



Center for European  
Integration Studies

**Rike Sohn  
Ama Konadu Oppong (eds.)**

**Regional Trade  
and Monetary Integration  
in West Africa and Europe**

**WAI-ZEI PAPER**

SPONSORED BY THE



Federal Ministry  
of Education  
and Research

**No.6  
2013**

Terhemba Ambe-Uva is Professor at the Department of International Studies, National Open University of Nigeria in Lagos.

Simona Beretta is Professor of International Economics at the Università Cattolica del Sacre Cuore in Milano, Italy.

Sanoussi Bilal is Head of Economic Governance, Trade and Regional Integration at the European Centre for Development Policy Management (ECDPM) in Brussel, Belgium.

Lelio Iapadre is Associate Professor of Economics at the University of L'Aquila and Adjunct Professor in International Economics at the John Hopkins University, SAIS Bologna Center, Italy.

Ludger Kühnhardt is Director at the Center for European Integration Studies (ZEI) and Professor for Political Science at Bonn University, Germany.

Philippe De Lombaerde is Associate Director at the United Nations University, Institute on Comparative Regional Integration Studies (UNU-CRIS) in Bruges, Belgium.

Giovanni Mastronardi is Lecturer at University of L'Aquila, Italy.

Paulina Mendes is Permanent Researcher at the Center of Socio-economic Studies of the National Institute of Education and Research (INEP) in Bissau, Guinea-Bissau.

Volker Nitsch is Professor of Economics at the University of Darmstadt, Germany.

Ama Konadu Opong is Project Coordinator at WAI for the WAI-ZEI cooperation project.

George Owusu is Professor at the Institute of Statistical, Social and Economic Research at the University of Ghana in Accra.

Rike Sohn is Junior Fellow at ZEI and Project Coordinator for the WAI-ZEI cooperation project.

Djénéba Traoré is Managing Director at the West African Institute in Praia, Cape Verde.

## Content

<i>Ludger Kühnhardt and Djénéba Traoré</i>	3
Preface	
<i>Rike Sohn and Ama Konadu Oppong</i>	5
Introduction	
<i>George Owusu</i>	9
Factors Shaping Economic Integration and Regional Trade in West Africa	
<i>Sanoussi Bilal</i>	33
External Influences on Regional Integration in West Africa: The Role of Third Parties	
<i>Lelio Iapadre, Philippe De Lombaerde, and Giovanni Mastronardi</i>	57
Measuring Trade Regionalisation in Africa: The Case of ECOWAS	
<i>Volker Nitsch</i>	87
Make or Break: The Varying Trade Effects of the Euro	
<i>Simona Beretta</i>	99
Monetary Integration: the Choice of the Right Policy	
<i>Terhemba Ambe-Uva</i>	139
The European Experience of a Common Currency: Lessons Learned	
<i>Paulina Mendes</i>	161
The Experience of Guinea-Bissau's Integration in WAEMU: Lesson for the Euro Zone	
Appendix	175

*Note:* All articles were originally written in English, with the exception of Dr. Mendes' paper which was translated from French to English by WAI-ZEI, Praia/Bonn.

## *Ludger Kühnhardt and Djénéba Traoré*

### **Preface**

Regional groupings aimed at political community-building have become an important element for political, economic and cultural autonomy across the globe, often using the experience of the European Union as a source of inspiration. Against this background, the bi-regional project “Sustainable regional integration in West Africa and Europe” - a co-operation between the West Africa Institute (WAI) in Praia, Cape Verde, and the Center for European Integration Studies (ZEI) in Bonn, Germany - analyzes problems and factors of regional integration in West Africa, taking the European experience into account. This unique bi-regional research project is funded by the German Federal Ministry of Education and Research (BMBF).

Between 2012 and 2016, the cooperation between WAI and ZEI brings European and West African scholars of different backgrounds together for the first time in order to analyze the challenge of sustainable regional integration from various perspectives. The project is structured into three interrelated research areas: (a) regional integration and policy formulation processes; (b) economic integration and regional trade; and (c) institutional capacity development for regional integration. Researchers and experts from West Africa and Europe jointly analyze and discuss their perspectives, share methodologies and content, thus contributing to a new bi-regional scientific network that supports the partnership between Africa and Europe.

This anthology presents the results of intensive study group discussions in research area (b) during meetings in Praia, Cape Verde, in October 2012, and in Bonn, Germany, in March 2013. Overcoming the barriers of language, distance and scholarly perspectives, the authors have leveraged their knowledge and outstanding expertise in order to compare and synergize on the opportunities

## Preface

for economic integration and regional trade, as well as the lessons learnt by the European experience of a common currency. We hope that the results of this hard work will stimulate further discussions among other researchers, government stakeholders and practitioners involved in processes of sustainable and effective regional integration in West Africa and in Europe.

Prof. Dr. Ludger Kühnhardt  
ZEI Director

Prof. Dr. Djénéba Traoré  
WAI General Director

Bonn/Praia, August 2013

## *Rike Sohn and Ama Konadu Oppong*

### ***Introduction***

Both, the member states of the European Union (EU) and the member states of the Economic Community of West African States (ECOWAS) initially began their cooperation with the aim of enhancing regional trade. Since their foundation, both regional organizations have worked towards a customs union in order to benefit from, as economic theory assumes, combined prosperity. The assumed benefits of which include economies of scale and facilitating access to existing resources and infrastructure, with the overall aim of stimulating economic growth. As economic integration increases the weight and significance of regional markets, it is also considered a tool for improving the position of member states in the global economy, with monetary union being a further stepping stone on the way to enhanced economic coherence and harmonization.

In this context, the European integration process can be seen as a source of inspiration and as a potential role model for regional integration around the world and, more particularly, the West African region. Nevertheless, both sides are confronted with different problems in regard to their respective level of integration: While the EU is economically and monetarily united, it is dealing with current imbalances and potential spill-overs effects resulting from advanced financial integration. ECOWAS, on the other hand, struggles with low levels of intra-regional trade, external dependencies and the continuing goal of establishing a region-wide common currency.

With current crises in the Euro zone marking a watershed moment for global economic and regional development, focus has shifted away from de-regulative liberalization policies, towards expected protectionism against global fiscal downturns and improving economic and fiscal governance structures. While the institutional set-up of regional organizations, in principle, offer opportunities to manage and solve these problems, vested national interests which can lead

## Introduction

to long decision-making procedures and avoidance of policy implementation remain. In West Africa, further key challenges are the different operating modes and institutional overlaps between the two main regional institutions ECOWAS and the West African Economic and Monetary Union (WAEMU).

In the quest, for a more systematic approach towards current questions of African economic cooperation and integration and the need for targeted capacity development and knowledge dissemination to practitioners and the wider public, that the West Africa Institute (WAI) in Praia, Cape Verde, has been launched. WAI is the first research institute of its kind that offers academic analysis of processes and institutions, concrete policy advice and the dissemination of knowledge and information about regional integration processes in West Africa. It was founded in 2008 with the significant encouragement of the West African regional integration groupings ECOWAS and WAEMU, the ECOBANK, UNESCO and the government of Cape Verde.

Since then, the Center for European Integration Studies (ZEI) and the West Africa Institute have developed an ever closer partnership, resulting in a multilateral research and consulting project funded by the Federal Ministry of Education and Research (BMBF) over the period 2012-2016. The project “Sustainable Regional Integration in West Africa” reflects the special focus of the German federal government on the internationalization of science and research and promoting new and innovative forms of research cooperation between German institutions and partners in developing countries, especially in Africa.

Within this framework, the thematic outline of this WAI-ZEI anthology deals with three of the most important questions regarding economic and monetary integration in West Africa and which are also focal areas of the respective WAI-ZEI study group in economics:

- How can regional integration schemes contribute to enhance regional trade and the integration of the West African region into the global economy?
- What are the effects of monetary integration and how can synergies be created?
- To what extent can experiences of other regions be helpful in this process and how can Europe benefit from the perspectives of other regional integration schemes?



The topics of regional trade and monetary integration were chosen to begin with as they mark the basis and core elements of regional integration processes worldwide; second both subjects are highly relevant for the recent political agendas in West Africa and Europe, and thirdly because their intrinsic interconnectedness makes a joint analysis even more necessary.

Specifically, the respective authors focus on the following:

The first article by Prof. George Owusu, University of Ghana, gives an overview of the structural characteristics of West African markets, as well as recent trends in their macroeconomic development. Using data from the World Bank's World Development Indicators, he compares intra-regional trade patterns to external trading partners, analyzes the effects of Breton woods policies and gives practical recommendations to increase trade within the ECOWAS economic bloc.

In a similar context, Sanoussi Bilal analyzes the European influence on regional integration processes in West Africa, comparing it with other external factors such as pan-African dynamics and emerging players. Bilal, the Head of Economic Governance, Trade and Regional Integration Unit at the European Centre for Development Policy Management in Brussels, Belgium, also reflects on the EU's economic partnership agreements (EPAs) as a comprehensive set of reform dynamics for regional integration.

Philippe De Lombaerde, Associate Director at the United Nations University in Bruges, Belgium, Professor Lelio Iapadre and Lecturer Giovanni Mastronardi, both from the University of L'Aquila, significantly add to this research by presenting a thorough overview of statistical indicators and models to measure the degree of trade regionalization. Applying these methods to the specific cases of ECOWAS and WAEMU, they draw important conclusions regarding the effect of trade openness and distance-related barriers on regional economic integration in West Africa.

Building the bridge from trade to financial analysis, Professor Volker Nitsch from the Technical University of Darmstadt analyzes the effects of monetary integration on trade. Whereas most literature in this regard focuses on overall effects, he uses pairs of countries, for his gravity-type regressions, in order to examine whether the adoption of a common currency is likely to foster economic integ-

## Introduction

ration among member countries or if the elimination of exchange rate flexibility rather leads to bilateral trade imbalances.

In a concise review of the consensus literature, on whether joining a monetary union is the appropriate monetary and exchange rate regime for a specific country, Professor Simona Beretta, Catholic University of Sacred Heart in Milan, shows how the current “Euro crisis” illustrates the inherent weaknesses of the institutional design of the Economic and Monetary Union (EMU). Underlining the importance of non-material conditions and furthering political integration in times of deep financial uncertainty, she makes a plea for ‘incomplete’ but resilient institutional architectures.

Further drawing from the European experiences of monetary integration, Terhamba Ambe-Uva, Professor at the National Open University of Nigeria, contributes a more specialized perspective regarding the option of a common currency for the entire West African region. This could, for example, be done by introducing a common currency in non-WAEMU countries and consequently joining it with the WAEMU zone’s CFA Franc into a region-wide currency, the Eco.

The final article of Dr. Paulina Mendes, Permanent Researcher at the National Institute for Research and Analysis (INEP) in Bissau analyzes the experience of Guinea-Bissau’s integration into WAEMU. The article highlights not only the effects of integration on macroeconomic stabilization but also on socio-economic developments and cultural convergence. Furthermore, she investigates which lessons the Euro zone could draw from WAEMU’s experience.

The WAI-ZEI anthology at hand, reveals the magnitude of existing obstacles and the number of open questions which remain, in regard to economic and monetary integration. Demonstrating, that in order to provide a sound basis for concrete policy advice, further academic analysis is needed. This collection is intended to inspire further research and policy reflection in order to enhance the knowledge-base of sustainable regional integration.

*George Owusu*

## ***Factors Shaping Economic Integration and Regional Trade in West Africa***

### ***Introduction***

After many years of efforts to promote economic integration and regional trade, countries of the West African economic bloc still remain surprisingly isolated from each other. The attention paid in the past on talks and seminars aiming to deepen harmonization of administrative rules and regulations for effective integration appear to have achieved very little. Most of member countries of the region still have their umbilical cord tied tightly to the womb of their colonial masters. This situation has been compounded by the recent influence of new global players such as Brazil, Russia, India, China and South Africa (BRICS). In addition, similarities in export commodities and overreliance on the Bretton Wood institutions for economic relief and global regulations on trade, have contributed immensely to the external influences currently exerted upon various attempts to promote free trade and effective integration among member countries in the region.

Indeed, the prevailing complexities of the international financial markets and the intricacies of trade regulations conveniently twisted by the various global economic powers, call for an urgent attention towards effective integration among countries in West Africa. Foroutan (1992) observed factors such as structural characteristics of the economies, the pursuit of import-substitution policies and the uneven distribution of costs and benefits of integration arising from economic differences, as the main reasons why effective integration in sub-Saharan Africa (SSA) has almost remained a mirage. He adds that despite a renewed interest in regionalism in the world, it remains unlikely that regional integration as pursued in Sub-Saharan Africa so far will succeed any more in

## **Factors Shaping Economic Integration And Regional Trade**

the future (Foroutan 1992, p. ii). Years after these observations and predictions, countries in the region are still struggling to achieve any meaningful trade integration.

While Foroutan's (1992) concerns remain formidable obstacles, the colonial geographical boundaries between countries appears to have deepened in recent times, due to widespread political unrest and unbridled colonial ties. The current political situation in Cote d'Ivoire and Mali, and the involvement of France is a clear illustration of how the political space in the region is controlled by outside forces. In the areas of trade and economic management, the less the influence of the western institutions such as WTO, IMF and the World Bank, the better!

In spite of these seemingly insurmountable challenges, free trade and effective regional integration in West Africa remains an integral part of the current efforts towards achieving socio-economic development in the region. Not for nothing, is open regionalism viewed among scholars as a sensible response to the ongoing turbulent and asymmetric process of economic globalization (Ansah-Koi and Boafo-Arthur 1995; Machinea and Rozenwurcel 2005). It is therefore time the member countries rekindle their resolve for the old agenda towards achieving effective economic integration (Ansah-Koi and Boafo-Arthur 1995).

Using selected data from the recent World Bank's World Development Indicators (2012 Edition), this paper examines external influences on economic integration and regional trade in West Africa. It starts with a brief historical account of the economic blocs in West Africa, followed by a discussion of structural characteristics of the countries in the region. The paper analyzes trends of important macroeconomic variables, in order to explain external influences on economic integration and regional trade in West Africa. It concludes with possible means to overcome the relatively low levels of intra-regional trade within the ECOWAS economic bloc.

### ***Economic Blocs in West Africa***

The Economic Community of West African States (ECOWAS), which was founded on 28th May 1975, is the main economic bloc in West Africa. It is made up of fifteen West African countries, namely: Benin, Burkina Faso, Cape Verde,

Côte d'Ivoire, The Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo. As one of the pillars of the African Economic Community, it has been primarily tasked to achieve collective self-sufficiency for its member states, by creating a single large trading bloc through an economic and trading union. Outside of peace-keeping missions in the region, which usually reminds the people in the sub-region of the existence of ECOWAS, ECOWAS has achieved very little.

Considering the difficulties in penetrating the markets of the countries of the North, due to trade barriers, especially non-tariff barriers, the quest for integration was perceived as one of the best means to attain development objectives and address globalization issues (Zannou, 2010). Yet, years after its establishment, the ECOWAS Treaty had to be revised in 1993 to reinforce the integration process. The revised treaty created new entities for monitoring and refereeing (the Court of Justice and the Parliament) as well as new financial mechanisms (ECDPM, 2006). The new treaty aimed to ensure the establishment of an economic and monetary union, with a view to boosting economic growth and development in West Africa (Diop et al., 2008; Zannou, 2010). This was to be achieved through the elimination of customs duties on intra-ECOWAS trade and taxes of similar effects, through establishment of a common external tariff, harmonizing economic and financial policies, and creating a single monetary zone.

While much was expected of the 1993 Treaty, its overall achievements have prompted many to question whether the ECOWAS Treaty needs further revision. Series of reformations, since the 1993 revision, have failed to make any meaningful impact. Although ECOWAS has been a free-trade zone since 2000 (ECDPM, 2006), the desire to have effective intra-community trade is yet to materialize and intra-West African trade remains stunningly low. According to CEDEAO (2005) and Zannou (2010), the share of intra-community trade to the total ECOWAS trade volume, is around 12 to 15 percent. This share of intra-regional trade among ECOWAS countries compares favorably to several other regional economic communities: 10.7 percent in the case of the West African Economic and Monetary Union (WAEMU); 12.8 percent (EAC); 7.7 percent in Southern Africa Development Community (SADC); 16.2 percent for Southern Common Market (MERCOSUR); 9.6 percent for Caribbean Community (CARICOM) and; 9.6 percent (ANDEAN). However, intra-regional trade in West Africa is far below the European Union's 60.4 percent share of of intra-region

## Factors Shaping Economic Integration And Regional Trade

trade in 2003 (Rahman et al., 2006; Zannou, 2010); and about 72 percent in 2009 (Murray, 2011).

Other groups within the ECOWAS bloc include the Mano River Union (MRU), which was created in 1973. MRU was initially composed of Liberia and Sierra Leone but now includes Guinea and Côte d'Ivoire, which joined in 1980 and 2008 respectively. In 1994, another regional integration initiative, the West African Economic and Monetary Union (WAEMU) was created in the context of the devaluation of the CFA franc (Zannou, 2010). WAEMU inherited much of its institutional framework from the West African Monetary Union (created in 1962) and the West African Economic Community (created in 1973) (ECDPM, 2006). WAEMU membership includes seven French-speaking West African countries from the former CFA zone (Benin, Burkina Faso, Cote D'Ivoire, Mali, Niger, Senegal and Togo) and Guinea Bissau. With its political agenda focused on the consolidation of its customs union, along with the improvement, convergence and monitoring of national macroeconomic policies and the elaboration and implementation of sector policies, the WAEMU is the most advanced regional integration process in West Africa (ECDPM, 2006).

According to Ngaide (2012), although the WAEMU is exclusively made up of Francophone countries in West Africa, it represents a deepening of the integration process in the entire sub-region. He adds that based on its achievements, in terms of exchange stabilization and the establishment of common and organized tariff regimes, WAEMU has inspired respect from both domestic and international donors and has demonstrated that obstacles to sub-regional integration can be overcome when players focus on the essentials of integration.

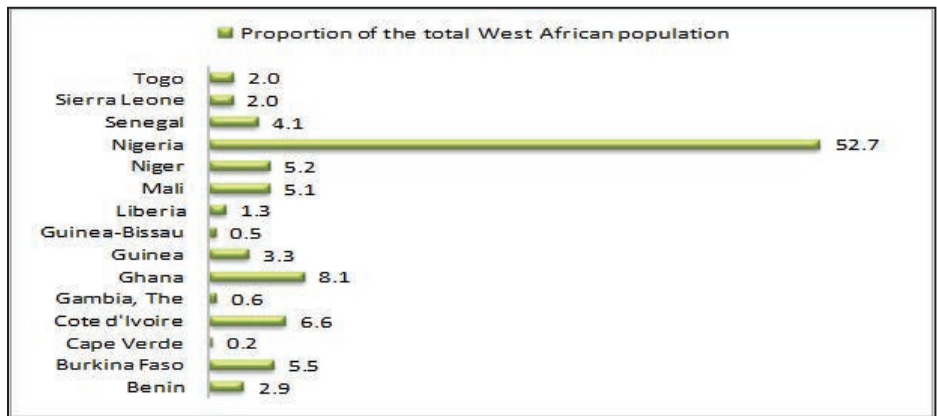
Another economic group, the ECOWAS Monetary Cooperation Program (EMCP), was adopted in 1987 to create a single monetary zone in the sub-region. As part of efforts to implement the EMCP, the Heads of State of six ECOWAS countries decided in 2000 to establish a second monetary zone known as the West African Monetary Zone (WAMZ). The WAMZ is made up of mostly Anglophone countries of the West African sub-region, namely Nigeria, Ghana, Sierra Leone, The Gambia, and Liberia plus Guinea, none of which are members of the WAEMU. These countries account for about 60% of the population in the ECOWAS sub-region, as well as its GDP. In January 2001, in order to hasten the realization of WAMZ objectives, the West African Monetary Institute (WAMI) was established to commence preparatory work towards the

introduction of a single currency and a common central bank in the WAMZ. However, persistent failures in achieving convergence criteria outlined for the introduction of a single currency, for WAMZ zone, have rendered WAMZ very ineffective to date.

### ***Structural Characteristics of Countries in West Africa***

The structural characteristics of countries have been described as one of the main determinants of open regionalism (Foroutan, 1992). In situations where countries appear to have similar macroeconomic characteristics, it becomes very easy for them to financially integrate. However, the difficulty of achieving free exchange of goods and services among these countries becomes tricky if they produce the same exportable goods. We discuss in this section some structural characteristics of countries in West Africa.

Figure 1: Estimated proportion of people living in the various ECOWAS countries in 2010



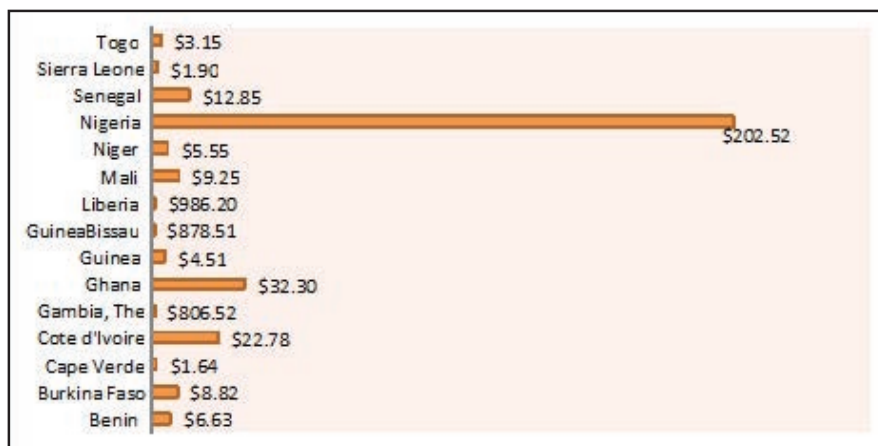
Source: World Development Indicators 2012

The size of an economy can explain, to some extent, the benefits it is likely to attain from integration and free trade. Figure 1 and Appendix 1 illustrate the size of the economies in terms of proportion of the total number of people living in West Africa. Out of the estimated 300.7 million people in the sub-region in the year 2010, almost 53 percent were reported to be living in Nigeria alone. Ghana, the second largest country in terms of population possessed just about

## Factors Shaping Economic Integration And Regional Trade

8 percent. This distribution suggests that Nigeria has the needed market power to attract foreign investment and possibly parade as a strong force in the globalized economy of powers. Therefore, Nigeria compared to Cape Verde, the least populated country in the region, might not be in as serious need of a regional integration.

Figure 2: GDP in current billion US\$ (2010)



Source: World Development Indicators 2012

In terms of Gross Domestic Product (GDP) (see Figure 2 & Appendix 2), Nigeria still dominates with about \$202.5 billion, out of the total regional GDP of \$314.6 billion recorded in 2010. This represents 64.4 percent of the region's GDP, making Nigeria a potential power to contend with other economic powers of the world. However, per capita GDP as shown in Table 1 suggests that Nigeria is economically not too powerful. The country's per capita GDP in 2010 was the third highest in the region, after that of Cape Verde and Ghana. Therefore Nigeria is only a low middle income country, with the potential for fast economic growth through regional economic integration.



Table 1: GDP per capita (current US \$)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	346.00	352.90	404.60	496.60	547.10	561.60	601.50	683.70	799.80	771.70	749.50
Burkina Faso	212.40	222.40	252.70	318.80	370.50	382.30	394.70	449.30	518.60	509.30	535.60
Cape Verde	1,233.30	1,265.00	1,371.60	1,769.40	1,980.20	2,055.40	2,316.50	2,756.00	3,181.90	3,227.90	3,322.80
Cote d'Ivoire	628.20	624.20	668.60	787.00	873.10	908.00	947.70	1,061.60	1,233.20	1,190.80	1,154.10
Gambia, The	324.50	312.90	268.70	259.00	274.40	306.60	328.50	409.00	502.40	436.10	466.50
Ghana	259.70	270.40	306.20	369.90	420.10	495.40	919.60	1,084.50	1,226.20	1,090.40	1,324.60
Guinea	373.00	341.40	354.80	394.10	412.40	324.80	306.60	449.10	395.30	426.70	451.90
Guinea-Bissau	173.70	157.40	157.90	361.40	389.80	418.80	414.60	485.00	582.50	562.40	579.90
Liberia	197.00	184.70	186.70	135.00	148.70	166.60	184.60	211.40	230.30	229.30	246.90
Mali	214.50	225.90	278.50	352.40	381.60	402.60	431.60	509.70	604.30	601.30	601.90
Niger	164.60	172.00	185.40	225.40	243.30	262.10	270.80	307.70	371.60	351.30	357.70
Nigeria	371.80	378.80	455.30	508.40	644.00	802.80	1,014.60	1,129.10	1,374.70	1,091.10	1,278.40
Senegal	493.60	499.80	532.20	666.00	758.90	799.10	838.80	986.50	1,135.70	1,054.70	1,033.90
Sierra Leone	153.50	187.20	207.70	209.50	221.30	240.50	266.90	303.70	348.30	323.50	324.70
Togo	277.30	269.60	292.20	340.20	389.70	391.10	398.30	446.40	547.60	534.90	523.10

Source: World Development Indicators 2012

Nevertheless, a general trend across the countries in the sub-region as shown in Table 1, is the significant growth in GDP per capita (see Alaba, 2012). Across the region for many countries, growth of GDP per capita has doubled or tripled. The outliers, in terms of GDP per capita growth are Ghana, Nigeria and Senegal. In the case of Ghana, GDP per capita rose from about US\$260 in 2000 to about US\$1324 in 2010. A similar trend, to some extent, is observed in Nigeria and Senegal.

A key question to consider, is the extent to which increasing prosperity across the individual countries facilitates or hinders economic and trade integration, in the West African sub-region. Arguably, this situation could be described as a double-edged sword whereby increasing prosperity reinforces the current condition, or the status quo, in terms of weak trade and economic integration. As countries find no compelling reason to discontinue or weaken their links with their current trading partners outside of ECOWAS. On the other hand, increasing prosperity could accelerate and deepen the process of integration as economic infrastructure is developed to facilitate further growth – fuelling regional trade directly or indirectly.

Inflation, a measure of cost of living in a country, is one of the convergence criteria being adopted by WAMI to measure the degree of uniformity for the possible adoption of a single currency in the WAMZ and later in the whole West African sub-region. Table 2 indicates the trend of average inflation in West

## Factors Shaping Economic Integration And Regional Trade

African countries for the period 2000-2010. In broad terms, the Table shows that the costs of living vary across countries in the region.

Table 2: Average inflation, consumer prices (annual %), 2000 - 2010

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	346.00	352.90	404.60	496.60	547.10	561.60	601.50	683.70	799.80	771.70	749.50
Burkina Faso	212.40	222.40	252.70	318.80	370.50	382.30	394.70	449.30	518.60	509.30	535.60
Cape Verde	1,233.30	1,265.00	1,371.60	1,769.40	1,980.20	2,055.40	2,316.50	2,756.00	3,181.50	3,227.90	3,322.80
Cote d'Ivoire	628.20	624.20	668.60	787.00	873.10	908.00	947.70	1,061.60	1,233.20	1,190.80	1,154.10
Gambia, The	324.50	312.90	268.70	259.00	274.40	306.60	328.50	409.00	502.40	436.10	466.50
Ghana	259.70	270.40	306.20	369.90	420.10	495.40	919.60	1,084.50	1,226.20	1,090.40	1,324.60
Guinea	373.00	341.40	354.80	394.10	412.40	324.80	306.60	449.10	395.30	426.70	451.90
Guinea-Bissau	173.70	157.40	157.90	361.40	389.80	418.80	414.60	485.00	582.50	562.40	579.90
Liberia	197.00	184.70	186.70	135.00	148.70	166.60	184.60	211.40	230.30	229.30	246.90
Mali	214.50	225.90	278.50	352.40	381.60	402.60	431.60	509.70	604.30	601.30	601.90
Niger	164.60	172.00	185.40	225.40	243.30	262.10	270.80	307.70	371.60	351.30	357.70
Nigeria	371.80	378.80	455.30	508.40	644.00	802.80	1,014.60	1,129.10	1,374.70	1,091.10	1,278.40
Senegal	493.60	499.80	532.20	666.00	758.90	799.10	838.80	986.50	1,135.70	1,054.70	1,039.90
Sierra Leone	153.50	187.20	207.70	209.50	221.30	240.50	266.90	303.70	348.30	323.50	324.70
Togo	277.30	269.60	292.20	340.20	389.70	391.10	398.30	446.40	547.60	534.90	523.10

Source: World Development Indicators 2012

A striking feature of Table 2 is that average annual inflation rates appear to be generally low across the Francophone West African countries, compared to the Anglophone countries of the region. For instance, the average inflation rates in 2010 were relatively high for Sierra Leone, Nigeria and Ghana (the region's three key economic giants). With the exception of Guinea, with annual average inflation of 15.5 percent, all the other Francophone countries and Guinea-Bissau have annual inflation rates of less than 3.0 percent in 2010. In addition, the average inflation rate differences among the Francophone countries are not too striking compared to the Anglophone countries. This means that while the cost of living appears to be similar for the countries in Francophone West Africa, it varies across the Anglophone West African countries. The extent to which this tendency facilitates or hinders regional integration is a matter yet to be explored.

Integration and free trade among economies is greatly enhanced by the level of technology available. According to Mussa (2000), technology is one of the important factors which influence the pattern and pace of economic integration in its various dimensions. Using the number of internet users per 100 people as a proxy for technology use, it appears ICT is yet to catch the attention of the people in the sub-region (see Table 3). However, there seems to be an encouraging growing trend in technology use, especially in countries such as Cape Verde, Nigeria and Senegal, and to a limited extent Ghana and The Gambia.

Table 3: Number of internet users per 100

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	0.2	0.4	0.7	1.0	1.2	1.3	1.5	1.8	1.8	2.2	3.1
Burkina Faso	0.1	0.2	0.2	0.4	0.4	0.5	0.6	0.8	0.9	1.1	1.4
Cape Verde	1.8	2.7	3.5	4.3	5.3	6.1	6.8	8.3	20.0	25.0	30.0
Cote d'Ivoire	0.2	0.4	0.5	0.8	0.8	1.0	1.5	1.8	2.0	2.3	2.6
Gambia, The	0.9	1.3	1.8	2.4	3.3	3.8	5.2	6.2	6.9	7.6	9.2
Ghana	0.2	0.2	0.8	1.2	1.7	1.8	2.7	3.8	4.3	5.4	9.5
Guinea	0.1	0.2	0.4	0.5	0.5	0.5	0.6	0.8	0.9	0.9	1.0
Guinea-Bissau	0.2	0.3	1.0	1.4	1.8	1.9	2.1	2.2	2.4	2.3	2.5
Liberia	0.0	0.0	0.0	0.0	0.0	..	..	0.6	0.5	0.5	7.0
Mali	0.1	0.2	0.2	0.3	0.4	0.5	0.7	0.8	1.6	1.9	2.7
Niger	0.0	0.1	0.1	0.2	0.2	0.2	0.3	0.4	0.7	0.8	0.8
Nigeria	0.1	0.1	0.3	0.6	1.3	3.5	5.5	6.8	15.9	28.4	28.4
Senegal	0.4	1.0	1.0	2.1	4.4	4.8	5.6	7.7	10.6	14.5	16.0
Sierra Leone	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	..
Togo	1.9	2.8	3.6	3.7	3.8	4.0	4.3	4.5	4.8	5.1	5.4

Source: World Development Indicators (2012 Edition)

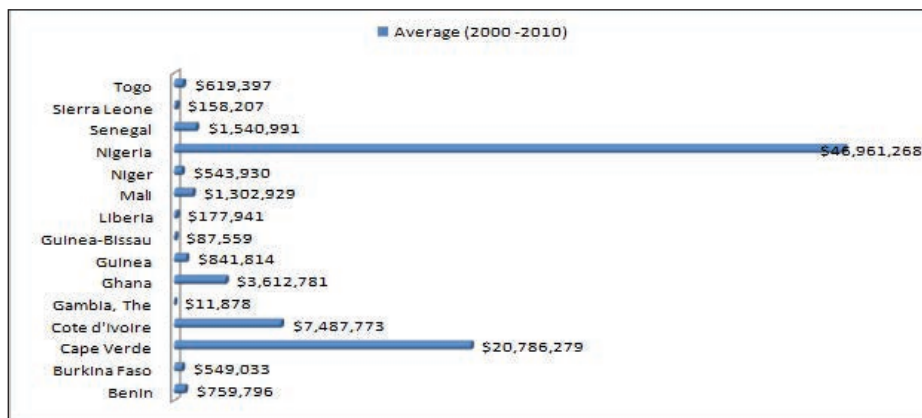
The role of modern means of communication, such as the internet, as a key facilitator of trade across borders cannot be overemphasized. According to Awotwi and Owusu (2007), the incorporation of web-based internet applications and other information technologies, combined with processes that implement these technologies, enhance access to and delivery of information and services to the public and business enterprises. This brings about improvements in business operations and thus, facilitates the process of economic growth and poverty reduction. In principle, weak ICT technology and its use amongst countries of the West African sub-region, may partly account for the relatively low level of intra-trade among the countries of the region.

