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COORDINATING AND MERGING MONETARY AND NON-MONETARY BLOCS IN AFRICA FOR MONETARY INTEGRATION

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STAGES IN REGIONAL INTEGRATION

FTA
- Tariff removal
- NTB removal

Customs Union
- Common External Tariff (CET)

Single market
- Labour mobility
- Capital mobility
- Regulatory harmonisation
- Free trade in services

Monetary Union
- Single currency & central bank
- Transfer union
- Banking union

Each stage marks a pre-requisite for the next – sequencing is important

OPTIMUM CURRENCY AREAS (OCAS): PRE-REQUISITES

- Diversified economies;
- High level of intra-regional trade;
- Flexible economies with well-functioning markets;
- Integrated markets for goods, services, capital and labour;
- Countries mainly subject to homogeneous (common) shocks rather than heterogeneous (country-specific) shocks.
- Prior implementation of customs union and single market (goods, services, capital & labour)

OPTIMUM CURRENCY AREAS (OCAS) POSSIBLE COSTS & BENEFITS

Benefits

- Reduced transactions costs (forex conversion)
- Reduced volatility vs. some trading partners (exchange rate stability)
- Monetary policy credibility (central bank)
- Lower inflation
- Larger and deeper markets
- Lower cost of capital

Costs

- Loss of national macroeconomic policy instruments (monetary, XR policy)
- Fiscal policy constraints
- Loss of national political autonomy
- More volatile growth
- Reduced ability to deal with shocks

OCAS: LESSONS

- Balance of costs and benefits varies from country to country
  - Can be a net benefit or a net cost
- Monetary union is difficult and high risk
- Loss of national macroeconomic policy instruments requires adjustments to shocks via markets
  - real exchange rate adjustment through relative costs & prices, not nominal exchange rate
- Level of political commitment required is high
  - To detailed institutional and policy reforms
  - To long-term benefits vs. short-term costs

EXISTING MONETARY UNIONS

Name of Union	Single Currency	Members	Central Bank	Exchange rate regime	Associated Trade Area
WAEMU	CFA franc (XOF)	8	BCEAO	Peg (EUR) [1]	ECOWAS
CEMAC	CFA franc (XAF)	6	BEAC	Peg (EUR) [1]	ECCAS
ECCU	EC dollar	8	ECCB	Peg (USD) [2]	CARICOM
Euro Zone	Euro	19	ECB	Float	EU Single Market
CMA	*None (peg to ZAR) [3]*	*4*	*None*	*Float*	*SACU; SADC FTA*

Notes: [1] External guarantee; [2] Currency Board; [3] Internally, peg to ZAR supported by quasi-currency board arrangement

Limited interest in monetary union elsewhere in the world

EXISTING MONETARY UNIONS: LESSONS

Relevance

- 4 of the 5 examples date from colonial era
- Eurozone is only example of a new monetary union formed by countries that previously had their own currencies
- No single structure or policy framework for MU, but all involve:
  - transfer of sovereignty from national to regional institutions
  - political will
  - economic convergence

Lessons

- Common monetary policy can be problematic for countries/regions at different stage of economic cycle
- Internal adjustments (e.g. real devaluation) are difficult; burden falls on deficit countries
- Requirements
  - Limits on national fiscal policy autonomy
  - Deeper integration (e.g. banking union)

MERGERS OF MONETARY AND NON-MONETARY BLOCKS

INSTITUTIONAL ARRANGEMENTS

- Two options for “merger” of monetary and non-monetary blocks:
  - Non-members join existing monetary blocks (WAEMU, CEMAC, CMA)
  - Non-members form new monetary blocks (e.g. EAC, WAMZ) and merge with existing monetary blocks
- No single answer, depends on circumstances:
  - Can WAEMU and CEMAC (and do they wish to) accommodate large new members (e.g. Nigeria, DRC) and maintain fixed peg/external guarantee?
    - If not, new West & Central African monetary blocks will be required
  - CMA could accommodate new members, but implications for governance and trade arrangements (SACU, SADC FTA)
  - New monetary unions required in East Africa and North Africa

