

QUOTING AND TRADING IN WAMZ CURRENCIES: CHALLENGES AND WAY FORWARD

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Abstract

In the past few years, concerted efforts have been made by policy makers towards achieving full implementation of the quoting and trading in the West African Monetary Zone (WAMZ) national currencies as a precursor to full currency convertibility. Quoting and trading in WAMZ national currencies implies that these currencies are freely convertible and can be used to finance goods and services produced and traded in the Zone. Since the WAMZ convergence Council endorsed that commercial banks and other private financial institutions operating within the zone should pilot the quoting and trading in WAMZ currencies, not much has been achieved. The framework for currency convertibility would facilitate the eventual issuance of the single currency (ECO) by the common central bank (WACB). Thus, the full implementation of the quoting and trading in the WAMZ currencies is a precursor to meeting the basic requirements for currency convertibility, including strong commitment to sound macroeconomic management, exchange rate stability and adequate stock of international reserves. In the WAMZ, convertibility of member countries' currencies refers to the ease with which a Member State's currency can be converted into other local currencies within the Zone, to engender intra-regional trade. It is, therefore, crucial because it will eliminate the use of third party currencies (US dollars, euro, pounds, etc) from the trade links between and among the countries. The European experience has shown that the attainment of convertibility for groups of currencies requires coordinated and concerted efforts. In this regard, WAMZ member countries would be required to pursue policies aimed at achieving at the minimum, current account convertibility. This paper reappraises the issues concerning quoting and trading in the WAMZ currencies, highlights the challenges and proposes a new framework for jumpstarting the programme to facilitate currency convertibility within the Zone.

Key Words: Quoting and Trading, WAMZ Currencies

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1. INTRODUCTION

In the past few years, concerted efforts have been made by policy makers towards achieving full implementation of the quoting and trading in the West African Monetary Zone (WAMZ) national currencies as a precursor to full currency convertibility. Quoting and trading in WAMZ national currencies implies that these currencies are freely convertible and can be used to finance goods and services produced and traded in the Zone. Historically, the programme started following the Banjul Action plan of May 2005, when the Commencement date for the Monetary Union was shifted to December 2009.

The Authority approved an expanded work programme to facilitate the establishment of the monetary union with quoting and trading in the WAMZ currencies as a major task to be undertaken by the Member States before the end of December 2008. Consequently, the WAMZ convergence Council endorsed that commercial banks and other private financial institutions operating within the zone should pilot the quoting and trading in WAMZ currencies. However, these attempts had been fraught with challenges, since the commercial banks that were expected to pioneer the implementation of the programme showed little enthusiasm while the central banks have not effectively backed the process.

The aim is to promote the use of national currencies in intra regional transactions as a means to achieving currency convertibility and enhancing efficiency in financing trade. The need to conserve scarce foreign exchange resources in the Zone, reduce transaction costs and facilitate intra-regional trade is a strong justification for promoting currency convertibility initiative. Moreover, the informal sector operators in WAMZ countries were already practicing convertibility of regional currencies in their cross border activities with significant degree of success within parallel market conditions. The formalization of these activities is bound to improve their efficiency, minimize the use of cash in business transactions, reduce the incidence of counterfeiting and ensure the

expansion of documented intra-regional trade transactions.

The framework for currency convertibility would facilitate the eventual issuance of the single currency (eco) by the common central bank (WACB). Thus, the full implementation of the quoting and trading in the WAMZ currencies is a precursor to meeting the basic requirements for currency convertibility, including strong commitment to sound macroeconomic management, exchange rate stability and adequate stock of international reserves.

In the WAMZ, convertibility of member currencies refers to the ease with which a Member State's currency can be converted into other local currencies within the Zone, to engender intra-regional trade. It is, therefore, crucial because it will eliminate the use of third party currencies (US dollars, euro, pounds, etc) from the trade links between and among the countries. The European experience has shown that the attainment of convertibility for groups of currencies requires coordinated and concerted efforts. In this regard, WAMZ member countries would be required to pursue policies aimed at achieving at the minimum, current account convertibility.

The objective of this paper is to reappraise the issues concerning quoting and trading in the WAMZ currencies, highlight the challenges and propose a new framework for jumpstarting the programme to facilitate currency convertibility within the Zone. Following this introduction, the rest of the paper is organized as follows: some advantages and disadvantages of quoting and trading in WAMZ currencies are presented in Section II and the current status of quoting, trading and convertibility as well as challenges militating against the full operationalisation of the quoting and trading in the WAMZ currencies is presented in section III. Section IV makes a case for currency convertibility in the WAMZ. In section V, a new framework is proposed as a way forward for jumpstarting the programme, while section VI highlights the policy environment and concludes the paper.

I. SOME OF THE ADVANTAGES AND DISADVANTAGES OF QUOTING AND TRADING IN WAMZ LOCAL CURRENCIES.

Quoting and trading in WAMZ local currencies entails the purchase and sale of these currencies by financial intermediaries who partake in international trade transactions. It is important to emphasize that as a result of reforms implemented by WAMZ member countries, the necessary and sufficient conditions for the sustainability of currency convertibility which are: exchange rate stability; an adequate stock of international reserves and macroeconomic stability have been met (WAMI,2011). Thus, the quoting and trading in WAMZ currencies for the purpose of intra-regional trade finance should have been on course given the major benefits, which include:

II.1 Reduction in Transaction Costs

The direct convertibility of WAMZ currencies without going through a third hard currency will reduce currency exchange transaction costs for the economic operators as well as the non-business travelers.

II.2 Facilitate Payments and Transfers

The use of local currencies in intra-regional transactions will facilitate payments and transfers by making them more direct and less protracted and consequently, enhance free movement of goods and services within the Zone.

II.3 Savings in Foreign Reserve

Promoting the use of local currencies in intra-Zonal transactions will conserve the scarce foreign currencies (dollar, pound, euro, etc). This implies that no reserves will be needed to cover imports within the WAMZ.

