DISCUSSION NOTE

Lisbon, May 6-7, 2024

”80 years after Bretton Woods : Relaunching Multilateralism through Regional Monetary Unions”

The Prospects for Regional Monetary Unions in a Changing Global Context

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Abstract

The Bretton Woods institutions, established post-World War II to promote multilateralism and economic cooperation, have greatly contributed to financial stability and economic and social development in the world. However, they now face significant inadequacies in dealing with transnational issues such as climate change, energy transition, food security, pandemics, and security crises. This note examines the evolving landscape of global economic governance and highlights the need to reform the international monetary system to address contemporary challenges more equitably. It examines the distinctive role of monetary unions in global governance, emphasizing how they can promote multilateralism by reducing barriers and enhancing economic and social cooperation. The experience of the West African Economic and Monetary Union (WAEMU) is presented as a successful example of regional monetary integration. The article concludes by advocating that regional monetary unions represent a viable and effective model for achieving a more balanced and equitable international monetary system.

Introduction

The Bretton Woods institutions, namely the International Monetary Fund (IMF) and the World Bank were established in the aftermath of World War II to promote and reinforce multilateralism and international economic cooperation. These institutions were created to ensure financial stability, facilitate global economic reconstruction, and foster sustainable development. However, nearly eight decades later, despite significant progress, the global economy stands at a critical crossroads.

The multiple shocks affecting the world today disproportionately affect developing countries and underline the need to reform the global governance system. These shocks have particularly highlighted the limitations of the current international monetary system in addressing global challenges, underscoring the necessity for comprehensive reform in global governance. The celebration of the 80th anniversary of the Bretton Woods Conference provides a timely opportunity to reflect on the future of multilateralism, especially through the perspective of regional monetary unions.

In the next section, we will discuss the global challenges facing the international monetary system. We will then demonstrate how Monetary Unions can reinforce multilateralism and contribute to better address these new challenges. The third section will present the experience of the West African Economic and Monetary Union (WAEMU), highlighting the factors behind its resilience and economic performance.

1. Global challenges for the International Monetary System

Today, the world faces a myriad of challenges that disproportionately affect developing countries. These include recurring climatic shocks, the lingering effects of the COVID-19 pandemic, impact of geopolitical tensions, and security crises, particularly in regions like the Sahel in West Africa. These crises have highlighted the inadequacies of the current international monetary system in addressing global issues effectively.

One of the most pressing issues is the energy transition. As countries strive to reduce their carbon footprint and transition to renewable energy sources, the financial and technological requirements are immense. Despite some progress made, the current international monetary system has not adequately supported this transition, leading to disparities across regions and exacerbating global inequalities. Indeed, it still faces many difficulties in tackling global challenges and addressing the inefficient allocation of public goods.

Indeed, the effects of climate change pose a significant threat to financial stability. Developing countries, which contribute the least to global emissions, often suffer the most from the consequences of climate change. These include extreme weather events, rising sea levels, and disruptions to agriculture and water supplies. An effective international monetary system should be able to facilitate the flow of resources to these vulnerable regions to help them adapt and mitigate the impacts of climate change.

Food security is another critical issue. The COVID-19 pandemic has, among other, disrupted global supply chains, leading to food shortages and price increases in many parts of the world. The international monetary system needs to support mechanisms that ensure more efficient and climate smart production systems as well as stable and resilient food supply chains. Various trade restrictions on food products need to be banned to allow optimal allocation of resources.

Pandemic management has also highlighted major flaws in the system. There is an urgent need for a more coordinated and supportive international monetary system. The uneven distribution of vaccines and medical supplies during the COVID-19 pandemic has exposed the limitations of the current system. Mechanisms must be put in place to ensure that all countries have equal access to medical treatment as well as adequate resources to manage public health crises.

Security crises, particularly those occurring in the Sahel, have profound humanitarian, economic and social impacts. These crises have a negative impact on private investment. They also lead to significant expenditures on security, diverting resources from essential investments in infrastructure and human development. Security is a public good that needs to be addressed at a global level. Greater support should be provided to countries facing such challenges, helping them to maintain stability and productive investment for long-term development.

In light of these challenges, it is clear that the international monetary system needs to be reformed to better address transnational problems and ensure more balanced and equitable multilateralism. Faced with slow progress in this process and rising geopolitical tensions in a more fragmented world, regional economic and monetary unions can provide alternative solution.The experience of existing Monetary Unions can provide valuable insights into how such systems might be designed and implemented.