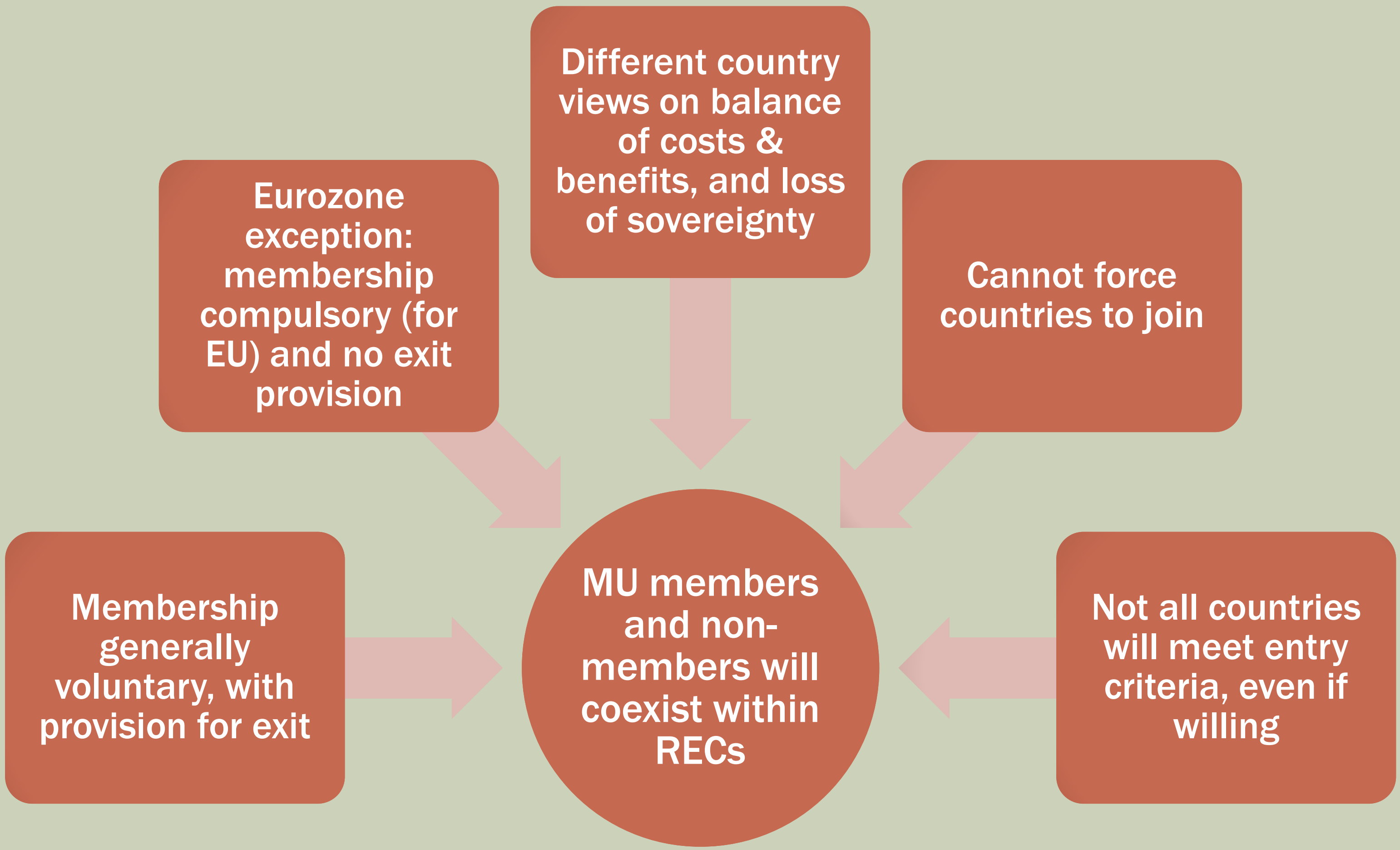
INSTITUTIONAL ARRANGEMENTS

- Standard "roadmap" for monetary integration applies in both cases:
  - Macroeconomic convergence (esp. inflation, interest rates & fiscal (deficits, debt))
  - Exchange rate stability (whether through direct or indirect mechanisms)
  - Policy convergence (monetary, exchange rate, fiscal)
  - Prior completion of trade and single market integration
  - Establishment of common financial infrastructure (e.g. payments & settlement system)
  - Institutional structures to oversee and enforce all of the above
- Countries & regional groups will need to decide which route they wish to follow (new blocks or join existing blocks)

MEMBERSHIP

- In most MUs membership is voluntary and there have been both entry and exit
- Eurozone an exception – membership track is compulsory (if in EU), and no provision for exit
- Countries can legitimately have different views on whether:
  - MU membership will be beneficial, on balance (benefits > costs)
  - How much national sovereignty they wish to give up
- Hence countries cannot be forced to join MUs
  - Membership must be voluntary

