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BUDGET DEFICITS AND THE CHOICE OF EXCHANGE RATE REGIME: THE CASE OF ECOWAS COUNTRIES

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Abstract: This article examines the effect of budget deficits on exchange rate regimes in the ECOWAS region. The empirical literature dealing with the problem of choosing an appropriate exchange rate regime generally relies on the analysis of logit models. This type of model has proved to be an effective tool for characterising the relationship between the typology of exchange rate regimes and their determinants. This article follows a similar methodological line by exploiting the World Bank database covering the period 2000-2020. Our results show that the budget deficit has a significant impact on the choice of exchange rate regime. Our estimates also show that financial development, inflation and political stability are also determinants in the choice of an exchange rate regime. The empirical results highlight that the optimal regime depends strongly on the macroeconomic challenges facing the region and its situation.

Keywords: Deficit, exchange rate regime, inflation, ECOWAS.
JEL classification: C51, C54, C58, E58, F36

1. INTRODUCTION

The issues of budget deficits and debt have been at the heart of discussions in developing countries for several decades. In 2021, the African Development Bank issued a strong warning on this issue (ADB, 2021). In line with the Keynesian thesis, the budget deficit is indeed a tool of economic policy. The efficiency of some public spending, as Aremo and Olanubi (2016) suggest, is imperative in the face of rising public finance aggregates that have no return in terms of positive externalities on the economy (Gomez-Puig and Sosvilla-Rivero (2015) and Dutu and Sicari, 2016). The case of the financial crisis in the United States is a case in point, (Égert 2015), then Colesnic *et al.* (2016). The problem of debt and its effects is a central issue in applied macroeconomics and requires the use of models based

on the economic realities of countries (Bova *et al.* (2015), then Fournier and Fall (2015)). From this aspect, Yanushevsky and Yanushevsky (2018), believe that applied macroeconomics for public policy applies systems and control theory approaches to macroeconomic problems. Baharumshah et al (2017) and Niang and Sane (2020) have demonstrated the need to control the increase in debt and avoid negative effects on economic activity.

Macroeconomic management and post-crisis outcomes in most major economies are leading governments to address fiscal consolidation issues (Cantore et al, 2019)). Shen and Zheng (2019), for example, find the need to put fiscal consolidation on a firmer footing in the medium term. This remains a strong requirement for sustainable growth following increased uncertainty in the macroeconomic environment (Paret, 2017), then Everaert and Jansen (2018).

In the Economic Community of West African States, the profile of macroeconomic convergence has deteriorated slightly, on average, in recent years. For all the first- and second-tier criteria, the number of countries meeting the required threshold has fallen, at least until 2016, except for the criterion relating to gross foreign exchange reserves. Macroeconomic convergence performance improved on the budget deficit and central bank deficit financing criteria but remained unchanged on the inflation and gross foreign exchange reserve standards in 2019. Only 6 of the 15 ECOWAS countries met all the first-tier criteria in 2019, compared with 2 in 2018 and 3 in 2017. In 2016, no country managed to meet all six convergence criteria. Moreover, only Togo met all the first-tier criteria on a sustainable basis over the period 2017-2019. However, with the global outbreak of the Covid-19 pandemic, the progress made over the years in terms of macroeconomic stability and convergence towards the creation of a single currency is under threat. Growth contracted in 2020 (to -1.1% for ECOWAS as a whole), due to the adverse effects of the health crisis. As a result, performance under the macroeconomic convergence criteria deteriorated considerably in 2020, particularly those relating to the budget deficit and deficit financing by the central bank, as a result of an increase in spending on health and social programmes and a fall in revenue, against a backdrop of a considerable deterioration in the current account.

Ultimately, analysis of convergence performance shows that the number of countries meeting the convergence criteria varies from year to year and from criterion to criterion. That said, ECOWAS countries are not meeting the convergence criteria on a sustainable basis, which is precisely a necessary, but not sufficient, condition for launching the single currency. Furthermore, a major challenge for the countries is above all compliance with the first-tier criterion relating to the budget deficit, even though 11 countries have managed to comply with this criterion in 2019. Compliance with the 3% budget deficit threshold

continues to be a problem for most Member States due to the low tax burden and high level of expenditure. Faced with the problem of increasing debt and its effects on small economies, what analysis do we have of budget deficits in explaining exchange rate regimes in ECOWAS? From this research question, and drawing on the work of Guissé (2016), the general objective of this article is to assess the effect of budget deficits on exchange rate regimes in ECOWAS.