II.4 Reduction in the size of informal trade in the WAMZ

It is important to underscore the fact that the informal sector in the WAMZ is already practicing the free convertibility of regional currencies with significant degree of success

under parallel market conditions. The absence of an efficient official financial market and cross-border trading system coupled with regulatory and institutional rigidities explain the size of informal trade. The formalization of these activities will improve their efficiency, minimize the use of cash in business transactions, encourage a greater use of the banking system and ensure the expansion of recorded intra-regional trade transactions.

II.5 Lower premium in dealing in WAMZ local currencies

It is on record that in the informal sector and in some private banks like Ecobank who are already involved on a small scale in the quoting and trading of currencies, the premium is quite high. The full implementation of this policy would greatly lower the premium and engender intra-regional trade.

The main constraints raised by banks in the transactions of WAMZ currencies are: the exchange control regulations and the lack of a central point to off load the long position. The implementation of the convertibility arrangement will therefore increase the volume of transactions and lower the premium in dealing in WAMZ currencies.

On the other hand, the financial intermediaries engaged in these transactions are exposed to risks. The effective management of these associated risks is central to the performance of the financial intermediaries, and by extension, the sustainability of the programme.

II.5.1 Foreign Exchange Risk

This risk results from exchange rate depreciation that can affect the banks' balance sheet. Exchange rate movements in the WAMZ countries are not uni-directional, given the differences in underlying economic structures. For instance, when one currency is appreciating against the US dollar due to favorable external sector conditions, another can face depreciation

because of unfavorable developments in the external sector. To mitigate this risk, banks usually match their foreign currency assets to liabilities in a given currency and match purchases and sales in their trading in that foreign currency. The balance of these transactions is called net exposure, which can be defined as the degree to which a bank is net long or short in a given currency. A bank holding a net long exposure may try to sell it to avoid losing when it anticipates that the currency is likely to depreciate.

II.5.2 Sovereign Risk

Another risk which may arise in the trading of WAMZ local currencies is the problem of sovereign risk. Sovereign risk is the risk that repayments from foreign borrowers may be interrupted because of difficulties encountered by that country to meet its obligations. Most commonly, the government may limit payments due to foreign currency shortages. For instance, a bank can accumulate a net long exposure in one of the currencies of the WAMZ if it did not find another partner to purchase that excess liquidity. This problem can be solved by the intervention of the monetary authorities of that country by the purchase of the excess liquidity. In this regard,

the intervention of the Central Bank as the settlement bank of last resort will become not just the necessary condition for the effective implementation of the 'Quoting and Trading in currencies' arrangement but indeed a sufficient condition.

II.5.3 Capital Flight

Another non-negligible risk is the problem of capital flight, mainly from The Gambia, which has already liberalized its capital account. To avoid the risk of capital flight arising from over invoicing, The Gambia should scrutinize all the transactions from other countries to ascertain that they are related to legitimate current account transactions (trade finance). So far, even with trading in foreign (non-WAMZ) currencies, capital flight has not been recorded in the Gambia.

II.5.4 Other Risks

Furthermore, trading and quoting in WAMZ currencies might produce other downside risks which would require strengthening of institutional capacity to minimize the costs. These include money laundering and counterfeiting.

III. CURRENT STATUS OF QUOTING & TRADING AND CONVERTIBILITY OF WAMZ NATIONAL CURRENCIES AND HIGHLIGHT OF PROBLEMS ENCOUNTERED

III.1 Current Status of Quoting and Trading of WAMZ National Currencies

Investigations by WAMI revealed that in spite of the mandate given to commercial banks and other private financial institutions within the Zone to pilot the programme of quoting and trading in the WAMZ currencies, only very miniscule progress has been made. Commercial banks that were expected to pioneer the implementation of the programme have showed little or no enthusiasm. In the past four years, only Ecobank Transnational Incorporation has shown some signs of interest in the scheme. Available data for 2009-2011 indicates that no trading took place in WAMZ currencies. Ecobank's regional transactions are denominated in CFA francs which it considers the predominant trading currency in the zone. Even though no extensive trading was done in WAMZ currencies in 2009-2011, the Bank traded in Cedi, Leone and Naira in an equivalent amount of US\$ 961,425 in 2008.

III.2 Status of the Convertibility of WAMZ National Currencies

On the status of the convertibility programme, it will be recalled that in the 1980s and 1990s the countries who now make up the West African Monetary Zone implemented Structural Adjustment Programmes (SAP) which, amongst other things, included economic liberalization measures. This resulted in the attainment of an increasing degree of convertibility, which culminated in The Gambian dalasi becoming convertible internationally. Thus, as stated below, significant steps have been taken by the other member States to reduce the degree of inconvertibility of their currencies.

In **The Gambia**, both current and capital account transactions are open and unrestricted. The country has acceded to the current account convertibility obligations of Article VIII of the IMF Articles of Agreement. The Gambia has also allowed its exchange rate to be determined by market forces. Authorized dealers in foreign exchange include the commercial banks and the foreign exchange bureaux. The export and import of the dalasi, the national currency, is unrestricted.

In **Ghana**, current account transactions have been liberalized while there is a partial liberalization of the capital account. The country has acceded to the current account convertibility obligations of Article VIII of the IMF Articles of Agreement. Authorized dealers in foreign exchange include the banks and foreign exchange bureaux. The exchange rate of the cedi is market determined under a floating exchange rate system. A maximum of GHc 5,000 is permissible to residents travelling abroad which imposes a ban on the import or export of the national currency. There is no restriction on the importation of foreign currency into the country.

Guinea has acceded to the current account convertibility obligations of Article VIII of the IMF, thereby liberalizing its current account transactions. Authorized dealers in foreign exchange include the commercial banks and the bureaux de change. Foreign exchange liberalization measures include: freedom of residents and non-residents to open and operate foreign currency accounts; freedom to bring foreign currency into the country without restrictions; and, freedom to obtain foreign exchange from authorized dealers without reference to the Central Bank. There are, however, restrictions on capital transactions and the export and import of the Guinean franc is limited to GNF 100,000. The country is

operating a floating exchange rate system in which the exchange rate of the national currency is determined by market forces with the US dollar as the intervention currency.