It has been argued that regional trade is facilitated, to a large extent, if countries in the region produce commodities others in the region do not, but are in need of (Adenikinju et al. 2002). Figure 3 provides information on the average merchandise exports for the ECOWAS countries for the period 2000-2010. The figure reveals the overwhelming position of Nigeria as the dominant economy in West Africa, with average merchandise exports of almost US\$47 billion for the period, 2000-2010. This is followed, to a limited extent, by Cape Verde (almost US\$20.8 billion), Cote d'Ivoire (about US\$7.5 billion) and Ghana (US\$3.6 billion). Interestingly, petroleum products dominate the exports of the last two countries. In the case of the average merchandise imports for the region between 2000 and 2010 (see Figure 4), Nigeria dominates with Liberia, Ghana and Cote d'Ivoire following in that order. This renders Nigeria, Cote d'Ivoire and Ghana as very

## Factors Shaping Economic Integration And Regional Trade

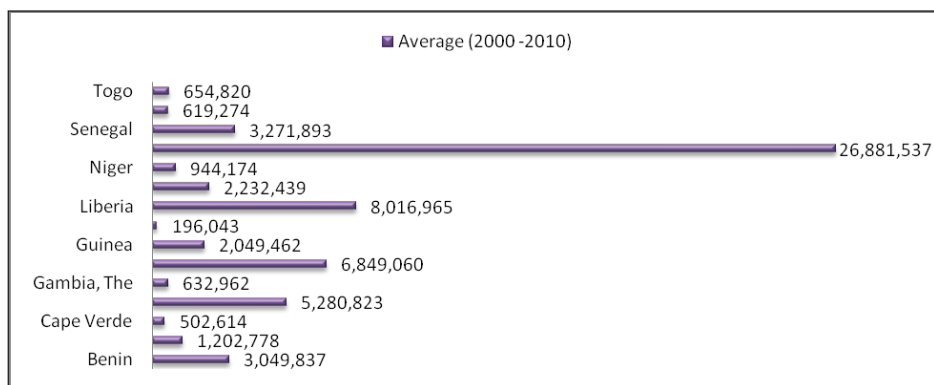
important agents for trade and economic integration in the sub region, as they have relatively high levels of both merchandise exports and imports.

Figure 3: Average merchandise exports (000' US\$), 2000- 2010



Source: World Development Indicators 2012

Figure 4: Average merchandise imports (in million US\$), 2000-2010



Source: World Development Indicators 2012

Table 4 shows merchandise trade as a proportion of GDP of the West African countries. Liberia tops in this category with a trade volume of 95.5 percent of the country's GDP. However, like many developing countries, Liberia's trade is

hugely influenced by exports and the trend of the country's volume of exports during the past decade is quite discouraging (Figure 3). Apart from Burkina Faso, where the volume of trade had always been far below 50 percent, all the other countries have been reporting trade volumes more than half of their GDPs.

Table 4: Merchandise trade (% of GDP)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Country Average
Benin	44.6	42.0	41.8	40.3	36.1	37.2	41.5	55.6	53.4	49.0	51.3	44.8
Burkina Faso	31.4	31.2	30.0	29.2	34.2	31.8	33.0	34.0	33.7	34.0	37.8	32.8
Cape Verde	44.7	43.3	46.1	44.7	48.3	46.9	50.8	57.8	55.3	46.9	47.7	48.4
Cote d'Ivoire	61.2	61.6	68.5	66.0	75.1	82.9	82.3	77.6	78.0	77.9	79.7	73.7
Gambia, The	48.0	34.5	46.7	44.8	59.6	58.0	53.3	51.2	40.9	43.5	36.1	47.0
Ghana	93.3	91.7	74.2	72.6	73.5	76.0	51.4	49.8	54.5	53.5	57.6	68.0
Guinea	41.1	46.1	45.1	36.2	41.6	57.0	70.5	57.5	71.7	50.7	52.1	51.8
Guinea-Bissau	56.2	62.8	55.5	27.4	30.4	34.1	34.7	39.8	38.6	41.9	39.3	41.9
Liberia	177.8	65.7	63.3	67.9	95.8	83.2	102.1	95.2	125.3	79.6	94.4	95.5
Mali	55.8	65.2	53.9	50.4	48.0	49.8	57.4	52.4	62.2	53.1	56.2	54.9
Niger	37.7	35.2	34.4	35.7	38.9	42.1	40.0	42.2	48.5	52.5	55.5	42.1
Nigeria	64.6	61.7	43.2	51.6	60.1	63.4	58.6	61.1	64.7	52.7	62.3	58.5
Senegal	52.0	56.0	56.7	53.2	54.1	58.4	56.2	57.8	65.0	52.7	54.0	56.0
Sierra Leone	25.5	26.2	33.4	39.9	38.8	40.6	43.6	41.5	38.4	40.5	58.1	38.8
Togo	69.6	68.5	69.0	78.1	71.9	81.3	77.9	75.8	76.2	73.1	74.5	74.2
Regional Average	60.2	52.8	50.8	49.2	53.8	56.2	56.9	56.6	60.4	53.4	57.1	55.2

Source: World Development Indicators (2012 Edition)

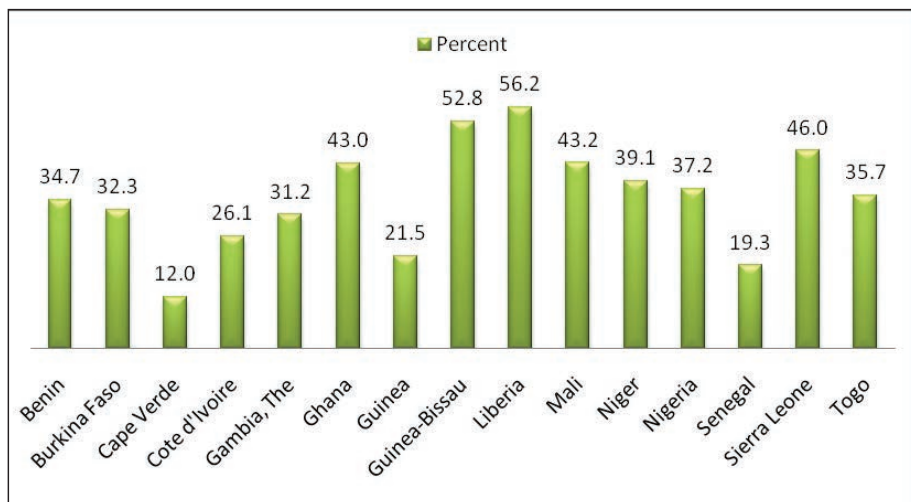
Figure 5 and Appendix 4 show the trend and level of difference amongst the structures of the various economies in West Africa, from 1980 to 2010. Apart from Cape Verde (12 %), Guinea (21.4%) and Senegal (19.3%), all other countries generated/gained at least a quarter of their GDP from activities in the agricultural sector. This means that economies in West Africa are largely dependent on agriculture. Agriculture is the main source of income for 60 percent of the region's population and satisfies 80 percent of regional food needs (Alaba, 2012).

According to Alaba (2012), agriculture possesses the most significant potential to foster regional integration in West Africa, due to the diverse ecological endowments and livestock and crop varieties that cut across many countries in the region. He adds that although regional agricultural production and trade have improved in recent decades, meat, dairy and cereals still remain high on the import bills of countries. These agricultural products, which are mainly imported from Europe, Asia and North America, represent about half of the regional imports and their value has doubled in the last decades.

## Factors Shaping Economic Integration And Regional Trade

Yet, these are products which can be produced and traded amongst countries within the West African sub-region, with positive multiplier consequences for regional economic growth and poverty reduction.

Figure 5: Average agriculture value added (% GDP), 1980 - 2010



Source: World Development Indicators 2012

## Factors Influencing Regional Economic Integration and Trade

This section examines the trends of some important macroeconomic variables, in order to explain external influences on economic integration and regional trade in West Africa. It examines external influences on economic development and trade in the sub-region, such as the growing debt stock, the continued attachment to former colonial masters, the economic community's weak legal and institutional regimes and poor infrastructure within and across countries.

### *Growing Debt Stock*

We begin the discussions with the impact of the growing debt stocks owed to external entities by the member countries of West Africa. Historically, West African economies are noted for their economic alliances with developed economies and western international financial institutions, especially the World

Bank and International Monetary Fund (IMF). For instance, in the early 1980s, some countries in the region had to subscribe to World Bank/IMF economic reforms. These reforms were designed in light of neo-liberal orthodoxy, with a particularly optimistic view about the efficacy of the market mechanism (Donkor, 1997; Aryeetey and Tarp, 2000; Nugent, 2004). By implication therefore, upon subscription to the reforms, a country was expected to liberalize its financial sector, to the standard designed by the donors. This means the countries in the sub-region that went under the Economic Recovery Program (ERP), had to operate under the directives of World Bank/IMF for some years. Such directives usually have no reference to the treaties of regional economic groups in the sub-region.

Another economic programme directly related to the accumulated debt stock, is the Heavily Indebted Poor Countries (HIPC) relief initiative. The initiative created a series of conditions within which countries should operate in order to receive a package of debt relief. These debt relief packages have terms and conditions which compromise local and regional standards, and therefore expose debt-burdened countries to influences external to their national and regional boundaries. In short, as long as countries in the sub-region are prepared to receive loans, they must expect external influences from donors.

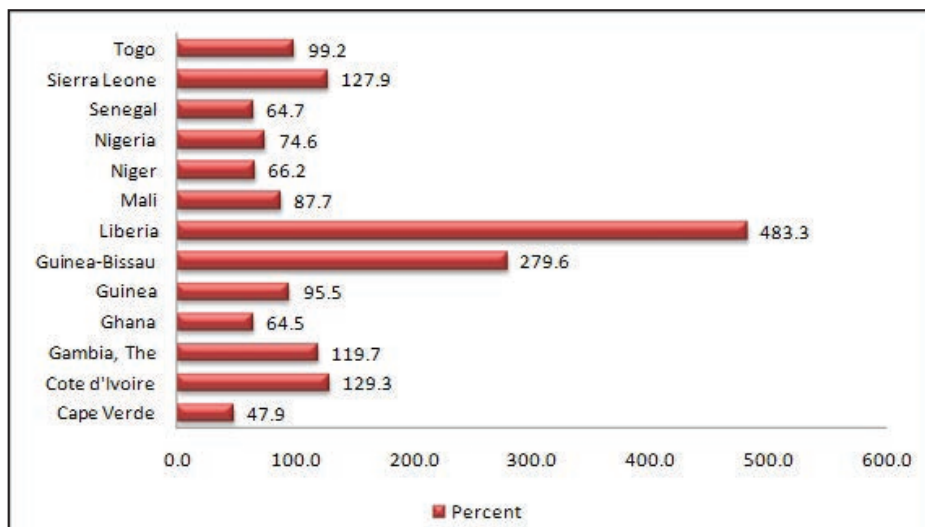
Figure 6 illustrates (see also Appendix 4) the average external debt stock as a percentage of each country's GNI, from 1980 to 2010. Liberia and Guinea-Bissau led in this category. In the case of Liberia, the managers of the economy may need to dedicate about five-years of total gross national income to debt repayment, in order to wean themselves out of external directives.

A close observation of Figure 6 reveals that across the countries of the West Africa sub-region average debt stock to GNI remains high. While the situation for Liberia and Guinea Bissau is extremely high, it is also high in countries such as Cote d'Ivoire, Sierra Leone, The Gambia and Togo. Even for the country with the lowest debt stock, Cape Verde, its average external debt stock as a proportion of GNI for the period 1980 – 2010, was almost 48 percent. In light of weak economic growth, these debts are likely to be serviced and repaid by further borrowing and/or using revenues generated from exports. In both scenarios, the integration project stands to be compromised as resources through borrowing are required, which come with further conditions, or through forgoing in-country investments, which could have facilitated regional integration. Thus, as countries struggle to

## Factors Shaping Economic Integration And Regional Trade

use their limited resources to wean themselves off further debts, the prospect of deepening regional integration is likely to be put to the backburner.

Figure 6: Average external debt stock (% GNI), 1980 - 2010



Source: World Development Indicators 2012

### *Continuous Attachment to Colonial Masters*

Even though it is recognized that in recent decades, African countries (including countries in West Africa) have developed a strong attachment to the new global players of the BRICS, there is overwhelming evidence of the continuous influence colonial masters exert on their former colonies.<sup>1</sup> However, this condition prevails due to the failure of independent African countries to restructure their economies, as well as the poor governance systems experienced by most countries in the post-independence era (Nugent, 2004). Table 5 shows the trend of net bilateral flow of financial resources between France and countries in West Africa. It is clear from Table 5 that a significant proportion of financial

1 The analysis here focuses on the influence exerted on West African countries by their former colonial masters. This, however, does not in any way belittle the influence exerted by other global players, such as the BRICS (Brazil, Russia, India, China and South Africa).



resources from France go to its former colonies. The only exception to the trend was the flow from France to Liberia, in the year 2010. Just like France and its former colonies, Table 6 also reports that a chunk of net bilateral aid flow from the United Kingdom (UK) to the economies in the West African bloc go principally to the UK's three former colonies; Nigeria, Ghana and Sierra Leone.

With such a huge bilateral flow of aid, it does not come as a surprise to see these former French- and British colonies economically and politically aligned to France and Britain respectively. However, the unflinching alliance between the colonial masters and their former colonies may damage economic integration and regional trade amongst countries in the sub region. This is against the backdrop of the economic community's weak legal and institutional regimes. Under such conditions, countries feel emboldened to side-step ECOWAS primary laws (treaty provisions establishing ECOWAS) and secondary laws (composed of all other legal instruments passed by ECOWAS) (Salami, 2011).

Table 5: Country share of total net bilateral flows from France to ECOWAS (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	11.12	9.29	4.49	5.64	5.28	2.12	2.55	6.53	7.50	2.81	4.78
Burkina Faso	12.31	9.62	5.98	10.12	7.02	3.93	4.54	13.28	16.05	4.32	6.26
Cape Verde	0.65	0.57	0.35	0.59	0.39	0.20	0.15	0.69	0.99	0.22	0.29
Cote d'Ivoire	23.40	24.13	58.96	17.86	5.22	2.72	3.69	5.86	4.46	66.91	13.58
Gambia, The	0.01	0.11	0.04	0.06	0.01	0.01	0.02	0.09	0.05	0.02	0.03
Ghana	0.49	0.97	1.13	2.79	6.26	1.88	0.80	4.81	4.86	2.77	3.31
Guinea	2.96	4.46	2.50	4.54	6.07	1.48	0.71	6.37	8.25	4.58	3.53
Guinea-Bissau	1.00	0.84	0.44	0.55	0.45	0.15	0.34	0.39	0.63	0.34	0.18
Liberia	0.12	0.33	0.19	0.20	0.07	0.03	0.07	0.13	3.03	0.02	22.75
Mali	14.69	13.29	7.05	10.72	6.84	4.14	2.82	24.76	9.25	4.17	7.60
Niger	6.19	8.08	3.82	23.92	16.44	3.48	3.07	6.56	7.66	3.20	4.90
Nigeria	0.61	3.24	0.98	1.23	0.62	70.51	70.07	1.37	1.34	0.51	0.87
Senegal	22.04	22.38	11.59	18.33	42.80	7.78	9.94	20.44	21.36	7.86	15.41
Sierra Leone	0.11	0.43	0.40	0.21	0.29	0.10	0.07	4.82	0.14	0.02	0.03
Togo	4.31	2.26	2.07	3.25	2.23	1.47	1.15	3.90	14.43	2.26	16.47
Total	100	100	100	100	100	100	100	100	100	100	100

Source: World Development Indicators, 2012

### *Liberal Trade Policies and Technical Obstacles for Regional Exchanges*

While there is a yearning desire to pursue regional integration, the process has been challenged by liberal trade policies and technical obstacles for regional trade. Like many countries in Sub-Saharan Africa, economic reforms and structural adjustment programmes (SAPs) since the mid-1980s have resulted in West African countries adopting a liberalized economic model involving the free

## Factors Shaping Economic Integration And Regional Trade

import and export of commodities. These liberal trade policies which favored massive imports from the West and Asia, are in direct competition with regional products. According to Soule (2012), regional trade is further hampered by the multiplication of control points along national borders, as well as racketeering and corruption which increases transaction costs. He adds that recent studies have shown extremely high transaction costs of the many control points in West Africa. It is therefore no wonder that many countries in the region look elsewhere in terms of trade and economic exchanges.

Table 6: Country share of total net bilateral flows from UK to ECOWAS (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	0.08	0.04	0.02	8.22	0.00	0.00	0.07	-0.03	0.00	0.01	0.00
Burkina Faso	0.24	0.90	0.12	0.04	1.25	0.11	0.08	-0.07	0.05	0.04	0.02
Cape Verde	0.02	0.00	0.00	0.00	0.00	0.00	0.02	0.10	0.23	0.15	0.16
Cote d'Ivoire	0.59	0.62	4.76	0.83	1.14	0.13	0.05	-7.12	0.10	0.03	4.52
Gambia, The	1.14	1.94	0.70	0.36	0.09	0.06	0.12	0.96	1.09	0.77	0.34
Ghana	43.39	50.44	49.73	48.17	54.10	4.96	4.82	29.16	43.49	31.71	28.99
Guinea	0.22	0.56	1.08	0.82	0.61	0.06	0.03	0.21	0.33	0.18	0.00
Guinea-Bissau	0.08	0.02	0.00	0.00	0.00	0.00	0.00	0.01	0.04	0.03	0.01
Liberia	1.78	0.60	1.16	2.97	3.18	0.31	0.44	2.37	9.35	6.88	4.45
Mali	0.54	0.59	2.78	0.08	0.07	0.05	0.12	-0.08	0.00	0.01	0.01
Niger	0.86	0.27	0.24	0.17	1.62	0.33	0.18	0.45	2.12	1.28	0.55
Nigeria	12.43	16.90	16.93	16.56	24.36	91.16	91.88	54.86	13.62	38.91	46.05
Senegal	1.30	0.49	0.23	0.26	1.76	0.29	0.29	2.21	0.28	1.34	0.16
Sierra Leone	37.09	26.36	22.05	21.36	11.77	2.51	1.89	16.90	26.71	16.53	14.76
Togo	0.23	0.27	0.19	0.16	0.06	0.04	0.02	0.05	2.60	2.15	-0.01
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: World Development Indicators, 2012

Table 7: Merchandise imports from developing economies within region (% total merchandise imports)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Country Average
Benin	22.2	26.5	26.3	27.5	27.1	29.1	9.8	7.8	7.1	7.4	7.7	18.0
Burkina Faso	31.0	31.1	30.4	45.1	44.9	30.1	32.3	29.5	28.8	40.6	43.4	35.2
Cape Verde	1.8	2.1	2.4	5.4	2.7	3.2	1.7	1.5	1.9	2.3	1.5	2.4
Cote d'Ivoire	28.1	22.1	20.1	18.8	24.4	28.6	31.7	28.7	34.6	26.8	29.1	26.6
Gambia, The	16.0	13.2	15.2	14.3	18.3	22.1	22.1	18.3	20.7	15.5	16.9	17.5
Ghana	22.1	25.0	25.2	26.2	24.3	25.6	25.6	22.0	24.4	24.4	24.9	24.5
Guinea	24.4	21.2	10.5	12.5	21.4	10.6	8.1	6.5	5.9	5.7	6.4	12.1
Guinea-Bissau	13.6	16.6	23.1	37.4	30.1	23.3	21.5	24.1	24.6	17.8	22.1	23.1
Liberia	1.3	1.2	1.0	1.3	1.8	2.4	2.3	1.6	1.4	0.9	0.9	1.5
Mali	26.0	24.5	23.2	20.2	25.5	28.0	27.9	30.0	32.5	25.7	30.9	26.8
Niger	13.2	35.0	32.2	34.0	27.7	19.9	21.6	23.6	19.1	17.0	21.1	24.0
Nigeria	4.1	8.9	4.5	5.0	6.1	6.0	5.5	4.8	4.4	4.7	4.9	5.4
Senegal	19.2	16.0	15.0	19.2	18.9	18.0	11.1	15.0	19.7	15.9	15.2	16.7
Sierra Leone	6.4	8.1	9.6	11.5	17.0	18.9	18.4	16.2	12.3	24.3	24.8	15.2
Togo	22.1	16.8	17.0	19.5	18.0	17.1	16.4	14.2	19.1	16.0	13.6	17.3
Regional Average	16.8	17.9	17.0	19.9	20.5	18.9	17.1	16.3	17.1	16.3	17.6	17.8

Source: World Development Indicators 2012

The evidence of external influences on economic integration and trade in West

Africa is illustrated by Table 7. The data from Table 7 suggests that only 17.8 percent of total merchandise imports to the region, during the last decade (2000–2010), as coming from countries within the region. This means a significant amount of imports came from countries outside the region. However, the French-speaking countries (WAEMU) appear to have received a relatively higher number of imports from countries within the sub-region compared to Liberia, Cape Verde and Nigeria. In particular, the low regional imports of Nigeria and Cape Verde are of interest, as both countries are regarded as potential key propellers for regional economic growth – Nigeria for its large market and economy and Cape Verde for its growing per capita income and manufacturing base.

Table 8: Merchandise exports to developing economies within region (% total merchandise exports)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	country Average
Benin	10.7	7.3	28.2	19.9	26.7	25.7	24.8	27.6	27.1	31.9	29.9	23.6
Burkina Faso	22.0	23.2	22.2	89.3	79.4	23.7	22.8	30.2	25.4	14.6	13.7	33.3
Cape Verde	1.8	1.7	5.9	1.2	0.8	0.5	4.7	0.6	6.2	0.1	0.4	2.2
Cote d'Ivoire	27.5	27.4	29.1	20.9	25.5	27.6	26.9	28.8	29.1	27.6	30.6	27.4
Gambia, The	18.0	10.3	7.4	8.1	10.2	12.6	7.2	9.2	8.1	5.9	7.0	9.5
Ghana	5.3	6.1	8.4	8.9	8.9	9.6	10.0	11.0	10.4	11.5	10.7	9.2
Guinea	6.4	14.6	3.1	10.6	1.4	1.4	1.4	1.5	2.2	2.6	2.3	4.3
Guinea-Bissau	1.2	3.8	4.5	20.1	14.4	18.6	28.9	10.6	30.3	26.4	30.5	17.2
Liberia	1.2	0.8	0.9	1.3	1.4	1.3	13.6	1.1	4.4	18.2	32.2	6.9
Mali	6.4	9.1	6.9	3.8	3.4	2.4	2.1	4.2	8.5	11.3	6.6	5.9
Niger	48.5	45.3	43.7	41.0	31.1	26.7	22.5	32.5	54.4	26.6	77.6	40.9
Nigeria	7.0	6.4	9.4	8.4	9.3	8.8	8.3	8.8	8.9	10.8	9.6	8.7
Senegal	27.7	29.4	32.0	38.2	38.4	42.0	42.8	50.6	48.3	44.3	50.2	40.4
Sierra Leone	4.2	6.1	3.5	1.6	1.6	3.4	2.5	4.4	2.8	9.1	8.0	4.3
Togo	40.4	63.0	60.4	57.3	62.4	69.5	60.9	53.7	74.5	54.4	63.2	60.0
Regional Average	15.2	17.0	17.7	22.0	21.0	18.3	18.6	18.3	22.7	19.7	24.8	19.6

Source: World Development Indicators 2012

Additionally, merchandise exports (see Table 8) from West African countries to countries within the region, during the decade, were not very different from merchandise imports. Members of the WAEMU again exported relatively higher proportions of their total merchandise exports to countries within the sub-region: Togo (60%), Niger (40.9%), Senegal (40.4%), Cote d'Ivoire (27.4%) and Benin (23.6%). Compared to WAEMU members, the figures from Cape Verde and the Anglo-phone countries of the region are very low: Cape Verde (2.2%), Sierra Leone (4.3%), Liberia (6.9%), Nigeria (8.7%), Ghana (9.2%) and The Gambia (9.5%). Combining both merchandise imports and exports, it can be deduced that the French-speaking countries have been trading extensively among themselves. The extensive use of a single currency amongst the French-countries

## Factors Shaping Economic Integration And Regional Trade

within the WAEMU framework and the lingering Anglophone and Francophone divide could partly be facilitating factors. Added to this, are the prevailing liberal trade policies of countries which favor the massive importation of goods into of West Africa, as well as technical difficulties of conducting trade across national borders (Soule, 2012) as noted earlier.

Table 9: Merchandise exports to high-income economies  
(% total merchandise exports)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	country Average
Benin	23.4	8.1	17.5	20.5	15.9	13.1	24.8	22.6	27.2	14.5	13.0	18.2
Burkina Faso	76.5	75.1	72.8	9.8	19.7	73.0	68.5	66.6	70.6	41.3	39.2	55.7
Cape Verde	97.5	98.3	94.1	98.7	99.0	86.6	79.3	88.2	89.9	98.1	95.7	93.2
Cote d'Ivoire	50.2	52.1	57.8	65.2	61.3	57.3	60.3	58.2	59.3	59.3	51.6	57.5
Gambia, The	71.3	78.6	70.1	52.5	55.6	31.7	41.0	36.7	30.8	32.5	44.7	49.6
Ghana	74.8	72.7	70.1	66.9	63.3	60.3	60.5	56.3	50.5	51.9	52.8	61.8
Guinea	80.6	84.4	76.1	78.1	66.2	55.0	45.5	41.8	44.8	51.7	35.1	59.9
Guinea-Bissau	6.9	7.9	11.6	14.0	29.9	5.5	5.9	1.2	1.9	2.4	4.0	8.3
Liberia	84.2	81.8	89.1	87.5	86.1	76.7	76.5	73.6	52.3	72.9	58.4	76.3
Mali	50.7	47.6	53.3	38.2	28.3	33.1	45.0	28.6	24.9	28.7	43.9	38.4
Niger	51.0	54.3	55.7	58.2	68.4	72.5	64.6	64.6	43.6	72.9	16.7	56.6
Nigeria	70.4	69.3	61.5	69.1	72.4	78.5	72.2	67.8	69.2	63.2	64.3	68.9
Senegal	48.7	41.6	34.4	32.2	31.6	29.5	31.0	33.2	17.9	30.0	26.9	32.5
Sierra Leone	91.2	83.2	88.6	89.9	91.7	89.6	90.7	77.9	70.5	76.0	63.1	82.9
Togo	25.1	21.7	26.0	27.0	19.4	13.1	9.3	7.2	6.8	8.0	11.2	15.9
Regional Average	60.2	58.4	58.6	53.9	53.9	51.7	51.7	48.3	44.0	46.9	41.4	51.7

Source: World Development Indicators 2012

Table 10: Merchandise imports from high-income economies  
(% total merchandise imports)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Country Average
Benin	61.5	57.4	56.1	55.2	50.8	54.2	29.1	29.7	35.9	34.3	34.8	45.4
Burkina Faso	52.6	51.5	46.8	36.9	35.3	42.8	38.4	37.4	38.9	41.2	37.3	41.7
Cape Verde	85.9	85.6	86.7	82.6	84.5	82.3	84.7	85.4	84.2	83.9	83.7	84.5
Cote d'Ivoire	46.2	49.7	58.5	61.3	56.8	53.3	46.3	45.5	36.2	38.3	34.7	47.9
Gambia, The	46.8	46.5	42.0	40.5	34.0	33.7	29.5	27.4	30.0	30.5	27.0	35.3
Ghana	61.3	56.1	52.6	47.5	47.2	44.5	41.9	40.1	39.7	41.6	40.7	46.7
Guinea	61.5	62.4	71.1	59.6	33.4	39.3	35.1	34.0	36.1	32.5	26.2	44.7
Guinea-Bissau	48.5	49.8	46.9	37.2	43.0	55.7	50.7	46.0	42.0	36.1	38.8	45.0
Liberia	93.0	94.8	94.7	95.1	90.3	90.8	86.9	83.9	82.9	80.3	69.6	87.5
Mali	32.7	34.5	31.9	33.1	32.5	29.6	30.1	29.7	28.2	33.7	28.1	31.3
Niger	80.5	44.5	42.6	40.9	53.2	62.5	59.4	60.1	48.6	51.0	49.1	53.9
Nigeria	75.2	70.9	73.8	62.7	56.3	53.1	54.0	56.4	54.3	51.7	49.6	59.8
Senegal	58.8	59.9	59.8	54.0	52.4	52.5	60.1	51.1	45.9	48.9	51.7	54.1
Sierra Leone	81.3	75.4	77.2	69.5	60.0	56.2	43.3	45.6	42.5	37.7	35.5	56.7
Togo	62.6	64.1	63.7	61.1	55.4	54.1	55.5	55.7	47.9	50.4	50.9	56.5
Regional Average	63.2	60.2	60.3	55.8	52.3	53.6	49.7	48.5	46.2	46.1	43.8	52.7

Source: World Development Indicators 2012

Contrary to the low merchandise exports and imports recorded during the decade (2000 – 2010), amongst the economies within the West African sub region, merchandise exports and imports recorded during the same period amongst economies in West Africa and high-income economies, appear to be very high (see Tables 9 and 10). This means that countries in the sub-region do export and import a significant percentage of their total merchandise exports and imports to and from high-income countries. However, in percentage terms, merchandise exports to the high-income economies of Europe, North America and Asia appear to be very high in the case of Cape Verde and the Anglophone countries of West Africa.

Nevertheless, a closer look at Table 10 reveals that unlike merchandise exports to high-income economies, where relatively higher figures were recorded for Cape Verde and the Anglophone countries, there is some uniformity across countries in the sub-region with respect to merchandise imports. With the exception of Cape Verde and Liberia, the country averages for Francophone and Anglophone countries appear be fairly similar.

### *The Regional Economic Community's Weak Legal and Institutional Regimes*

According to Salami (2011), most of the sub-regional economic integration arrangements (including ECOWAS) aimed at establishing a common customs union and market, through the abolition of obstacles to the free movement of goods, persons, services and capital, have failed due to weaknesses in their legal and institutional framework. He adds that this weak legal and institutional framework has impacted negatively on the ability of regional economic communities to achieve their goals.

Using the European Union (EU) as a model for regional integration, Salami (2011) demonstrates why ECOWAS and other sub-regional economic communities in Africa are weak due to the absence of legal and institutional frameworks which enforce the laws and regulations of the organizations. In particular, Salami (2011) notes the significant role of the European Court of Justice (ECJ) in the effective functioning of the EU. As the institution charged with the interpretation and application of the EC treaty (both primary and secondary legislations), the ECJ, as part of its functions, has the power to interpret EU treaty provisions where national courts or tribunals fail to do so. Indeed, referrals of landmark

## Factors Shaping Economic Integration And Regional Trade

cases to the court and the subsequent implementation of these ECJ interpretations in national jurisdictions, confirm the existence of the supremacy of EU law (Salami, 2011).

Clearly, legal and institutional frameworks with the power and resources to interpret and enforce ECOWAS provisions, as with the EU/ECJ, are currently the rare condition in West Africa. As the legal and institutional structures of ECOWAS are lacking any real power to make member states comply with their treaty obligations, or the capacity to rule and enforce conditions hindering the development of a common market and integration process, the process is left to the whims and caprices of individual countries. However, these countries have few incentives to deepen the process of integration, due to the circumstances they find themselves in; namely growing indebtedness and the established links with colonial masters for development assistance. Thus, the weak legal and institutional framework of ECOWAS is both a cause and consequence of external influences and weak regional economic integration and trade in West Africa.