This article is of threefold interest: on the one hand, a historical understanding of economic policies in SSA, and on the other, the factors and consequences of economic policy management in ECOWAS. Theoretical and empirical analyses often focus on the exchange rate regime, as this allows the effects of fiscal policy and monetary policy on the economic performance of states to be taken into account. The articulation of analyses around the choice of exchange rate regime is quite beneficial in the sense that this subject is undeniably one of the most important topics in macroeconomics and international finance. It also allows all the central themes of macroeconomics and international finance to be addressed with analytical coherence.

Using World Bank data covering the period 2000-2020 for the fifteen ECOWAS countries, the logit model is estimated concerning the nature of the dependent variable. The results show that the budget deficit has a significant impact on the choice of exchange rate regime. The estimates also show that financial development, inflation and political stability are also determinants in the choice of an exchange rate regime. Furthermore, these empirical results underline that the optimal regime depends strongly on the macroeconomic challenges facing the region and its situation.

The rest of the article is structured as follows: The first section presents the convergence criteria within ECOWAS; the second section discusses the literature review; the third section presents the methodological approach; the fourth section is devoted to the results, leading to the conclusion and recommendations in the final section.

2. OVERVIEW OF ECOWAS IN THE LIGHT OF THE CONVERGENCE CRITERIA

ECOWAS currently has fifteen member countries. They are Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, Togo, Gambia, Ghana, Guinea, Nigeria, Sierra Leone, Cabo Verde and Liberia. The West African Economic and Monetary Union (WAEMU) is made up of the first eight members. Certain economic criteria, known as the convergence criteria, were adopted as Decision A/DEC.17/12/01 in December 2001. These criteria were amended in the Additional Act A/SA/4/06/12 of 29 June 2012 on the convergence agreement and macroeconomic stability between the ECOWAS Member States (ECOWAS, 2017).

The convergence criteria fall into two categories, primary and secondary. The primary criteria stipulate that the deficit-to-Gross Domestic Product (GDP) ratio must be less than 3%, the average annual inflation rate less than 10%, and gross external reserves greater than 3 months of imports. Only three Member States, namely Guinea, Liberia and Nigeria, met the first primary criterion, compared with six in 2015, namely Benin (6.2%), Gambia (9.5%), Ghana (10.9%), Niger (6.1%), Sierra Leone (6.4%) and Togo (8.5%). Concerning the second primary criterion, only Ghana, Nigeria and Sierra Leone recorded an inflation rate above 10% in 2016. In 2015, all ECOWAS members other than Ghana recorded an inflation rate below 10%. English-speaking countries recorded higher inflation rates. These higher inflation rates could be attributable to the depreciation of the currencies of these members in 2015 and 2016.

The target for the third primary criterion used to be six months of imports, but was reduced to three months of imports in 2015. In 2016, only The Gambia (2.4 months), Ghana (2.8 months) and Guinea (1.4 months) failed to meet this criterion. Nigeria (6.5 months) and Cabo Verde (6.4 months) had the highest import coverage in both 2015 and 2016 (ECOWAS, 2017).

The secondary criteria require that the debt-to-GDP ratio is below 70%, that central bank financing of the budget deficit does not exceed 10% of the previous year's tax revenues, and that the nominal exchange rate variation be within ±10%. Only Cabo Verde (128.6%), Gambia (117.3%) and Togo (79.4%) failed to meet the first secondary criterion. Guinea, Nigeria, Gambia and Sierra Leone did not meet the second criterion. About the third secondary criterion, three currencies in 2016, compared with two in 2015, experienced an average variation outside the ±10% range. The currencies concerned were the Guinean franc (16.4%), the Nigerian naira (23.5%) and the Sierra Leonean leone (19.1%) (ECOWAS, 2017).

The persistent increase in public debt in the Member States, due to the growing need to fill financing gaps, has led to a rise in the overall debt level of ECOWAS Member States. Although the nominal value of the debt and its level with GDP have risen steadily over the years, 2020 has seen a sharp increase. This situation will result in higher debt servicing costs in the medium and long term, further reducing countries' fiscal room for manoeuvre. Except for the Gambia, the debt/GDP ratio of all Member States has risen. By the end of 2020, five (5) Member States - Cape Verde, Gambia, Ghana, Guinea-Bissau and Sierra Leone - had passed the 70% debt-to-GDP threshold set by ECOWAS, while Senegal and Liberia were approaching it.

