Welfare Effects of Monetary Union and Flexible Exchange Rate Regimes in the Economic Community of West African States (ECOWAS)

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ABSTRACT

The quest for improved macroeconomic performance in African countries, coupled with the successful launching of the euro in 1999, has rekindled interest in the establishment of monetary unions in African Regional Economic Communities. To date, no attempt has been made to quantify the welfare consequences of alternative exchange rate regimes in the ECOWAS region within a rigorous theoretical framework that explicitly captures the crucial trade-off between the savings in transaction costs, resulting from a common currency, and the macroeconomic stabilization benefits of a flexible exchange rate regime. This paper overcomes the limitation. The main result is that a monetary union dominates a flexible exchange rate regime in the ECOWAS region if transaction costs are greater than 1 percent of regional GDP.

Descriptors : Regional Integration, Economic Integration, Exchange Rate, Monetary Areas.

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