### ***Conclusion***

It is clear from the ensuing discussions that trade and economic integration among countries in the sub region still remains very weak. Countries in the region rather find it more convenient to trade with the high-income countries instead of trading with their counterparts in the region. Moreover, these countries receive higher forms of assistance from the high-income countries and therefore use trade as an expression of gratitude. The study also finds the colonial umbilical cord as very tight, especially in relation to the flow of aid and concludes that colonial masters have greater influence on their former colonies compared to the influence of ECOWAS on the individual economies of the region. Furthermore, the weak trade pattern among countries is facilitated by the existing liberal trade policies of many countries which favour massive importation of goods (including those produced in the sub-region), and weak legal and institutional framework for ensuring the enforcement of the ECOWAS treaty.

Nevertheless, a strong and wide range of opportunities exists for economic and trade integration, especially in the area of agricultural commodities. The

argument has been made that economic and trade integration in West Africa is weak, perhaps due to similarities in the agricultural export commodities produced in the region. However, this argument fails to appreciate the diversity of ecological zones and cultures, and production of a wide range of different agricultural commodities including cereals (maize, rice, millet, etc), dairy and meat, currently high on the import bills of many countries in the region.

However, the process of integration is likely to be hastened through the strengthening of the legal and institutional frameworks of ECOWAS allowing regional institutions the capacity to rule and enforce member states compliance with their treaty obligations. In addition, there is the need for member states to make conscious efforts to loosen their umbilical cord with their colonial masters. Taking into account the entrenched nature of the existing relationships with colonial masters, this is not going to be an easy task. However, change will only come about if there is recognition among all member states of the crucial importance of regional integration to their long-term socio-economic development. 2012.

### References

Adenikinju, A., Soderling, L., Soludo, L. and Varoudakis, A. 2002. *Manufacturing competitiveness in Africa: Evidence from Cameroon, Cote d'Ivoire, Nigeria and Senegal*. Economic Development and Cultural Change 50(3), pp.643-665.

Alaba, O. 2012. *The geographic and economic potentials of West Africa*. A paper presented at the Scientific and Political Dialogues Activities of the West African Institute (WAI), Abidjan, March 29-30, 2012.

Ansah-Koi, K. and Bofo-Arthur, K. 1995. *Regional integration in West Africa: Proceedings of a conference held October 1994 in Accra/Ghana*. Accra: Friedrich Ebert Stiftung.

Aryeetey E. and Tarp F. 2000. *Structural adjustment and after: Which way forward for economic reforms in Ghana?* Academy of Management Review 12(1), pp.67-75

Awotwi, J. A. and Owusu, G. 2007. *E-Governance in an environment with limited resources: A case study of Ghana*. ACM International Conference Proceeding Series 232, pp.345-348. Available at: <<http://doi.acm.org/10.1145/1328057.1328129>>

Donkor, K. 1997. *Structural Adjustment and Mass Poverty*. Aldershot: Ashgate

European Centre for Development Policy Management (ECDPM) 2006. *Overview of the regional EPA negotiations: West Africa-EU Economic Partnership Agreement*. ECDPM InBrief 14B, Maastricht. Available at: <[www.ecdpm.org/inbrief14b](http://www.ecdpm.org/inbrief14b)>

Foroutan, F. 1992. *Regional integration in Sub-Saharan Africa: Experience and prospect*. Trade Policy Research Working Papers, Country Economics Department, Washington: World Bank

Harsch, E. 2002. *Making African integration a reality*. Africa Recovery 16(2), pp.10-15.



Machinea J. L. and Rozenwurcel G. 2005. *Macroeconomic coordination in Latin America: Does it have a future?* Santiago: United Nations Publication.

Murray, E. 2012. *Outlook of regional integration in Latin America: Lessons learned, key players and potential network in West Africa*. A paper presented at the Scientific and Political Dialogues Activities of the West African Institute (WAI), Abidjan, March 29-30, 2012.

Mussa M. 2000. *Factors driving global economic integration*. A paper presented at a symposium on Global Opportunities and Challenges sponsored by the Federal Reserve Bank of Kansas City, on August 25, 2000, in Jackson Hole, Wyoming.

Ngaide, A. 2012. *Historical and cultural foundations of regional integration in Africa*. A paper presented at the Scientific and Political Dialogues Activities of the West African Institute (WAI), Abidjan, March 29-30, 2012.

Nugent, P. 2004. Nugent, P. (2004) *Africa since independence*. New York: Palgrave Macmillan.

Salami, I. 2011. *Legal and institutional challenges of economic integration in Africa*. European Law Journal 17(5), pp.667-682.

Soule, B.G. 2012. *Research assessment and strategy of key players on regional integration in West Africa*. A paper presented at the Scientific and Political Dialogues Activities of the West African Institute (WAI), Abidjan, March 29-30, 2012.

Zannou A. 2010. *Determinants of intra-ECOWAS trade flows*. [pdf] African Journal of Business Management 4(5), pp.678-686. Available at <<http://www.academicjournals.org/AJBM>>



*Sanoussi Bilal*

## ***External Influences on Regional Integration in West Africa: The Role of Third Parties***

### ***Introduction***

To be successful and meaningful, regional economic integration must first and foremost be driven by domestic forces. This is true also for West Africa. Nonetheless, regional integration does not happen in a vacuum. Numerous factors, ranging from historical and geopolitical to economic and ideological factors influence this process. Among these are the external partners to the regional grouping.

In the case of West Africa, former colonial powers, and more broadly the European Union (EU), have had a key impact on the contours, structure, content and dynamics of West African integration. But they are not the only ones. For instance, other African countries/regions and the African Union (AU) have also had an influence. So have some international organizations. Increasingly, emerging players may play a role as well, among others.

The aim of this paper is to briefly sketch some of the key influences of third parties to the regional integration processes in West Africa. In this context, particular attention is given to the European influence on West Africa, positive or not, which is then put in perspective with other influences. Section 2 looks at the influence of the European Union as a role model and source of inspiration for integration objectives and institutional setting, whereas Section 3 highlights the European support, notably in terms of development assistance, to West African integration. Section 4, 5 and 6 sketch the roles of other international partners,

## **The Role of Third Parties on Regional Integration in West Africa**

the pan-African dynamics and emerging players, respectively. Section 7 reflects on the ambitions of the economic partnership agreements promoted by the European Union, as a comprehensive set of reforms dynamics for integration, and how it can backfire. Finally, Section 8 concludes by stressing the primary role of endogenous dynamics in West African regional integration, which can at best only be accompanied by third parties, not more.

### ***The European Influence***

The experience of the European integration has been widely perceived as not just an example, but also a model for regional integration. Indeed, in view of its long history, broad scope, further deepening and successive enlargements, the European Union has been perceived as the symbol of regional integration. And while replication is never an objective, the EU is often referred to as a possible aspiration, or at least point of reference, notably in terms of its institutional setting and policy coverage. In this sense, the EU has strongly influenced the recent integration process in West Africa.

Consider first the institutional setting. The West African Economic and Monetary Union (UEMOA) and the Economic Community of West African States (ECOWAS) have adopted some of the norms, legal provisions, institutions and policies similar to those of the EU. This development can be traced back from the colonial past of this region and its cultural, political and economic close ties with France. Like in Europe, West African economic integration is perceived as a tool to pursue deeper forms of integration with broader objectives.

UEMOA and ECOWAS have some of the key characteristics along the lines of the EU institutional setting (see Annex 1): a regional Commission, Council (Heads of States and Ministers), regional Parliamentary Assembly, regional Court of Justice, complemented by a Court of Auditors in UEMOA, an Economic and Social Council/Committee, a regional central bank and development bank. It is also worth pointing that the UEMOA Treaty is inspired by the Maastricht Treaty.

This is not to say that the European and West African institutions are exactly the same. Their powers and functioning differ, as does their level of integration. However, the closer integration between ECOWAS and UEMOA, which are in the process of forming a common customs union and monetary union, also

calls for an adaptation and further strengthening of their institutions, which are inspired by the EU experience.

One should stress the key role of France, and now the EU, in the monetary union of UEMOA. The establishment of the Franc CFA zone is the direct result of the will to keep the monetary tie with France following the independence of many former French colonies. Similarly, the creation of the UEMOA is linked to a 50% devaluation of the West Africa CFA Franc. With the creation of the Euro, the CFA Franc is no longer solely tied to the French Treasury and its French Franc, but to the European Central Bank and the Euro.

One of the European influences on West African integration results thus from its historical ties with the region, its geographical proximity and its cultural, economic and political connections and the attractiveness of the European model of integration. This may thus partly explain the strong emphasis on institutional and deep economic integration in the West African agenda of regional integration, as opposed to a more ad hoc or pragmatic approach to economic integration focused on effectively lowering barriers to integration and improving infrastructure ties, as somewhat pursued in Asia for instance.

### ***EU Support to West Africa***

The European Union strongly believes in the merits of regional integration, including as a tool for development. According to the European Commission (EC), regional integration among developing countries, if carried out in a transparent and open manner (i.e. open regionalism), contributes to their integration in the world economy and plays a key role in conflict prevention and peace consolidation (European Commission, 1995, 2002). Therefore, the EU, “in light of its experience and of the instruments at its disposal”, provides support to developing countries in their regional initiative (Council of the European Union and European Commission, 2000).

The European Parliament also shares the view of the European Commission and Council on the important role that regional integration and free trade agreements can play “in the establishment of a more equitable world trade system” and therefore fully support and encourage regional integration among developing countries (European Parliament, 2002, p.14).

## The Role of Third Parties on Regional Integration in West Africa

This support to regional integration initiatives takes various forms. It is part a political support on the principles of regional integration. That is, the EU should embrace and facilitate open regional integration initiatives among developing countries, which are perceived as a complement to multilateral trade integration. In this context, the EU is also willing to share its experience on regional integration matters with developing countries, acknowledging that each region has its specificities.

This is exactly what the EU is doing for West Africa. The EC has used Economic Partnership Agreement (EPA) as one of the main trade tools to support regional integration (see Section 4). Besides this 'political support' and experience sharing, the EU has also committed a sizeable share of its development aid and technical assistance to regional support, which is one of the six priority areas of its development assistance.

The European Commission support to West Africa focuses on priority areas such as building regional markets, including on services and investment, facilitating business development by improving the regulatory environment, strengthening productive capacities, and encouraging the mobilization of capital; connecting regional infrastructure networks (notably through the Infrastructure Trust Fund); contributing to improve food security, notably by supporting the ECOWAS Common Agricultural Policy (ECOWAP) and the Comprehensive Africa Agricultural Development Programme (CAADP); strengthening regional institutions by providing technical assistance and capacity building programmes as well as by improving national institutional capacities; improving regional governance and cooperation for peace and security, including in efforts to address terrorism, piracy, organized crime, drug trafficking and human trafficking, as well as by supporting efforts (notably by the AU and the United Nations) in peace consolidation and post-conflict reconstruction; and developing regional policies for sustainable development, especially with regards to the common management of natural resources, migration and social cohesion.

Regarding financial assistance, the 10th European Development Fund (EDF), which covers the period 2008-2013, currently constitutes the primary instrument of EU support to regional integration in West Africa. The regional funds thus received have the overall objectives to promote regional integration as a means to reduce poverty, promote economic growth, and favour peace and security. In West Africa, €597 million has been committed to the Regional Indica-

tive Programme (RIP). As illustrated in Table 1, out of these, €418 million been allocated to the specific objective of ‘deepening regional integration, strengthening competitiveness and implementing the EPA (see Table 2 for a specific articulation of these objectives); the rest is dedicated to improve good governance and regional stability and to finance other programmes such as environment and support to non-state actors.

Table 1: Regional Indicative Programme for West Africa, 2008-13

Type of support	Amount (€m)
Focal sector I: Deepening of regional integration, strengthening of competitiveness and implementation of the EPA	418
Focal sector II: Consolidation of good governance and regional stability	119
Other programmes (that could include support to non state actors)	60
Total	597

Source: European Union, 2008. *European Community – West Africa. Regional Strategy Paper and Regional Indicative Programme 2008 – 2013*. [pdf] Available at <[http://ec.europa.eu/development/icenter/repository/Scanned\\_r10\\_rsp\\_2007-2013\\_en.pdf](http://ec.europa.eu/development/icenter/repository/Scanned_r10_rsp_2007-2013_en.pdf)>

The respective National Indicative Programmes (NIPs) for West African countries under the 10th EDF also allocate €247 million for support in the areas of trade-related assistance and €1.067 billion for infrastructure, which to a large extent also contributes to foster regional integration.

## The Role of Third Parties on Regional Integration in West Africa

Table 2: Focal Sector 1 of the RIP for West Africa, 2008-2013

<b>Global objective</b>	Deepening of regional integration, strengthening of competitiveness and implementation of the EPA
<b>Specific objectives</b>	Support the region in: <ul style="list-style-type: none"> <li>a) Continuing the regional integration process through the implementation of reforms to come to a common market and the consolidation of macro economic stability</li> <li>a) Assure the effective implementation of the EPA by profiting fully of the expected positive effects and minimizing possible adjustment costs</li> <li>b) Strengthen the competitiveness of productive sectors and the network of regional infrastructure</li> </ul>
<b>Expected results</b>	The expected results of the RIP are the following: <ul style="list-style-type: none"> <li>a) customs union under ECOWAS created</li> <li>b) intra-community trade increased</li> <li>c) common market strengthened</li> <li>d) EPA being implemented</li> <li>e) export capacities of the region strengthened</li> <li>f) food security improved</li> <li>g) fiscal reforms implemented and fiscal effects of the EPA compensated</li> <li>h) knowledge of challenges for regional integration in key productive sectors strengthened</li> <li>a) management of regional road infrastructure improved</li> </ul>
<b>Intervention areas</b>	The main intervention areas for the focal area are <ul style="list-style-type: none"> <li>a) Deepening of regional integration</li> <li>b) Food security</li> <li>c) EPA programmes for development and improvement of competitiveness</li> <li>d) Continuing support to regional policy of inter-connectivity and strengthening of infrastructure</li> <li>e) Institutional support to economic governance</li> </ul>

Source: European Union, 2008. *European Community – West Africa. Regional Strategy Paper and Regional Indicative Programme 2008 – 2013*, see Table 1



In addition to these instruments, there are also a number of EU-wide Institutions and Initiatives that might potentially provide support to the PAPED in coming years, most notably as the European Investment Bank (EIB) and the EU Africa Infrastructure Fund. The EIB for example manages the Investment Facility established under the Cotonou Partnership Agreement. For the period 2008-13, €1.5 billion are available. This is in addition to the significant level of funds still available from the EDF9 tranche (which was originally set at €2 billion), as well as an additional €2 billion which it can lend to ACP countries from its own resources. The EU Infrastructure Fund includes contributions from the European Commission and EU member states.

There is also direct support by EU member states through their bilateral development cooperation programmes, particularly at the national level in partner countries in West Africa, but increasingly also at the regional level, in support of regional institutions (e.g. ECOWAS and UEMOA) and programmes (e.g. ECOWAP – the ECOWAS Agricultural Policy).

### ***International Support to West African Integration***

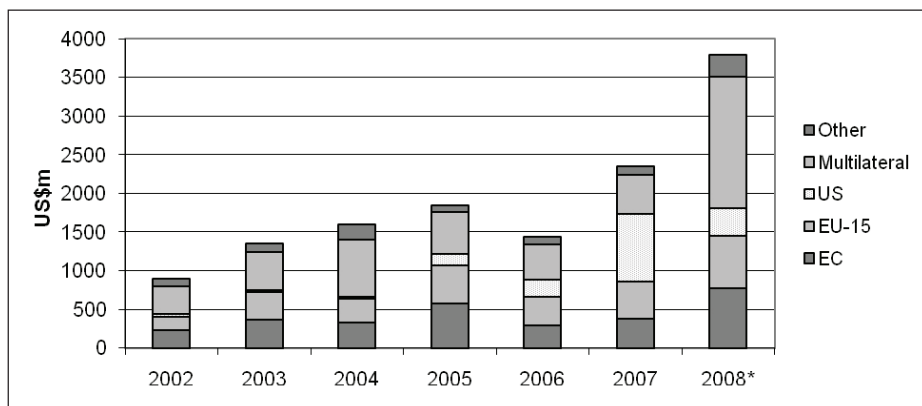
It is important to recognize that if Europe is a major source of financial support to regional integration in West Africa, it is by far not the only one. Data are notoriously difficult to obtain on regional aid. The most comprehensive source of information however can most probably be found by focusing on aid for trade (AfT), an important dimension of economic integration. As a result of recent commitments and increased attention to AfT amongst donors, levels of resources devoted to trade-related projects have witnessed significant increases in recent years. As illustrated in Figure 1, AfT flows to West Africa have increased significantly from US\$889m in 2002, to US\$3,789m in 2008 (an average nominal growth rate of more than 23 per cent per annum). Over the same period, AfT from the EU (EC and Member States) to West Africa has more than tripled in nominal dollar terms, from US\$400m to US\$1448. It is also worth noting that the largest increases have taken place in 2007 and 2008, as the 2005 AfT initiative began to be implemented in earnest.

Multilateral Institutions and Facilities, such as the World Bank, the African Development Bank and UN agencies, as well as the Enhanced Integrated Framework have delivered substantial assistance to West African countries. Their role

## The Role of Third Parties on Regional Integration in West Africa

has been predominant not only in terms of financial assistance, but also technical assistance, policy advice and knowledge partners.

Figure 1: Aid for Trade to West Africa, 2002-2008



Source: OECD-DAC, 2010: *QWIDS Query Wizard for International Development Statistics, Aid for Trade Activities*. Amounts are for commitments, in current US\$; amounts for 2008 are based on provisional data.

Interestingly, the bulk of the assistance to economic integration is taking place at the national level, not the regional one. As a result, some West African countries have received proportionally greater support for economic integration than others.

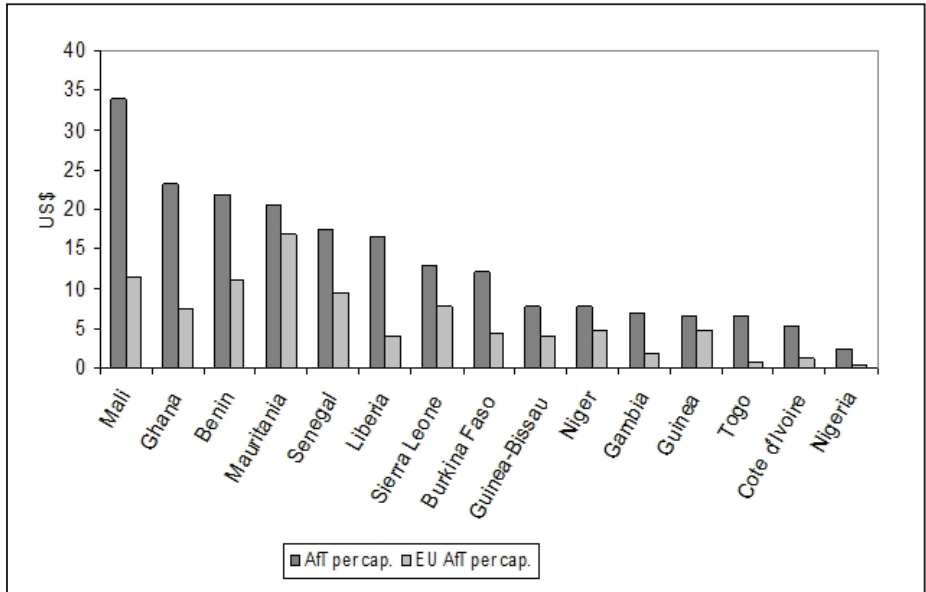
Considering the AfT per capita, Figure 2 helps identify possible 'Aid for Trade orphans' (e.g. Cote d'Ivoire, Gambia and Togo) that receive much less AfT on average when compared to more favoured countries (e.g. Benin, Mali, Mauritania and Senegal). This calls for a greater attention by all donors to the support provided to regional integration and a greater coherence between domestic agenda, at the national and regional levels, and the support received.

### **The African Dimension**

The regional integration process in West Africa cannot be fully appreciated if taken in isolation. Instead, it is part of a broader African dynamics to integration. Besides the historical dimension and somewhat arbitrary national borders

resulting from its colonial past, West Africa is part and parcel of the pan-African integration process. This is true in terms of dynamics as well as institutional setting.

Figure 2: Aid for Trade ‘Darlings’ and ‘Orphans’ in West Africa, 2008



Note: Data are provisional; EU = 15 EU members of the DAC

Source: OECD (Aft data), IMF (population and GDP), author's calculations.

In this respect, the African Union is playing an increasingly important role. The AU has recognized only 8 regional economic communities (RECs) as building blocs to the pan-African integration. Among them figures ECOWAS. But UEMOA, the still more deeply integrated region, is not included. The rationale is not to deny the achievements of UEMOA. On the contrary, the principle adopted is one favouring the deeper integration of West Africa under the ECOWAS umbrella but building on UEMOA's achievements.

Pan-African integration remains an ambitious and somewhat distant programme. But recent developments have contributed to pave the way to concrete progress. The two AU Summit of Head of States in 2012 have put 'boosting intra-Africa trade' on top of the agenda. The objective is to fast-track the move

## **The Role of Third Parties on Regional Integration in West Africa**

towards greater effective integration, making concrete steps to significantly reduce barriers and various impediments to trade among African nations, within and among RECs. While the setting of the Continental Free Trade Agreement (CFTA) by 2017 is unlikely to be achieved in time, it marks a clear indication of renewed political will to keep regional integration high on the agenda.

In this context, the dynamics of the Tripartite Free Trade Agreement (TFTA) among the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC), may have a significant bearing on West African integration as well. Launched by the Heads of States of the three RECs in Kampala in 2008, the TFTA has three pillars: market integration, infrastructure development, and industrialization.

The potential influence on West Africa is twofold. First, the TFTA perceived at the pan-African level has a key pillar to the CFTA. West Africa has been keen since to be perceived as the other main pillar of the AU integration process, building on its UEMOA-ECOWAS integration axis and its deep integration agenda. There may thus be a sense of emulation between West Africa and the CFTA, as well as sharing of experience. The AU may thus become a more dynamic forum for interaction among the RECs. The second possible influence may be to broaden the focus from the removal of trade barriers and the establishment of common external tariffs, to the effective integration agenda, with greater attention paid to the development of cross-border infrastructures and enhanced productive capacity, notably by fostering regional value chains. This might be translated again in West Africa by greater attention to regional programme implementation as a key complement to institutional and policy integration.

### ***The Role of Emerging Players***

The rising influence of emerging economies such as China, Brazil, India and others is also strongly felt in West Africa. In considering the role of such emerging players in the integration process of West Africa, two key characteristics must be kept in mind. First, emerging players are not donors, and though some traditional donors like to refer to them as 'emerging donors', they do not see themselves as such. Instead, South-South cooperation is the dominant framework of reference, for which aid has little relevance. Considering aid flows and

traditional development cooperation frameworks, as done in Section 3 and 4 for instance, would be strongly misleading. Second, most emerging players have engaged in South-South cooperation in a bilateral way, country-to-country relations, so far somewhat neglecting the regional dimension of cooperation. The main exception of course is the pan-African engagement of China and India for instance, in arenas such as the Forum on China-Africa Cooperation (FOCAC), the India-Africa Summits and India-Africa Business Council. But these remain mainly umbrella frameworks under which bilateral cooperation is further developed.

It should therefore come as no surprise that emerging players do not yet feature high in their engagement with regional integration initiatives, including in West Africa. Recent trends among emerging players do suggest however that African integration processes may be given more attention in a near future. This will mainly depend on the cohesion of regional groupings and the will of their members to engage emerging players on a regional platform as well, and not only in a bilateral way.

In West Africa, there are signs that this may slowly happen. For instance, on October 2012, China signed an agreement with ECOWAS for cooperation in infrastructure development, trade and investment. The agreement aims at encouraging business cooperation, promoting exchange of information and training on regional and international trade, and stipulating investment in agriculture, forestry, fishery, manufacturing, construction and financial sector.<sup>1</sup> But one of the key features of such agreement is to stimulate infrastructure development, as part of the US\$20 billion credit line offered to Africa at the last FOCAC Summit. This could include Chinese support to the trans-West African coastal highway stretching from Dakar to Lagos. More generally, infrastructure financing in West Africa has been stimulated by the Chinese investment in extractive resources and the need to develop appropriate infrastructure, notably in rail transport. Political and economic interests of China in West Africa seem to be well aligned.

This is apparently also the case of other emerging players, such as India and Brazil. India has privileged economic relations and business ties, which are reflected in the Memorandum of Understanding it signed with ECOWAS in May

1 See ECOWAS Press Release No 289/2012, 25 October 2012.

## The Role of Third Parties on Regional Integration in West Africa

2011 for instance. This covers strengthening of cooperation in areas such as banking, food and agro-business, as well as in metallurgical, mechanical, energy, textile, leather, transport, communication, electronic and biotechnology industries.<sup>2</sup> The increasing intensity of the relationship between West Africa and India has also been visible in the Indian support to the highly sensitive Cotton initiative in West Africa (notably for the Cotton-4 countries Benin, Burkina Faso, Chad and Mali), as well as through the development of regional business fairs.

Similarly, Brazil and ECOWAS have launched common initiatives to enhance their cooperation on poverty, food security, environment, renewable energy, capacity building and political dialogue<sup>3</sup>, though in practice efforts have concentrated on agriculture.

While the regional cooperation of emerging countries in West Africa remains in its infancy, it is mainly up to ECOWAS/UEMOA and their member countries to more forcefully engage with emerging partners on a regional basis, should they wish so.

### ***The EPA and West Africa Integration: Make it or Break it***

One of the most ambitious agendas to strengthen West African integration rests with the EU however, and the prospect of concluding a regional economic partnership agreement between ECOWAS and the EU. Paradoxically, however, it may also turn out to be one of the greatest threats to West African integration process.

#### *EPA rationale*

Following the provisions contained in the Cotonou Agreement, the African, Caribbean and Pacific (ACP) States and the EU officially launched negotiations on economic partnership agreements (EPAs) on 27 September 2002. After one year of initial negotiations at an all-ACP level, each of the main ACP regional groupings initiated bi-regional EPA negotiations with EU: Central Africa

2 See ECOWAS Press release No 065/2011, 9 May 2011.

3 See ECOWAS Press Release No.105/2010, 3 July 2010.

(CEMAC-plus) and West Africa (ECOWAS-plus) in October 2003, East and Southern Africa (COMESA) in February 2004, the Caribbean (CARIFORUM) in May 2004, Southern Africa (SADC-minus) in July 2004, and Pacific in September 2004.

The purpose of the negotiations with West Africa, as with other regional ACP groupings, has been to establish reciprocal free trade areas that aim to be first and foremost development-oriented, which should build on and foster the regional integration process of the region and facilitate their integration into the world economy. The negotiations were due to be completed by the end of 2007 for EPAs to enter into force by 2008.

The EPAs, as proposed by the European Commission, should be essentially enhanced, development-oriented free trade areas (FTAs). They were initially intended to cover not only trade in goods and agricultural products, but also in services, and address tariff, non-tariff and technical barriers to trade. Other trade-related areas should also be covered, including by increased cooperation between the EU and the ACP, such as competition, protection of intellectual property rights, standardisation and certification, sanitary and phytosanitary (SPS) measures, investment, trade and environment, trade and labour standards, consumer policy regulation and consumer health protection, food security, public procurement, etc.

A basic principle of EPAs contained in the Cotonou Agreement is that they should build on and reinforce the regional integration process of the ACP. According to the European Commission, by building on larger well-integrated regional markets, regional EPAs should contribute to foster the integration of the ACP in the world economy, provide for economies of scale, stimulate investment and contribute to lock in the necessary trade reforms.

The principle advocated by the European Commission is that economic integration at the regional level with the EU should reinforce the respective integration process of regional groupings. It should enhance the benefits from regional integration among developing countries, in the form of enhanced trade and investment flows for instance, from Europe and within the developing regions. This should provide stronger incentives to the members of regional groupings to commit to the objectives of the region (and not opt out from a grouping which is tied to the EU). This regional partnership with the EU should hence help to in-

## The Role of Third Parties on Regional Integration in West Africa

crease the credibility of regional integration processes, in particular in Africa. In this respect, the EU should also be perceived as an 'external guarantor' to avoid economic and integration policy reversal and create a lock-in effect through cooperation with the EU and possible bi-regional agreement (Lee, 2003).

For West Africa, the EPA should thus mainly offer the prospect of consolidation of the economic integration process within and between UEMOA and ECO-WAS. The partnership with Europe should also offer parallel accompanying development support to facilitate the adjustment process during the EPA implementation and strengthen the capacity of the West African countries and regions to take full advantage of the new development opportunities that the EPA should provide.

### *The reality check*

Perhaps with few exceptions, the EPA agenda has not generated the enthusiasm for effective development partnership it was meant to stimulate, not least in West Africa.

West Africa, like many other ACP regional groupings, has encountered some difficulties in having to speak with one voice during the negotiations with the EU. This was to be expected from a region which had never engaged in free trade negotiations with a third party such as the EU, on such a broad array of issues. Besides, tensions emerged, mainly during the early phase of the negotiations, between the UEMOA, which as a customs union with a common external policy, considered itself more advanced and homogenous in its negotiation positions than the broader, less integrated ECOWAS framework, which was only a free trade area where member countries retain full sovereignty in the determination of the external trade policy. A common position by an FTA like ECOWAS requires therefore a strong, well-developed coordination process among the member countries. Political will has often been insufficient, both at the national and regional level. Conflicting interests have generated tensions within the region. Weak institutional capacity, at domestic as well as UEMOA/ECOWAS levels, has also at times prevented West Africa to effectively defend the interests of its members during the negotiations with the EU.

The European Commission has also further contributed to exacerbate some of the regional tensions. This had already started in 2002-2003, when the EU



Trade Commissioner Lamy invited UEMOA representative to informally talk to him before the start of the formal regional negotiations. At that time, UEMOA was claiming to be ready to engage with the EU on an EPA, and complained about the lack of engagement of its other ECOWAS partners and more generally ACP countries. Later on, in 2007, the EU Trade Commissioner also fingered Nigeria for its lack of engagement in the negotiations, calling it “the elephant in the room” preventing progress.

But the EPA negotiations also contributed to put a greater emphasis on the regional agenda, including in West African countries and organisations. During the early phase of the regional EPA negotiations, particular attention was given during the negotiation sessions to the review of the regional integration process in West Africa. In addition, the pressure to reach regional positions on all EPA issues has contributed to elevate the profile of the regional dimension on the political agenda of West Africa. Hence, the EPA negotiation process has played a stimulus role to foster the attention to the regional integration and sharpen the regional agenda of West Africa, if only to provide a coherent front in the EPA context.

Yet, the conclusion of interim EPAs has had a very detrimental impact on the regional cohesion of many ACP groupings, and in particular in West Africa.

To date, only 37 ACP countries have concluded some type of agreement and only 25 have confirmed their commitment by signing an agreement, (15 of which are Caribbean).

In West Africa, only Ivory Coast and Ghana have concluded an interim EPA by the end of 2007, only to preserve their access to the EU market as the Lomé-type/Cotonou unilateral preferential trade regime expired at the end of 2007. Indeed, by October 2007, the West Africa region informed the EU that in view of the numerous issues still to be negotiated under the EPA, it would not be in a position to conclude an agreement by the end of the year. This was of little consequence for most West African countries. Indeed, out of the 16 countries in the West Africa grouping (15 ECOWAS plus Mauritania), 13 were Least Developed Countries (LDCs) at the time – Cape Verde has since graduated out of the LDC group. Under the Everything But Arms (EBA) initiative of the EU, as part of its Generalised System of Preferences (GSP), all LDCs exports are granted duty-free and quota-free market access to the EU. The end of the Co-

## The Role of Third Parties on Regional Integration in West Africa

tonou preferences on 1 January 2008 therefore did not translate into a loss of preferences for these 13 countries. On the contrary, Ivory Coast, Ghana and Nigeria are non-LDCs, and as such could only benefit from the GSP as of 2008 in the absence of an EPA. The resulting loss of preferences was of little value for oil-rich Nigeria, which therefore sided with the rest of the region. However, for Ivory Coast and Ghana, the loss of preferences would have had a significant impact on their economy, notably due to the high dependence on cocoa and banana exports to the EU preferences, not covered by the EU GSP. As a result, Ivory Coast and Ghana hurried to conclude on a country basis individual interim EPAs, which also effectively grant duty-and quota-free status to all their exports.