2. The Role of Monetary Unions in Multilateralism

Monetary unions can greatly contribute to address current economic fragmentation and revive multilateralism. By their very nature, these unions promote deeper integration among member states. They achieve this by eliminating or substantially reducing economic, monetary, and financial barriers, thereby facilitating an environment conducive to free trade and cross-border payments, as well as financial stability. As such, it promotes economic growth and social development. This, in turn, solidifies the foundations of multilateralism.

The increased cooperation required in a monetary union extends far beyond financial arrangements. It necessitates a close coordination of monetary, economic, and fiscal policies, enabling member countries to respond more effectively to global economic challenges and better distribute the economic and social costs of shocks.

Moreover, the principle of solidarity is of paramount importance to the functioning of monetary unions. This principle is essential to foster a more balanced and equitable multilateralism. The interest of richer countries is linked to the progress of the poorest ones (Shared interest is the key to success). As such, monetary unions provide a suitable framework for addressing global challenges in a more effective way.

The emergence of monetary unions can also help mitigate the polarization of influence around a limited number of countries or blocs, which is a constraint to multilateralism. As cooperation is the essence, monetary unions can contribute to the promotion of a more balanced and inclusive international order.

In a monetary union, the shared vision among member states is reinforced through common policies and institutions. This increased cooperation often extends to other areas, such as security, social policies, and environmental initiatives. Fostering collaboration across these domains allows monetary unions to strengthen the overall regional stability and promote development. Hence, it provides a robust framework for multilateralism that addresses both economic and non-economic challenges.

Monetary unions have undeniable advantages, but they can also involve a number of challenges. Indeed, their sustainability must be based on specific and fundamental principles, the most important ones being the following :

- A strong commitment from members to cooperate to overcome any crisis together. It involves the ability to make consensual decisions for the good of the community.

- A close coordination between monetary policy, fiscal and economic policies, with an independent central bank and the establishment of agreed fiscal rules, enabling countries to respond collectively and more effectively to global economic challenges and crises. This policy synergy is essential to maintain economic stability and to address global turbulences. In case of deviation from the fiscal rules, a clear process of returning to the agreed path must be implemented.

- Strong, independent and transparent institutions are essential to carry out the regional agenda and to strengthen public confidence in the Union.

In light of the recent multifaceted crisis that the world has experienced these past few years, a coordinated response between a group of countries with a shared vision and common objectives has proved to be a more effective alternative.

3. The Experience of the West African Economic and Monetary Union (WAEMU)

The West African Economic and Monetary Union (WAEMU), established on May 12, 1962, comprises eight developing countries in West Africa, with a total population of 142 million and a GDP of $199,0 billion in 2023. The union is characterized by a common currency, the CFA Franc, pegged to the euro through a fixed exchange rate, with full convertibility guaranteed by the French Treasury. The currency is issued by a common Central Bank.

WAEMU is also distinguished by its unified banking regulatory and supervisory framework. More specifically, any bank or financial institution can operate across all eight member states without applying for new licenses in each country. Banking supervision is carried out by the same entity, the Banking Commission. This regional organization facilitates effective crisis prevention, management, and resolution across member states.

A notable feature of WAEMU is the pooling of foreign exchange reserves, enabling member states to access these resources for balance of payments support and foreign liquidity needs. This mechanism has proven to be particularly valuable in times of crisis.

Additionally, the Monetary Union has established an Economic Union with free movement of people, goods, services, managed by a Regional Institution. This is supported by harmonized tax systems. The establishment of a Common External Tariff (CET) and the harmonization of indirect taxes, such as VAT and excise duties, has further integrated the economies of the region.

WAEMU's unified financial market allows member states to issue bonds and treasury bills on the regional market, in order to mobilize financial resources. This integrated market allows not only governments but also the private sector to access savings from other countries within the Union. Banks, in particular, can easily access excess liquidity from other banks across the Union through the single interbank market. This system has allowed efficient liquidity distribution and significantly fostered investment and economic growth throughout the region.

The common Central Bank for WAEMU (BCEAO) has also initiated important projects to promote financial inclusion and the digitalization of the economy at the regional level. For instance, the development of interoperable digital payment systems across the union aims to enhance financial access and efficiency in the eight countries. Discussions are also underway to explore the prospect for introducing a central bank digital currency, which could further streamline transactions and enhance financial inclusion.

The region also features a development Bank for the eight member countries of WAEMU whose role is to finance projects in various sectors that promote economic integration and development in member states. Additionally, a regional stock exchange market operates as an instrument for financial intermediation among these countries.