In Liberia, a dual currency regime exists, with the US dollar enjoying legal tender status, and accounting for about 90 percent of the money supply. Exchange rate is market driven, with the commercial banks and bureau de change as the main participants. Residents are allowed to hold bank accounts in either the Liberian dollar or US dollar, as well as in other fully convertible currencies. There are no restrictions on current and capital account transactions in Liberia, as the country has fully acceded to the IMF Article VIII in that respect.

In Nigeria, the authorities have expressed the desire to move from the prevailing situation of partial convertibility to the IMF Article VIII convertibility. However, it should be underlined that currently, exchange control restrictions on payments for current account transactions have been eliminated. The liberalization of foreign exchange transactions has also made it possible for residents and non-residents to open and operate domiciliary accounts in convertible foreign currencies. The institutional players in the foreign exchange market include the Central Bank, the commercial banks and the bureaux de change. The Naira exchange rate is market driven under the Wholesale Dutch Auction System. The export and import of the naira remains prohibited.

In Sierra Leone, current account transactions have been fully liberalized while a partial liberalization of capital transactions has also been effected. Commercial banks can process and approve request for foreign currency transfers and remittances abroad arising from current international transactions without reference to the Central Bank. Residents may operate a foreign currency denominated account at a commercial bank in Sierra Leone. The exchange rate is market-determined under a floating rate regime in which the major players are the Central Bank, the commercial banks and bureaux de change. There is a restriction on the

import and export of domestic currency above a maximum of Le 50,000.

III.3 Some of the Problems Encountered

A survey of various commercial and central banks in the zone undertaken by WAMI brought to the fore the underlying issues that have impeded the implementation of the quoting and trading in the WAMZ currency arrangement. These include:

Lack of a clearly defined Institutional and Regulatory Framework

A robust institutional and regulatory framework is essential for the success of any regional currency quoting and trading arrangement. Agreements specifying the obligations of members' central banks as well as a clearly delineated role for financial institutions driving the programme would need to be plainly stated. Currently, WAMZ countries are quoting and trading in international currencies such as the dollar, the euro and the British Pound, under the framework of the current account liberalization in Article VIII of the IMF even without full capital account liberalization. What is essentially required is for this framework to be extended to include WAMZ currencies. Moreover, the role of financial institutions (commercial banks and Forex bureaux) in the exercise is not clearly defined and formalized. Quoting and trading in WAMZ currencies is therefore hampered significantly under the existing circumstance.

The absence of Settlement Arrangements

Settlement Arrangements including for instance, a bilateral clearing system are critical for the implementation of a framework for quoting and trading in WAMZ currencies. Such a system would ensure that commercial banks can settle their net open positions in WAMZ currencies with the respective central banks. However, in the WAMZ there is no multilateral agreement among member countries with respect to a bilateral and or multilateral clearing system. This has significantly hindered the implementation of

the framework for quoting and trading in WAMZ currencies. Buyback and repurchase agreements, and credit ceiling positions are also nonexistent.

The large Informal Sector and limited Formal Intra-Regional Trade

WAMZ countries are generally characterized by large informal sectors. A substantial level of trade in the various countries operates mainly in the informal sector. The absence of efficient official cross-border trading systems coupled with regulatory and institutional rigidities are responsible for the large informal trade. Informal sector participants are not motivated to use the banking system thereby undermining the implementation of the convertibility programme.

Large informal trade also impede intra-WAMZ trade as it usually includes a wide variety of imported goods, which flood most sub regional and domestic markets, displacing local products in both quality and price, as they normally evade customs duties and taxes. Additionally, formal trade across WAMZ countries is very limited. There is generally a low capacity to produce goods and services to take advantage of the liberalization policy within the zone; consequently, production of tradable goods for regional trade is minuscule. This has translated into very minimal trading of WAMZ currencies as the demand for the various currencies is low. For instance, in 2009, some commercial banks and foreign exchange bureaux in Sierra Leone reported quoting in WAMZ currencies but recorded no trading due to the lack of demand for WAMZ currencies.

Unstable Exchange Rate

As a prelude to the smooth introduction of the eco, WAMI adopted an Exchange Rate Mechanism (ERM) in order to ensure that exchange rate fluctuations between the various WAMZ currencies and the US dollar are kept within a band ($\leq 15\%$ of the 2006 central rate). However, exchange fluctuations in WAMZ countries are rarely within the band and no country has made any effort to respect the

fluctuation band in the last four years. This has posed serious challenges for the WAMZ convertibility programme.

Money and Capital flow problems

Majority of WAMZ member countries have not attained full capital account liberalization. In these countries there are restrictions (though limited) on capital flows; that are regarded as self-protective measures against volatile exchange rates movements. This policy works in tandem with prudential measures, which involve controlling foreign exposures of banks or by 'taxing' short-term capital inflows by means of special reserve. These policies when taken together, hinders the WAMZ currency convertibility programme, which requires relatively substantial liberalized capital markets to be effective.

Money lending problems

In the WAMZ, banks are conservative about the creation and expansion of credit to the private sector due to perceived high levels of risk. Banks prefer to participate in the relatively risk-free government securities at the expense of high-yielding private sector investment. The ability of the private sector to promote the WAMZ currency convertibility programme through cross-border flow of investments is therefore restrained.

Weak regional Payments and Transfer systems

A sound and efficient payments system infrastructure is critical to the WAMZ quoting and trading in currency programme. Apart from Ghana and Nigeria, whose payments and settlement systems are fairly well developed, the WAMZ payments system infrastructure is generally weak and underdeveloped. Cross-border transfer of funds within the zone is costly and inefficient. This scenario has not helped the course of the WAMZ currency convertibility programme. However, the ongoing implementation of the WAMZ Payments System Development Project (funded by the African Development Bank Group) in the Gambia, Guinea, Liberia, and Sierra Leone is expected to

improve the situation and boost the WAMZ quoting and trading in the national currency programme.

Absence of a publicly agreed unit of account mechanisms

A mutually agreed and stable Unit of Account facilitates the determination of bilateral exchange rates between member countries in the zone thereby promoting the WAMZ currency convertibility programme. Currently, there is no mutually agreed Unit of Account. The exchange rates between member countries are determined through a convertible international currency; typically the US dollar. This defeats the objective of using WAMZ currencies in regional transactions since market participants will first need to convert their currencies to US dollar and then to the target WAMZ currency.