Needless to say, this has been the source of serious tensions within West Africa. Ivory Coast was chairing the region at the time. Ivory Coast and Ghana were blamed for undermining the regional solidarity. At the same time, Ivory Coast and Ghana complained about the lack of support of the two regional organisations, UEMOA and ECOWAS, which did not help them in finding a solution and conclude a more appropriate EPA. So, instead of consolidating regionalism in West Africa, the interim EPAs are a splinter in the economic integration process.

Ivory Coast signed its interim EPA on 26 November 2008, which was duly notified a few days later to the World Trade Organization (WTO). In contrast, Ghana only initialised its interim EPA at the end of the negotiations in December 2007, but has never signed it. It is worth noting that Ivory Coast has not yet initiated the ratification process of its agreement and none of them has started implementing their interim EPAs. Concluding an interim EPA has thus allowed both countries to keep the EU market open to their exports, without having conceded to start offering some reciprocity yet.

In parallel, negotiations towards a final regional EPA have continued since 2008 with all West African countries. Progress has been slow, but the European Commission remains hopeful of reaching a conclusion soon. There is indeed a new sense of optimism among some EPA negotiators, not least in the European Commission, which could mean that the conclusion of some EPAs is in sight, notably in West Africa and EAC. This would be a welcome outcome, provided it would reflect key interests of all parties. Indeed, should the region not be able to reach a common position on EPA, it would seriously disrupt the economic integration process in West Africa. Not only could ECOWAS not become an effective custom union, but the UEMOA common external tariff would also be-

come meaningless, as all imports from the EU would transit via Ivory Coast and Ghana to reach the West African market. So while a regional ECOWAS-EU EPA would be desirable, many uncertainties remain, and the disappointing experience of protracted negotiations definitely call for caution.

### *The development dimension*

Linked to the regional integration dimension, another fundamental concern for West Africa and the ACP in general has been the development dimension of the EPAs, or at times the perceived lack of it. The commitment to development-oriented EPAs, agreed upon by all the parties to the Cotonou Agreement, has been reiterated on numerous occasions by the key EU institutions (European Commission, European Parliament and the EU Council and its member states), ACP institutions (ACP Council), and West African and pan-Africa groupings (African Union, ECOWAS, UEMOA) and countries, as well as joint ACP-EU institutions (Council, Joint Parliamentary Assembly).

This development dimension can be articulated along three distinct but closely linked axes:

- (1) EPA commitments to liberalise trade and establish clear rules for the promotion of a better business environment, taking into account the exclusions and transition periods available to ACP countries for tariff liberalisation and for implementation of other parts of the agreement, and flexibilities in areas such as safeguards and infant industry protection;
- (2) the accompanying policies and reforms to institutions and structures that are necessary to take advantage of the new trading opportunities, and
- (3) the provision of appropriate development support to cover adjustment costs, carry out reforms and implement the agreement.

Within this framework, the Parties also recognise the clear need for the provision of development assistance to build capacity, and implement the EPAs and accompanying reforms. The EU is committed to provide EPA-related development assistance as part of the Aid for Trade initiative, through the European Development Fund and other EU institutions' and member states' sources, as discussed in Section 3. However, West Africa has called for larger and more comprehensive explicit binding commitments from the EU in the framework of the EPA.

### *The PAPED/EPADP*

It is in this context that the West Africa EPA Development Programme (EPADP/PAPED) originated. The PAPED is a West-African initiative, which has been elaborated by and for the region through a broad participatory approach led by the ECOWAS and UEMOA Commissions at both the regional and national levels. It intends to provide a framework to the request by the EU to identify the development cooperation needs resulting from an EPA.

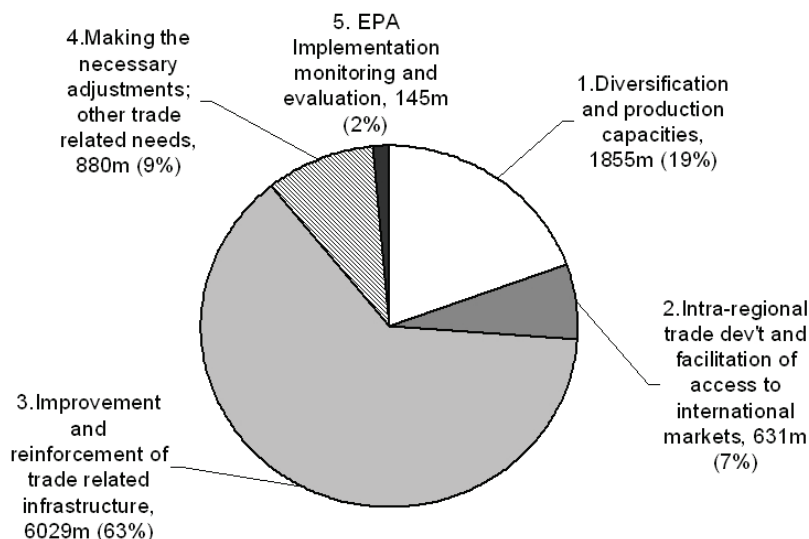
In terms of structure, the PAPED justifies the need for EPA accompanying measures, related to regional integration, on two grounds: to reap the benefits and to mitigate the negative impacts of the EPA. The PAPED consists of 5 'axes' for which EPA development support is needed, which are broken down further into different 'components' describing areas for programmatic support. Specific projects are elaborated at the national level through the definition of 'National Operating Plans' and an overall financing cost for each component for the initial five-year timeframe has been provided within the PAPED itself.

A breakdown of these costs by PAPED axis is shown in Figure 3.

In 2010, the total estimated cost of the PAPED, as presented in the overall regional framework, was €9.54billion over an initial period of five years. Two thirds of this amount is currently earmarked for trade-related infrastructure, such as rehabilitation of energy, road and telecommunications networks.

It should be stressed here that many elements of the PAPED embody goals with much broader relevance than the strict context of EPAs. The PAPED sets out a common regional vision – shared by the two regional organisations ECOWAS and UEMOA – of economic integration both within West Africa and with the wider world. As such, the PAPED may serve as a useful technical tool and an invitation for all donors, EU and non-EU, to engage in a more effective and coherent approach to addressing the trade-related and economic integration needs of the region in general.

Figure 3: Estimated Cost of Programmes by PAPED Axis (in Euro)



Source: PAPED

The EU has responded positively to the PAPED initiative. In its Conclusions on EPA Development Programme (PAPED) of 10 May 2010, the Council of the European Union agreed to “increase its total aid for trade in coherence with the gradual increase in overall development aid towards the established 2015 target and in response to needs prioritized by partner countries”. This is also in line with the joint Aid for Trade Strategy adopted by the EU in 2007. This commitment will be implemented through a range of existing channels at the EU level and through the bilateral programmes of the EU Member States, as well as through the contributions to the region via multilateral agencies, such as the World Bank, the African Development Bank (AfDB) and United Nations (UN) bodies. Besides reiterating commitments on aid for trade and aid effectiveness, the EU estimates that (i) “funds available for PAPED-related activities from all of its financing instruments over the next five years amount to at least 6.5bn Euros”, while (ii) “total aid for trade to West Africa from all donors can be projected to exceed 12bn US dollars in the same period”.

## The Role of Third Parties on Regional Integration in West Africa

However, while the EU highlights the availability of resources to support the PAPED, the Council Conclusion falls short of meaningful new funding commitments. The potential of the EU response to the PAPED therefore lies in its operationalisation.

The challenge ahead involves putting the Programme into operation, through the work of the West African countries, regional organisations, and donors, in order to exploit its potential added value as a strategic framework for AfT to West Africa.

To do so requires coherence between the PAPED and other regional and national strategic frameworks. As a tool designed, inter alia, to enhance the economic integration of the region, the PAPED sits alongside other important regional integration frameworks in West Africa, most notably the Regional Economic Programme of the UEMOA, the Community Development Programme of ECOWAS, Peace and Security initiatives and key sector policies (such as in energy and the ECOWAP in agriculture), as well as national development strategies. Effective mechanisms to ensure continuing coherence and coordination of the frameworks' implementation will be key to their success.

Ultimately, the merit of the PAPED and the EU support of it will depend on the political will and capacity of both West Africa and the EU to effectively translate principles and good intentions into coherent and coordinated actions.

### *The New EU Deadline: Amending MAR1528*

The European Commission announced on 30 September 2011 that countries that have concluded an Economic Partnership Agreement, but not taken the necessary steps to initiate its ratification, would no longer benefit from the EPA market access to Europe as from 1 January 2014. While the Council endorsed the EC proposal, the European Parliament then voted in favour of a 2016 deadline instead. Following a trilogue between the European Commission, the Council and the European Parliament, October 2014 has been set as a compromise, to match the end of the current Commission.

The EC Market Access Regulation (MAR) 1528 of 1 January 2008 provides duty free quota and free market access for African Caribbean and Pacific (ACP) countries that have concluded an EPA. The Regulation requires countries to

initiate the ratification process of the Agreement within a “reasonable period of time”. As it currently stands, the MAR is a temporary, unilateral instrument of the EU to ensure that, pending the implementation of the agreement by ACP countries, there would be no trade disruption.

The message sent by the EU is clear: if countries like Ivory Coast and Ghana want to continue to benefit from EPA market access, either they have to sign and start the ratification of their existing EPA or conclude a new regional EPA. For others, either they will fall under one of the schemes of the new GSP (i.e. Everything but Arms for LDCs, Standard GSP or GSP Plus) or they will have no preferences (as might be the case for Botswana and Namibia).

The intention of the EU is also clear: set a new deadline to provide a new impetus towards the conclusion of final EPAs, wherever possible, at the regional level. Replacing interim EPAs by regional final EPAs would certainly be a better outcome. The threat of removing EPA market access has the parallel advantage of seeking compliance with the WTO obligations should some countries be tempted to maintain the *status quo*.

As a result, it should be expected that some countries, somewhat like in 2007, will think harder about whether to conclude an EPA or not. Some countries might be pressured to sign and start ratification, and ultimately implement, of an EPA that might not really fulfil their ambitions and interests in terms of content, timing and geographical configuration, by fear of market disruption, in particular if they risk losing preferential access to the EU. However, others might simply walk out. If no common position can be found at the regional level, the EPAs could seriously disrupt any regional integration effort. Indeed, how can Ivory Coast and Ghana each have a bilateral free trade agreement with the EU, opening their domestic market to European products, while their West African partners, with whom they form a customs union, keep protecting their market from the EU? As already mentioned above, in practice, EU goods would flood the whole regional market via these two countries, rendering the West African customs union and further integration process totally ineffective. This scenario is not unique to West Africa; but it would have particularly detrimental consequences for that region.

However, 2014 is not 2007. The world has changed and this time the response might be different. The financial crisis invited itself to the dance, Africa has

## The Role of Third Parties on Regional Integration in West Africa

gained a lot more confidence in its economic prospects and the increasing importance of “emerging” partners has brought in a new geopolitical dynamism, de facto reducing the leverage of the EU. If a suitable agreement cannot be reached, expect some West African countries to walk out of the negotiations table. Whether the regional solidarity and common position will ultimately be maintained remains to be seen.

### ***Conclusion***

The regional integration process of West Africa is first and foremost an endogenous process, owned by West African countries and the regional institution setting they have designed to this end. Overreliance on external partners can only undermine this ownership. West Africa must thus keep their regional destiny in their own hands.

In doing so, however, they can usefully engage with third parties in a constructive way to best accompany their own integration process. Europeans have played an important role in this respect, as a source of inspiration as well as a source of support to regional dynamics in West Africa. But the dominant role played by Europe, as a model as well as aid dependency, may have also contributed to some of the problems faced by the integration process in West Africa. The arguably well-intended economic partnership agreements have already contributed to strain the relationship among West African countries and may ultimately lead to a break up of the economic integration process in ECOWAS and UEMOA, should West African countries fail to reach a common position at the regional level.

In this respect, multilateral and international support to regional initiatives may appear less constraining. So does the increasing engagement of emerging players such as China, India and Brazil, but also Turkey, South Korea, Indonesia, etc., who could become more active partners of West African integration. And the pan-African integration process may offer new opportunities for a multi-speed, yet more coherent integration of the Continent and West Africa.

Ultimately, it should be for West Africa to determine the terms of engagement with third parties in its integration process. Domestic and regional ownership, as well as clear political leadership, will be key in this endeavour.



## **References**

ECOWAS (Economic Community of West African Countries), 2012. *ECOWAS Press Release*, 289/2012, 25 October 2012.

ECOWAS (Economic Community of West African Countries), 2011. *ECOWAS Press Release*, 065/2011, 9 May 2011.

ECOWAS (Economic Community of West African Countries), 2010. *ECOWAS Press Release*, 105/2010, 3 July 2010.

*Treaty of ECOWAS 1975*. [pdf] Available at: <[http://www.iss.co.za/AF/RegOrg/unity\\_to\\_union/pdfs/ecowas/3ECOWASTreaty.pdf](http://www.iss.co.za/AF/RegOrg/unity_to_union/pdfs/ecowas/3ECOWASTreaty.pdf)>



*Lelio Iapadre, Philippe De Lombaerde, and Giovanni Mastronardi*

## ***Measuring Trade Regionalisation in Africa: The Case of ECOWAS<sup>1</sup>***

### ***Introduction***

The process of trade regionalisation can be defined as the tendency of trade flows to grow more intensely among neighbouring countries belonging to the same region (intra-regional trade) than among countries belonging to different regions (extra-regional trade). This results from the setting up of an increasing number of regional integration agreements on a preferential basis (regionalism), as well as from the tendency of firms to develop their activities more intensely within the borders of regions, than on a global scale (market-driven regionalisation).

More generally, it must be acknowledged that the network of international trade relations does not develop at the same rate across different partner countries. On the contrary, as predicted by gravity models, the intensity of bilateral trade flows exhibits a high degree of variability, depending on the relative size of the partner countries and on their distance, as well as on a set of additional factors segmenting national markets (tariffs, quantitative restrictions, different currencies, regulations, and so on) or creating preferential linkages, such as the use of a common language, migration flows, and free-trade agreements.

1 This paper is an updated and extended version of Iapadre and Luchetti (2009).

Regionalism is at the core of an intense debate in academic and policy circles. On the one hand, regional integration, particularly if it goes beyond the simple removal of trade barriers, has the potential to augment the production of transnational public goods and solve many difficult problems in the governance of cross-border relations. More specifically, the integration level that can be achieved on a regional scale is believed to be deeper than what could be feasible at the multilateral level. On the other hand, the development of often overlapping preferential integration schemes can have detrimental effects, by fragmenting the set of market regulations, diverting trade flows, and making the progress of multilateral negotiations more difficult. It is, therefore, of paramount importance to measure correctly the intensity of trade regionalisation, in order to improve the understanding of economic globalisation, feed the public debate on its effects on the progress of societies, and support decision-making at all levels.

One of the central stylized facts about intra-regional trade in Sub-Sahara Africa refers to its relatively low levels, which can then either be interpreted as an illustration (or even demonstration) of the ineffective or failing regional economic arrangements, or as an indicator of the lacking pre-conditions for further and deeper regional integration in the various African sub-regions. However, empirical evidence about trade regionalisation is often based upon simple statistical indicators that do not take adequately into account cross-country differences in the value of total trade, leading to unreliable rankings across regions. After recalling the limitations of these traditional measures, this paper presents a set of relatively new statistical indicators, with the aim of assessing more correctly the actual degree of regionalisation of trade among African countries.

The approach followed here is one of descriptive statistics. There is no ambition to establish causal relationships between the intensity of trade flows and regional integration agreements or other possible factors, a task which would require an econometric exercise going beyond the limits of this paper.

The next section presents a brief overview of the empirical literature on intra-regional trade dynamics in West-Africa with its main findings. Section 3 presents an overview of the results obtained by applying to African countries a set of traditional and new indicators of trade regionalisation. To this purpose, Africa has been divided into six non-overlapping regions, which correspond, as far as possible, to the main regional integration areas. Countries belonging to more

than one RIA have been assigned to the region towards which they show the maximum level of revealed trade preferences, as defined below. A list of regions with their member countries is provided in the Annex. The country composition of each region has been kept constant over time, regardless of the dates in which member countries accessed the RIAs. Section 4 is devoted more specifically to Western Africa, distinguishing between member countries of the West Africa Economic and Monetary Union (WAEMU) and the other members of the Economic Community of West African States (ECOWAS). The idea is to show to what extent the use of a common currency results into more intense intra-regional trade flows. Section 5 concludes by putting the issue of trade regionalisation under the more general perspective of Africa's role in global trade, arguing that the policy priority should be creating the material and immaterial infrastructure needed to increase the international openness of African countries, in a view to expand simultaneously intra- and extra-regional trade.

### ***Trade Regionalisation in West-Africa: a Brief Literature Review***

It is commonly believed that trade among African countries is relatively low, even in comparison with other developing areas. For example, UNCTAD (2009) compares the intra-regional trade share of African countries (9 per cent on average between exports and imports in 2004-06) to that of developing America (20 per cent) and Asia (47 per cent), and presents data going back to 1960, concluding that "Africa has consistently had a considerably lower proportion of intra-regional trade than other regions" (UNCTAD, 2009: 21).<sup>2</sup> Other analysts have also pointed to the low and insufficient levels of intra-regional trade in West-Africa, in particular, and Sub-Saharan Africa, more in general, and to the marginal increase of intra-regional trade levels over several decades of formal regionalism (Straubhaar 1987; Foroutan 1993; Foroutan and Pritchett 1993; Elbadawi 1997; O'Connell 1997: 140-142; Lyakurwa et al. 1997: 180; Jebuni 1997; Ogunkola 1998; Inter Africa Group 2002; Goldstein 2002, 2003; Diabré 2003; Kennes 2003; Slocum et al. 2003; Longo and Sekkat 2004; Odu-laru 2009; Keane et al. 2010; Zannou 2010; Igue 2011; Rommel 2011). The low

2 It is often argued that official data underestimate the actual importance of intra-regional trade in Africa, due to the large size of illegal and informal cross-border transactions. Although this problem can be particularly relevant for some countries, the overall picture should not be affected significantly (UNCTAD, 2009: 107).

levels of manufactured intra-industry trade have also been observed (Goldstein 2003: 42). And as Elbadawi remarked, “any number of ‘normative’ approaches - based on growth or welfare considerations - could be marshalled to derive the conclusion that [Sub-Sahara Africa] is not sufficiently integrated and that intra-SSA trade is ‘too little’” (Elbadawi 1997: 213).

These low levels of intra-regional trade are considered to be the long-lasting result of trade patterns established in the colonial age, when African countries were led to export their natural resources to Europe, without building economic linkages with neighbouring countries (NISER 2002). Moreover, this is often presented as evidence of the failure of regional integration agreements (RIAs) among African countries to achieve their trade goals. As Yeates (1999) and Goldstein (2003: 42) have noted, the ‘mild’ increase in intra-African trade observed in the early 1990s (from approximately 8 per cent in 1989 to approximately 12 per cent in 1995) cannot be ascribed to the expansion of trade within country groupings covered by a preferential trade agreement. Using a gravity model of bilateral (non-oil-trade) flows, Foroutan and Pritchett (1993) did not find a statistically significant dummy variable for ECOWAS; only for CEAO did they find a significant effect of membership on bilateral trade flows. At the same time, they point to the fact that intra-African trade appears to be relatively close to what their gravity model predicts. In other words, the ‘relatively low’ levels of intra-African can be explained relatively well by the economic size of the trade partners and their mutual distance, at least on average. This is an important point which connects with what will be said in the rest of this article. Using an extended gravity model, Elbadawi (1997: 224-226) finds that both CEAO and ECOWAS significantly increase intra-bloc trade, using data for the first half of the 1980s. However, using data for the second half of the 1980s, it is shown that CEAO ceases to stimulate intra-regional trade (while being trade diverting), and that the trade effect of ECOWAS is reduced. In another study by Soloaga and Winters (2000) no significant changes were found in the propensity for intra-block trade in their econometric evaluation of the trade effects of the creation or revamping of several regional integration schemes in the 1990s.<sup>3</sup> Gbetnkom and Avom (2005) estimate gravity-type models for analyzing intra-WAEMU trade and arrive at the conclusion that, although WAEMU membership

3 In only a few cases, either imports or exports (not combined) showed significant trade diversion (Soloaga and Winters 2000).

positively (and statistically significantly) influenced trade flows in the late 1990s, intra-regional trade is still at levels below their predicted potential, generally speaking.

This weak link that seems to exist between regional integration and intra-regional trade is not only due to poor implementation of regional commitments (rules and policies), but also to the multiplication of non-tariff barriers (NTBs) and the lack of fundamental conditions for their success, such as good infrastructure, the complementarities of specialisation patterns, macro-economic stability, and good governance (Oyejide 1997; Lyakurwa et al. 1997; Kennes 2003: 156-157; Longo and Sekkat 2001, 2004; Keane et al. 2010; DFID 2011).

With respect to the trade effects of exchange rate stability, West Africa obviously offers an interesting case, with some countries sharing a common currency and others maintaining monetary autonomy. Although some cross-country studies suggest that there is some evidence of a positive effect of exchange rate stability on trade for developing countries, overall there seems to be mixed evidence when zooming in on Sub-Sahara Africa in the 1980s and 1990s (O'Connell 1997: 126-127). Using data on UEMOA imports, for example, Medhora (1990) finds no evidence of an effect of exchange rate stability/volatility on trade. El-badawi (1997) does find significant positive effects of monetary integration in CEAO on intra-bloc trade in the early 1980s, but these effects are reversed in the late 1980s.<sup>4</sup> However, more recent work by Fielding and Shields, in the context of testing the endogeneity of the OCA criteria for the franc zone, shows substantial and statistically significant effects of common CFA membership on bilateral trade flows in Sub-Sahara Africa (Fielding and Shields 2005).<sup>5</sup> And Zannou (2010) also finds evidence of a positive linkage between exchange rate stability and intra-ECOWAS trade.

For the reasons stated above, increasing intra-African commercial interactions is often considered as one of the priority intermediate objectives of national, regional or inter-national policy action by e.g. African Union, NEPAD, UN agencies, the OECD, Common-wealth Secretariat, United Bank of Africa, Afreximbank, DFID, etc. (UNU 2002; Diabré 2003; Campbell 2003; UNECA

4 Similar effects were obtained by Devarajan and de Melo (1990).

5 See also, Cuyvers et al. (2005: 130-132).

2004; Odularu 2009; Keane et al. 2010; Nonor 2010; DFID 2011; Ekra 2012). Apart from the to-be-expected static and dynamic economic gains from further integration it has also been suggested that reaching minimal critical levels of economic interdependence in West Africa, might produce positive effects on the political dynamics in the region (Goldstein 2003: 56).

The apparently low levels of intra-African trade will be closer looked at in the next section.

### ***Trade Regionalisation in Africa: a Quantitative Assessment***

The simplest statistical indicator used to assess the relative importance of intra-regional trade is its share of the region's total trade (*intra-regional trade share,  $S_i$* ):

$$S = t_{ii}/t_i \quad [ 1 ]$$
$$0 \leq S_i \leq 1$$

in which:  $t_{ii}$  = region i's intra-regional trade (exports plus imports);  
 $t_i$  = region i's total trade.

Given its intuitive appeal, this indicator is often used in the empirical analysis of RIAs (see, for example, WTO 2011: Table I.4).

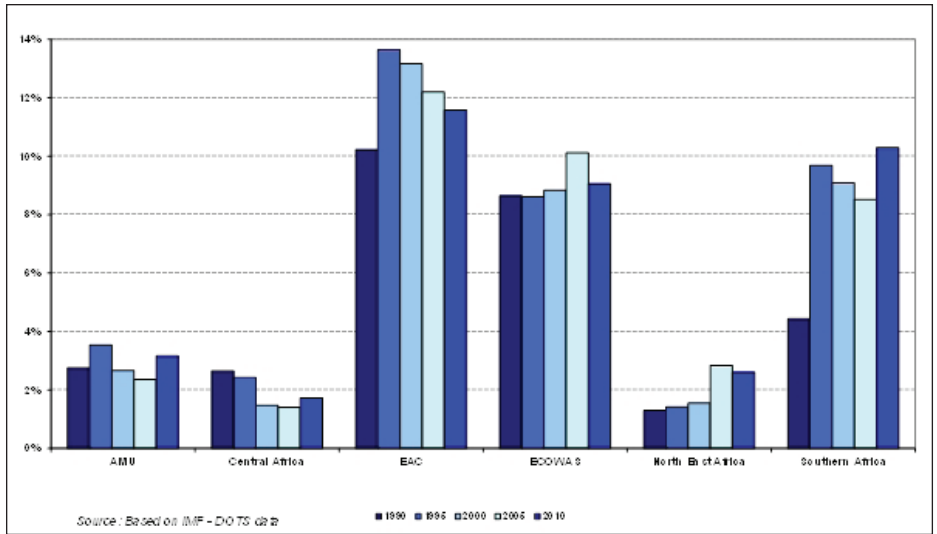
Intra-regional trade shares for the six African regions identified in this paper are shown in Figure 1. In Figure 2, the shares for ECOWAS and WAEMU are compared with the corresponding values for selected regions worldwide.

EAC, ECOWAS and Southern Africa show relatively larger intra-regional trade shares, at levels slightly lower than in some American regions, such as Caricom, Central America and Mercosur. This indicator is only about 2 per cent in AMU, Central Africa and North East Africa, even below the level in SAARC, where it is currently around 3.5 per cent.

An upward trend of the intra-regional trade share in the last two decades is visible only for ECOWAS, North East Africa, and Southern Africa.

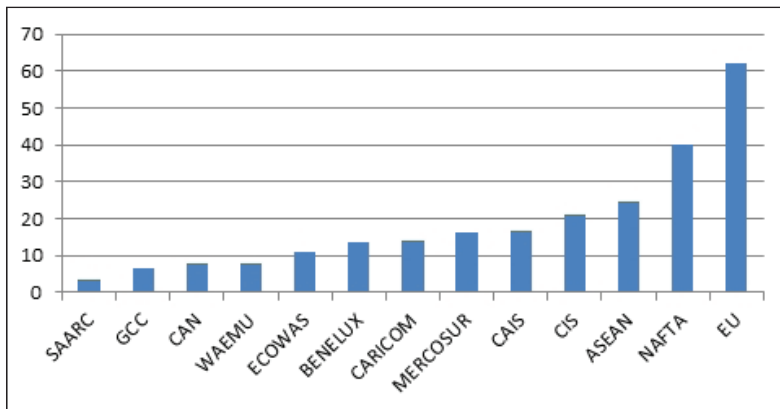


Figure 1: Intra-Regional Trade Shares for African sub-regions, 1990-2010



Source: Based on IMF DOTS data, years: 1990, 1995, 2000, 2005, 2010

Figure 2: Intra-Regional Trade Shares for ECOWAS, WAEMU and Selected World Regions in %, 2008



Source: RIKS

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

Unfortunately, as shown by Anderson and Norheim (1993), among others, the intra-regional trade share incurs at least two problems, impairing its use for cross-region and time-series analyses. Regardless of the level of trade integration, a region's intra-regional trade share is positively affected by:

the number of its member countries, for any given value of its total trade;  
its size in terms of total trade, for any given number of member countries.

The latter problem is particularly insidious, because it gives the intra-regional trade share a pro-cyclical bias, so that dynamic regions, whose trade grows more rapidly than the world average, tend to show rising intra-regional trade shares regardless of their degree of trade integration, that is, even assuming that the weight of every partner in the region's trade is equal to its weight in world trade ('geographic neutrality').

One possible alternative is offered by the *intra-regional trade intensity index* ( $I_i$ ), which, in its simplest specification, is equal to the ratio between region  $i$ 's intra-regional trade share ( $S_i$ ) and its share of world trade ( $W_i$ ):<sup>6</sup>

$$I_i = S_i / W_i = (t_{ii} / t_i) / (t_i / T) \quad [ 2 ]$$
$$0 \leq I_i \leq (T / t_i)$$

in which:  $t_{ii}$  = region  $i$ 's intra-regional trade;  
 $t_i$  = region  $i$ 's total trade;  
 $T$  = world trade.

6 It should be reminded that, since no country can trade with itself, the denominator of the index should be corrected by subtracting from the region's total trade, as well as from world trade, one  $n$ -th of the region's total trade (where  $n$  is the number of countries in the region), as shown by Anderson and Norheim (1993: 82, footnote 6). This correction ensures that the index is approximately equal to unity, if the geographic orientation of the region's trade is not inward biased. The more similar are the trade values of member countries, the lower is the approximation error. See also Frankel (1997: 25-29). The Anderson and Norheim correction is important for comparing trade intensity levels of different regions, but may be neglected if the interest is focused on the time path of intra-regional trade intensity in a single region. On the other hand, this correction does not solve other problems raised by the fact that no country can trade with itself, which were highlighted by Savage and Deutsch (1960). A more rigorous correction procedure has been proposed by Freudenberg, Gaulier and Ünal-Kesenci (1998). See also Gaulier, Jean and Ünal-Kesenci (2006).

This index is equal to one if the region's weight in its own trade is equal to its weight in world trade (geographic neutrality). In contrast, if intra-regional trade is relatively more important than trade flows with the rest of the world, as is usually the case, the index is higher than one.

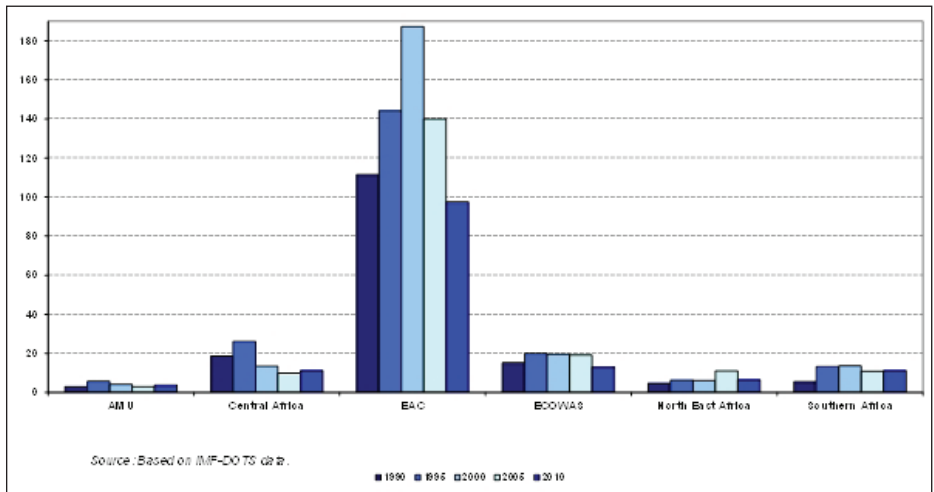
Correspondingly, an *extra-regional trade intensity index* ( $E_i$ ) can be defined as:

$$E_i = (1 - S_i) / (1 - W_i) \quad [ 3 ]$$

$$0 \leq E_i \leq [T / (T - t_i)]$$

Intra-regional trade intensity indices have sometimes also been used in the study of African trade (see, for example, Yang and Gupta, 2007), in which they reach very high levels, leading to the conclusion that intra-regional trade is much more important for African countries than could be expected upon the basis of their weight in world trade. Figure 3 shows these indicators for the six African regions of this paper.

Figure 3: Intra-Regional Trade Intensity Index



Source: Based on IMF DOTS data, years: 1990, 1995, 2000, 2005, 2010

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

The figure is made difficult to read by the extremely high levels reached by this indicator in EAC, in which the intra-regional trade share happens to be more than 100 times larger than the region's weight in world trade. Intra-regional trade-intensity indices are always much higher than the value of 1 also in the other five regions, but show an upward trend only in North East Africa and Southern Africa.

