

UTILIZATION OF COMMON CURRENCY IN ENHANCING INTERNATIONAL TRADE IN A RECESSED ECONOMY

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Abstract

One of the reasons for establishing common currency is a result of instability of various countries economy and varying conflicting financial policies of different countries on how best to achieve economic stability. A single currency gets rid of uncertainty within the single currency zone, thereby encouraging international trade. Economic stability is normally achieved in a country through increased trade exchanges and varying opportunities for external investment. This article identified and discussed the implications of utilization of common currency in enhancing international trade. The study revealed that introduction of a common currency will create economic stability, a viable market size and expansion, a more stable currency, prevention of devaluation of currencies,, lowering interest rate, and more improvement in Foreign Direct Investment (FDI). The authors recommend that, Nigeria Government at all levels should support the bid by the African Union on introduction of a Common Currency in the sub-region. Financial policy makers of different countries in Africa should also encourage the introduction of a common Central Bank, Investors should encourage the introduction of a common currency as it ensures economic stability which encourages more Foreign Direct Investment (FDI).

Keywords; Utilization, Common Currency, International Trade, Recessed Economy

Introduction

The prospect of a single African Currency had been mooted as a goal of the Organization for African Unity (OAU), created in 1963, the project was given renewed priority in 2001 when the OAU's 53 member states agreed to transform the intergovernmental organization into the African Union (AU), retaining its predecessor's dedication to political and economic unity, while taking on a broader mandate to meet the challenges of globalization. In August 2003, the Association of African central Bank Governors announced that it would work for a single currency and common central Bank by 2021. According to Paul (2014), the goal of a common African currency has long been a pillar of African Unity, a symbol of the strength that its backers hope will emerge from efforts to integrate the continent. One of the reasons for establishing Common Currency is as a result of instability of various countries and varying conflicting policies of different countries on how best to achieve economic stability. A single Currency gets rid of the uncertainty within the single currency zone, thereby encouraging trade (Masson, 2015).

Recently, trade in African sub-region and the world at large has been obstructed by the emergence of corona virus pandemic. Beyond its impact on human health (materialized by morbidity and mortality), covid-19 is disrupting and interconnected world economy through global value chains, which account for nearby half of global trade, abrupt falls in commodity prices, fiscal revenues, foreign exchange receipts, foreign financial flows, travel restrictions, declining of tourism and hotels, and frozen labour markets, etc. Declared a pandemic by the World Health Organization (WHO) on 11 March 2020, Covid-19 has become a global emergency, given its impact on the entire world population and the economy. According to scenario simulations of the International Monetary Fund (IMF), global economic growth could fall by 0.5 for the year 2020. Several other sources are also predicting a fall in global economic growth due to the direct effect of the Covid-19 outbreak on Trade and Investment. As a result, the global economy may enter a recession at least in the first half of the year 2020, when adding the direct and indirect effects of the crises (e.g. supply and demand shocks, commodity slump, fall in tourism arrivals, etc). However, as the pandemic progresses on the African Continent, studies by International Organizations have less addressed the economic impact on individual African

Countries. It is against this backdrop that this study seeks to indentify and discuss the implication of utilization of Common Currency in creating viable market size with lower transaction costs, enhancing more capacity to negotiate better trade agreement, more Foreign Direct Investment (FDI), gains of economics scale, improved productivity through higher competition and export diversification in this period of global economic recession.

Conceptual Clarification

Common Currency Utilization

The topic of a Common Currency becomes important in terms of economic growth that can facilitate sustainable development. One of the many challenges with trading with other countries is that traders never know which way the exchange rate will move. It may move in your favour or against you. According to Masson (2015), a single currency gets rid of the uncertainty within the single currency zone, thereby encouraging trade. Common Currency or single currency means two or more countries coming together to adopt one Common Currency as the unit of their exchange. Here, such countries will lock their individual foreign exchange values of their national currencies to Common Currency adopted. According to Surridge (2008) one of the reasons for establishing Common Currency is as a result of instability of various Countries Economy and varying conflicting policies of different Countries on how best to achieve economic stability.