Existence of Trade Barriers

Despite formal agreements between member countries to allow the free movement of goods and services within the zone, countries still face difficulties when trading with each other. Countries also face enormous challenges in implementing regional programmes like the ECOWAS Trade Liberalization Scheme (ETLS). Most WAMZ countries have shown half-hearted commitment to trade liberalization schemes because of the perceived loss in public revenues associated with such schemes. For a majority of these countries, customs and excise duties constitute a large share of public revenues. The reality is that trade barriers still exist between WAMZ countries and this restrains the level of intra-regional trade.

IV. THE CASE FOR QUOTING AND TRADING IN WAMZ LOCAL CURRENCIES

The increased wave of globalization strongly underscores the need for WAMZ member States to move into monetary cooperation under a framework of currency convertibility and macroeconomic policy harmonization in order to pave the way for the ultimate goal of achieving a single economic space with a single currency and a centralized monetary authority. The case for enforcing that framework may be based on some of the following arguments: The necessary conditions for the sustainability of currency convertibility are: exchange rate stability; an adequate stock of international reserves and macroeconomic stability. As a result of the reforms implemented in the WAMZ countries, these have been substantially achieved.

Currently, all WAMZ countries are operating a system of flexible market-determined exchange rates, with increasing stability in nominal terms. During the first half of 2011, the Liberian dollar was relatively stable, shedding only 0.7 percent in that period. The same 0.7 percent was gained against the dollar in the second part of the year. While the Guinean franc takes the credit for recording the most reduction in the gap between itself and the US dollar in 2011, cutting the loss from 10.9 percent depreciation by end June to 2.9 percent by end December. The Nigerian naira on the other hand, lost ground against the US dollar as the naira wound up the year, having depreciated by 4.1 percent by end December 2011, from 1.0 percent as at end June 2011. Like the naira, the Ghanaian cedi and the Gambian dalasi lost further ground, albeit at a reduced rate, against the dollar in the second half of 2011, shedding 3.0 percent and 2.8 percent from 0.3 percent and 1.7 percent, respectively. The leone, like the Liberian dollar appreciated against the US dollar in the later part of the year, shedding only 0.02 percent from 2.4 percent recorded in June.

Achieving an adequate level of external liquidity defined as the international reserves at the disposal of the monetary authorities is one of the

primary convergence criteria stipulated under the WAMZ Programme. The availability of reserves is essential to cope with shortfalls and other shocks that, on a recurrent basis, will affect balance of payments. On the average, all the WAMZ member countries have been achieving this requirement in the last five years. At the end of 2011, it was only in Sierra Leone that the reserves did not cover up to three months of imports. Nigeria and the Gambia recorded top performance, with 6.4 and 6.1 months of imports cover, respectively. The implication of the foregoing is that there exist sufficient reserves in almost all member countries of the WAMZ to support the convertibility of their currencies. The requirement of a high reserves level is even lessened by the implementation of a flexible exchange rate regime in the WAMZ and the commencement of intra-Zone convertibility of WAMZ currencies

WAMZ member States are committed to sound macroeconomic management through appropriate fiscal and monetary policies that reduce inflation, absorb excess liquidity, narrow the budget deficit, and introduce non-inflationary means to finance the budget deficit. Conscious of the importance of macroeconomic stability, member States are to meet a set of convergence criteria based on internal financial balance, including a single digit inflation rate, a reduction of fiscal deficit and a central bank financing of the fiscal deficit not exceeding 10 percent of the previous year's tax revenue. WAMZ countries are making efforts in order to meet all these criteria before the introduction of the common currency in 2015.

WAMZ countries are implementing macroeconomic and structural policies with a view to achieving better resource allocation and market efficiency. There has been a liberalization of trade and payments systems culminating in the removal of restrictions on current account transactions, thereby achieving current account convertibility, and a significant progress in

liberalizing capital account transactions throughout the Zone.

It is generally agreed that intra-trade transactions will increase among member States when they start sharing a single currency with a common monetary policy. To illustrate this assertion, available data on formal intra-West African trade during the years (2000-2010) revealed that intra-trade was far higher in the UEMOA countries than in the Non-UEMOA countries of ECOWAS. In the UEMOA, intra-trade increased during the period, from 20.60 percent to 22.52 percent, while in the Non-UEMOA, in the same period, intra-trade declined from 6.44 percent to 5.48 percent.

The increase in intra-trade in the UEMOA can be explained by the fact that countries forming the

Empirical Illustration of the Benefits of Convertibility: Gains in Foreign Reserves

Consider the international reserves to imports ratio for individual countries and for the Zone using the traditional equations below.

Before Convertibility

• Reserves/Months imports for individual countries is given by:

$$r_m = R_i / M_i \quad (1)$$

Where

Reserves/Months of Imports for the WAMZ is given by:

$$R_m = \sum R_i / \sum (M_i) \quad \text{With } i=1, \dots, 5 \quad (2)$$

After convertibility, the foreign exchange disbursement is expected to reduce by the share of member countries in intra-trade. (See

Union share the same currency and have adopted a common trade policy with a common external tariff, which has fostered free movement of goods and labour within the union.

The informal sector is already practicing the free convertibility of regional currencies with significant degree of success under parallel market conditions. The absence of an efficient official financial market and cross-border trading system coupled with regulatory and institutional rigidities explain the increase in operations of the informal trade. The formalization of these activities will improve their efficiency, minimize the use of cash in business transactions and ensure the expansion of documented intra-regional trade transactions.

Aizenman and Lee: 2005). Thus, the ratio of reserves to import for individual countries is given by:

$$r_m = R_i / (M_i - \varepsilon_i M_i) \quad (3)$$

While

• Reserves/Months imports for the WAMZ is

$$R_m = \frac{\sum_{i=1}^5 R_i}{\sum_{i=1}^5 (M_i - \varepsilon_i M_i)}, \quad i = 1, \dots, 5 \quad (4)$$

Where

R_i = is the average level of reserves over five years for country i

M_i = is the average monthly total imports of country i

ε_i = is the share of country i in intra-trade.

The share of intra-regional imports in WAMZ total imports is given in Table 4.1 below.