Over the past two decades, WAEMU has demonstrated remarkable resilience in the face of various crises. During the COVID-19 pandemic, the union recorded positive economic growth of 1.4% in 2020, while the global economy (-2.7%) and Subsaharian countries (-1.7%) were in recession. Also,from 2012 to 2019, economic growth in the union averaged

6.3%, compared to 3.6% for sub-Saharan Africa.This performance and resilience can be attributed to several factors, including the union's strong institutional framework, effective policy coordination and the solidarity among member states.

Since 2021, the union's economic growth has returned to pre-pandemic rates, despite ongoing challenges such as climatic shocks, security crises, and the effects of geopolitical tensions. Economic growth is estimated to reach 5.4% in 2023, after 5.7% in 2022. In 2024, growth is expected to be 6.3%. This robust growth trajectory underscores the effectiveness of the union's policies and institutions in managing crises and fostering development.

Inflation, which peaked at 8.8% in August 2022, has been brought under control and now stands at 2.7% as of January 2024. In comparison, the inflation rate in Sub Saharan Africa is 16.2% in 2023. The achievement of the WAEMU reflects the successful coordination of monetary and fiscal policies to counteract the effects of rising world food and oil prices as well as the post Covid inflationary pressures.

However, the magnitude of recent shocks has led to significant expenditures and subsidies by governments to mitigate the social consequences of the crises. As a result, the union's debt ratio increased from 43% in 2019 to 52% in 2023. The reliance on the regional financial market to mobilize resources, in the context of tightening international financial conditions, has also led to an increase in domestic interest rates, with treasury bill rates rising from 4,0% in 2019 to 6,1% in 2023.

The experience of WAEMU offers valuable lessons. Four key factors have been critical to the effective functioning and sustainability of the union:

- Monetary Union as a Shock Absorber for members: The monetary union acts as a buffer against economic shocks, preserving monetary and financial stability and maintaining investor confidence. This stability is crucial for attracting investment and fostering economic growth.

- Coordination of Policies: Better coordination of fiscal and monetary policies among member states enhances economic performance and policy effectiveness. Sharing best practices, particularly in national fiscal policies, has been a significant factor in the union's success. The existence of a regional market and fiscal convergence Pact, which sets rules for external and internal debt of member countries, further enhances the effectiveness of monetary policy.

- Principle of Solidarity: The union's solidarity ensures mutual support among member countries during crises, facilitating access to both international and domestic liquidity. This solidarity is essential to maintain stability and address imbalances within the union. For instance, a country experiencing a balance of payment shock can still benefit from the international liquidity of the other member states (pool of foreign exchange) to conduct its economic policy and cover its external payments. The mechanism therefore prevents such countries from defaulting on their external debt, provided actions are taken to correct the imbalance according to the fiscal rule.

- Strong and Independent Regional Institutions : Effective functioning of the union relies on strong, transparent, and independent regional institutions capable of managing effects of negative shocks and maintaining policy coherence. These institutions provide a framework for peer surveillance and support, ensuring that member states comply with agreed upon policies and rules.

WAEMU is currently discussing with seven other countries in West Africa to create a larger monetary union within the ECOWAS (Economic Community of West African States) with a combined population of 435 million and a GDP of 686.8 billion US dollars in 2023.

Significant steps have already been achieved in this major regional project, such as the trade liberalization scheme, the establishment of the ECOWAS Monetary Cooperation Program and a multilateral surveillance mechanism for the economic and financial policies of member states. Additionally, a detailed roadmap is being implemented with the objective of creating a single currency and a common Central Bank for ECOWAS in the near future.

Other regions in Africa are also committed to similar processes. These efforts underscore a shared belief among stakeholders that monetary unions have the potential to act as powerful catalysts for stronger multilateral cooperation and economic resilience.

Concluding remarks

In conclusion, the journey towards a more supportive and cooperative global order is challenging but filled with opportunities. Economic integration and solidarity are fostered through regional monetary unions which offer a pathway to a revamped multilateralism. They exemplify how aligning economic policies and pooling resources in a shared vision can collectively build a more prosperous and harmonious future.

As we reflect on the 80th anniversary of the Bretton Woods Conference, it is imperative to consider the role of monetary unions in the construction of a more balanced and resilient international monetary system, capable of addressing the global challenges of the 21st century.

Monetary unions demonstrate the potential of regional integration to enhance financial stability, support economic growth, and promote social and human development. Drawing on the lessons learned from the experiences of WAEMU and others, policymakers can better design frameworks that strengthen cooperation, resilience and shared prosperity in other regions.