union.

5.0 RECOMMENDATIONS

The study recommends that further research be carried out to explore official trade linkages between the countries proposing to form the West African monetary union to determine the true extent of unofficial ties between these countries. A political union should also be put in place alongside the monetary union to ensure that fiscal disparities amongst member states are balanced off and future trade agreements such as tax rebates etc. are jointly agreed by national governments as a means of controlling factor disequilibrium. Overall, a strong political union between member states will provide a strong foundation for the nurturing of a single currency.

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