3. OVERVIEW OF THE LITERATURE: BUDGET DEFICITS AND THE CHOICE OF AN EXCHANGE RATE REGIME

In the ECOWAS context, the choice of exchange rate regime (fixed, floating or intermediate) is the most important economic policy decision, since the exchange

rate is a key variable in determining trade flows in goods, services and capital (Friedman, 1953; Lutz, 1954; Mundell, 1960, 1961a, 1961b, 1963). However, the choice of exchange rate regime is preceded by monetary and budgetary imbalances which are incompatible with the exchange rate mechanism. The problem of the choice of exchange rate regime dates back more than two centuries. But it has taken on renewed interest since the establishment of the Bretton Woods system. It remains topical in the ECOWAS zone, where the adoption of the future currency will depend on the superiority of the exchange rate regime. The question of the optimal choice of exchange rate regime has become more complex and controversial.

However, growth theory and the literature on exchange rate regimes suggest that the nature of the regime adopted by a given zone can have consequences for economic performance in the medium and long term through two (02) mechanisms: either directly through a policy of targeting adjustment to demand or supply shocks; or indirectly through other economic and institutional variables, such as the GDP growth rate, investment, trade openness, inflation, financial development and political stability (Bailliu *et al.* 2005). The empirical literature remains mixed on the determination of the choice of the regime, but also on the benefits and consequences arising after the adoption by the monetary authority of the fixed, intermediate or floating exchange rate regime. The effects of exchange rate regimes on economic performance have been studied by several studies, both theoretical and empirical.

The table on the link between the choice of exchange rate regime and economic growth is initially almost non-existent given the nominal value of the monetary regime, which may not affect economic growth (Sali *et al.*, 2019). However, the theoretical literature establishes a link between the exchange rate regime and economic performance. According to a study by Baxter and Stockman (1989) on a sample of 49 countries covering the period 1946-1986, the authors suggest that the exchange rate regimes adopted do not affect economic growth. Similarly, the work of Mills and Wood (1993) and Rose (1993) confirms the absence of any effect of exchange rate regimes on economic growth.

In contrast to other studies, Levy-Yeyati and Sturzenegger (2002) investigate the relationship between exchange rate regimes and economic growth in a sample of 183 countries during the period of the Bretton Woods implementation process redefining new rules. Their findings lead to the following conclusion: for developing countries (DCs), less flexible exchange rate regimes are associated with lower growth. Some argue that fixed exchange rate regimes are unable to adjust to shocks, and can therefore lead to a slowdown in economic activity (Edward and Levy-Yeyati, 2003). However, for Diaw and Ka (2012), the effect of the flexible exchange rate regime on growth is greater than that of the fixed

exchange rate regime. This is the superiority of the flexible exchange rate regime over the fixed exchange rate regime, due to the latter's rigidity.

Friedman's arguments (1953) went against the fixed exchange rate system, which generated speculative crises and instability. The work of Mundell (1960) went beyond Friedman's conclusion by emphasising the importance of capital mobility. For them, if capital is mobile, the ideal system is that of a fixed exchange rate because the interest rate has a direct influence on the balance of payments. On the other hand, if capital is immobile, it is preferable to opt for a flexible exchange rate regime. The consequence of adopting an exchange rate regime is the pursuit of macroeconomic stability. The stability objective, which consists of minimising a loss function, is an approach adopted by some authors such as Friedman (1953), Mundell (1960, 1961, 1963), Aizenman and Frenkel (1985), Aizenman and Hausmann (2001) and Allegret, Ayadi and Haouani Khouni (2006). In addition, foreign trade can influence exchange rate regimes.

The degree of trade openness can also have an impact on the exchange rate regime. Thus, we find that the degree of openness of an economy also remains a channel through which the nature of the regime can indirectly influence economic growth (Rizzo, 1999; Bailliu, Lafrance and Perrault, 2002). Based on a sample of 29 countries over the period 1980-1995, Rizzo (1999) finds that the degree of openness is an important variable in the choice of exchange rate regime. Similarly, studies by Bailliu, Lafrance and Perrault (2002) on a sample of 25 emerging countries from the 1973-1998 period suggest that a change in the exchange rate regime is accompanied by a fall in growth. Moreover, their results show that a floating exchange rate regime generated strong growth only for countries that were open to international trade and perfect capital mobility. In addition to trade openness, inflation plays an important role, depending on the type of regime a country or region chooses.