The intra-regional trade intensity index, despite overcoming the limitations faced by the unadjusted trade share, is, in turn, affected by a number of statistical problems, which limit its interpretability and usefulness:

1. *range variability*: the maximum value of the index is a decreasing function of the region's total trade, so that indices computed for different regions and/or periods are not perfectly comparable with each other;
2. *range asymmetry*: the range of the index below the threshold value of 1 is much smaller than above, which may give rise to biased assessments of its changes, and create problems in econometric estimates involving the index;
3. *dynamic ambiguity*: intra- and extra-regional trade-intensity indices can move in the same direction, if certain conditions hold, creating problems in their interpretation.

A possible solution has been proposed by lapadre (2006) with a regional trade introversion index, which measures the intensity of "revealed trade preferences" (RTP) among countries belonging to the same region.<sup>7</sup>

The *regional trade introversion index* ( $J_i$ ) is based upon a modified version of intra- and extra-regional intensity indices ( $HI_i$ ,  $HE_i$ ), in which the intra-regional trade share is compared to the region's share of the trade of other regions (and not of world trade), so that their range is independent of the size of the region.  $J_i$  rises (or falls) only if the intensity of intra-regional trade grows more (or less) rapidly than that of extra-regional trade. The index is made symmetric through a transformation of the ratio between  $HI_i$  and  $HE_i$ , so that the threshold value of geographic neutrality ( $J_i = 0$ ) divides its range into two equal parts. Moreover, an increase in  $J_i$  shows that the intensity of intra-regional trade flows has grown

7 See also, lapadre and Plummer (2011).

more than that of extra-regional trade, solving the dynamic ambiguity problem of traditional trade intensity indices. Its formula is the following:

$$J_i = (HI_i - HE_i)/(HI_i + HE_i) \quad [ 4 ]$$

$$-1 \leq J_i \leq 1$$

in which:

$$HI_i = S_i/V_i = (t_{ii}/t_i)/(t_{ri}/t_r)$$

$$HE_i = (1 - S_i)/(1 - V_i)$$

$t_{ii}$	=	region i's intra-regional trade;
$t_i$	=	region i's total trade;
$t_{ri}$	=	region i's extra-regional trade;
$t_r$	=	total trade of the rest of the world.

The corresponding regional trade extroversion index ( $F_i$ ) can be defined as:

$$F_i = (HE_i - HI_i)/(HE_i + HI_i) = -J_i \quad [ 5 ]$$

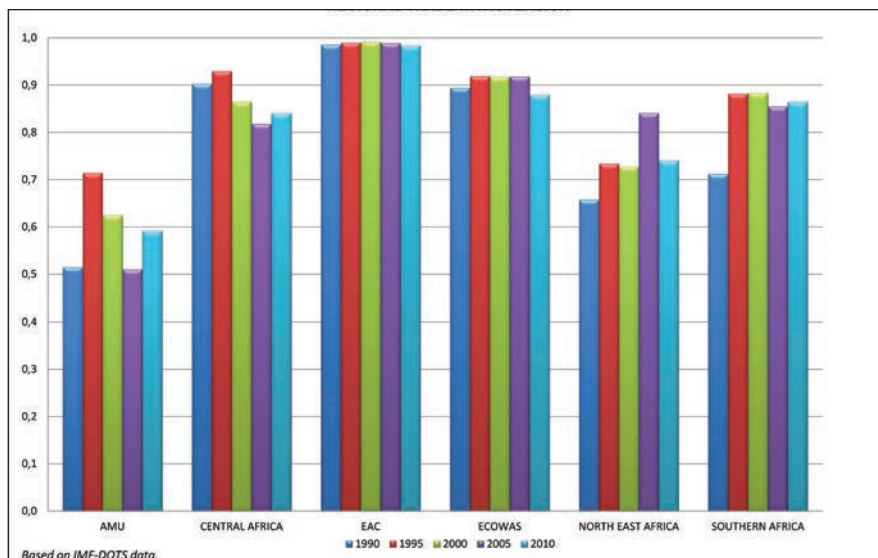
$$-1 \leq F_i \leq 1$$

A further interesting property of the regional trade introversion index is that it simultaneously measures the relative intensity of intra-regional trade in the target region  $i$  and in the rest of the world, taken as a single “complementary region”. Stated differently, if the world is divided into two regions, since, by definition,  $S_2 = (1 - V_1)$ ;  $V_2 = (1 - S_1)$ , and *vice versa*, it is easy to show that  $J_2 = J_1$ , independently of the size of the regions. Intuitively, it is reasonable that, if the world is divided into only two regions, any level of trade introversion in one of them implies the same result in the other, with the limiting case in which both regions are completely isolated from each other.

The trade introversion indices for our six African regions are shown in Figure 4. The main facts already visible in the previous figures are not altered, but this indicator is better suited to allow reliable comparisons across different regions.

The regional trade introversion index can be seen as a particular case of the bilateral RTP index, showing the relative intensity of trade flows between a pair of countries or regions (Iapadre and Tironi, 2009).

Figure 4: Regional Trade Introversion



A more comprehensive picture of regional trade in Africa is offered by Table 1, which shows RTP indices not only for intra-regional trade (introversion indices), but also for trade between each pair of African regions, as well as for their trade with the European Union (27), which is by far the most important extra-regional partner of African countries.

Taking the RTP index of the “rest of the world” as a benchmark of international trade integration, the table shows that regional trade introversion is particularly high in Sub-Saharan Africa (SSA). In other words, the inability of SSA countries to participate successfully in extra-regional trade translates into a relatively high intensity of trade with regional partners, which illustrates the concept of “trade introversion” used to name the RTP index for intra-regional trade. On the other hand, regional trade introversion is relatively low in the AMU region, due mainly to its more intense linkages with the European Union. While, in the 1990s, trade introversion was on the rise everywhere (except in Central Africa), most African region have experienced a marked decline of the index in the last decade.

Table 1: Revealed Trade Preference Index

Revealed Trade Preference Index								
1990	AMU	CENTRAL AFRICA	EAC	ECOWAS	NORTH EAST AFRICA	SOUTHERN AFRICA	EUROPEAN UNION	REST OF THE WORLD
AMU	0,52							
CENTRAL AFRICA	0,56	0,90						
EAC	-0,36	-0,99	0,99					
ECOWAS	-0,32	0,68	-0,37	0,89				
NORTH EAST AFRICA	0,31	-0,83	0,69	-0,93	0,66			
SOUTHERN AFRICA	-0,82	-0,54	0,47	-0,27	-0,72	0,71		
EUROPEAN UNION	0,53	0,32	0,09	0,07	0,08	0,01	0,68	
REST OF THE WORLD	-0,57	-0,44	-0,32	-0,22	-0,10	-0,05	-0,70	0,71
2000	AMU	CENTRAL AFRICA	EAC	ECOWAS	NORTH EAST AFRICA	SOUTHERN AFRICA	EUROPEAN UNION	REST OF THE WORLD
AMU	0,62							
CENTRAL AFRICA	-0,02	0,87						
EAC	-0,87	-0,52	0,99					
ECOWAS	0,08	0,78	-0,25	0,92				
NORTH EAST AFRICA	0,19	-0,76	0,83	-0,64	0,73			
SOUTHERN AFRICA	-0,54	0,27	0,85	0,29	-0,44	0,88		
EUROPEAN UNION	0,60	0,09	-0,15	-0,03	0,04	-0,03	0,77	
REST OF THE WORLD	-0,63	-0,18	-0,30	-0,17	-0,07	-0,16	-0,77	0,78
2010	AMU	CENTRAL AFRICA	EAC	ECOWAS	NORTH EAST AFRICA	SOUTHERN AFRICA	EUROPEAN UNION	REST OF THE WORLD
AMU	0,59							
CENTRAL AFRICA	0,00	0,84						
EAC	-0,79	-0,19	0,98					
ECOWAS	-0,20	0,68	-0,37	0,88				
NORTH EAST AFRICA	0,56	-0,51	0,75	-0,41	0,74			
SOUTHERN AFRICA	-0,51	0,03	0,83	0,47	-0,28	0,86		
EUROPEAN UNION	0,46	-0,04	-0,41	-0,19	-0,19	-0,20	0,79	
REST OF THE WORLD	-0,49	-0,05	-0,10	-0,04	0,09	-0,05	-0,78	0,77

Source: based on IMF DOTS data.

Trade flows among different African regions are relatively less intense than intra-regional flows and strongly affected by geographical distance. In fact, positive RTP indices for inter-regional flows were recorded almost exclusively between neighbouring regions in 2010. However, RTP indices for inter-regional flows among African areas have been generally increasing in the last two decades, particularly those involving ECOWAS and Southern Africa, whose bilateral index has become positive.

What is possibly more striking in Table 1 is that RTP indices between African regions and the European Union show a generalized downward trend in the last two decades and, leaving aside AMU, all became negative in 2010. Far from stimulating more intense trade with African countries, EU preferential integration policies have failed to prevent a weakening of bilateral trade linkages.

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

On the other hand, RTP indices for African regions with the rest of the world (excluding Africa and the EU), despite remaining mostly negative, have consistently risen in the last two decades, possibly reflecting the growing role of African countries as the suppliers of raw materials to China and other emerging countries.

The fact that, overall, trade among African regions has been growing more rapidly than intra-regional trade is confirmed by the dynamics of the assortativity coefficient, an indicator proposed by Newman (2003) in the context of “binary network analysis” in order to measure to what extent interactions among a network’s nodes tend to follow a “homophilic” pattern. When applied to a multi-region matrix of trade values (Iapadre and Tironi, 2009), this index measures globally the tendency of countries to trade more intensely with intra-regional partners than with partners in other regions.

The resulting *intra-regional assortativity coefficient* can be defined as:

$$CAI = (Tr(R) - ||R^2||) / (1 - ||R^2||) \quad [ 6 ]$$

in which R is the matrix of intra- and inter-regional trade flows, divided by their total, Tr is the trace operator, and  $||R^2||$  is the sum of all the elements of matrix  $R^2$ .

IAC is equal to zero in the case of geographic neutrality, that is, when regions trade with each other in proportion to their total trade values, and reaches a maximum value of one in the limiting case of no inter-regional trade. On the other hand, in the limiting case of no intra-regional trade, the minimum (negative) value of IAC is equal to:

$$- ||R^2|| / (1 - ||R^2||).^8$$

8 The minimum IAC of  $-1$  (perfect disassortativity) is reached when  $Tr(R) = 0$  (no intra-regional trade) and  $||R^2|| = 0.5$ . The latter parameter depends on the distribution of extra-regional flows and on the number of regions. It can be shown that  $||R^2||$  is equal to 0.5 only for a two-region world with no intra-regional trade. For a symmetric matrix with a number of regions larger than 2, the minimum IAC is higher than  $-1$  and grows with the number of regions.



In the case of Africa, the IAC index is relatively high, confirming the presence of regional trade introversion, but tends to fall over time (from 0.64 in 1990 to 0.51 in 2010), reflecting the relative intensification of inter-regional flows.

Another important aspect of trade regionalisation is the geographic diversification of trade flows. If the distribution of intra-regional exports and imports were proportional to the trade size of regional partners (geographic neutrality), this could reveal that distance-related intra-regional barriers do not affect the direction of bilateral trade flows, showing the progress of regional integration.

An intra-regional geographic neutrality index (IIRGNI<sub>i</sub>) can be defined as the Finger-Kreinin similarity measure between the country distribution of each region's intra-regional trade and its neutrality benchmark, based upon the value of each partner's extra-regional trade. Its formula is as follows (Iapadre and Tironi, 2009, p. 12):

$$\text{IIRGNI}_i = 1 - \frac{\sum_{j \neq i} |IS_{ij} - IV_{ij}|}{2} \quad [ 7 ]$$

in which:

$IS_{ij}$  = partner  $j$ 's share of region  $i$ 's intra-regional trade;  
 $IV_{ij}$  = partner  $j$ 's share of region  $i$ 's total extra-regional trade.

This index ranges from 0, when region  $i$ 's intra-regional trade is concentrated with partners which have no extra-regional trade, to 1, when it is neutrally-distributed across all its possible regional partners. Figure 5 shows IIRGNI<sub>i</sub> for the six African regions of this paper.

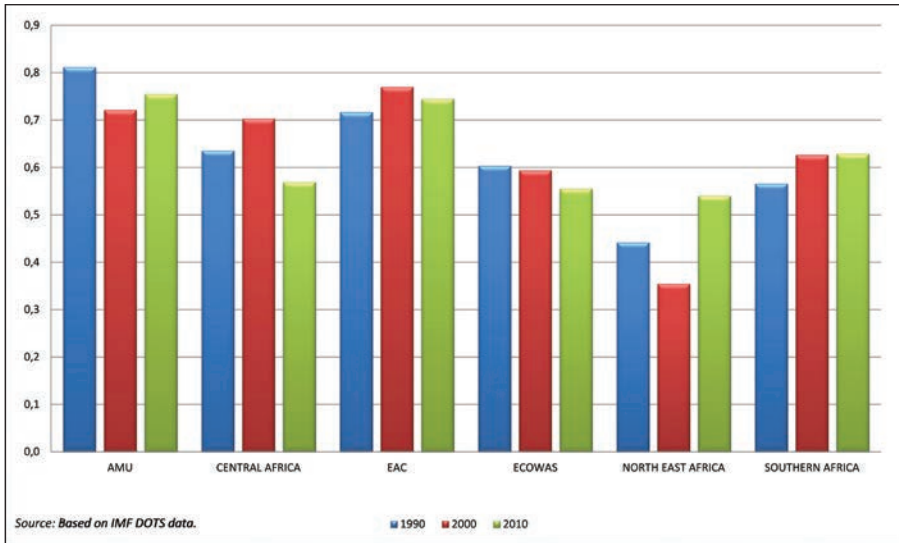
There is no clear trend in the data, with Southern Africa evolving towards a higher degree of intra-regional neutrality, and other regions moving more erratically or in the opposite direction (ECOWAS). Overall, the process of regional integration does not appear to have significantly reduced the importance of distance-related barriers to bilateral trade within African regions.

A more precise assessment of trade regionalisation can be given by considering also the overall (intra- and extra-regional) trade openness level of each region. High levels of regional introversion are more worrying when they come together with low levels of trade openness, underlying the fact that intra-regional trade

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

preferences are not so much the result of successful integration policies as the unavoidable outcome of problems in extra-regional trade.

Figure 5: Geographic Neutrality of Intra-Regional Trade



A region's relative degree of openness ( $O_i$ ) can be measured by its trade-to-GDP ratio relative to the world average trade-to-GDP ratio:

$$O_i = (t_i / y_i) / (T / Y) \quad [ 8 ]$$

in which:

$t_i$	=	region i's total trade
$T$	=	world trade
$y_i$	=	region i's gross domestic product (GDP)
$Y$	=	world GDP

However, this indicator is affected by several problems, similar to those already discussed for trade-intensity indices. A possible solution is a symmetric indicator of relative trade openness ( $SO_i$ ), which is equal to zero if the region's degree of openness is equal to the world average:

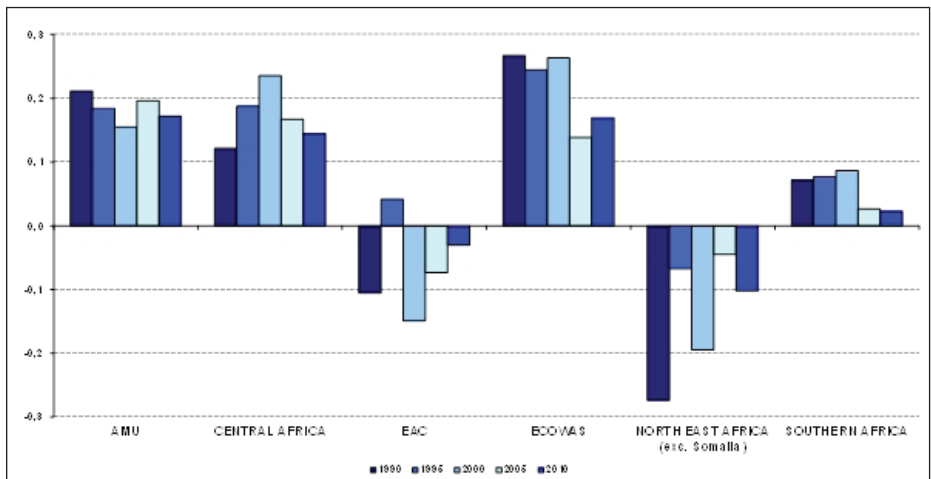
$$SO_i = \frac{\{(t_i / y_i) - [(T - t_i) / (Y - y_i)]\}}{\{(t_i / y_i) + [(T - t_i) / (Y - y_i)]\}} \quad [ 9 ]$$

$$-1 \leq SO_i \leq 1$$

The trade-to-GDP ratio is an imperfect measure of trade openness for a variety of reasons. First of all, it should be recalled that trade flows are measured in terms of gross output (including the value of intermediate goods), whilst GDP is expressed in terms of value-added. This problem cannot be easily solved because data on the value of gross domestic production are not readily available.<sup>9</sup> Secondly, since GDP includes the services sector, trade in goods and services should be used in the numerator. Thirdly, independently of these statistical problems, the trade-to-GDP ratio should be used very cautiously in cross-country comparisons, because it is inversely related to country size (see Anderson and Norheim, 1993: 80, footnote 1). All other things being equal, larger countries tend to show lower trade-to-GDP ratios, only because they face a smaller ratio between the size of foreign and domestic markets.

Keeping these reservations in mind, we can assess the relative trade-openness levels of our six African regions in Figure 6.

Figure 6: Relative Openness (Symmetric indicators)



Source: Based on IMF DOTS data, years: 1990, 1995, 2000, 2005, 2010

9 Recently, the World Trade Organization has launched the "Made in the World" initiative, a project aimed at measuring trade in value-added terms, and some preliminary results have already been published (see: <[http://www.wto.org/english/res\\_e/statis\\_e/miwi\\_e/miwi\\_e.htm](http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm)>).

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

Notwithstanding their very small size, which should translate into high openness indicators, all African regions tend to show relatively low and often decreasing SOi indices. In two of them, the trade-to-GDP ratio is even lower than the world average, as shown by the negative sign of the SOi index.

It can be argued that high levels of regional introversion tend to be accompanied by a low degree of overall trade openness, and this is particularly evident in the case of EAC.

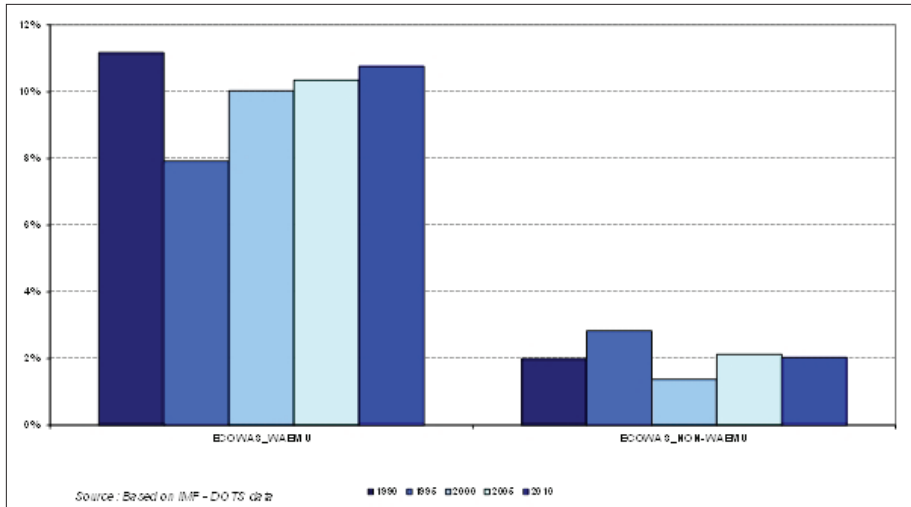
### ***Monetary Integration and Trade Regionalisation in Western Africa: a Description of the Evidence***

Western Africa is sometimes indicated as one of the few African regions in which regional integration initiatives have been relatively successful in terms of actual trade liberalization. Yet, the structural features limiting the international openness of African countries are also particularly strong in this area, exacerbated by very serious problems of political instability. On the other hand, the use of a common currency, which is one of the legacies of the colonial past in an important sub-set of the region's countries (WAEMU), might have facilitated the growth of intra-regional trade.

A preliminary quantitative assessment of these issues can be given by applying the indicators presented in section 2 to two distinct sub-regions of Western Africa, namely the eight countries belonging to the WAEMU (Benin, Burkina Faso, Côte d'Ivoire, Guinea Bis-sau, Mali, Niger, Senegal, and Togo) and the remaining seven ECOWAS members (Cape Verde, Gambia, Ghana, Guinea, Liberia, Nigeria, and Sierra Leone).

As in other African regions, the intra-regional trade share looks relatively low both in the WAEMU and among the other ECOWAS members (figure 7). However, there is a strong difference between the two groups, with the WAEMU showing much higher levels than the rest of ECOWAS, notwithstanding its lower size (in 2010 total trade was about 45 billion dollars in WAEMU, against about 165 billion dollars for the rest of ECOWAS, largely recorded by Nigeria).

Figure 7: Intra-regional trade shares in Western Africa



Source: Based on IMF DOTS data, years: 1990, 1995, 2000, 2005, 2010

A similar message is conveyed by the regional trade introversion index (figure 8), which, in the case of WAEMU, stands at levels very close to the range maximum of one, whereas for the rest of ECOWAS shows a downward trend, reaching levels among the lowest in Sub-Saharan Africa. This result stems mostly from the fact that WAEMU's weight in world trade has remained very low in the last two decades (slightly more than 0.1 per cent), whereas the rest of ECOWAS has risen from 0.3 per cent in 1995 to more than 0.5 per cent in 2010. In other words, the latter sub-region, although expanding its participation in world trade, has not succeeded in strengthening its intra-regional integration. It is interesting to note that revealed trade preferences between the two sub-regions are much higher than among non-WAEMU ECOWAS countries (0.93 vs. 0.59 in 2010).

The higher level of regional introversion in the WAEMU is to be related also to its lower degree of trade openness with respect to the rest of ECOWAS. As shown by figure 9, in both sub-regions the index of relative openness is positive, i.e. higher than the world average. However, its level is particularly low in the WAEMU, notwithstanding the tiny size of its economy.

Figure 8: Regional trade introversion in Western Africa

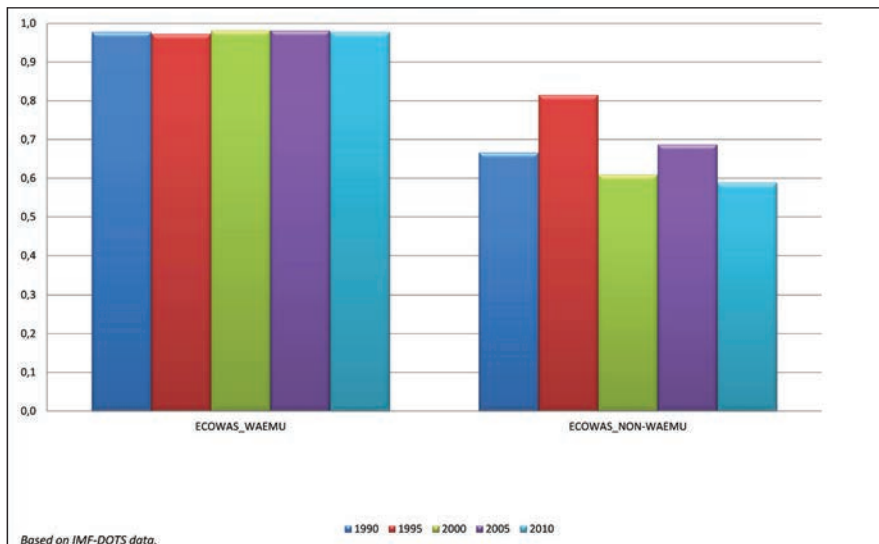
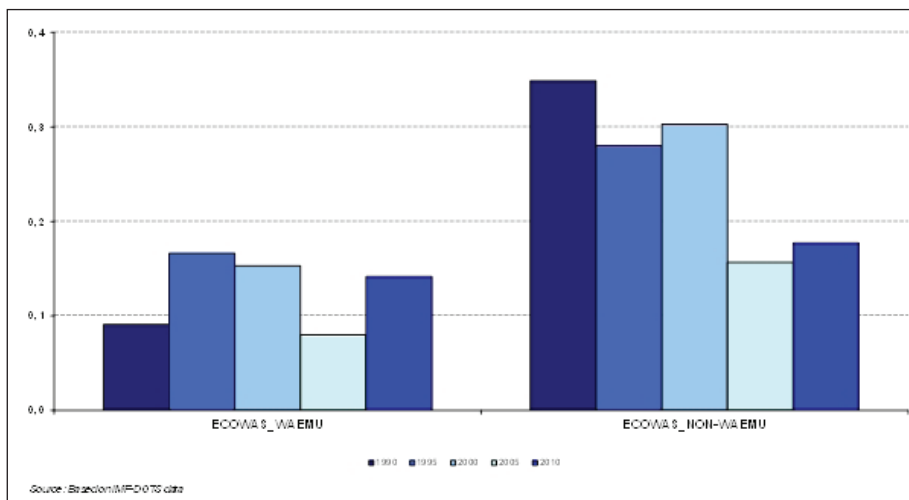


Figure 9: Relative trade openness in Western Africa (symmetric indicators)

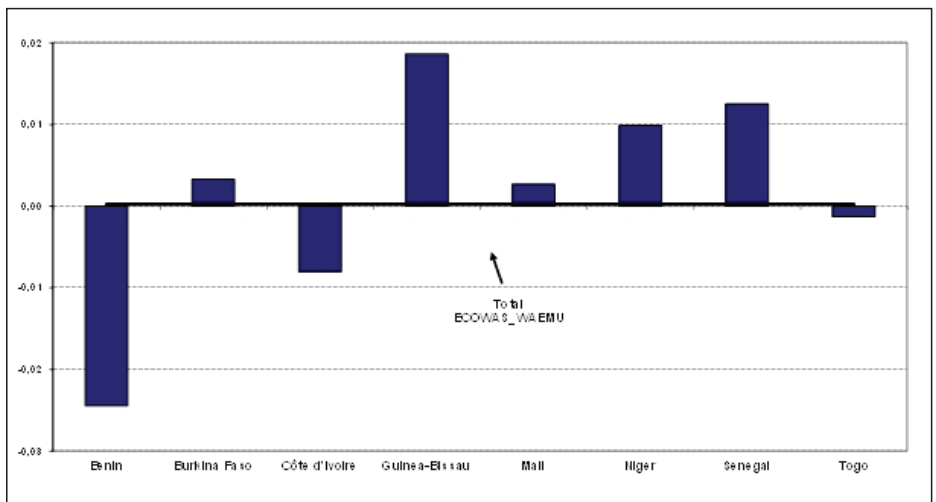


Source: Based on IMF DOTS data, years: 1990, 1995, 2000, 2005, 2010

Figures 10 and 11 allow to see synthetically how intra-regional revealed trade preferences have changed in each country over the last two decades. In the case of WAEMU, most member countries have reinforced their already extremely high levels of intra-regional RTPs. Conversely, in the rest of ECOWAS, the dominant trend is downward, with the only exception of Cape Verde.<sup>10</sup>

As already argued, these descriptive indicators, although offering a precise measure of trade regionalisation, do not allow to establish causal relationships, and in particular do not allow to estimate to what extent the differences between the two ECOWAS sub-regions are due to the use of a common currency in WAEMU.

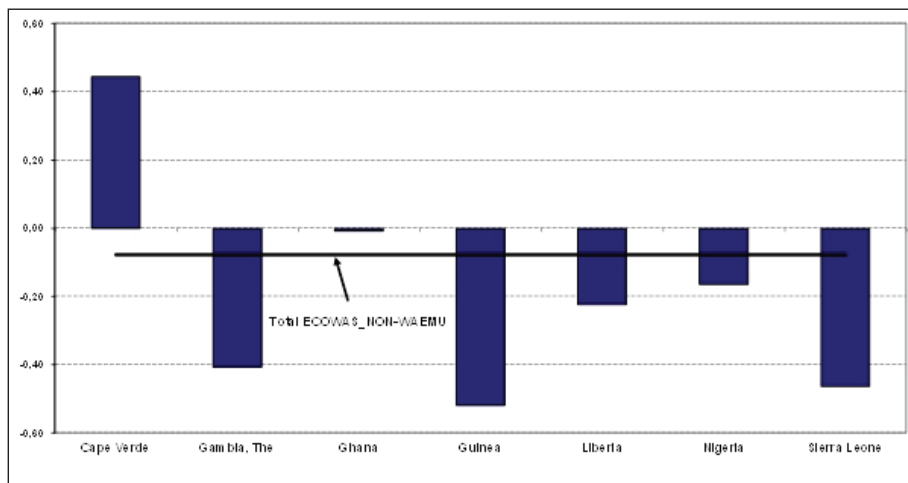
Figure 10 Intra-regional revealed trade preferences in the WAEMU (changes 1990-2010)



<sup>10</sup> According to IMF DOTS data, Cape Verde had no trade with any country of its sub-region in 1990. Even in 2010, its intra-regional RTP index remains negative and very low. Negative intra-regional RTP indices are also shown by Guinea and Liberia.

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

Figure 11: Intra-regional revealed trade preferences among non-WAEMU ECOWAS countries (changes 1990-2010)



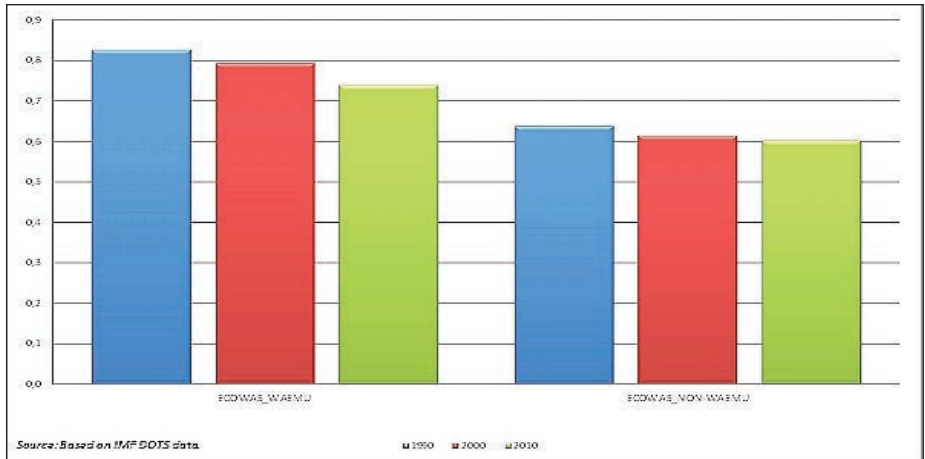
Other factors may play a role, for example, the fact that most non-WAEMU countries (except Guinea, Liberia and Sierra Leone)<sup>11</sup> do not share common borders. However, it seems reasonable to guess that monetary integration has facilitated intra-regional trade in WAEMU.

Considering the geographic diversification of intra-regional trade, figure 12 shows that WAEMU is also characterised by a higher index of neutrality, with respect to the rest of ECOWAS. In other words, trade among WAEMU countries appears to be relatively less affected by distance-related barriers, confirming a better degree of intra-regional integration. However, in both sub-regions the index of geographic neutrality shows a de-creasing trend in the last two decades, which could suggest that bilateral preferential flows have become more important.

<sup>11</sup> Guinea, Liberia and Sierra Leone are also members of the Mano River Union (MRU), but political instability and conflicts have seriously undermined their integration agenda (ECA, 2007).



Figure 12: Geographic Neutrality of Intra-Regional Trade in Western Africa



Source: Based on IMF DOTS data, years: 1990, 2000, 2010

### ***Conclusions: Regional Trade Integration and the Role of Africa in World Markets***

All the indicators presented so far tend to convey the idea that trade regionalisation in Africa is not low. Although intra-regional trade shares are much smaller than in other developing regions, they are much larger than would be expected, given the size of African regions in world trade. In other words, Africa shows a high degree of regional trade introversion, which seems to be mainly due to its very limited capabilities in extra-regional trade (constrained by several domestic and external barriers), rather than to the process of regional integration.<sup>12</sup> This is true also in Western Africa, and particularly in the WAEMU, though in this sub-region intra-regional trade might have been facilitated by the use of a common currency.

Some small signs of change are, however, visible in the data, notably the downward trend of trade introversion in some regions, and in particular in ECOWAS, which is matched by slightly more intense flows among African regions and with the rest of the world, with the striking exception of the EU.