Table 4.1: Country Share of Imports in Total WAMZ Imports

	2006	2007	2008	2009	2010	Annual Average
The Gambia	0.012	0.011	0.005	0.008	0.010	0.009
Ghana	0.430	0.729	0.616	0.583	0.579	0.612
Guinea	0.032	0.010	0.010	0.010	0.010	0.012
Liberia	0.020	0.009	0.010	0.005	0.008	0.009
Nigeria	0.432	0.193	0.319	0.347	0.338	0.310
Sierra Leone	0.074	0.048	0.040	0.046	0.055	0.049
Intra-WAMZ Imports/Total Imports (%)	2.55	2.37	2.31	2.29	2.24	2.35

Source: Computed by authors

Evidently, the average intra-WAMZ trade in terms of imports (2.4 percent) is very low compared to an estimated 15.0 percent of the UEMOA zone and more than 60 percent of the European Union.

Table 4.2: Actual External Reserves in Months of Imports before convertibility

	2006	2007	2008	2009	2010	Average
The Gambia	6.4	6.5	4.4	7.2	7.1	6.3
Ghana	3.7	3.9	2.2	4.1	4.6	3.7
Guinea	0.5	0.4	0.6	2.2	1.9	1.1
Liberia	1.8	2.0	1.5	3.6	4.3	2.7
Nigeria	14.4	13.4	13.8	17.7	7.8	13.4
Sierra Leone	4.2	4.8	4.3	7.3	5.4	5.2
Total WAMZ	12.1	11.4	11.1	13.7	7.0	11.1

Source: ECOWAS and WAMI Staff Estimates

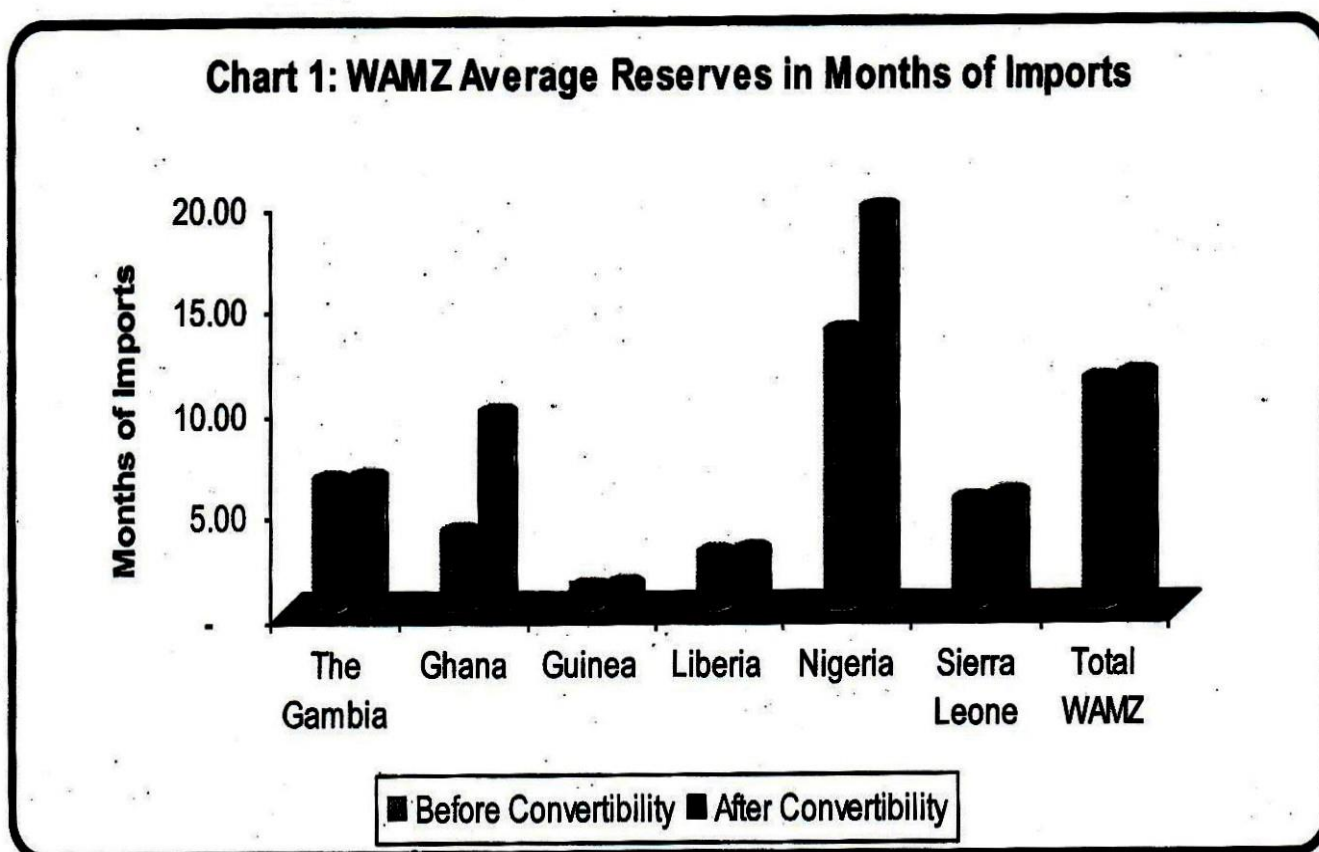
Using equations (3) and (4) above, we can compute the gains in external reserve in months of imports after convertibility taking into account the current WAMZ country's share in intra-regional trade. While Table 4.2 gives the actual external reserves in months of imports ex ante convertibility, Table 4.3 gives external reserves in months of imports ex post convertibility, computed by reserves before convertibility (r_m)/(1 - s (Share of intra-WAMZ import)). The results in Table 4.3 reveal marginal gains in reserves following convertibility, from an average of 11.1 months of imports cover before convertibility to an average of 11.3 months of imports cover after convertibility. The marginal increase in reserves is on account of low intra-

WAMZ trade (less than 2.4 percent). However, the analysis reveals that countries can maximize gains in reserves by increasing their share of intra-regional trade. For example, Nigeria and Ghana, with larger shares of intra-WAMZ trade recorded the biggest gains in reserves. In Nigeria, reserves in months of imports cover increased from an average of 13.4 months before convertibility to an average of 19.4 months after convertibility while in Ghana reserves increased from an average of 3.7 months to 9.6 months. Reserves in months of imports also increased, albeit marginally, in The Gambia, Guinea, Liberia and Sierra Leone (see Table 4.2 and 4.3) due largely to their low shares of intra-WAMZ trade.