MU MEMBERSHIP



A multi-speed/variable geometry approach should be followed

POLICIES: EXTERNAL

- Exchange rate policy choices of monetary unions vs RoW: fixed or floating
  - 3 existing have pegged rates – but historical, difficult conditions to generalise
  - Pegged rates require guarantees, currency boards or very high FX reserves
  - Pegged rates make adjustment to shocks difficult
- Very likely that new MUs will have floating/flexible XRs re. RoW
  - Alternative (peg) unlikely to be sustainable
  - Important adjustment tool to external shocks affecting entire block
  - Most countries in SSA (outside of existing MUs) have some form of floating rate
- Implies an active monetary policy, with a strong, credible, independent central bank

POLICIES: CONVERGENCE

- Policy convergence needed, but route depends on starting point:
  - All parties have fixed exchange rates:
    - Convergence on intra-exchange rate stability target
    - No change in monetary policy
    - Choose conversion parity
    - Reasonably straightforward (in principle), assuming basis for external peg can be maintained
    - More complex if new block will have a floating exchange rate
  - All parties have floating exchange rates
    - During "Convergence" Period
      - Focus on monetary stability (inflation & interest rates)
      - Indirect management of exchange rate stability
      - No change in monetary policy frameworks
    - Except: short "Conversion" period with formal exchange rate targetting

POLICIES: CONVERGENCE

- Merger of Fixed Rate and Floating Rate blocks/countries
  - Potentially the most problematic
  - Conflicting monetary and exchange rate policy frameworks and objectives
  - Nature of the convergence during transition will be driven by the desired post-merger monetary/exchange rate policy of the block
  - Some of the participants will need to undergo a fundamental change in monetary/exchange rate policy
  - Could be a particular problem in West Africa (combination of WAEMU (XOF) peg and floating WAMZ currencies.
- Final issue – is there a dominant regional currency around which a monetary block will converge?
  - If so, the convergence challenge becomes one of converging on the dominant currency
  - Similar to ERM – which was de facto convergence on the DM

POLICIES: CONVERGENCE

- Challenges of forming or merging monetary blocks are not just convergence of monetary and exchange rate policies.
- Practical aspects must not be forgotten:
  - Fiscal and debt harmonisation
  - Oversight and enforcement mechanisms
  - Integration of payment & settlement systems
  - Implementation of monetary policy (rules and mechanisms) e.g. liquidity management, repo markets, interbank markets, reserve requirements and calculations
  - Bank regulation, supervision, harmonisation, LOLR, deposit insurance.

MONETARY & NON-MONETARY BLOCKS

- Co-existence of monetary and non-monetary blocks/members inevitable within RECs, with membership of both changing over time
- No real problems, and lots of international experience:
  - Eurozone members & non-members within EU
  - ECCU and others within CARICOM
  - WAEMU and others within ECOWAS
  - CMA members & non-members within SACU, SADC FTA, Tripartite FTA
- Even within EU, greater acknowledgement of merits of "two-speed" approach (inner Eurozone and and outer non-monetary zone)
- Priorities within RECs apply to both members and non-members of monetary blocks:
  - Trade integration, esp. removal of NTBs
  - Infrastructure development
  - Regulatory harmonisation
  - Labour and capital market integration
  - => Single Market

CONCLUDING COMMENTS: MERGER OF MONETARY AND NON-MONETARY BLOCKS

- Merger of African monetary blocks is a long-term objective
  - No immediate candidates for merger of monetary blocks
  - Short- to medium- term objectives are expansion of existing monetary blocks or creation of new ones (e.g. EAC)
- Variable geometry preferred
  - Allow countries/blocks to move at their own speed
  - Countries must have options to join or not
  - Countries may not qualify to join
- Co-existence between monetary and non-monetary blocks
  - International experience suggests no problem of co-existence (EU, CARICOM, SACU/SADC, ECOWAS)
  - Emphasis on trade, infrastructure, market and regulatory integration (more important)
- Process of monetary integration and policy choices for monetary blocks:
  - Depends on starting points, desired end point and regional characteristics
  - Larger/broader monetary blocks most likely to have floating XR vs RoW
- Focus should be on making prior regional integration, harmonisation and infrastructure work effectively

THANK YOU

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