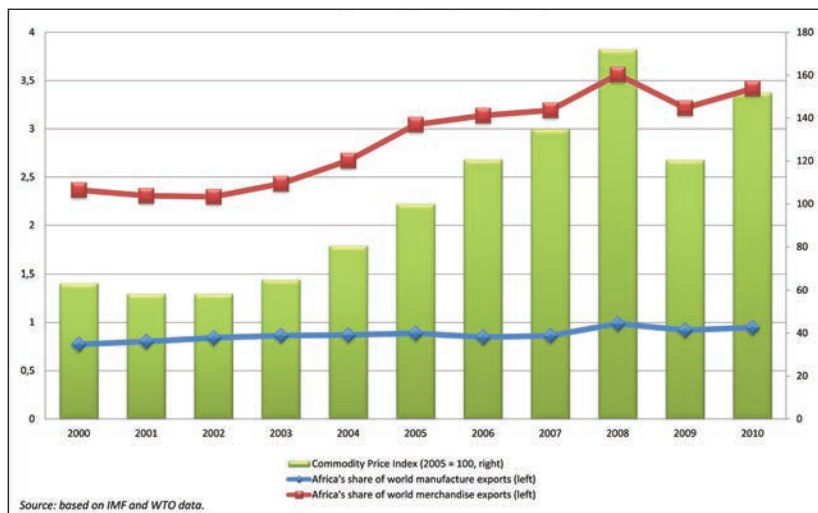
<sup>12</sup> See also, DFID (2011).

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

To a certain extent, these changes can be traced back to the recent upsurge of several African economies, led mainly by the booming demand for raw materials from China and other emerging countries. Africa's share of world exports, which had gradually declined until the late 1990s, has been rising in the last decade (Figure 13). However, this recovery is mostly due to the large increase in the prices of primary commodities, as is shown by the fact that Africa's share of world manufactured exports has grown less and re-mains much lower than its share of total merchandise exports.

The inability of African countries to develop a competitive manufacturing industry appears to be the main reason of their persistent marginality in world trade, which also explains their high regional trade introversion. Notwithstanding the persistent uncertainty about the global economic outlook, raw material prices remain high. This could create new opportunities to adopt the structural reforms needed to engender a sustainable development process in African countries. Regional integration policies could give an important contribution to overcoming this challenge. Their success will, however, be measured more by their ability to create the necessary infrastructure for a more effective integration of African countries into world markets, than on their impact on intra-regional trade.

Figure 13: Africa's Shares of World Exports



## References

- Anderson, K. and Norheim, H., 1993. From imperial to regional trade preferences: Its effect on Europe's intra- and extra-regional trade. *Weltwirtschaftliches Archiv*, 129(1), pp.78-102.
- Campbell, B., 2003. African Regional Integration in the Context of Globalization: Development Challenges and NEPAD. In: H. Van Ginkel, J. Court, J. and L. Van Langenhove, eds. *Integrating Africa: Perspectives on Regional Integration and Development*. UNU, Tokyo Press, pp.19-35.
- Cuyvers, L., De Lombaerde, P., De Souza, E. and Fielding, D., 2005. Regional Monetary Cooperation and Integration. In: M. Farrell, B. Hettne and L. Van Langenhove, eds. *Global Politics of Regionalism*. London: Pluto Press, pp.120-136.
- Devarajan, S. and De Melo, J., 1990. *Membership in the CFA Zone: Odyssean Journey or Trojan Horse?* PRE Working Paper, 428, Washington: World Bank.
- DFID, 2011. *Regional Integration and Trade in Sub-Saharan Africa*. Trade and Investment Analytical Papers, 7.
- Diabré, Z., 2003. UNDP Perspectives on African Integration. In: H. Van Ginkel, J. Court and L. Van Langenhove, eds. *Integrating Africa: Perspectives on Regional Integration and Development*. UNU, Tokyo Press, pp.146-153.
- ECA, 2007. Regional economic integration in Africa. In: P. De Lombaerde, ed. *Multilateralism, regionalism and bilateralism in trade and investment*. 2006 World Report on Regional Integration. Dordrecht: Springer, pp.127-157.
- Ekra, J.-L., 2012. *Obstacles to Intra-Regional Trade in West Africa*. [pdf] Available at: <<http://www.howwemadeitinafrica.com/obstacles-intra-regional-trade-west-africa/1732/>>.
- Elbadawi, I., 1997. The Impact of Regional Trade and Monetary Schemes on Intra-Sub-Saharan Africa Trade. In: A. Oyejide, I. Elbadawi and P. Collier, eds. *Regional Integration and Trade Liberalization in Sub-Saharan Africa. Vol. 1: Framework, Issues and Methodological Perspectives*. London: MacMillan, pp.210-255.

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

Fielding, D. and Shields, K., 2005. The Impact of Monetary Union on Macroeconomic Integration: Evidence from West Africa. *Economica*, 72(288), pp.83-704.

Foroutan, F., 1993. Regional Integration in Sub-Saharan Africa: Past Experience and Future Prospects. In: J. De Melo and A. Panagariya, eds. *New Dimensions in Regional Integration*. Cambridge: Cambridge University Press, pp.234-271.

Foroutan, F. and Pritchett, L., 1993. Intra-Sub-Saharan African Trade: Is It too Little? *Journal of African Economies*, 2(1), pp.74-105.

Frankel, J.A., 1997. *Regional trading blocs in the world economic system*. Washington: Institute for International Economics.

Freudenberg, M., Gaulier, G. and Ünal-Kesenci, D., 1998. *La régionalisation du commerce international : une évaluation par les intensités bilatérales*. [pdf] CEPII Working Paper, 98(05), Paris: Centre d'Etudes Prospectives et d'Informations Internationales. Available at: <<http://www.cepii.fr/francgraph/doctravail/resumes/1998/dt98-05.htm>>.

Gaulier, G., Jean, S. and Ünal-Kesenci, D., 2006. Explaining Regionalisation via Relative Trade Intensities. In: P. De Lombaerde, ed. *Assessment and Measurement of Regional Integration*. London: Routledge, pp.86-106.

Gbetnkom, D. and Avom, D., 2005. Intégration par le marché: le case de l'UEMOA. *Région et Développement*, 22, pp.85-103.

Goldstein, A., 2002. *The New Regionalism in Sub-Saharan African Trade: More Than Meets the Eye?* OECD Policy Brief 20.

Goldstein, A., 2003. Regional Integration and Development in Africa. In: H. Van Ginkel, J. Court and L. Van Langenhove, eds. *Integrating Africa: Perspectives on Regional Integration and Development*. UNU, Tokyo Press, pp.36-68.

Iapadre, L., 2006. Regional Integration Agreements and the Geography of World Trade: Statistical Indicators and Empirical Evidence. In: P. De Lombaerde, ed. *Assessment and Measurement of Regional Integration*. London: Routledge, pp.5-85.

Iapadre, L. and Luchetti, F., 2009. *Trade Regionalisation and Openness in Africa*. European University Institute, Working Paper RSCAS 2010/54.

Iapadre, L. and Tironi, F., 2009. *Measuring Trade Regionalisation: The Case of Asia*. UNU-CRIS Working Papers, W-2009/9.

Iapadre, L. and Plummer, M., 2011. Statistical Measures of Regional Trade Integration. In: P. De Lombaerde, R. Flôres, L. Iapadre and M. Schulz, eds. *The Regional Integration Manual. Quantitative and Qualitative Methods*. London: Routledge, pp.98-123.

Igue, J., 2011. Economic Integration in West Africa. In: C. Tolentino and M. Vogl, eds. *Sustainable Regional Integration in West Africa*. ZEI Discussion Paper, C208, pp.35-45.

Inter Africa Group, 2002. *The Economic Dimension to the African Union*. Paper prepared for the Africa Development Forum III: Defining Priorities for Regional Integration, Addis Ababa, 3-8 March 2002.

Jebuni, C.D., 1997. Trade Liberalization and Regional Integration in Africa. In: A. Oyejide, I. Elbadawi and P. Collier, eds. *Regional Integration and Trade Liberalization in Sub-Saharan Africa. Vol. 1: Framework, Issues and Methodological Perspectives*. London: MacMillan, pp.353-369.

Keane, J., Calí, M. and Kennan, J., 2010. *Impediments to Intra-Regional Trade in Sub-Saharan Africa*. London: ODI-Commonwealth Secretariat.

Kennes, W., 2003. The European Union and Regionalism in Developing Countries. In: H. Van Ginkel, J. Court and L. Van Langenhove, eds. *Integrating Africa: Perspectives on Regional Integration and Development*. UNU, Tokyo Press, pp.154-169.

Longo, R. and Sekkat, K., 2001. *Obstacles to Expanding Intra-African Trade*. Technical Paper, OECD Development Center, 174.

Longo, R. and Sekkat, K., 2004. Economic Obstacles to Expanding Intra-African Trade. *World Development*, 32(8), pp.1309-1321.

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

Lyakurwa, W., McKay, A., Ng'eno, N. and Kennes, W., 1997. Regional Integration in Sub-Saharan Africa: A Review of Experiences and Issues. In: A. Oyejide, I. Elbadawi and P. Collier, eds. *Regional Integration and Trade Liberalization in Sub-Saharan Africa. Vol. 1: Framework, Issues and Methodological Perspectives*. London: MacMillan, pp.159-209.

Medhora, R., 1990. The Effect of Exchange Rate Variability on Trade: The Case of the West African Monetary Union's Imports. *World Development*, 18(2), pp. 313-324.

Newman, M.E.J., 2003. *The Structure and Function of Complex Networks*. SIAM Review, 45, pp.167-256.

NISER, 2002. *Reflecting on Africa's Historic and Current Initiatives for Political and Economic Unity*. Paper prepared for the Africa Development Forum III: Defining Priorities for Regional Integration, Addis Ababa, 3-8 March 2002.

Nonor, D., 2010. *ECOWAS Must Strengthen Her Institutions to Enhance Intra-Regional Trade*. [pdf] Available at <<http://www.trademarsa.org/news/ecowas-must-strengthen-her-institutions-enhance-intra-regional-trade>> [Accessed 28 September 2012].

O'Connell, S.A., 1997. Macroeconomic Harmonization, Trade Reform, and Regional Trade in Sub-Saharan Africa. In: A. Oyejide, I. Elbadawi and P. Collier, eds. *Regional Integration and Trade Liberalization in Sub-Saharan Africa. Vol. 1: Framework, Issues and Methodological Perspectives*. London: MacMillan, pp.89-158.

Odularu, G.O., 2009. Export Diversification as a Promotion Strategy for Intra-ECOWAS Trade Expansion. *African Journal of Business Management*, 3(2), pp.32-38.

Ogunkola, E.O., 1998. *An Empirical Evaluation of Trade Potential in the Economic Community of West African States*. AERC Research Paper, 84.

Oyejide, T.A., 1997. *Regional Integration and Trade Liberalization in Sub-Saharan Africa*. Special Paper, AERCDC, 28.

Rommel, C., 2011. Barriers to Intra-Regional Trade in West Africa. In: C. Tolentino and M. Vogl, eds. *Sustainable Regional Integration in West Africa*. ZEI Discussion Paper, C208, pp.47-58.

Savage, I.R. and Deutsch, K.W., 1960. A statistical model of the gross analysis of transaction flows. *Econometrica*, 28, pp.551-572.

Slocum, N., Mordonu, A. and De Lombaerde, P. 2003. The Zambia-Malawi-Mozambique Growth Triangle (ZMM-GT): A Case Study of New Regionalism in Africa. In: H. Van Ginkel, J. Court and L. Van Langenhove, eds. *Integrating Africa: Perspectives on Regional Integration and Development*. UNU, Tokyo Press, pp.89-121.

Soloaga, I. and Winters, A.L., 2000. *Regionalism in the Nineties: What Effect on Trade?* The World Bank, Development Economics Group, Working Paper 2156

Straubhaar, T., 1987. South-South Trade: Is Integration a Solution? *Intereconomics*, 1.

UNCTAD, 2009. *Economic Development in Africa Report 2009. Strengthening Regional Economic Integration for Africa's Development*. Geneva: United Nations Conference on Trade and Development.

UNECA, 2004. *Assessing Regional Integration in Africa*. Addis Ababa: UNECA.

UNU, 2002. *Integrating Africa. Seven-Point Plan Prepared for the G8 Summit 2002*. Africa Day Symposium, African Diplomatic Corps and United Nations University, Tokyo.

WTO, 2011. *International Trade Statistics 2011*. Geneva: WTO.

Yang, Y. and Gupta, S., 2007. Regional Trade Arrangements in Africa: Past Performance and the Way Forward. *African Development Review*, 19(3), pp.399-431.

Yeats, A., 1999. *What Can Be Expected from African Regional Trade Arrangements? Some Empirical Evidence*. World Bank Policy Research Working Paper, 2004.

## Measuring Trade Regionalisation in Africa: The Case of ECOWAS

Zannou, A., 2010. Determinants of Intra-ECOWAS Trade Flows. *African Journal of Business Management*, 4(5), pp.678-686.



*Volker Nitsch*

## ***Make or Break: The Varying Trade Effects of the Euro***

### ***Introduction***

In the 1990s, the revival of monetary unions as a real world policy option was accompanied by controversial debates about economic preconditions for successful integration. In Europe, a sizable literature empirically examined the level of economic integration among countries, aiming to determine if potential candidates were ready for Economic and Monetary Union (EMU). The definition of convergence criteria, along with the establishment of the stability and growth pact, provide further evidence supporting the view that the real convergence of member countries was widely considered to be of relevance for the success of the common currency. In a similar fashion, in the Western Hemisphere, Ecuador's (emergency) plans to adopt the US dollar as its national currency were greeted with great skepticism. Stanley Fischer (2001, p. 7), then Vice President of the International Monetary Fund, notes: "The decision to dollarize was taken in desperation. The authorities did not consult with us [...] if they had asked us; we would have said that the preconditions for making a success of dollarization were not in place."

In recent years, however, policy-making, especially in Europe, seems to have been increasingly dominated by the Nike ("Just Do It") approach to monetary integration; see Barry Eichengreen (2002) for a more extensive discussion of the possible sequencing of policy measures. This policy shift may have been initially due to the early success of EMU. Institutions, most notably the newly established European Central Bank, were functioning well and the internal and external value of the new currency proved to be stable. With the EMU operating smoothly, a partial departure from previously agreed principles seemed

## Make or Break: The Varying Trade Effects of the Euro

affordable. Later, in times of crisis, policy-makers agreed to a wide range of unconventional and ad hoc measures, desperately trying to signal that they were prepared to do whatever it takes to save the euro.

In this paper, I further examine the effects of monetary integration on trade, specifically, the argument that the adoption of a common currency is likely to foster economic integration among member countries. Frankel and Rose (1998), for instance, convincingly argue that the optimum currency area criteria are endogenous.<sup>1,2</sup> In contrast, Berger and Nitsch (2013a,b) emphasize in a series of papers, the possible emergence of asymmetries such as bilateral trade imbalances after the elimination of nominal exchange rate flexibility.<sup>3</sup> Nitsch (2005) further highlights the costs of monetary integration by analyzing the extensive evidence of currency union break-ups in the post-WWII period. In this paper, I explore the possible disintegration effects of monetary integration.

To analyze this issue, I follow the empirical literature on the real effects of EMU. A sizable body of previous work interpreted the free decision of eleven European countries to adopt the euro as a natural experiment to examine the effects of monetary integration. In contrast to most of this work, my main focus is not on the overall effect; rather I am particularly interested in the variation of the effect across member countries.

The result of this examination is that, although trade among EMU member countries seems to be particularly intense on average, the trade effects have spread more unevenly over time. These results add to previous findings of growing trade imbalances in the euro area.

- 1 Frankel and Rose (1997, p. 754) even argue: "Countries which join EMU, no matter what their motivation, may satisfy optimum currency area criteria ex post even if they do not ex ante!" (emphasis added).
- 2 A sizable number of studies indeed document an increase in trade intensity among EMU member countries after the adoption of the euro; see Baldwin (2006) for an extensive summary and Berger and Nitsch (2008) for an alternative view.
- 3 Earlier literature was particularly concerned about possible industry location effects after a decline in transaction costs due to monetary integration; see, for instance, Krugman (1993).

The remainder of the paper is structured as follows: the next section briefly describes the methodology and data, followed by the main section of the paper which presents the empirical results. Finally, a short summary concludes.

## ***Methodology and Data***

As standard in the literature, I use a gravity model to identify the effects of monetary integration on trade. Whenever possible, I have replaced structural variables, such as measures of the economic size of trading partners or the geographic distance between them, with a comprehensive set of country-specific and pair-specific fixed effects. Specifically, I estimate gravity-type regressions of the following very general form:

$$(1) \quad \ln(\text{Exports}_{rpt}) = \alpha + \beta \text{EMU}_{rpt} + \psi X_{rpt} \{ + \sum_t \Phi_t T_t \} \{ + \sum_{rp} \Phi_{rp} \text{RP}_{rp} \} \\ \{ + \sum_{rt} \Phi_{rt} R_{rt} \} \{ + \sum_{pt} \Phi_{pt} P_{pt} \} + \varepsilon_{rpt},$$

where the regression is the log of exports from reporter country  $r$  to partner country  $p$  at time  $t$ , EMU is a dummy variable that takes the value of one, if both trade partners are members of the euro area at time  $t$  and zero otherwise,  $X$  is a vector of structural (gravity) variables, and  $\varepsilon$  is the disturbance term. As noted above, I include various combinations of fixed effects, whenever possible. For instance, for panel analysis, I use common time fixed effects  $\{T\}$  to control for joint variations in trade over time. I also allow pair-wise trade to consistently deviate from the sample average by adding pair-specific fixed effects  $\{RP\}$ . Finally, I replace the common time effects by country-time fixed effects for both reporter  $\{R\}$  and partner  $\{P\}$  countries, to capture any dynamic, country-specific features that could affect the countries' overall trade position. This includes changes in the institutional environment, trends in country-specific competitiveness, or changes in the ease with which exports can be financed.<sup>4</sup> Given the comprehensiveness of the set of fixed effects, I consider these demanding specifications a fairly strong test of the hypothesis that euro area membership will influence trade.

4 Examples for changing institutional arrangements captured by time fixed effects include the country-specific effects of the "Single Market" initiative but also pre-EMU exchange rate arrangements. Arguably, the introduction of the euro has eased the financing of trade deficits through tighter financial integration and, for some countries, through the decline of real interest rates. Time fixed effects will also capture any systematic decline in (real) exchange rate volatility.

## Make or Break: The Varying Trade Effects of the Euro

Following Berger and Nitsch (2008, 2013a,b), the analysis focuses on a homogeneous set of 18 European countries. This approach has the advantage of including countries which either share the European Union's (EU) institutional framework, or are closely associated with it. The sample comprises of the 15 countries, which were member of the EU at the time of the introduction of the euro, (eleven of which adopted the currency from the beginning, followed by Greece in 2001) plus Iceland, Norway and Switzerland. This sample covers the period from 1948 to 2011, but I often analyze much shorter time periods, typically only cross-section data for individual years, mainly for computational and interpretational convenience.

The data is taken from standard sources. I use trade data from the International Monetary Fund's Direction of Trade Statistics (in US dollars). Other variables are constructed based on information taken from the CIA World Factbook.

### ***Empirical Results***

I begin by updating the results in Berger and Nitsch (2013a, b). Instead of analyzing overall trade, Berger and Nitsch examine pair-wise trade relationships between European countries, focusing in particular on the evolution of bilateral imbalances under different exchange rate regimes. Specifically, they ask: When does trade become a one-way relationship? To account for differences in the importance of a trade relationship, both across partners and over time, they normalize the trade surplus or deficit by the total value of bilateral trade. The measure of interest is defined as:<sup>5</sup>

$$(2) \quad \text{TradeBalance}_{rpt} = (\text{Exports}_{rpt} - \text{Imports}_{rpt}) / (\text{Exports}_{rpt} + \text{Imports}_{rpt})$$

Figure 1 illustrates average absolute trade imbalances by groups of country pairs, distinguishing between pairs of countries in which both partners are members of the euro area and pairs which include at least one country that is

5 Given the interest in the symmetry of trade relations, normalizing by total trade is the natural choice (rather than, for instance, normalizing by country size). Larger magnitudes of the variable of interest indicate greater imbalances in bilateral trade.

not member of the euro area.<sup>6</sup> In line with Berger and Nitsch (2013a, b), it is shown that trade imbalances among euro area members widened considerably with the introduction of the euro (and during the ‘phase-in’ period), with a partial adjustment of imbalances, or rebalancing, during times of crisis.

Figure 1: Trade Imbalances by groups of country pairs

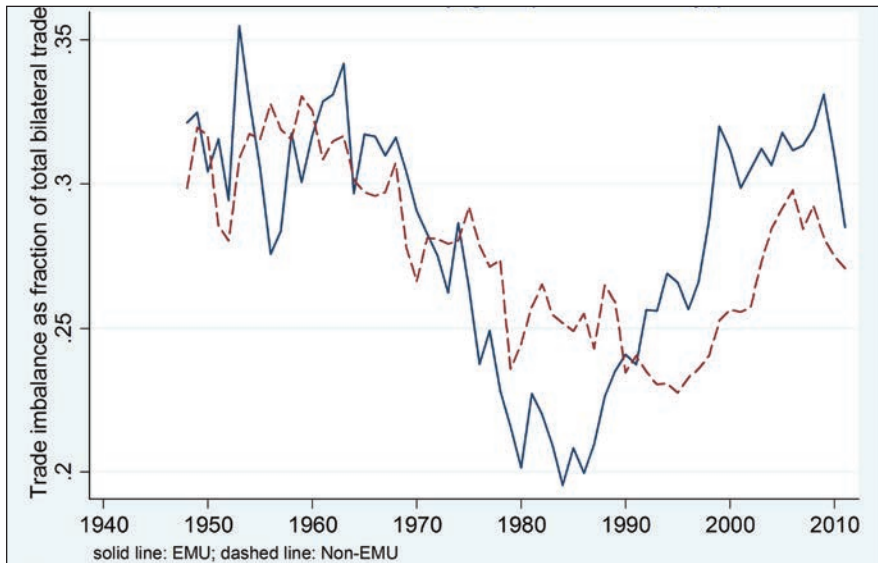


Table 1 provides accompanying regression results. The first three columns on the left of the table replicate the results in Berger and Nitsch (2013a, b) (with an updated set of trade data). The remaining three columns present analogous estimates for an extended sample, covering data until 2011. As in Berger and Nitsch, I begin with the most parsimonious specification of equation (1): a regression of the absolute value of bilateral trade imbalances on an EMU membership dummy and a comprehensive set of year fixed effects. Next, I add a comprehensive set of pair-wise fixed effects, so that the EMU coefficient captures only the time variation in the trade imbalance for EMU member countries after the

6 Using the median instead of the mean has left the results qualitatively unchanged. The differences between country groups become even more pronounced when the Non-EMU group is additionally split into EMU-Non-EMU and Non-EMU-Non-EMU pairs; see Berger and Nitsch (2013a, b).

## Make or Break: The Varying Trade Effects of the Euro

adoption of the euro. Finally, I control for time-variant, country-specific features, in the reporter and partner country.

Table 1: Trade Imbalances under Fixed Exchange Rate Regimes

Period	1948-2007			1948-2011		
EMU	<b>0.018*</b> (0.009)	<b>0.033**</b> (0.007)	<b>0.035*</b> (0.015)	<b>0.023**</b> (0.007)	<b>0.034**</b> (0.006)	<b>0.045**</b> (0.013)
Common time fixed effects?	Yes	Yes	No	Yes	Yes	No
Pair-wise fixed effects?	No	Yes	Yes	No	Yes	Yes
Country time fixed effects?	No	No	Yes	No	No	Yes
Number of observations	16,491	16,491	16,491	17,579	17,579	17,579
Adj. R2	<b>0.02</b>	<b>0.53</b>	<b>0.63</b>	<b>0.01</b>	<b>0.52</b>	<b>0.63</b>

Note: OLS regression. The dependent variable is the absolute trade imbalance as a fraction of total bilateral trade. Robust standard errors are reported in parentheses. \*\*, \* and # denote significant at the 1%, 5% and 10% level, respectively.

As shown, the additional coverage of the crisis episode in Europe leaves the main results essentially unchanged. If anything, the estimated coefficients turn out to be even stronger, both economically and statistically. In sum, there is consistent evidence that imbalances in trade, among euro area member countries, widened markedly after the introduction of the common currency.

One issue related to the emergence of trade imbalances and which has the potential to create frictions between partners, is whether all member countries benefit equally from the adoption of a common currency. While the overwhelming majority of studies finds a statistically significant positive effect of the euro on trade, with Baldwin, DiNino, Fontagné, De Santis and Taglioni (2008) providing an excellent survey, the distribution of these benefits across countries (and pair-wise trade relationships) is much less clear.

To explore this issue, I analyze the distribution of the residuals from a gravity regression. Specifically, I estimate year-specific variants of equation (1) in which

all country-specific features are summarized in comprehensive sets of exporter and importer fixed effects and the log of geographic distance. A common language dummy and a common border dummy are intended to capture (the most relevant) pair-specific features, for the value of exports.<sup>7</sup> I then analyze the residuals separately for trade pairs, where both partners are members of the euro area ('EMU') and pairs which include at least one partner with national currency ('Non-EMU').

For illustration, Table 2 presents the accompanying estimation results when an EMU dummy is added to the specification, with each line in the table reporting the result of a separate estimation. Generally, I do not intend to interpret the results literally, as the precise estimates are likely to suffer from endogeneity and omitted variables bias. However, it is interesting to note, that trade between EMU member countries was particularly intense over the full EMU period from 1999 through to 2011. There was no clear trend towards further integration, but a strong increase in intensity in 2008, at the time of the 'Great Trade Collapse'.

In order to analyze differences in trade intensities across country pairs, Figure 2 plots the Epanechnikov kernel densities of residuals of a gravity regression (without an EMU dummy), split by groups of country pairs. Reviewing the results, two findings appear particularly noteworthy. Firstly, there is indeed evidence of particularly strong trade intensity among euro area member countries, as residuals of EMU pairs are, on average, considerably larger than residuals of non-EMU pairs. This suggests that the specification of the gravity model tends to systematically fall short in explaining the actual value of trade between euro area member countries. The difference between EMU and non-EMU trade is typically picked up by the EMU dummy variable. Secondly, and more importantly, the range of the distribution of residuals for euro area member countries had increased over time. This indicates that for trade between some EMU country pairs, the specification of the gravity model has gradually become a more appropriate description. The distributions become increasingly skewed to the right, with more negative residuals. There is even a slight tendency towards a bi-modal twin peaks distribution in the most recent years.

7 Note that joint membership in the EMU is a country pair-specific characteristic which prevents the use of pair-wise (dyadic) fixed effects.

## Make or Break: The Varying Trade Effects of the Euro

Table 2: Gravity Regression

	EMU		EMU
1999	0.343* (0.138)	2006	0.476** (0.170)
2000	0.317* (0.139)	2007	0.472** (0.168)
2001	0.548** (0.167)	2008	0.626** (0.175)
2002	0.530** (0.161)	2009	0.600** (0.169)
2003	0.510** (0.112)	2010	0.555** (0.181)
2004	0.501** (0.167)	2011	0.570** (0.186)
2005	0.475** (0.166)		

Note: OLS regression. The dependent variable is the log of exports. Additional regressors for which estimated coefficients are unreported: the log of distance, common border and common language. All regressions include exporter-specific and importer-specific fixed effects. Robust standard errors are reported in parentheses. \*\*, \* and # denote significance at the 1%, 5% and 10% level, respectively. Number of observations: 272.

Figure 2: Kernel Densities of Gravity Residuals

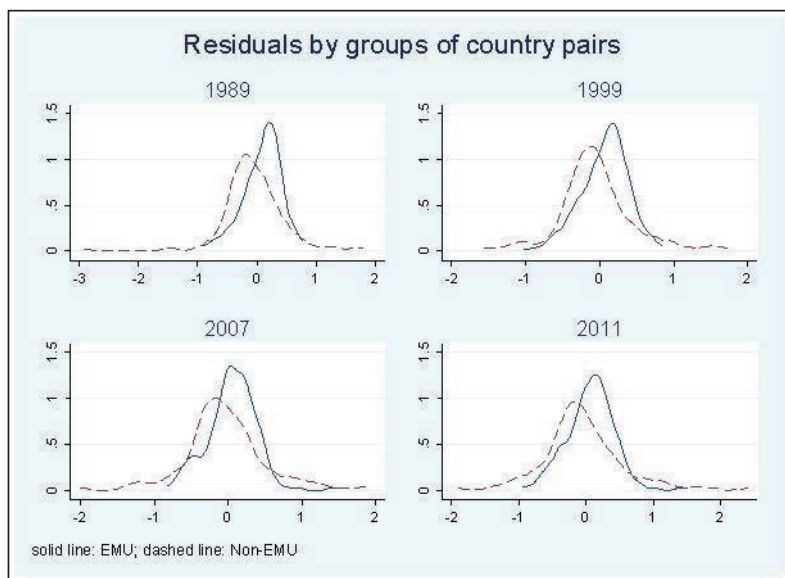
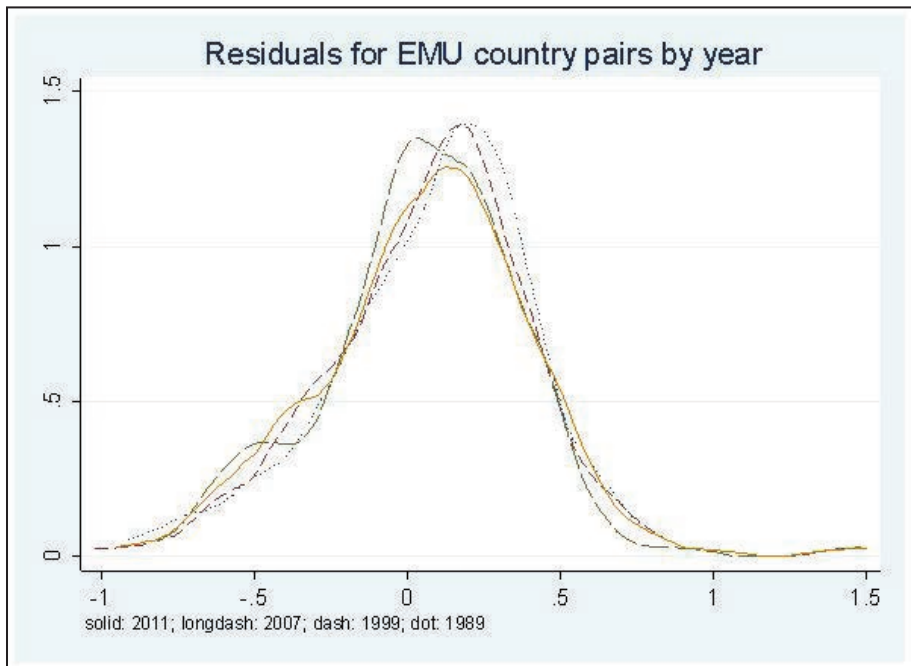




Figure 3 reinforces these observations, plotting the evolution of cross-sectional kernel densities for EMU member countries over time. The distributions of the gravity residuals shift to the left over time, with the mode moving closer to zero. Further, the distributions have become flatter.

Figure 3: Kernel Densities of Gravity Residuals for EMU Pairs over Time



In Table 3, I provide some additional statistics on the distribution of the gravity residuals. Each column of the table presents the results for a single year. For each year, I compute averages of the gravity residual for intra-EMU trade and for the control group of country pairs, which includes at least one non-EMU member. These averages are presented in the top rows of the table. As illustrated before, the mean values for EMU pairs are consistently larger than for non-EMU pairs. However, the differences seem to be generally of borderline statistical significance, with p-values of a t-test for the equality of means often close to 0.1.