Table 4.3: External Reserves in Months of Imports after Convertibility

	2006	2007	2008	2009	2010	Average
The Gambia	6.5	6.5	4.5	7.3	7.2	6.4
Ghana	6.5	14.6	5.8	9.9	10.8	9.6
Guinea	0.5	0.4	0.6	2.3	1.9	1.2
Liberia	1.8	2.1	1.5	3.6	4.4	2.8
Nigeria	25.4	16.5	20.3	27.1	11.8	19.4
Sierra Leone	4.5	5.0	4.5	7.7	5.7	5.5
Total WAMZ	12.4	11.7	11.3	14.1	7.1	11.33

Source: ECOWAS and WAMI Staff Estimates



Source: Authors Estimates

The stock of reserves after convertibility is then computed by multiplying the ratio of months of imports by the monthly imports. The result of this calculation is shown in Table 4.4 and depicts a gain in reserves of USD 2.8 billion, obtained as

the difference between the reserves computed after convertibility and before convertibility. The overall gain in reserves was largely driven by the huge reserve gains in Ghana and Nigeria.

Table 4.4: Gains in Reserve at Current Intra-trade

	Actual Average Reserves (2006 - 2010) in Million USD	Reserves After Convertibility in Million USD	Gains in Reserve in Millions USD
The Gambia	143.9	145.8	1.9
Ghana	3,005.8	7,746.2	4,740.4
Guinea	130.2	132.9	2.7
Liberia	122.6	136.9	14.3
Nigeria	44,202.9	66,601.7	22,398.8
Sierra Leone	248.5	248.6	0.1
Total WAMZ	47,853.8	50,700.6	2,846.7

Source: Computed by Authors

On the whole, the analysis indicates that the gains in external reserves under a currency convertibility arrangement depend on the level of intra-trade. In other words, the higher the level of intra-trade in the WAMZ the higher will be the gains in reserves. The following scenario was utilized in the analysis:

- i. Without convertibility the gains in reserves is nil
- ii. With convertibility at the current level of intra-trade of 2.4 percent the reserves will increase from USD 47.8 billion to USD 50.7 billion representing a gain of 2.8 billion.
- iii. Suppose we assume the Intra-WAMZ trade increases to the current level of intra-trade in the UEMOA zone at 15.0 percent. The stock of external reserve

will increase to USD 58.2 billion, representing a gain of USD 10.4 billion.

Overall, currency convertibility in the WAMZ should contribute to monetary integration through:

- i. Increase in foreign competition by the removal of the protection accorded by exchange controls, thereby contributing toward increased domestic productivity;
- ii. Promoting a conducive environment for increasing trade and investment required to accelerate the growth of the economy; and
- iii. Improved international credibility which will enhance integration into the global economy, competition and efficiency, greater exploitation of economies of scale and accelerated growth over time.

Table 4.5: Gain in Reserve under Increased Intra - Trade

	Without convertibility	Convertibility at Current level of Intra-trade of 2.4%	Convertibility at UEMOA level of Intra-trade of 15.0%
WAMZ Reserves USD (billion)	47.8	50.7	58.2
Gains in reserves USD (billion)	0.0	2.8	10.4

Source: Computed by the Authors

V. PROPOSED FRAMEWORK FOR JUMPSTARTING THE PROGRAMME ON QUOTING AND TRADING IN WAMZ CURRENCIES

In the light of the aforementioned problems, it is crucial to develop an appropriate framework that will promote quoting and trading in WAMZ currencies. The framework would essentially entail putting in place an institutional mechanism that accurately defines roles for financial institutions including settlement arrangements as well as policies that will promote intra-regional trade. A schematic representation of this framework is presented in Chart 5.1

V.1 Institutional Framework

Using WAMZ currencies to settle cross-border transactions will be simplified if there is a robust institutional framework in place. Member countries should adopt the same documentation and procedures in the IMF's Article VIII when trading in WAMZ currencies. Under the proposed framework, there are clearly defined roles for the various central banks, commercial banks, and Forex bureaux. Generally, banks will carry out operations, such as: opening accounts and accepting deposits, selling and buying of notes and coins and executing transfers for cross-border transactions. Forex bureaux on the other hand will conduct spot transactions (buying and selling of notes and coins) and deposit their excess funds in the banking system. These operations will involve the handling of surplus funds in these currencies, which will be settled through appropriate settlement arrangements instituted by the member Central Banks.

Overall, an appropriate institutional arrangement is critical to the implementation of the currency convertibility arrangement. The following institutional framework is therefore proposed.

▪ *Settlement Arrangements*

A concrete settlement agreement among WAMZ countries' central banks is vital for the successful

implementation of the programme on quoting and trading in WAMZ currencies. The settlement agreement will incorporate bilateral clearing systems, buyback and repurchase agreements, and bilateral ceiling positions. The settlement agreement should emphasize the framework for quoting and trading in WAMZ currencies and also guarantee the compliance of WAMZ countries with the programme.

▪ *Bilateral Clearing System*

Bilateral clearing is a system of monthly settlement of accounts between countries that are facilitated by the various central banks. It also includes correspondent banking arrangements where commercial banks are allowed to settle net positions with each other and as a last resort, settle net positions with their respective central banks. WAMZ central banks should therefore enter into bilateral agreements with each other. In this regard, three complementary agreements are proposed to ease the settlement of outstanding balances.

▪ *Buyback Agreement*

A buyback agreement between WAMZ countries should be similar to the International Monetary Fund's (IMF) agreement on convertibility of foreign-held balances in the Fund's Article VIII, Section 2. Under this agreement, each member country shall buy balances of its currency held by another member on demand provided:

- ✓ The balances have been recently acquired as a result of current intra-trade transactions or
- ✓ The conversion of the balances is needed for making payments for current intra-trade transactions.