The level of inflation also depends on the exchange rate regime. The choice of an optional regime can be a source of inflation or disinflation. The exchange rate also has an indirect impact on inflation through its disciplinary and credibility effects. The monetary exchange rate has several advantages over monetary aggregates. According to Cukierman (1990), the exchange rate should be used all the more as a temporary instrument to stabilise economic activity and the economy is used for inflation. For Tormell and Velasco (2000), inflation and fiscal policy influence the choice of option and the stability of the exchange rate regime. They conclude that the fixed exchange rate regime protects countries against budget shocks arising from increased spending.

Tormell and Velasco (2000) suggest that the flexible exchange rate regime imposes greater fiscal discipline, arguing that fixed exchange rate regimes restore the cost of deficits in the long term and lead to fiscal and political imprudence.

The results of Ripoll (2001) show that inflation is significantly lower in the case of fixed exchange rates. He also shows that fixed and flexible exchange rate regimes have broadly similar growth performances. In addition to economic factors, the quality of governance can reduce to a strict minimum the adverse effects caused by the adoption of a fixed regime leading to improved economic growth (Fraj *et al.*, 2018).

In countries where there is poor governance, this can lead governments to choose the fixed exchange rate regime and vice versa. The quality of institutions can reduce the adverse effects of adopting a fixed exchange rate. There is abundant literature on the link between monetary policy and governance (Rogoff, 2004). This literature has focused much more on the independence of central bank institutions or other forms of institutions capable of stabilising the level of inflation (Siklos, 2000).

In the ECOWAS zone, countries are exposed to corrupt practices in tax revenue mobilisation. Studies by Rafael and Alberto (1999) confirm the idea that many transitions and developing countries have a flagrant corruption problem that affects tax revenues, particularly in resource-rich countries. The quality of institutions can be an asset in preventing the spread of an economic or financial crisis. For example, most of the difficulties encountered in Europe during the EMS crisis, in Mexico, Argentina and Brazil, in Japan and Asia, and more recently in Germany, are closely linked to the choice of the wrong exchange rate policy (Artus, 2003). Thus, the quality of institutions can have a significant influence during financial crises (Klomp and De Haan, 2014). It also influences the volume of trade (Blanchard and Kremer, 1997; Berkowitz *et al.*, 2006; Levanko, 2007; Méon and Sekkat, 2008).

4. METHODOLOGICAL APPROACH

This section essentially presents the methodology used. It comprises two subsections, one dealing with the specification of the model and the other describing the study data and the estimation technique to be used in the analysis.

(i) Model specification

The study of the relationship between budget deficits and the choice of exchange rate regime will be based empirically on specifications based on the determinants of the exchange rate regime. These determinants are based on different approaches, in particular the theory of optimal currency areas (OCAs). This theory produces a set of potential determinants of exchange rate regimes. It should be noted that in the first works based on the OMZ, Mundell (1961) emphasised geographical and trade characteristics to evaluate the gains in terms of trade and well-being resulting from a stable exchange rate compared to the advantages of exchange rate flexibility acting as a shock absorber in the presence of nominal rigidities.

Based on the work of Markiewicz, (2006) as well as Zidat and Achouche, (2018), we use a discrete variable that takes a value equal to zero if the fixed exchange rate regime is chosen, during period t and equal to 1 if the floating exchange rate regime is chosen. The basic model is as follows:

$$lnRC_{it} = \beta lnX_{it} + \gamma Deficit_{it} + \vartheta_{it} \quad (1)$$

$$\vartheta_{it} = \eta_t + \mu_i + \varepsilon_{it} \quad (2)$$

$$lnRC_{it} = \gamma Deficit_{it} + \beta lnX_{it} + \eta_t + \mu_i + \varepsilon_{it} \quad (3)$$

Where RC_{it} is a dummy variable equal to 0 if the exchange rate regime is fixed and 1 if it is flexible; lnX_{it} represents the control variables that can influence the exchange rate regime (gross domestic product, GDP growth rate, trade openness, financial development, inflation, quality of institutions, etc.); Deficit represents the budget deficit of country i in period t ; η_t is the time fixed effects; μ_i is a vector representing country fixed effects; ε_{it} is the error term, i is the country, t is the period.

(ii) Data and Estimation Technique

The impact of budget deficits on the choice of exchange rate regime will be analysed using the World Bank's World Development Indicators database (see Table 1 for details). The study focuses on the fifteen ECOWAS countries.