Table 3: Analysis of Gravity Residuals

Averages	1989	1999	2007	2011
<b>EMU</b>	0.079	0.065	0.055	0.067
<b>Non-EMU</b>	-0.053	-0.044	-0.038	-0.045
<b>t-test (p-value)</b>	0.02*	0.05	0.11	0.07
<b>Kolmogorov-Smirnov (p-value)</b>	0.00*	0.00*	0.00*	0.00*

Note: Residuals from a gravity model, as tabulated in Table 2; without an EMU dummy, are used. The t-test denotes the absolute value of a t-test for the null hypothesis of equal means of residuals between EMU and Non-EMU countries. Kolmogorov-Smirnov denotes the probability for the Kolmogorov-Smirnov test for the null hypothesis of equality of distributions between EMU and Non-EMU countries. \* denotes significance at the 5% level.

However, I am mainly interested in the dispersion of the gravity residuals. Therefore, I report the results of non-parametric Kolmogorov-Smirnov tests, for the equality of distributions. The p-values are tabulated in the bottom row. As shown, the hypothesis of equal distributions is always strongly rejected at the 1% level. However, since there is no statistically identifiable variation across years, the results provide only limited insights into the effects of the euro.

For the sake of completeness, I also make use of the full sample of available trade data, reaching back to 1948. The appendix provides further results for selected years, analogous to those in analogues Figure 2 and Table 3, illustrating the decades-long process of European integration that had already taken place before EMU.

Overall, the results indicate that estimates of the average effect of the euro on trade mask considerable variation in the effect of the common currency on bilateral trade patterns. With the formation of EMU, some pair-wise trade relationships became increasingly dominated by one of the partners and other pairs have experienced a relative decline in trade intensity. As a result, the introduction of a common currency does not necessarily imply future trade integration. It may also lead to greater disintegration.

## ***Conclusion***

It has long been argued that the criteria for optimum currency areas, such as the intensity of trade, are at least partly, endogenous. The adoption of a common currency is expected to further intensify trade relationships. Taking this view to the extreme, economic and institutional preconditions for monetary integration seem to be irrelevant, as the formation of a monetary union will itself promote further integration, thereby putting all the necessary elements in place.

Indeed, early results from the euro area seemed to provide supportive evidence for this hypothesis. A number of studies found an economically sizable and statistically significant increase in trade among member countries.

However, over time, it has become increasingly obvious that the common currency has also been associated with less favorable developments, such as the emergence of trade imbalances or the growing dispersion of the trade-promotion effects across country pairs. In light of the possible disintegration effects of monetary union, economic and institutional preconditions, and not just political will, become a key element for successful monetary integration.

### References

- Baldwin, R., 2006. *The Euro's Trade Effects*. ECB Working Paper, 594.
- Baldwin, R. et al, 2008. *Study on the Impact of the Euro on Trade and Foreign Direct Investment*. European Economy Economic Papers, 321.
- Berger, H. and Nitsch, V. 2008. Zooming Out: The Trade Effect of the Euro in Historical Perspective *Journal of International Money and Finance*, 28 (December), pp. 1244-1260.
- Berger, H. and Nitsch, V. 2013a. Wearing Corset, Losing Shape: The Euro's Effect on Trade Imbalances. *Journal of Policy Modeling* (forthcoming).
- Berger, H. and Nitsch, V. 2013b. *Bilateral Imbalances in Europe*. CESifo Economic Studies (forthcoming).
- Eichengreen, B. 2002. When to Dollarize. *Journal of Money, Credit and Banking*, 34 (February), pp. 1-24.
- Fischer, S. 2001. *Ecuador and the International Monetary Fund*. In: Alberto Alesina and Robert Barro eds., 2001. *Currency Unions*. Stanford: Hoover Institution Press.
- Frankel, J.A. and Rose, A. K., 1997. Is EMU More Justifiable Ex Post than Ex Ante? *European Economic Review*. 41 (April), pp. 753-760.
- Frankel, J. A. and Rose, A. K., 1998. The Endogeneity of the Optimum Currency Area Criteria. *Economic Journal*, 108 (July), pp. 1009-1025.
- Krugman, P. R., 1993. *Lessons of Massachusetts for EMU*. In: Francisco Torres and Francesco Giavazzi eds., 1993. *Adjustment and Growth in the European Monetary Union*. Cambridge: Cambridge University Press.
- Nitsch, V. 2005. *Have A Break, Have A ... National Currency: When Do Monetary Unions Fall Apart?* In: Paul de Grauwe and Jacques Méliitz eds., 2005. *Prospects for Monetary Unions after the Euro*. Cambridge, MA: MIT Press.

*Simona Beretta*

## ***Monetary Integration: the Choice of the Right Policy***

### ***Choosing an Appropriate Exchange Rate Regime in Developing Countries***

The long-term history of international monetary regimes and national exchange rate policies tends to demonstrate an avoidance of extreme solutions with the basic alternative being either a 'repressed' foreign exchange market or a liberalized one.<sup>1</sup> Within an open foreign exchange market, choosing a middle-of-the-way regime seems to be the most frequent choice. Alternatives to (dirty) floating, have usually taken the form of 'tying one's hand' by pegging to a foreign currency with different degrees of commitment, from soft peg to currency boards. Dollarization or euroization is also a practicable solution, especially for small countries with a large natural partner (for economic and/or geopolitical reasons). Regional approaches to monetary cooperation/ integration, usually connected

1 Maehle Teferra and Khachatryan (2013) review success stories of foreign exchange regime reforms in selected sub-Saharan African (SSA) countries, analyzing contextual macroeconomic policies and economic performance during and after these reforms were undertaken. Before liberalization, most of the reviewed countries were characterized by extensive foreign exchange rationing, sizeable black market premiums, and declining per capita real income. The countries were successful when reforms were sustained. Ownership and commitment to reforms are critical to avoid damaging stop-and-go policies, where policies are reversed after the costs associated with the reforms have been endured but before the benefits can be reaped. Exchange rate liberalization was a fundamental element of the reform efforts in all successful cases, but so were structural reforms, reduced fiscal deficits and monetary expansions, and external assistance. Exchange rate based stabilization efforts, without supportive fiscal and monetary policy, are in fact dangerous. Similarly, attempts to fix the nominal exchange rate through administrative means at levels that are inconsistent with underlying fundamentals and fiscal and monetary policies resulted in an increasingly overvalued exchange rate, leading to failure.

## Monetary Integration: the Choice of the Right Policy

with preferential trade agreements, have been used in practice up to creating a common currency. Regional peg to an international currency and intra-regional peg (with a local anchor) are particularly worth mentioning. The intra-regional peg may bring with it an increased vulnerability with respect to extra-regional transactions. This may be reduced by adopting some form of common-block floating. Monetary union can be seen as the completion of reciprocal monetary involvement in a region.

Can crucial criteria for choosing the appropriate exchange rate regime be identified? As the current debate within the Eurozone clearly shows, the question as to which are the most significant conditions for a monetary union to be desirable, is relevant in general, not just for developing countries. Yet, the adjustment costs of a monetary regime switch are more likely to be problematic in low- and medium-income countries (because of a possible impact on low-income population) and in rapidly transforming emerging countries (which often internally face important inequality issues).

### *Choosing the Exchange Rate Regime: Considering the Nature of Prevalent Shocks*

As Jeffrey A. Frankel titled one of his most famous speeches, it is quite true that *No Single Currency Regime is Right for All Countries or at All Times* (Frankel, 1999). For example, in the basic short-run open macro model, opposite exchange regimes would be desirable for stabilization purposes (i.e. for limiting the impact of exogenous shocks on income and employment) depending on the nature of the shock (whether it is of real versus monetary/financial nature). In the simple IS-LM- $i^*$  framework, prevalence of real turbulence would be associated with more stable output and employment outcomes under flexible exchange rates. On the other hand, monetary and financial turbulence could be better faced within a fixed exchange rate regime.

Frankel's statement makes the choice of monetary integration attractive to countries which are more likely to be exposed to real shocks (for example, terms of trade shocks) and which are characterized by low financial integration. Despite monetary unions are far from being irrevocable, they possess a significant degree of persistence, higher with respect to all other fixed exchange rate regimes – as creating a monetary union requires a number of new institutions,

which are known to be characterized by significant inertia. Hence, engaging in a monetary union might lead to regret at a later time, as one member country may experience a change in the prevalent nature of turbulence. However, exiting the monetary union may be more costly than simply abandoning a fixed exchange rate regime, due to the deep institutional reconstruction that would be required to re-nationalize money.

### *Choosing the Combination of Financial / Exchange Rate Regime*

While in principle, money and finance are different from each other (finance is a form of real inter-temporal trade, transferring real purchasing power from an agent to another over time, while money serves as a spot transaction instrument), the two are inextricably connected because spot transaction among relationally distant agents (i.e. impersonal transactions) requires money to be perceived as a reliable store of value – hence possessing essential inter-temporal qualities (trust and credibility are crucial in both financial and monetary markets).

Consequently, monetary regimes and financial regimes strongly influence each other. With the process of ‘globalizing capital’ (Eichengreen, 2008), the evolution of exchange rate regimes and financial regimes have been intertwined, resulting in regime-switches because of unsustainable reciprocal configurations and/or politically unacceptable economic consequences domestically.

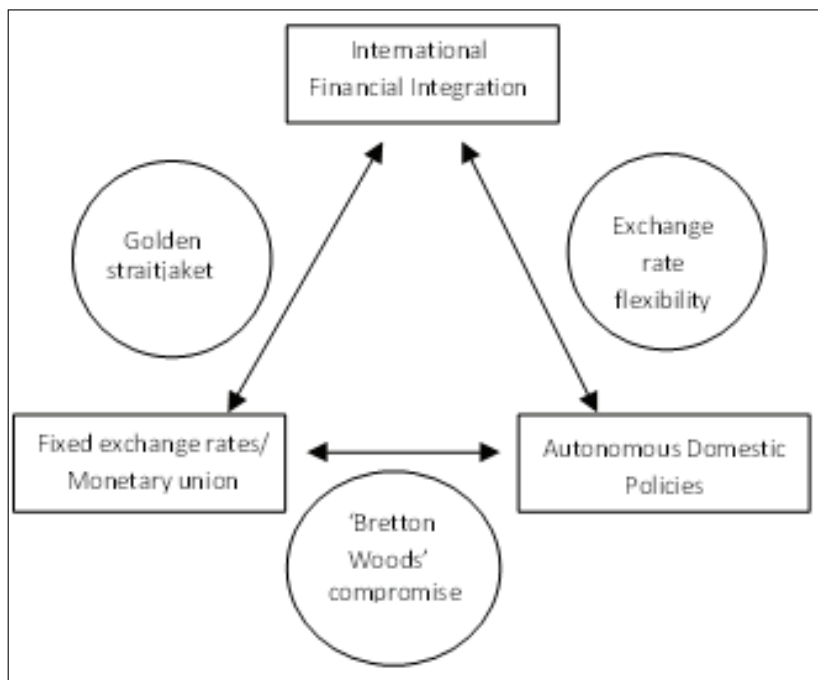
One simple, yet robust, representation of how monetary regimes, financial regimes and domestic economic policy stances (monetary and fiscal) relate to each other is the so-called ‘trilemma’<sup>2</sup>. Fig. 1 below helps to summarize the logical structure of the ‘trilemma’: out of the three corners only two are compatible at a time. International financial integration reduces the scope of national macroeconomic policies under fixed exchange rates (as in the Gold Standard, or with a currency board and even more so within a monetary union). National policy autonomy can be re-gained via exchange rate flexibility (although whether this macroeconomic policy space is sufficient for achieving the desired outcomes is debatable). As a third option, countries may pursue a macroeconomic policy

2 Obstfeld, Shambaugh and Taylor (2005) provide empirical tests on the ‘trilemma’; Pisani-Ferry (2012) offers a re-interpretation to the recent Euro crisis.

## Monetary Integration: the Choice of the Right Policy

setting in which international financial flows are effectively controlled (via administrative control, or some other 'hands-on' direct intervention), so that national macroeconomic autonomy is preserved even under fixed exchange rates.

Fig. 1 – The 'trilemma'



Source: Adapted from Rodrik 2000, p.181.

The processes of innovation, deregulation and internationalization, which has profoundly changed the landscape of financial actors and financial instruments over the last few decades, largely explains the progressive tendency for countries to abandon the 'Bretton Woods' compromise configuration. This included a variety of forms of domestic control over international capital mobility and opting either for (dirty) exchange rate float or for stronger forms of international or regional monetary collaboration. This tendency was strikingly evident up until the 1997 South East Asian financial crisis, which triggered the decision of some countries to re-introduce capital controls as part of their post-crisis management policy.



One issue to be addressed is whether and to what extent international financial integration is actually possible in countries where the local financial sector (actors and instruments) is organized in ways which do not facilitate market interactions with the global financial market, which itself is characterized by low intermediation. Such a market, in fact, is 'global' only in some sense – as it is very hierarchical and asymmetric in terms of access (Beretta, 2012).

Financial intermediation in sub-Saharan Africa is very low, compared to other regions of the world (Ahokpossy, 2013). This is due to many factors which vary greatly across regions, including financial policies, market structure and bank micro-behavior. As a result, bank lending is low and interest margins are high compared to the rest of the world. Also, non-banking financial institutions are under-dimensioned or virtually lacking (Allen, Otchere and Senbet, 2010).<sup>3</sup> Financial depth, access to financial services, operational quality and overall financial profitability is also problematic because of deep institutional reasons.<sup>4</sup> While these remarks may give the impression that the 'trilemma' does not hold for Africa at present, one should also recall that financial transformation – possibly induced by external agents – may be very sudden. Moreover, many would advocate for a deepening of African financial integration.<sup>5</sup> Just consider the many cases in which emerging economies experienced a sudden expansion

- 3 Allen, Otchere and Senbet (2010) provide a thorough review of African financial systems including central banks, deposit-taking banks and non-bank institutions, such as the stock markets, fixed income markets and microfinance institutions. The review also covers West Africa (part III).
- 4 Theoretical and empirical studies, along the lines of the seminal work by Douglas North, emphasize the need to pay more attention to institutional development, as institutions play a vital role in financial sector development, as well as to analyze the impact of institutional factors on financial sector development. In particular, a paper by Anayiotos and Toroyan (2009) studies the interplay between four main institutional factors (namely corruption, political stability, contract enforcement and availability of reliable information) and indicators of financial sector development in Africa.
- 5 Mu, Phelps and Stotsky (2013) maintain that there is a strong need to promote bond market development, as the development of bond markets in sub-Saharan Africa can improve the intermediation of savings. In fact, Africa is a net capital exporter to the rest of the world, mainly because there is a lack of effective local channels to absorb this capital. Furthermore, promoting bond market development in sub-Saharan Africa can improve the structure of the African financial system which is currently dominated by banks. Bond markets and bank finance can be complementary, as banks provide short-term (working) capital and bond markets enjoy a comparative advantage in longer-term financing of government deficits and infrastructure investment. Although a number of African countries have issued sovereign bonds in foreign currencies, local currency bond markets are perceived to be important in order to overcome the so called 'original sin', that is the inability to issue debt in their local currency.

## Monetary Integration: the Choice of the Right Policy

of their financial markets in terms of dimensions and institutional innovations, as foreign investors massively moved in. This is typical in financial markets, where 'winners take all' and a small number of countries tend to attract all the investment in a given moment of time, with a sort of 'herd' effect. Hence, overlooking the trilemma may be dangerous for potentially successful countries.

### *The Fragility of 'Incomplete' Monetary Unions*

'Incomplete' monetary union, is the expression that De Grauwe (2009) uses to identify the various forms a fixed exchange regime can take. Their fragility is connected to the enhanced risk of speculative attacks, which are likely to exhibit a self-fulfilling nature, especially when a multiplicity of equilibria exists.

Basically, when exchange rates are fixed at a level which creates problems either in the real dimension of international integration (say, current account deficits), or with the degree of internal acceptability of the macroeconomic situation (say, excess unemployment or unacceptably high levels of inflation), the situation engenders the reasonable expectation that defense of the target exchange rate level *may* be abandoned by policy authorities and that a new exchange rate will be established. Given the nature of the problem, the direction of change of the exchange rate is also given. Hence, speculative attacks tend to become 'safe bets', while their own existence is actually able to modify the ability of policy authority to defend the target exchange rates. Expectations may become self-fulfilling in multiple equilibria settings, as it is the case when currency transactions mainly occur with reference to financial markets, where asset prices are basically expectation-driven.

The relevance of this remark can be highlighted with reference to the sovereign debt crisis in the Euro area. In anticipation of the discussion later, it is worth noticing that, while the fragility of incomplete monetary unions is a well-established result of theoretical and empirical analysis (one-way bets, self-fulfilling crises), monetary unions can also be financially fragile, for reasons that are not so different from those relevant for incomplete unions.

## ***What Do We Know About Costs and Benefits of Currency Unions?***

In a nutshell, the traditional teaching is the following: a common currency provides an integrated area mainly with micro benefits and macro costs. As in real life, it is not so easy to disentangle micro and macro motives for agents' decisions, the above can only be a useful starting point for a thorough empirical analysis, where both material elements (real and financial integration, macro convergence, institutional convergence) and symbolic elements (expectations, motivations, beliefs) need to be considered.

The basic benefit consists in reducing transaction costs: money - due to its nature as a 'language' for economic transactions - exhibits increasing returns to scale (network externalities). That is, the more a 'language' can be used for transactions with a plurality of potential partners, the more it will actually be used, in a self-reinforcing process. It would take a single currency at the world level to maximize the benefits related to positive network externalities. This was the idea, when the international monetary system was characterized by a dominant reference currency (the £ in the Pax Britannica, the \$ in the Bretton Woods and post-Bretton Woods era)<sup>6</sup>. The visible lack of such a worldwide single currency today, despite the fact that structural international monetary power remains quite concentrated (Gu, 2012), is precisely the reason why regional alternatives tend to become more attractive – along with other deep determinants of regionalism (Baldwin, 2006).

The basic cost of a monetary union consists of losing macro-policy instruments. A monetary union implies loss of control over domestic interest rates, as the policies which are expected to influence them will be set at the centralized level and are by definition a loss of intra-area exchange rate policy. The relevant questions are: how effective are these policies anyway? And what are countries actually losing in creating a monetary union?

6 See the vast International Political Economy literature and the 'endogenous instability' hypothesis. For an effective introduction, see Cooper et al (1989).

### ***How Do We Get High Benefits and Low Costs From a Monetary Union? The Classical Theory of Optimal Currency***

According to tradition, six criteria for an Optimal Currency Area (OCA) have been identified over the years. They are clearly explored in Baldwin and Wyplosz (2009) and summarized below.

1. *Factor mobility across national borders (Mundell)*: Labor mobility across national borders – the international adjustment mechanism required with a common currency can be costly, because of different cultures, languages, legislation, welfare systems, etc. Regarding capital mobility, we would probably need to distinguish between financial, physical, human and social capital. While human and social capital mobility is costly for the same reasons as labor, financial capital might exhibit high international mobility over a geopolitical space which can largely exceed the currency area. One caveat that needs to be added is that factor mobility is likely to follow a ‘circular causation’ mechanism, enhancing asymmetries within the area.<sup>7</sup> Hence, it provides an effective adjustment in the short and medium-term, but the mechanism is likely to generate long-run asymmetries which may feed into political discontent.
2. *Production diversification (Kenen)*: Countries whose production and exports are widely diversified and/or countries with similar production structures are likely to face few asymmetric shocks (similar structures) or small asymmetric shocks (diversification), hence avoiding tensions in the process of macro policy making at the area level<sup>8</sup>.
3. *Trade openness (McKinnon)*: Countries which are very open to trade and trade heavily with each other are more likely to succeed in forming and sustaining a currency area.

7 The ‘circular causation’ mechanism: As productive resources abandon a depressed area in order to relocate in a faster growing region, local prospects worsen and make it the more likely it becomes that other outflows will follow.

8 An important source of asymmetry within a currency area could be the relative economic dimensions of member countries, especially when there is a ‘big player’ as in the case of Germany in the EU and Brazil in Mercosur. Canales-Kriljenko, Gwenhamo and Thomas (2013) study South Africa’s role in SACU. As a contribution to understanding Nigeria’s potential spillovers in the ECOWAS area see also “Nigeria and South Africa: Spillovers to the Rest of Sub-Saharan Africa”, chapter 2 of IMF (2012).

4. *Fiscal transfers*: Countries that agree to compensate each other for adverse shocks are more likely to form a robust common currency. Interregional transfers usually exist within national borders, either implicitly (welfare system) or explicitly (in federal states). They are required for keeping consensus about national unity. Something similar is all the more necessary when countries and not regions, aspire to sharing the same currency.
5. *Homogeneous preferences (inflation-unemployment mix) across member countries*: Countries sharing a broad consensus on the way to deal with shocks are likely to agree on similar policies. This (non-material!) optimality criterion is very relevant for agreement on policies required in case of both symmetric and asymmetric shocks (as it provides the basis for a better understanding of partners' actions).
6. *Commonality of destiny (Baldwin)*: Common economic interests can be powerful glue for creating a common currency area. In particular, at some point it can be in one country's interest to give up policy autonomy and 'buy' credibility from following a more credible area leader. But this initial situation is no guarantee that economic interests of member countries will continue to overlap over the years. In a monetary union, countries will necessarily face temporary conflicts of interests at some point (possibly due to the asymmetric impact of adjustment policies) and might consider dis-integration. Commonality of destiny (non-material criterion!) can exert credible pressure for accepting economic costs in the name of a higher purpose.

### ***The Endogenous Nature of Optimal Currency Areas (OCA)***

A remarkable, consolidated line of research, stresses the idea that the mere fact of participating in a monetary union, changes domestic structures and institutions in a way that is coherent with making the domestic system more similar to what would be required for it to be an 'optimal' member of the currency area (Frankel and Rose, 1998). As a matter of fact, political unification forced a common currency upon a heterogeneous set of regions, with the consequence of producing monetary areas which are characterized by long-run duration. The most interesting question, though, is whether the creation of a monetary union does in fact endogenously enhance the optimality of the currency area when members are not regions of the same nation-state, but remain independent states.

## Monetary Integration: the Choice of the Right Policy

Here, it is worth noticing that participating in a monetary union *does* changes both economic structures and institutions, in a way that reflects the incentives produced by the unification itself. Harmonization of institutions is likely to reinforce feasibility and long-run sustainability of a currency area (Tavlas, 2009). On the other side, structural change is very likely to produce asymmetric impacts on different countries, regions and sectors (see below), which may lead to strong political tensions within countries and/or across member countries. Consequently, the economic and political feasibility of a monetary area, at some point in time, does not necessarily equate with long-run political sustainability of the same nature – unless common institutions are also developed to address intra-area equity issues.

### ***Currency Areas: A Further Exploration of Microeconomic Benefits***

#### *Transaction Costs and Uncertainty*

The micro-benefits of a monetary union include; reduction of transaction costs, both direct costs (money changing in case of international mobility of persons and goods) and indirect transactions costs (information on real prices is more readily available). Greater transparency in prices simplifies comparisons of domestic and foreign products, as they are priced in the same currency, potentially enhancing competition.

As exchange rate changes, over the decision period are ruled out, when a common currency is in place, uncertainty is reduced. While decisions about trading goods and services usually do not span over a long-time horizon, in the case of investment decisions, exchange rate stability provides a significant reduction of uncertainty and is very likely to lead to better quality investment decisions over the long-run. Curiously, the short-run implications of exchange rate stability on trade and business may be ambivalent, as price fluctuations (driven by exchange rate fluctuations) may offer business opportunities of their own.

Thus, the reduction of uncertainty is valuable, especially for its impact on cross-border investments, which can possibly be reinforced by dynamic economies of scale (“endogenous” growth). Another potential benefit, connected to creating a monetary union, is increased international seignorage which may go with increased economies of scale in financial markets. This is a dubious benefit, possibly relevant for the European Monetary Union.

## *Can We Measure Expected Micro Benefits of a Monetary Union?*

Measuring expected microeconomic benefits of a monetary union requires a massive investment in empirical research, including a fair amount of approximation.

In the case of the European real and monetary integration process, Emerson et al (1988) provided a summary estimate of the expected benefit of the European 1992 single market,<sup>9</sup> which played a very significant role in reinforcing consensus for its realization. As to additional expected benefits, following monetary integration, the Report of the Directorate-General for Economic and Financial Affairs (1990) has also played a very important role in creating consensus. Possibly because it succeeded in riding the wave of a strong pro-EU feeling, due to the economic success of the launching the single market. This launch produced its most significant economic effects *before* being implemented, as investment activities flourished as firms prepared for the event, in order to be better positioned to reap the opportunities that the realization of the single market would offer. Again, we observe the importance of non-material conditions (expectations, beliefs, motivations) in shaping the material consequences of a policy decision.

As the impact of a monetary unification goes well beyond reducing microeconomic transaction costs, it is fair to say that the 1990 Directorate-General Report was an effective communication device, but not a robust exploration of what was involved in creating ‘one money’. This is not a fault; it is a matter of fact. The relevance of Baldwin’s *Condition six: Commonality of destiny*, in particular, became clearer over time. The non-material nature of this condition for optimality does not make it less stringent – it is simply more difficult to explore and remains largely unexplored even today.<sup>10</sup> Furthermore, creating a common currency was an unprecedented experience, lacking both applicable precedent

9 The information basis for the estimates of expected benefits of Emerson et al (1988) was a thorough examination of the likely changes occurring in productive sectors and most relevant in quantitative terms – the likely consequences of opening public procurement to single market competition.

10 New Economic Institutionalism represents an interesting path of exploration, covering very long run perspectives, as in Acemoglu and Robinson (2012). The logical and practical intertwining between economic performance, democracy and domestic institutions, represent a fascinating research frontier for studying integration processes.

## Monetary Integration: the Choice of the Right Policy

experiences and academic consensus on its presumable effects. While theoretical consensus on the sources of microeconomic benefits from creating a single market was wide, the micro and macroeconomic consequences of monetary unification were (and possibly remain) highly controversial. It is to this controversy, we now turn.

### ***What Are the Macroeconomic Costs (and Benefits)?***

By adopting a common currency, member countries lose two policy instruments for external and internal adjustment: exchange rate management and domestic monetary policy. However, given members may reap macroeconomic gains through reciprocal insurance.

### *Losing Intra-Area Exchange Rates for External Adjustment*

Member countries lose the possibility to avail themselves of intra-area exchange rate devaluation, which may be a very effective adjustment instrument if prices are sluggish or rigid, switching aggregate demand from foreign to home production when a country is facing an unfavorable current account balance. Intra-area exchange rate devaluation is deemed to be a particularly valuable instrument, especially when intra-area trade represents a sizable portion of one country's external trade (that is, when Condition three for OCA is satisfied). Giving up the possibility to control intra-area exchange rates has a costly consequence: wage flexibility and labor mobility remain as the only (costly!) adjustment mechanisms.

Adjustment is a crucial and often painful task. Exchange rate changes are widely perceived to be a less costly instrument than real wage reductions for satisfying a country's inter-temporal budget constraint (for example, adjusting to correct excessive current account deficits). Similarly, adjusting exchange rates would be preferred in case a country needed to respond to an asymmetric shock that other countries do not face. However, empirical evidence on the effectiveness of nominal exchange rate changes for real adjustments is at best mixed, with many examples of vicious cycles of inflation-devaluation that have a very limited impact on real price competitiveness. In addition, competitiveness itself has many determinants, beside price competition. Hence, it is reasonable to conclude that the macroeco-



conomic costs of foregoing intra-area exchange rates are dubious and should not be exaggerated.

### *Losing Domestic Monetary Autonomy*

A second instrument which, by definition, is lost in a monetary union is domestic monetary policy. While national central banks may retain some of their previous tasks, they need to give up monetary control. How costly, in terms of losing policy space, this situation is, remains highly controversial.

The potential cost is due to the fact that it becomes impossible to pursue the preferred domestic policy mix between inflation and unemployment. Adopting a flexible exchange rate allows, in principle, to choose the optimal domestic rate of inflation. This becomes impossible in a monetary union.

But is this really a macro cost of a monetary union? From a monetarist perspective, it is quite doubtful, as money neutrality holds and rational forward looking agents immediately adjust to changes in monetary policies. Hence, all macroeconomic policies, including monetary policy, are likely to be ineffective at stabilizing GDP at the desired (above 'natural') level.<sup>11</sup> In other words, there is not much policy space to lose in joining a monetary union, more so if the potential member of the monetary union is a small one, with poorly developed domestic capital markets and with no reputation and little experience of operating in a world of highly mobile capital flows. Such a country would lose little or nothing in joining a monetary union. Rather there may be some clear gains in the monetary policy dimension, as the real rate of interest may decline after joining, as the risk premium associated to operating an independent monetary policy disappears (Artis, 2006).

### *Possible Macro Benefits Of A Monetary Union: 'Importing' Better Policies And Reciprocal Insurance*

Macro benefits of a monetary union, for a given country, include the implicit reciprocal insurance ensuing from the pooling of foreign reserves and possibly from

11 For example, the announcement of an 'optimal' domestic rate of inflation is time inconsistent in the monetarist perspective; hence, it is not effective in stabilizing GDP at a desired level (De Grauwe, 2009).

## Monetary Integration: the Choice of the Right Policy

importing prudent macroeconomic management from a more reputable external monetary authority, such as the dominant economy's monetary authority in an 'incomplete' monetary union, or the Union's monetary authority. The obvious caveat to this view is that it assumes, almost by definition, a better quality of macroeconomic management by the country or institution which is setting the monetary policy for the entire currency area (a quality which can be hoped for, but cannot be taken for granted).<sup>12</sup> Furthermore, reciprocal insurance, as such, may be perceived to be generally desirable for every member, over a long-time span, but in the short to medium-term perspective, each country is likely to perceive its position in the insurance mechanism to be on the 'give' or on the 'take' side. Hence, there needs to be good (material or non-material) reasons for a country to accept being continuously on the 'give' side.

A further potential macro benefit that member countries can reap by joining a monetary union is channeled by the fact that a monetary union favors the formation of a unified capital market,<sup>13</sup> where national savings could be more mobile across countries. This could help member countries in facing temporary asymmetric shocks, allowing for consumption smoothing. Again, 'too much of a good thing' may turn out to be bad, when it unduly postpones adjustment by allowing for the build-up of excessive imbalances or excessive debt.

More dubious is whether the formation of a unified capital market can be useful in facing structural problems (permanent shocks, long-run GDP growth differentials, structural inequalities). It is very likely that realizing a unified capital market is not sufficient, but that a centralized budget for the integrated area (as in EMU) would be required.

In all cases, the effectiveness of unified capital markets in supporting countries facing shocks have more to do with the intrinsic qualities of capital markets than

<sup>12</sup> The 'fall' of the Bretton Woods system in 1971 can be explained in terms of 'hegemonic instability' (Cooper et al, 1989)

<sup>13</sup> Kalemli-Ozcan, Papaioannou and Peydró (2010) investigate the underlying channels of the euro's effect on financial integration combining data on bilateral banking linkages with a dataset that records the timing of legislative–regulatory harmonization policies in financial services across the European Union. They find that the euro's impact on financial integration is primarily driven by eliminating the currency risk. Legislative–regulatory convergence has also contributed to cross-border financial transactions, while trade in goods does not play a key role in explaining the euro's positive effect on financial integration.

with their being unified. The role of large trans-national financial institutions can by no means be downplayed, at the global, macro-regional and national levels.

*An Additional Macroeconomic Cost:  
Enhanced Financial Vulnerability In A 'Complete' Monetary Union*

The recent financial crisis highlighted a second relevant macro cost, in addition to losing policy instruments at the national level. This cost is the enhanced vulnerability of national sovereign debt.

In fact, member countries of a monetary union *do not* have control – by definition - over the currency in which their own debt is issued. This makes them structurally similar to emerging countries, which are unable to issue debt denominated in national currency, as it would be not considered for portfolio investment. This '*original sin*' (Eichengreen, 2003) is attached to any member of a monetary union, as there is no possibility for this country to print domestic currency to service debts denominated in the domestic currency. Thus, there is no possibility to reduce the burden of debt by inflationary policies. Hence, speculative attacks may become more frequent. Multiple equilibria would be likely, and whether a 'bad' or a 'good' outcome ensues depends on market sentiments, which may overlook fundamental long-run variables and focus only on the short-run perspective (yet, the short-run may be long enough to put serious pressure on domestic fiscal policies).