The buying member would be required to pay in any convertible currencies (USD, Euro, Yen, and GBP) or any other WAMZ currency as may be agreed from time to time.

▪ *Repurchase Agreement*

Commercial banks and Forex bureau will enter into repurchase agreements with the central banks in the Zone, to forestall liquidity problems arising from long positions in currencies other than the national currency of that WAMZ country. The central bank will thus be required to provide liquidity support under the terms and conditions of the agreement. If after the agreed period, the commercial bank or Forex bureau is unable to buyback the currency, the securities/collateral with which the liquidity was obtained shall be realized by the Central Bank, which will also assume the management of the surplus currency, including selling it to other dealers. In the case where WAMZ currencies continue to remain in the books of the Central Bank, it shall "repatriate" the currency concerned, based on a bilateral agreement between the Central Bank delivering and the Central Bank receiving the currency. To be effective, the repurchase agreement should be complemented by a sound anti-money laundering regulation in order to tackle fraud and speculative behavior. Bank examiners should have the authority to conduct inspections of financial institutions (including Forex bureaux) to ensure compliance with the regulation.

▪ *Bilateral Ceiling Positions*

Under a buyback agreement, Central Banks should as last resort buy WAMZ currencies and/or reimburse their currency held by another member central bank. However, limits should be established on bilateral basis through mutual agreements between member Central Banks on the amount that each of them can hold in WAMZ currencies. The current volume of intra-trade transactions should be used to set the ceiling position. Whenever the ceiling is reached the Central Bank should settle on demand the amount above the ceiling with a third currency (USD, Euro, GBP, Yen or any WAMZ currency). An indication of the value of intra trade in the WAMZ from 2006 to 2010 is given in the appendix.

The ceiling may be fixed as a multiple of the average monthly import between two countries. The multiple can be 1, 1.5, 2, 3.... In our case, we are suggesting 3. This will take into account the increase in intra-trade due to the implementation of the convertibility and the formalization of operations in the informal sector.

Table- 5.1 gives the computation of the ceiling between WAMZ countries, obtained by multiplying the average monthly imports by 3.

Table 5.1: WAMZ Intra-trade imports (US dollar)

		Annual Average (2006-2010) (2)	Average Monthly Imports (3) (3)=(2)/12	Ceiling (4) (4)=(3)*2
The Gambia	Ghana	449,361	37,447	112,340
	Guinea	64,842	5,403	16,210
	Liberia	670,958	55,913	167,739
	Nigeria	1,457,583	121,465	364,396
	Sierra Leone	321,708	26,809	80,427
				-
Ghana	Gambia	439,582	36,632	109,895
	Guinea	1,416,979	118,082	354,245
	Liberia	1,943,716	161,976	485,929
	Nigeria	200,283,883	16,690,324	50,070,971
	Sierra Leone	229,684	19,140	57,421
				-
Guinea	Gambia	359,671	29,973	89,918
	Ghana	1,747,207	145,601	436,802
	Liberia	118,127	9,844	29,532
	Nigeria	1,346,403	112,200	336,601
	Sierra Leone	311,144	25,929	77,786
				-
Liberia	Gambia	0	0	-
	Ghana	318,251	26,521	79,563
	Liberia	948,045	79,004	237,011
	Nigeria	0	0	-
	Sierra Leone	1,680,600	140,050	420,150
				-
Nigeria	Gambia	317,629	26,469	79,407
	Ghana	53,453,837	4,454,486	13,363,459
	Guinea	47,048,068	3,920,672	11,762,017
	Liberia	2,532,475	211,040	633,119
	Sierra Leone	88,762	7,397	22,190
				-
Sierra Leone	Gambia	1,378,729	114,894	344,682
	Ghana	873,176	72,765	218,294
	Guinea	1,800,722	150,060	450,180
	Liberia	10,435,351	869,613	2,608,838
	Nigeria	2,014,890	167,908	503,723
				-
Total		449,207,397	27,837,615	83,512,846

Source: Computed by the Authors.

V.1.2 Role of Commercial Banks

The commercial banks as authorized dealers should be the backbone of the quoting and trading arrangement. They should therefore perform the following functions:

- ✓ Quote and trade in WAMZ local currencies.
- ✓ Encourage the use of WAMZ national currencies to finance intra-regional trade.
- ✓ Open and maintain in their books, WAMZ currencies for their own account and on behalf of their customers.

- ✓ Establish correspondent relationship across WAMZ countries.
- ✓ Adhere to documentation requirements as may be prescribed by WAMZ member countries in all WAMZ currency transactions.
- ✓ Handle the repatriation of surplus local currencies to their correspondent bank and to the central banks when necessary.
- ✓ Report WAMZ currencies position to their respective central banks, periodically.

V.1.3 Role of Foreign Exchange bureaux

The Forex bureaux as authorized dealers should play an important role in attracting the informal sector into the formal foreign exchange market thereby facilitating the trading in WAMZ currencies. Specifically, the foreign exchange bureaux should:

- ✓ Quote and trade in WAMZ currencies.
- ✓ Operate and establish correspondent relationship across WAMZ countries and report their foreign exchange position to their Central Banks and to the private information bureau.

V.1.4 Role of Central Banks

Member Central Banks should play the following role:

- ✓ Act as buyer of last resort for the WAMZ currencies in accordance with the IMF article VIII.
- ✓ Central banks on bilateral basis should maintain correspondent relationship with each other and buyback balances of their currency held by another member country.
- ✓ Report buyback operations and transactions to the Private Information bureau.
- ✓ Coordinate with other member Central Banks to ensure the orderly functioning of WAMZ currencies foreign exchange markets.
- ✓ Promote and facilitate the convertibility of WAMZ currencies by setting operational

guidelines and holding discussions with authorized dealers.