To estimate the impact of budget deficits on the choice of exchange rate regime, the econometric literature suggests using a country-fixed effects model on panel data. However, a country-specific fixed-effects model can produce inconsistent results when using the maximum likelihood estimator (MLE) (Chamberlain, 1980). Given the nature of the dependent variable, which is a categorical variable taking two values: 1 for fixed and 0 for flexible, the use of logit for the regression. According to Aliyev, (2015), this technique is the most relevant in a discrete choice analysis.

5. RESULTS AND ANALYSIS

(i) Descriptive statistics

Table 2 provides descriptive statistics for the variables used in this article. It gives an overview of the nature of the data in the estimation. The public deficit variable (deficit) has a mean above 50%, which implies that there is a relatively high level of debt in the majority of the countries included in the sample. In other words, public spending in these countries exceeds the income generated by taxes and other sources of government revenue. An average of 15.5355 for private sector credit indicates that, on average, ECOWAS countries have a relatively low level of private sector credit in terms of financial development. This suggests that financial systems in ECOWAS countries are not sufficiently developed to meet

Table 1: Model variables and their sources

Variables	*Definitions*	*Sources*
Exchange rate regime	This is a dummy variable which is equal to 1 if the exchange rate regime is fixed and 0 if it is flexible,	Built by the author
Budget deficit	General government budget balance as a percentage of GDP; a positive entry indicates a surplus balance.	WDI
GDP per capita	Gross Domestic Product per capita (current $).	WDI
GDP growth rate	It represents the change in gross domestic product	WDI
Commercial opening	It is measured by the ratio of imports and exports as a percentage of GDP (X+M)/GDP.	WDI
Financial development	It is measured by credit to the private sector, which refers to the financial resources provided to the private sector by financial companies.	WDI
Inflation	It indicates the rate of price change in the economy as a whole.	WDI
Political stability	This is a measure of the quality of institutions (between -2.5 and +2.5).	WGI

Source: Author

the financing needs of the private sector. Political stability is used as an indicator of governance in ECOWAS countries. This variable has an average value of -0.5. It determines the probability of destabilisation of the political situation in a particular country or politically motivated violence, including acts of terrorism. This result indicates a level of political stability close to zero in ECOWAS. In terms of inflation, the average is around 5.54969. This indicates a fairly high level of inflation in the zone.

Table 2: Descriptive statistics for variables

Variable	*Obs*	*Mean*	*Std. Dev.*	*Min*	*Max*
Opening	293	60.21227	21.0765	16.35219	132.3825
credit	311	15.5355	12.80423	0	73.19206
inflation	299	5.54969	6.6566	-3.502586	41.5095
GDP	315	973.5859	751.0133	138.7139	3537.14
GDP growth	314	1.517436	4.335608	-30.70154	19.45672
deficit	315	71.09272	73.55912	7.276108	523.382
stab	300	-.5336377	.8200048	-2.403348	1.2236

Source: Author

(ii) Econometric Results

The estimated variables play an important role in determining an exchange rate regime, as the majority of the coefficients are significant. Contrary to what is

predicted by the theory of optimal currency areas, in terms of the choice of exchange rate regime, the results of this model indicate that an increase in the degree of openness leads to a choice of a flexible exchange rate regime. Indeed, Eichengreen and Masson (1998) consider that a highly open economy is associated with variable exchange rates to cushion external shocks. Mussa et al (2000) also assert that variable exchange rates are more favourable to more open economies because they provide a better adjustment to external shocks. In contrast, Von Hagen et al (2002) argue that increased economic openness is associated with fixed exchange rate regimes. Similarly, Levy-Yeyati *et al* (2010) empirically support the theory of optimal currency areas, including the criterion of economic openness.

Table 3: Results of Econometric Estimates

Variables	*(1)* *rc*	*(FE)* *rc*	*(RE)* *rc*
ldeficit		-18.68	-3.751**
		(0)	(1.714)
lgdpgrowth		6.633	-1.200
		(0)	(1.558)
lgdp	0.0270*	113.2	-1.837
	(0.0138)	(0)	(2.264)
lcredit	-0.000338	-51.37	4.668**
	(0.0150)	(0)	(2.063)
infl	0.000745	-1.832	-0.655**
	(0.00101)	(9.336e+06)	(0.294)
louv	0.0245	-71.96	0.297
	(0.0218)	(0)	(4.188)
stab	0.0154*	29.92	8.736***
	(0.00930)	(0)	(1.984)
deficit	-4.02e-07		
	(0.000161)		
GDP growth	-0.000356		
	(0.00106)		
Constant	0.220		22.38
	(0.184)		(19.03)
Comments	266	15	196
Number of countryid	14	1	14