Economic stability is normally achieved in a Country through increased trade exchanges and varying opportunities for external investment. According to Hill (2009) exchange rate is the price of one Currency expressed in terms of another. More so, the domestic rate of interest and the value of a nation's Currency is called an exchange rate. Common Currency enable interest rate to rise and a rise in interest rate increases the value of Currency which attract foreign investors. Interest rates are the price paid for borrowed money. Robert Mundell's theory of optimum Currency areas of 1961 has to say in a nutshell, a Common Currency can save on various types of transaction costs, but a country abandoning its own currency give up ability to use national monetary policy to respond to asymmetric shocks. According to the theory, these costs in turn can be minimized by greater flexibility of the economy, mainly through labour mobility, wage and price flexibility, and fiscal transfers. The likelihood of a country experiencing asymmetric shocks depends on how similar its production and

export structures are relative to its partners in the monetary union. Inflation depends positively and significantly on the size of financing needs, and negatively on the extent of trade that is internal to the monetary union.

According to Collier (2016), given the widespread lack of both fiscal discipline and stable macroeconomic policies, it is vital to use the goal of monetary union to encourage greater discipline and better governance. A single African Currency has many promises in terms of boosting trade across the Continent and benefits for all member states through synergy and symbiosis. Common Currency utilization has capacity to increase economic cooperation among member African Union Nations and stimulate faster development efforts across the Continent (Debrun, 2012). There is an understanding that Currency unification could be a key catalyst to transforming the Continent.

International Trade

Trading globally gives consumer and Countries the opportunity to be exposed to goods and services not available in their own Countries, or which would be more expensive domestically. According to Afeti (2010) , International Trade allows Countries to expand their Markets for both goods and services that otherwise may not have been available domestically .He further opined that as a result of International Trade , the Market is more competitive which result in more competitive pricing which also brings a cheaper Product home to the Consumer . Therefore, International Trade is the exchange of goods and services between Countries. The World Economic Forum in the Digital Policy Playbook (2017), states that global trade allows wealthy Countries to use their resources, whether labour Technology or capital more efficiently. Since Countries are endowed with different assets and natural resources (Land, Labour, Capital and Technology), some countries may produce the same goods more efficiently and therefore sell it more cheaply than other countries in the International Trade.

International Trade not only results in increased efficiently but also allows Countries to participate in a global economy, encouraging the opportunity for Foreign Direct Investment (FDI), which is the amount of money that individuals invest into foreign companies and assets. For the receiving government, Foreign Direct Investment is a means by which Foreign Currency and expertise can enter the Country. According to Debrun (2012) Foreign Direct Investment raise employment levels, and leads to a growth in Gross Domestic Product (GDP). To the Investors, Foreign Direct Investment offers company expansion and growth, which means higher revenue. The European Union, the United States and Japan

account for half of the world's GDP. These economies are based on Trade, Services and Industries. However, measures to halt the Covid-19 pandemic have forced them to close their borders and drastically reduce economic activities; which would lead to recession in some of these developed economies. The Chinese economy account for about 16% of global GDP and it is the largest trading partner of most African Countries and the rest of the world. The Organization for Economic Cooperation and Development (2019), forecast a decline in economic growth rate for these major economies as follows: China 4.9% instead of 5.7%, Europe 0.8% instead of 1.1%, the rest of the world 2.4% instead of 2.9%, with world GDP falling by 0.412 from the first quarter of 2020. The UNCTAD also forecasts downward pressures on Foreign Direct Investment from -5% to -15%. The International Monetary Fund (ITF) has announced on the 23 march 2020 that Investors have withdrawn US\$83billion from emerging markets since the start of the Covid-19 crisis. Oil prices lost about 50% of their value, dropping from US\$67 a barrel to below US\$30 a barrel. This drop in oil prices has contributed to a significant decline in GDP growth for Sub-Sahara Africa (Brookings Institution, 2020).