- ✓ Share intelligence information and provide indicative exchange rates between WAMZ currencies to authorized dealers on a daily basis.
- ✓ Implement policies that will ensure that the exchange rate of the national currency remains within the WAMZ ERM.
- ✓ Admittance of the WAMZ currencies into the fractional reserve requirement (reserve ratio) of commercial banks

V.2 Fast Completion of the WAMZ Payments System Development Project

The development of a sound and efficient payments system infrastructure will form the bedrock for facilitating cross-border transfer of funds among countries. To this end, the ongoing implementation of the WAMZ Payments System Development Project (funded by the African Development Bank Group) in the Gambia, Guinea, Liberia, and Sierra Leone is a step in the right direction. Upon completion, these countries' payments systems will be interfaced with payment system infrastructures in Ghana and Nigeria, thereby enhancing the currency convertibility programme

V.3 Establish a private settlement information bureau

To ensure transparency in the proposed settlement arrangement member countries should set up a private settlement information bureau. Member central banks and financial institutions in the zone should report all cross-border settlement transaction to the information bureau. The information bureau shall in turn provide periodic reports of cross-border settlement transactions to member countries.

VI. POLICY ENVIRONMENT AND CONCLUSION

VI.1 Policy Environment

The WAMZ convertibility programme will thrive better in the right policy environment. Key policies necessary to promote the programme include:

- ✓ Maintenance of market determined exchange rates for all currencies in the zone;
- ✓ Amendment of foreign exchange regulations to facilitate transactions in WAMZ currencies in the zone;
- ✓ Firm commitment to maintain the exchange rate of member currencies within the WAMZ ERM II as well as to accumulate adequate reserves to give credibility to the convertibility agreement;

- ✓ Member countries should continue to implement sound macroeconomic policies that are aimed at ensuring fiscal discipline and monetary prudence.
- ✓ Member Central Banks should implement the IMF Article VIII, which they all have already signed, to facilitate the convertibility of national currencies in the WAMZ. In other words Member Central Banks should accept the obligation to redeem their surplus currency circulating in other member states when required to do so.
- ✓ Elimination of tariff and non-tariff barriers on the cross-border flow of goods and services;
- ✓ Free movement of people within the zone.

VI.2 Conclusion

The paper examined the issues, challenges and prospects of quoting and trading in WAMZ currencies. It was observed that minuscule progress has been made - Ecobank is the only commercial bank that is quoting and trading in WAMZ currencies albeit limited to WAMZ countries where the bank operates (Ghana, Nigeria, and Sierra Leone). This paper also identified the problems encountered in quoting and trading in WAMZ currencies and proposed a framework for promoting the programme.

It is also clear that without all the national Central Banks acceding to and implementing the IMF Article VIII fully, the facilitation of the convertibility of national currencies in the WAMZ will be difficult. Indeed, the IMF Article VIII in its section 4, on the convertibility on foreign held balances, stipulates that each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, provides evidence:

- ✓ that the balances to be bought have been recently acquired as a result of current account transactions; or
- ✓ that their conversion is needed for making payments for current transactions.

Successful implementation of quoting and trading in WAMZ currencies would enable member countries to accumulate foreign exchange reserves while reducing transaction costs. It will also signal member countries' commitment to single currency programme. Without the adoption of appropriate framework outlined in this paper the quest for regional convertibility through quoting and trading in the WAMZ member countries' currencies will remain a mirage. To ensure successful implementation of quoting and trading in WAMZ currencies, central banks of the member countries would need to take up active roles in its implementation as indicated in this paper.

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APPENDIX

Appendix I: WAMZ Intra-trade imports in US dollar

		2006	2007	2008	2009	2010	Annual Average
The Gambia	Ghana	295,882	491,991	464,844	493,478	500,609	449,361
	Guinea	62,517	65,019	64,507	66,004	66,162	64,842
	Liberia	471,164	584,712	667,545	770,855	860,513	670,958
	Nigeria	339,085	2,756,617	714,270	1,645,176	1,832,768	1,457,583
	Sierra Leone	425,378	285,934	174,862	339,954	382,414	321,708
GHANA	Gambia	287,135	471,857	466,615	441,281	531,021	439,582
	Guinea	240,702	1,497,807	1,149,392	1,871,325	2,325,670	1,416,979
	Liberia	1,362,860	1,691,300	1,930,000	2,225,200	2,509,220	1,943,716
	Nigeria	55,003,004	278,234,627	242,281,969	222,727,261	203,172,553	200,283,883
	Sierra Leone	284,773	215,911	215,911	215,911	215,911	229,684
GUINEA	Gambia	145,601	302,202	411,730	455,355	483,469	359,671
	Ghana	2,524,571	2,097,522	1,520,108	1,548,032	1,045,800	1,747,207
	Liberia	82,818	102,777	117,337	135,221	152,480	118,127
	Nigeria	712,537	1,166,594	1,564,310	1,607,786	1,680,788	1,346,403
	Sierra Leone	828,934	68,871	264,538	203,235	190,144	311,144
LIBERIA	Gambia	0	0	0	0	0	0
	Ghana	222,917	276,639	315,829	364,707	411,163	318,251
	Guinea	1,122,780	1,393,360	1,590,750	0	633,337	948,045
	Nigeria	0	0	0	0	0	0
	Sierra Leone	1,350,000	1,671,100	1,912,340	1,660,000	1,809,561	1,680,600
NIGERIA	Gambia	17,473	290,597	382,421	427,600	470,053	317,629
	Ghana	54,607,353	70,940,062	46,369,593	48,101,484	47,250,693	53,453,837
	Guinea	1,225,954	1,307,086	78,115,666	83,933,469	70,658,163	47,048,068
	Liberia	1,583,030	2,050,680	2,590,410	2,970,028	3,468,230	2,532,475
	Sierra Leone	95,230	64,386	114,423	86,450	83,321	88,762
SIERRA LEONE	Gambia	168,357	2,189,601	1,112,734	1,519,845	1,903,109	1,378,729
	Ghana	741,418	948,813	906,595	897,017	872,037	873,176
	Guinea	826,328	3,693,566	1,439,588	1,532,082	1,512,044	1,800,722
	Liberia	7,316,180	9,079,330	10,365,600	11,945,469	13,470,177	10,435,351
	Nigeria	750,866	2,792,982	2,105,144	2,201,561	2,223,899	2,014,890
Total WAMZ		133,094,847	386,731,943	399,329,030	390,385,783	360,715,309	334,051,382