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Source: Author

As for GDP, it is less important than the other variables since its coefficient is negative and insignificant. An increase in real GDP, therefore, generates a preference for a floating exchange rate regime. This is explained by the instantaneous reaction of flexible regimes to real shocks, whereas in fixed regimes the reaction of prices is slow. The "inflation" variable is significant and has a negative sign. This result is similar to the work of Zidat et al (2018) in the case of Algeria. The desirability of a fixed exchange rate regime is therefore greater. This is explained, among other things, by the rise in export prices following a rise in domestic inflation rates. This explains the interest in adopting a fixed exchange rate regime to eliminate the negative effects of inflation rates on export and import prices.

Table 4 provides an overview of the marginal impacts of the logit model. Our results show that a 1% increase in the level of financial development increases the probability of choosing a fixed exchange rate regime by 4.6 percentage points. Political stability also remains a determining factor in the choice of an exchange rate regime. Our results show that a 1% improvement in governance scores increases the probability of choosing a fixed exchange rate regime by 8%. On the other hand, the budget deficit has the opposite effect. We note that a 1% reduction in budget deficits increases the probability of choosing an exchange rate regime

Table 4: Marginal effects

	(1)
Variables	*rc*
ldeficit	-3.751**
	(1.714)
lgdpgrowth	-1.200
	(1.558)
lgdp	-1.837
	(2.264)
lcredit	4.668**
	(2.063)
infl	-0.655**
	(0.294)
louv	0.297
	(4.188)
stab	8.736***
	(1.984)
Constant	22.38
	(19.03)
Comments	196
Number of countryid	14

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Source: Author

by 3.7 percentage points. This result shows how important it is for ECOWAS in general, and the Member States in particular, to comply with the convergence criteria.

Significant imbalances (deficits and surpluses) are more likely in rigid schemes, and resolving large deficits is more costly - in terms of lost growth - in such schemes. This highlights the need for other adjustment mechanisms (e.g. labour market flexibility) to address external imbalances in such regimes. The experience of emerging European countries in recent years can be illustrated in this respect. Although many countries with less flexible regimes experienced strong growth in the years leading up to the current crisis, they also accumulated large external imbalances, which increased their vulnerability to sudden and disruptive adjustment, as well as to a financial crisis. Less flexible regimes have also tended to limit the scope for counter-cyclical macroeconomic policies in the face of the current global crisis.

Finally, large surpluses are less likely to be absorbed promptly in rigid regimes and, if they occur in systemically important countries, are likely to amplify systemic risks.

6. CONCLUSIONS AND RECOMMENDATIONS

The choice of an appropriate exchange rate regime remains one of the most controversial issues in international finance. The collapse of the Bretton Woods system (1970) opened the door to experimentation with flexible exchange rate regimes. The 1990s saw the emergence of a formal debate on the virtues and limitations of exchange rate regimes, with an emphasis on intermediate solutions. Conceptually, this led to the development of a panoply of intermediate exchange rate regimes. The question of choosing a regime becomes even more complicated for countries, which will have to arbitrate between this multitude of different regimes (fixed, intermediate and floating). As a result, the answer to the question of choosing an exchange rate regime raises major challenges, due to its growing complexity and instability.

The objective of this paper is to examine the effect of budget deficits on exchange rate regimes in ECOWAS. We construct panel data with ECOWAS countries covering the period from 2000 to 2020. We use the logit estimator to estimate our econometric model. The results show significant effects, consistent with the literature, of the variables of interest and controls, indicating the important role that the budget deficit, inflation and political stability can play in the choice of an exchange rate regime in ECOWAS. Given the fragile state of equilibrium of most ECOWAS economies, the structure of their trade with the rest of the world and their degree of integration into the international economy, it would be wise for the issues of exchange rate regimes to be further matured in this period of

mega-regional agreements. Indeed, if it is more prudent for the ECOWAS authorities to adopt a fixed exchange rate regime, this must concern a period of transition towards a situation of greater integration into the international economy and the abandonment of this regime. The fixed exchange rate should lead to the development of an efficient exchange market which would reduce the risks of destabilising and very costly speculative attacks, and the development of a region with stable equilibrium structures capable of withstanding any shocks that might be produced by the value of the currency.

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