Today, crude oil is facing the biggest demand shock in its history, falling below 30 dollars a barrel, due to the cessation of World Trade. African economies have always been facing persistent current account imbalance which is mainly driven by trade deficits. A domestic revenue mobilization remains low in Africa; many African Countries heavily rely on foreign sources of financing of their current deficits.

Recessed Economy

Economic recession is a period of general economic decline and is typically accompanied by a drop in the stock market, an increase in unemployment, and a decline in the housing market (Bomberger, 2002). A recession is a decline of economic activity, more specifically, a decline in gross Domestic Product (GDP) for two or more consecutive quarters. A Gross Domestic Product is the market value of all goods and services produced within a Country in a given period of time. Generally, a recession is less than a depression.

Flandrean (2011), highlights some factors that cause recessions:

- **High Interest rate:** high interest rates are a cause of recession because they limit liquidity, or the amount of money available as cash for investment.
- **Reduced real wages:** this means workers pay cheque not keeping up with inflation. This reduces the purchasing power of the workers.

- **Reduced consumer confidence:** if consumers believe the economy is bad, they are less likely to spend money. Consumer confidence is psychological but can have a real impact on any economy.
- **Persistence inflation:** inflation refers to a general rise in the prices of goods and services over a period of time. As inflation increases, the percentage of goods and services that can be purchased with the same amount of money decreases.

Barriers of International Trade:

National Currency Utilization as a Barrier to International Trade

One of the principal reasons for the enthusiasm for African Monetary Union is transcend to the Conventional economic aims of higher growth and lower inflation (Alesina, 2012). In Africa, fiscal problems are much more severe and the credibility of monetary institutions are made fragile. According to Rose (2010), African Currencies have been characterized as ill managed and have been subjected to continued depreciation. The effect of this has not stimulate any pride in the region or has given African sub-region any clout on the world stage. According to Debrun (2012), creation of a regional Central Bank can be a vehicle for solving credibility problems that bedevil individual countries Central Banks. Many presidents of the African sub-regions appoints Central Bank Governors and Management Boards without due process. Poor management of this apex Financial Institution has affected the economy these Countries negatively. This article therefore, advocate for a Single Regional Central Bank where no single president of any Country shall have control over the Governor and the Management Board.

Exchange Rate Volatility as a Barrier to International Trade

A new strand of Literature, initiated by Rose (2010), addressed the question of whether Countries inside Currency unions tend to trade more, holding other factors constant. Rose (2010), distinguished three types of exchange rate variability as follows; volatility, Single Currency (permanent zero volatility), and misalignment. The literature on the “response of trading firms to exchange rate uncertainly” demonstrates that exchange rate uncertainly can affect trade behaviour, but gives no clear predictions as to the net effect on trade volume or trade growth. With the introduction of a Common Currency there will be no exchange rate uncertainty among various Countries, which have been a serious Trade barrier in the African Sub-Region.

Border Restriction as a Barrier to International Trade

Andrew (2010) estimates that trade barriers associated with national borders restriction are halved when Countries join a Currency union. He emphasized that the Common Currency will significantly raise trade and economic welfare of members. A Currency union should stimulate trade somewhat, since one money is more efficient than two as both unit of account and medium of exchange. Some trade barriers are government induced restrictions on International Trade. Man-made trade barriers come in several forms including, tariffs, non-tariff barriers to trade, import licenses, export licenses, import quotas, subsidies voluntary export restraints, local content requirement, embargo, Currency devaluation and other trade restrictions. Most trade barriers work on the same principle – the imposition of some sort of cost on trade that raises the price of the traded products. Economists generally agree that trade barriers are detrimental and decreases overall economic efficiency of a nation and a Sub-region at large. European Euro is more efficient than Euro members national currency. Therefore, Common Currency in Africa or West African Sub-region will be more efficient than individual nations Currencies.

Implication of Utilization of Common Currency in Enhancing International Trade

- **Common currency eliminate exchange rate fluctuation:** Businesses who operate within a Common Currency area would no longer have to worry about exchange rate fluctuations. A survey in Europe found that exchange rate fluctuations affected small businesses more than big multinationals. With a single currency like Euro, both our German and Italian firms can do away with exchange rate fluctuations and hedging costs. Thus, trade and investment are stimulated within this Currency Union.
- **Reduced Transaction Costs:**
 - (i) A single Currency would encourage tourisms in the single currency area. A tourist to the European Countries in the Euro Currency area (12 of them in 2002) would not have to worry about exchanging different Currencies and loss in transaction costs (omission and time) as she travel. A Survey in the past found that a unit of Currency say I French Franc would lose 40% of its values after if it is exchanged into each of the 12 National Currencies then used in the European Community (before the formation of EU).

- (ii) This also encourage trade across borders in this Single Currency area. A Euro for example eliminate the extra accounting costs needed to keep tract of different and fluctuating exchange rates among trading partners within the Single Currency area. This reduced cost of trading within the Single Currency area and thus stimulate more trade.

➤ **Price Transparency**

- (i) Within the Single Currency union, all prices would be quoted in the same Currency and this facilitates easy price comparison. Firms no longer could mask their high prices in local national Currencies.
- (ii) This would also encourage firms to improve their efficiencies and competitiveness in the Single Currency area.

➤ **Facilitate Market Expansion**

Common Currency lowers transaction costs, it helps in elimination of exchange rate fluctuations, and price transparency will give incentive for firms to expand their Markets within the Single Currency area. This would also generate Investment and employment.

➤ **A more stable currency**

- (i) The common currency would be more stable, that is, experiences less exchange rate fluctuations when compared to national Currencies because the value of the common currency reflects the average economic conditions of the whole Union and not that of a Single national economy.
- (ii) Moreover, Common Currency would enjoy more credibility because it is used in a larger Currency zone.
- (iii) The stability of Euro for instant is protected by the explicit stability - oriented monetary policy of European System of Central Banks (ESCB) that controls the value of Euro.

➤ **Prevent Competitive Devaluation by Nation States**

A Single Currency would prevent the need for Nations States to devalue their national currencies to achieve competitive edge over other nation states.

In the European Monetary System (EMS), Currencies of members are fixed within a band of 2.25% of the central parity.

➤ **Lower Interest Rates**

The Euro members enjoy monetary stability of the European Central Bank (ECB) and the absence of premium due to elimination of exchange rate fluctuation.

Conclusion

Common Currency establishment in African Sub-region in highly commendable as this will end instability of various Countries economy and varying conflicting policies of different countries. Common Currency ensures how best to achieve economic stability, Elimination of Exchange Rate Fluctuation, Reduction in Transaction Cost, Price Transparency, Facilitation of Market Expansion, a more stable currency, prevention of devaluation of Currencies among individual nation states and lowering of interest rate are some of the identified implications of utilization of common currency in enhancing International trade.

Recommendations

Based on the conclusion drawn, the following recommendations are hereby made:

1. Government of different Countries in African or the sub-region should as a matter of urgency adopt Common Currency in their region. With a Single Currency like Euro exchange rate fluctuation will be a thing of the past.
2. All the financial policy makers of different Countries in Africa, should encourage the establishment of common Central Bank, because the stability of Euro is protected by the explicit stability-oriented monetary policy of European system of Central Banks (ESCB) that controls the value of Euro.
3. Government of African nations should introduce a Common Currency that will expand its markets within the Currency area. Price transparency which Common Currency brings will give incentive for firms to expand their Markets.
4. Investors should encourage the introduction of Common Currency, as it helps to reflect the average economic condition of the whole nations within the union, than that of a single national economy. The Investors will enjoy more credibility because, the Common Currency will be used in a larger Currency zone which encourages more Foreign Direct Investment (FDI).

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