The case of Spain and the UK can be used to illustrate the "original sin" paradox (De Grauwe, 2011). Imagine a speculative attack on UK bonds: as UK government bonds are sold, domestic currency depreciation ensues, which provides over time a real boost to UK domestic production. The system does not experience any liquidity crisis, as UK money supply remains unchanged. In the case of a liquidity crisis, however, the Bank of England can play the role of lender of last resort (with a cost in terms of inflation).

A speculative attack on Spanish government bonds would look very different. As government bonds are sold, euros exit Spain and flow into other countries; but no depreciation occurs and no real boost can be experienced. Money supply in Spain decreases, prompting a liquidity crisis which can possibly lead to a solvency crisis, depending on market perceptions. That is: a sovereign debt

crisis spills into domestic bank crisis. With highly integrated markets (cross-holding of sovereign debt), a 'bad' equilibrium in one country tends to affect other financial markets (exporting instability).

### ***Beyond Aggregate Costs and Benefits of a Monetary Union: Assessing the Asymmetric Impacts on Member Countries, Regions and Sectors.***

In evaluating costs and benefits of a monetary union, the presence of asymmetries suggests *prudence* in creating a monetary union, even when building on a previous successful experience of real integration (either a single market or a preferential trade agreement). "One market, one money" may work well and create huge overall gains. Yet, these gains will inevitably be asymmetrically distributed across countries, regions and sectors. This result, which is well established in the literature concerning real integration, is very robust and applicable to monetary integration as well. Even successful monetary unions, such as EMU, will permanently be challenged by clashes of objective interests across countries, regions and sectors.

Besides the asymmetric impact of microeconomic effects of a monetary union (which will enhance cross border transactions, deepen integration and hence produce winners and losers across countries, regions and sectors), there are also macroeconomic conditions that can be identified as autonomous causes of asymmetries within a monetary union. Among the main causes of asymmetries, particularly relevant for the European experience, are the following: different labor and capital market institutions, different long-run rates of growth, different national preferences about the inflation/unemployment mix, different perspectives on what the role of the public sector should be, and different fiscal systems.

In his comprehensive survey of literature, assessing the advantages and disadvantages of monetary unions in Southern Africa, Tavlas (2009) recalls many studies of monetary union proposals for Africa, illustrating the potential costs of one-size-fits-all monetary policy for members of prospective unions, which are too different on too many counts, to allow for sustainable monetary unions. Tavlas also mentions problematic asymmetries ranging from production structures (hence asymmetric terms of trade shocks) to institutional effectiveness

(democratic accountability, corruption, and government efficiency). Debrun, Masson and Pattillo (2010) confirm the importance of asymmetries for the African case. They developed a cost-benefit analysis of monetary integration for currency unions actively pursued in Africa and demonstrate that the benefits of monetary union tend to come from a more credible monetary policy, while costs derive from real shock asymmetries and fiscal disparities. Furthermore, their simulations indicated that the proposed EAC, ECOWAS, and SADC monetary unions bring about net benefits to some potential members, but modest net gains and sometimes net losses for others.

### *The “Real” Impact of a Common Currency (De Grauwe)*

A common currency does not remove the problems a country faces with reference to external inter-temporal budget constraint, according to which, no country can systematically be a borrower from abroad through current account deficits (and even not for many years in a row, if it is a small, relatively weak country). In a monetary union, the problem of inter-temporal balance of payments equilibrium seems to be even aggravated by union membership (Berger and Nitsch, 2010), due to mechanisms that relate to either trade or financial flows, or both (Atoyan, Manning and Rahman, 2013).

In particular, price competitiveness of national production remains a problem in a monetary union, as by giving up the management of their nominal exchange rate, each country or region ends up facing real exchange rates changes (see Chart 1). Productivity differentials and inflation differentials matter with regards to the long-run growth sustainability of a country/region. Divergences in competitive positions in the Eurozone need to be understood and properly assessed.<sup>14</sup>

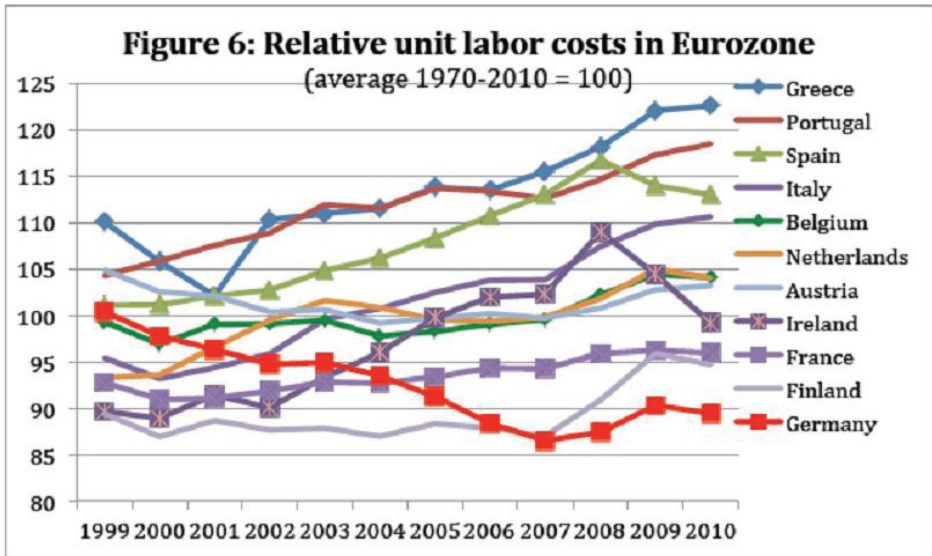
Why do these divergences occur? For a variety of reasons, this can be summarized by the fact that large part of economic policies remain in national hands. Spending and taxation, wage policies and social policies are all decided at the national level. Moreover, structural changes in the labor markets follow national border lines. This creates the potential for divergent developments in wages and prices and to significant changes in the competitive position, which in turn

<sup>14</sup> Mongelli (2010b) tests for a systematic relationship between the index of institutional integration and the degree of economic integration, as measured by trade openness within the EU.

## Monetary Integration: the Choice of the Right Policy

leads to difficult external adjustment problems.<sup>15</sup> In fact, divergent movements in competitiveness within the Eurozone in fact are partly the result of different structural changes in labor market institutions. As differences in national labor market institutions can create asymmetric shocks, which possibly lead to large adjustment costs.<sup>16</sup>

Chart 1 – Relative unit labor costs in the Eurozone



Source: European Commission, Ameco, cited in De Grauwe, 2011, p.12

15 De Grauwe (2011) provides the example of German wage moderation and lowering unit labour costs, which can be explained by the fact that labor unions' power has declined in Germany more than in other Eurozone countries, probably due to increased bargaining position of German employers, which can credibly threaten to move their activities to nearby Central European countries.

16 According to Dullien and Fritsche (2009), some kind of within-union divergence may not necessarily imply trouble. The important question is not whether inflation rates differ, but whether the differences result from structural features of the economy which might have serious economic consequences in the medium and long run. For example, an above-average rate of domestic inflation makes investment in the tradable sector less attractive, while cheaper finance might lead to excessive investment in the housing sector. Persistent deviations in the price trend might lead to a strong real overvaluation, where profits suffer and investments contract. Hysteresis may trap the country in a prolonged period of sub-trend economic growth.

## ***One Market, One Money, Many States: The Institutional “Architecture” of a Monetary Union***

As argued above, a monetary union is not only about economics. The Optimal Currency Area (OCA) criteria send ambiguous and inconclusive signals, because costs and benefits are asymmetrically distributed within and across countries. Hence there is not (and there cannot be) a clearly identified 'national interest' which is time-invariant. Thus, there is no set of well-defined policies that will automatically transform a number of countries into an OCA. In particular, purely nominal convergence can be necessary but is not sufficient. Once a currency union is in place, national and union policies need to be constantly adapted to the changing economic environment, always keeping in mind that negatively affected countries, sectors or regions may constitute a serious threat to the smooth functioning of the union itself.

The Eurozone itself does not qualify as a perfect OCA. It has functioned and may keep functioning at a cost. The cost of which is taking care that weak partners are supported by the union, with a view to encourage self-reliance (that is applying a 'positive' vision of subsidiarity where problems are to be faced at the lowest possible policy level). These costs tend to arise in labor markets and unemployment, in political tensions (within and across countries) in the presence of asymmetric shocks, and because of the emergence of protectionist tendencies in cases of deep negative symmetric shocks (such as the recent long recession). A willingness to support these costs is required for the monetary union to be preserved and also for keeping costs themselves at the minimal level (which may be perceived politically as too high, but inadequate policies are bound to make the level even larger). According to De Grauwe (2011), the crucial question is the following: can a monetary union survive with no political union?

In discussing which policies are required for a monetary union, the following paragraphs will cover three basic points: First, policy architecture: which institutional design should be devised for the policies of the union and of the member countries. Second, the need for an 'incomplete' institutional structure: future policy and institutional actions, which are unpredictable in their details, will be required for the survival of the monetary union, and member countries should consider being ready to take them if needed (i.e., contingent decisions within the architecture, possibly 'pushing' substantial, informal reforms). Third, transi-

## Monetary Integration: the Choice of the Right Policy

tion policies: which policies are to be adopted in transition towards the creation of a common currency and also the expansion or reduction in its membership?

### *Policy Architecture in a Monetary Union*

#### *Monetary Policy: Institutional Architecture and Aims*

Two main issues will be discussed. The first one refers to central bank independence from political influence: How independent *should* a Central Bank be from political interference? And how independent *can* it be?

The second refers to a central bank's internal governance framework: How would the two basic alternatives compare? Namely a federal structure (such as the FED), which takes into consideration members' perspectives, or a top-managing board where members are requested NOT to represent member countries (like in the European Central Bank, ECB) and the European System of Central Banks, ESCB)? Should the voting results of monetary policy decisions within the board be transparent or not?<sup>17</sup>

These issues raise a complex set of inter-disciplinary problems and likely require specific answers to specific situations. No institutional design can fit the needs of all would-be members, at any given time, and possibly not even the needs of all given members over time.

Concerning the institutional objectives of monetary policy, the basic discussion in economics concerns whether objectives are framed within a setting where rules or discretion prevail. Here, we can see in the 20th century - the century in which macroeconomic management was born - as experiencing wide swings. The attitude prevailing in the Western world after the collapse of the Bretton Woods system (of external rule) and after dissatisfaction with the inflationary experience many countries experienced in the seventies (discretion), led to an

<sup>17</sup> Gersbach and Hahn (2009) discuss pros and cons of voting transparency in a monetary union. Many central Banks – including the Bank of England and the Bank of Japan - publish voting records and the minutes of their meetings, while the European Central Bank has always insisted on keeping the details of the decision-making process secret. Thus, they argue that the ECB, as it is the central bank of a monetary union, has been right to do so, as the lack of transparency in decision making tends to protect a committee from political interference from national policymakers trying to promote national interests.



agreement that monetary rules (internal rules) could provide a viable solution. By providing a price-stabilizing nominal anchor in the short-medium run without impairing long-run growth (while active short-run monetary management seemed to produce short-run nominal variability and no visible long-run growth effects, due to quick expectation adaptations). Hence, we can understand the reasons why the euro zone architecture provides ‘price stability’ as an institutional aim of the ECB/ESCB. That decision represented the institutional imitation of the best medium-long-run performing monetary management in the area at that time, namely Germany’s.

As to policy instruments, one should also discuss the instruments through which the institutional monetary policy objectives of a Union are to be pursued. Traditionally, the effects of monetary policy actions are thought to be transmitted via money or credit channels—the so-called money versus credit view of monetary policy. In the former, changes in the nominal quantity of money affect spending directly, whereas in the latter case, open market operations induce changes in interest rates that affect spending. Inflation targeting has been the choice of the EMU.<sup>18</sup>

However, the exclusive emphasis on price stability, typical of the EMU experience has been suffering from an early critique from the ‘left’, maintaining that growth also matters. Further, a more recent critique from the ‘right’ is that prices of financial activities also matter, and that exclusive reference to the GDP deflator or similar indices is inadequate (see, for example, the annual reports of the Bank for International Settlements (BIS)). Hence, deciding which target (goods and services, assets, or real estate) should be set for inflation targeting is preliminary to discussing the instruments of monetary policy.

Despite ample agreement over the fact that a non-independent central bank, allowed to pursue discretionary monetary policies, would tend to produce high and variable inflation, with at best a modest impact on real rates of growth and

18 Davoodi, Dixit and Pinter (2013) discuss the effectiveness of monetary transmission mechanism in East African Countries considering both money and credit channels. They find that reserve money and the policy interest rate, two frequently used instruments of monetary policy, sometimes move in directions that exert offsetting expansionary and contractionary effects on inflation—posing serious challenges to harmonization of monetary policies across the EAC and transition to a possible future East African Monetary Union.

## Monetary Integration: the Choice of the Right Policy

employment over the longer run, a deep policy debate remains. Is price stability, as the *only* mandatory institutional objective, appropriate? Or should it be stability *and* growth? This crucial debate continues to be re-opened in Europe and the USA, where recent accommodating monetary policies are aiming to respond to high unemployment levels.

### *Fiscal Policy: How Much Fiscal Coordination is Feasible and Desirable?*

Are Common Fiscal Rules Required In A Monetary Union? There are good reasons to answer yes to this question. As debt default by one member country has negative spillovers for the whole monetary union and problematic national debt situations tend to raise interest rates in the whole monetary union, the institutional design should limit incentives for opportunistic behavior of national governments (Manasse, 2007).<sup>19</sup>

This position was heavily criticized by the theory of efficient markets, in which financial markets are able to properly price the risk of each member country. This critique, which was conventional wisdom before 2007, has been put to test with the financial crisis. We have good reason to believe that imperfect information, information asymmetry and strategic behavior on the part of agents, powerful enough to influence market prices, are structural features of financial markets, which implies a degree of structural ignorance that should not be overlooked. Yet, we also need to admit that obsessive, almost exclusive focus on daily indicators (namely, the spread between national and benchmark interest rates) seems to continue the tradition of attributing to financial markets the ability to correctly price national risks.

There is also a practical, as opposed to theoretical, criticism of common fiscal rules, stemming from a different question: Are common fiscal rules really

<sup>19</sup> The paper focuses on the discipline effects of common budget deficit limits, as compared to 'national' balanced budget rules and on implications of common rules for stabilization policy. As the lack of incentives for fiscal consolidation in good times is precisely why many observers have criticized the European Stability and Growth Pact. The findings suggest that deficit limits become less effective for providing fiscal discipline when the economy is subject to high output volatility. This result casts some doubt about appropriateness of this framework for economies facing high output volatility.

feasible? Rules are very difficult to enforce even when approved (both, because of creative accounting practices and political pressure). While creative accounting simply requires more transparent and coordinated accounting practices, political pressure may be hard to resist.

Fiscal criteria are very important, as fiscal policy is the primary instrument through which national governments can influence macroeconomic performance. Reciprocal surveillance and rules should ensure consistency with internal and external sustainability.<sup>20</sup>

Looking at the experience of the European Financial Stability and Growth Pact, one should really mention some problems of definition and application in this regard. The Maastricht limits (60% debt/GDP; 3% deficit/GDP) are both economically questionable (they are not 'magic numbers') and politically fragile. Deficits may be unsustainable because of the level of public expenditure  $G$  and taxation  $T$  and not just their differences (both,  $G/GDP$  and  $T/GDP$  may be too big). Also, deficits may be unsustainable because of the internal composition of  $G$  (current vs. investment spending) and  $T$  (taxing income vs. taxing rents, fiscal equality across social groups and so on).

A more significant question would then be: *Should better common fiscal rules be devised, where quality and not just quantity matter?* I am convinced this is one of the most urgent questions in the present experience of the European Union, demanding for an overall re-thinking on the philosophy of fiscal rules.

### *Financial Policy: Pursuing Financial Stability in a Monetary Union*

The hard path, described by Bagehot, required to balance the provision of lending of last resort in cases of illiquidity (to be carefully distinguished from insolvency), with the avoidance of moral hazard and the endangerment of central bank credibility. This path has become even harder with financial innovation and globalization, and with the increase of the number of 'too big to fail'

<sup>20</sup> Iossifov et al (2009) discuss the fiscal criteria in the Central African Economic and Monetary Community (CEMAC) in view of improving them by broadening the region's current criteria to include attention to external shocks. They argue that fiscal indicators excluding oil revenue, such as the non-oil fiscal stance, non-oil fiscal impulse and non-oil primary balance, should receive central attention.

## Monetary Integration: the Choice of the Right Policy

financial institutions (see also the debates of the International Monetary Fund about the need for a world lender of last resort<sup>21</sup>).

An important lesson of the financial crisis has been that regulation and supervision of the financial system needs greater macro-prudential orientation. Implicit in this, is the realization (rediscovery, some would say) that traditional macroeconomic stabilization and micro-prudential policies are not sufficient, as they leave a regulatory gap. This gap is created by externalities that individual financial actors do not internalize, and by collective behavior that market mechanisms are ill-equipped to address. The result is inter-dependencies and individual and collective action that leads to excessive pro-cyclicality and systemic fragilities (Agur and Sharma, 2013). Hence, the question: *How to design financial regulation and supervision with a common monetary policy?*

Cross-country banking and finance are very likely to be enhanced by the creation of a common currency, hence the need to address issues related to institutional architecture of financial supervision and financial policy, including a possible banking union<sup>22</sup>. This issue was largely underestimated in the preparation of the European Monetary Union, but in the 21st century a currency union is bound to stand or fall depending on the adequacy of the monetary union financial policy architecture. As is well known, the financial design of the euro area envisages a common currency, issued and managed by a single monetary authority and a plurality of national institutions for financial supervision. One financial market, one currency, many national institutions for financial supervision: a clearly problematic institutional mix that has revealed its inadequacy during the financial crisis.

21 Fischer (1999); Jeanne, Wyplosz (2003)

22 IMF (2013b) thoroughly explores the necessary elements of the banking union: a single supervisory framework, single resolution and common safety net and urgent issues related to ESM direct recapitalization of banks.

## *How Should This 'Lending + Supervision' Activity Be Framed Within a Monetary Union?*

In principle, a monetary union may provide better safeguards against a financial crisis. The lender of last resort function works better in large monetary area. Banks in small countries outside the euro zone have large fraction of liabilities expressed in foreign currency. When foreign currency liabilities are withdrawn, the national central bank cannot provide the necessary liquidity. On the contrary, banks of small countries in the euro zone have a larger proportion of liabilities in euros and the ECB can create unlimited amounts of euro liquidity.

Hence, localized crisis management, in principle, should be easier in a monetary union. Yet, such management inevitably involves clashes between national interests, so that national opting out becomes tempting. As a banking crisis invariably leads to a recession, managing the adjustment process after the banking crisis is resolved is politically costly. Hence, countries in a monetary union may find it more difficult to lift themselves out of the recession than 'stand alone' countries which can depreciate their currency in the hope of boosting aggregate demand.

While the ECB/ESCB stepped into the market, in order to provide lending of last resort at the euro zone level, in order to keep the 'hydraulics' of the system functioning, the sphere of financial supervision remained in the hands of national authorities. This created serious cross-country tensions whenever cross-border banking and financial institutions ended up in problematic situations. When the affiliate of bank A, active in country B, is facing problems of illiquidity-insolvency, who is in charge? Country B, where the affiliate is operating, or country A, where the parent institution is based? Also, accounting practices within cross-border financial institutions may, in fact, dislocate profits and losses. Here, you can see why the debate about the need of a banking union within EU arose.<sup>23</sup>

Pisani-Ferry (2012) provides a very clear analysis addressing the inherent weakness of EMU institutional design in terms of a 'new' trilemma as three current features of the institutional design can only be taken pairwise: Namely, strict prohibition of monetary financing of fiscal deficits, bank-sovereign inter-

<sup>23</sup> See Box 1. European Union: Existing Framework for Financial Stability in IMF (2013b), p.10-11.

## Monetary Integration: the Choice of the Right Policy

dependence and no co-responsibility for public debt. From the ‘trinity,’ three options for reform stand out: First, broadening ECB mandate to overcome the ‘no-monetary financing’ rule and take on the role of lender of last resort for sovereigns; Second, building a banking federation; Third, creating a fiscal union with common bonds.<sup>24</sup>

It is worth recalling that the European Commission (EC) issued a Green Paper on November 23, 2011 (EC, 2011) on the feasibility of introducing so called ‘stability bonds’<sup>25</sup>. However, as no decisive step has been taken in selecting one of the three options, despite some innovation in European financial stability facilities and some timid steps towards a banking union, subsequent waves of sovereign debt crises have been dealt with in a case-by-case approach, making solutions for relatively small problems (Cyprus), very complicated. That is to say, institutional and political indecision is very costly.

### *The Exchange Rate Regime of a Currency Area With Respect to Non-Member Countries*

Not much discussion was devoted to this issue in the case of EMU, which may be due to a variety of factors. Among them, we can mention the large magnitude of intra-area transaction in the EU – which obviously limits the importance of external exchange rates for production and employment in the area, as well as the member countries’ consolidated experience of exchange rate fluctuations *vis-à-vis* the US\$. Hence, the Maastricht Treaty removed exchange rate policies from ECB responsibility, leaving it to higher political levels to frame possible exchange rate targets and exchange rate agreements with non-members.

The issue of a common exchange rate policy, *vis-à-vis* third countries, may be much more relevant when the currency area is rather small and/or the share of

<sup>24</sup> Claessens, Mody and Shahin (2012) discuss proposals for common euro area sovereign securities that would serve two functions: in the short-term, they could stabilize financial markets and banks and in the medium-term, help improve the euro area economic governance framework, through enhanced fiscal discipline and risk-sharing.

<sup>25</sup> Initially, the rationale for common issuance focused mainly on the benefits of enhanced market efficiency through enhanced liquidity in euro area sovereign bond market and the wider euro area financial system. More recently, in the context of the ongoing sovereign crisis, the focus of debate has shifted toward stability aspects.

intra-area transactions is not too large. Finding an agreement would be especially demanding if there is no ‘dominant’ external economic partner, which is common to all members of the currency union.

## ***Can Currency Unions Increase Economic Convergence? If Yes, in Which Areas and to What Extent?***

### *Macroeconomic Convergence: The Honeymoon and Beyond*

A typical experience common to a variety of integration processes is the so-called ‘honeymoon’. The initial phase of an integration process tends to be driven by overly positive signals and expectations of success – possibly leading to critical situations (see e.g. Mexico’s financial crisis following the realization of the North American Free Trade Agreement, NAFTA).

There is also clear evidence of ‘honeymoon’ in the macroeconomic and financial performance of the euro zone. In particular, the interest rate spread of government bonds rapidly converged, after the creation of the EMU and remained quite stable and very low (possibly, *too low!*) for a relatively long-time. Chart 2 clearly illustrates that as the currency union eliminates exchange rate risk and domestic liabilities are re-denominated in the new common currency, the overall risk of domestic liabilities expected by markets is reduced (‘honeymoon’). This new situation tends to soften the market constraint on how much domestic debt can be issued, possibly softening the perceived budget constraints of individual countries. If excessive debt is issued, sustainability problems ensue.

Not only does ‘honeymoon’ not last forever, it may also endogenously affect the financial sustainability of individual countries and the area as a whole in a negative way.

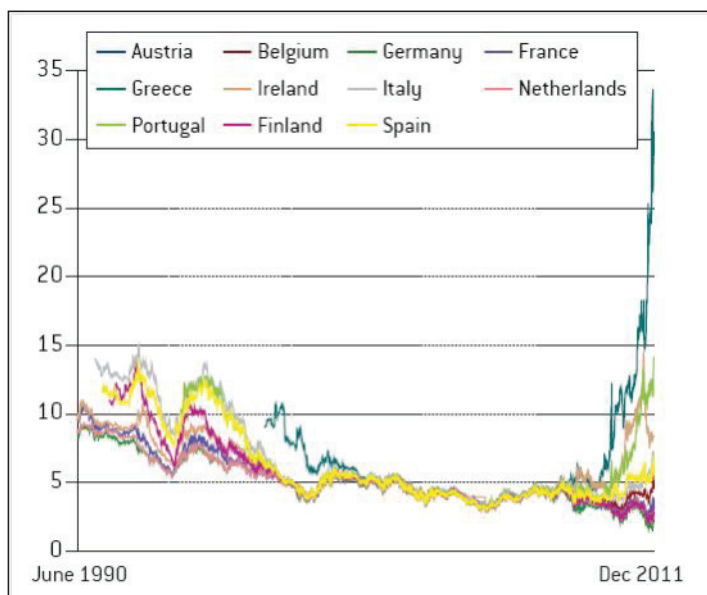
### *Real Convergence is not an Automatic Outcome of Currency Union*

A common currency can be a powerful basis for bottom-up real integration processes, including trade and production ‘unbundling’, factor mobility and cross-county investments. It is a basis, not a direct determinant! Real integration decisions taken by individual agents derive from a complex set of expectations, motivations and beliefs. The non-material drivers of actions refer to a

## Monetary Integration: the Choice of the Right Policy

set of (incomplete) information relative to the material dimension, pertaining to the decision itself (relevant technology, local versus foreign costs, and market conditions).

Chart 2 - Yields of 10-year government bonds of selected euro area countries from 1990 to 2011



Source: Datastream, Pisani-Ferry 2012, p. 5

There is a sort of asymmetry facing trade costs related to different currencies used by trading, finance and/or investment partners, which may imply the decision *not* to pursue the potential opportunities for integration, while on the other hand the simple existence of a single currency does *not* automatically imply that opportunities for integration exist, arise or are recognized.

This is because facilitating material conditions, such as a common currency, may be *necessary* for some forms of integration (that were already perceived as desirable in order to actually be implemented), but on the other hand a common currency is not *sufficient* to make things happen if material conditions (such as



transport costs<sup>26</sup>) and non-material conditions (such as reciprocal confidence) are not met.

### *Does a Common Currency Stimulate Other Forms of Integration?*

Integration processes, including currency unions, create winners and losers across and within countries. Divergence in long-run competitiveness trends also adds to building tensions within the area. These powerful forces should never be ignored. Cohesion and structural policies are required for the (political) survival of the currency union. Thus, a reasonably sized common budget is required.

As cohesion and structural policies redistribute costs and gains, they are bound to be controversial: a tense political negotiation among members is physiological, and not necessarily pathological, within a currency union. Institutional relationships should not be left to deteriorate to an unmanageable level of tension. Hence, partner countries, which share a common currency as well as the governance of the currency area,<sup>27</sup> *must* be ready to discuss and pursue further forms of integration, when it is required by strong asymmetric tensions endangering the stability of the currency framework. In other words, member countries should be ready to accept that, at some point in time, the policy architecture of their union may be shown to be lacking and in need of reforms and additions.

In summary, the answer to the question “can a common currency stimulate other forms of integration?” is a very hard on: It either brings along new forms of institutional integration (as required by the unfolding of events in the Union) and the common currency survive, or it does not, and the union faces unavoidable crises till potential collapse.

26 The trade costs data set of the World Bank (available at [http://data.worldbank.org/data-catalog/trade-costs-dataset?cid=ISG\\_E\\_WBWeeklyUpdate\\_NL](http://data.worldbank.org/data-catalog/trade-costs-dataset?cid=ISG_E_WBWeeklyUpdate_NL)) offers very interesting data on bilateral trade costs. These real costs would remain as a real obstacle to area integration, despite monetary cooperation/unification, unless directly addressed with appropriate structural policies.

27 Here, I am not referring to common currency practices, connecting a very small country to its natural large partner like San Marino to Italy. That would be a relatively easy case.

### ***Currency Unions: What Have We Learnt From the EU Experience?***

#### *About the Preparation Phase of a Common Currency*

The background philosophy of the Maastricht Treaty, laying the ground for European monetary unification, was that monetary and financial convergence (as given by the exchange rate stability within the European Monetary System and by nominal interest rates convergence) was a prerequisite for eligibility. Along with compliance with fiscal rules (both 'magic numbers', the 3% public deficit/GDP ratio and the 60% public debt/GDP ratio, have been loosely interpreted, the latter criterion has explicitly been rephrased in terms of direction of changing towards the 60% target).

As a matter of fact, the 1992 crisis of the European Monetary System led to its reform, allowing a much broader flexibility of exchange rates within the system (plus or minus 15% with respect to parities). The actual exchange rate fluctuations were much more contained, but the broad flexibility margins allowed for the possibility of sizeable deviation from central parities, making speculative attacks much less of a 'safe bet', and hence much less likely.

That is to say: in the preparatory phase, the actual policy stance of would-be members of the currency union (showing their commitment to substantial policy coordination) seemed to be much more relevant for the success of the transition phase than the formal definition of convergence rules.

In the end, a currency union is simply a (possibly 'well prepared') jump into a new framework. From the European experience, I think it is better not to frame it as the automatic conclusion of a smooth, continuous convergence process, as shocks (either symmetric or asymmetric) cannot be ruled out, and necessarily the map of winners and losers across and within countries must be redrawn. Thus, no continuous nominal convergence process can be trusted to be sufficient for preparation. Real commitment, within loose and basic formal requirements, seems to have worked better than strict formal rules in the EMU preparatory phase.

This remark further stresses the need for would-be members of a currency union to be ready to take what is required to reach the goal, knowing that deep uncertainty makes the future far from foreseeable. In other words, in a deeply

uncertain world, there is no such thing as an optimal institutional architecture and an optimal organization of the preparation phase.

### *'Incomplete' Institutional Policy Design and Long-Run Sustainability of a Common Currency*

Besides designing the strictly monetary institutions of a monetary union, other institutional issues should be addressed for its proper working, such as the degree and modality of fiscal policy coordination, well beyond fixing a 'magical number' deficit/GDP; the provision of lender of last resort facility, along with effective cross borders surveillance of financial and banking institutions; possibly, external exchange rate policies; and finally and necessarily, an appropriate cohesion budget in order to address divergences in competitiveness.<sup>28</sup> Institutional design is required to be resilient to unexpected shocks, more than being optimal with respect to necessarily unrealistic models. Incomplete architectures (that is: broad basic agreements that are meant to be adjusted on the go) may work exactly because they are not seen as perfect, unchangeable agreements: In analogy with microeconomic analysis, an uncertain world where transaction costs matter, requires incomplete contracts for sustainable long-term reciprocal commitments under uncertain conditions (like labor contracts). That is, long-run sustainability depends greatly on general political consensus, to which now we turn.

### ***Political Union in Monetary Unions***

OCA theory has been almost exclusively used to analyze whether countries should *join* a monetary union. Yet, it can also be used to study the conditions under which existing members of a monetary union may want to *leave the monetary union*. The persistence of nation-states within a monetary union,

<sup>28</sup> It is interesting to discuss whether the above mentioned institutional reforms could (not only should) actually be addressed in an existing currency union. A possible answer comes from revisiting the history of international monetary cooperation, which makes it clear that substantial regime switches are possible even within unchanged institutional frameworks (see IMF, radically changing the exchange rate regime within an unchanged institutional setting, with belated amendments limited to moving words around. The shift to flexible rates occurred in 1973; the IMF statute amendment only in 1978, from "a system of stable exchange rates" to "a stable system of exchange rates").

## Monetary Integration: the Choice of the Right Policy

in fact, is by itself a source of possible asymmetric shocks, as taxation and spending remains in the realm of national sovereignty and social and wage policies tend to be nationally (or even sub-nationally) defined. This creates a need to discuss the possible consequences of advancing political integration within a monetary union.

How would a political union affect the cost-benefit-analysis leading to the definition of an OCA? Two channels of influence stand out as most relevant: First, a political union makes it possible to organize a system of fiscal transfers that could provide insurance against asymmetric shocks. Second, the realization of a political union reduces the risk of asymmetric shocks that have a political origin (e.g. shocks due to government spending and taxation, social policies, as well as wage policies). Hence the 'optimality' of a monetary union can be served by advancing political union.

In all cases, the sustainability of a monetary union needs to be enhanced by the presence of a central budget to be used as a redistributive device among member states. This does not require a full fiscal union (which could even produce moral hazard problems), but a sizable and flexible common budget, allowing for resizing if needed.

The current challenge to the EMU is very much related to the perceived nature of the nation state, within the 'new trilemma'. If it is perceived to be non-renounceable, each member state is to be defended against temporary shocks (including market 'irrationality') upon the condition that it adheres to the commonly agreed rules of the game (such as fiscal prudence and open markets). In this case, some intra-monetary union bail-outs of national debt may be necessary. If, on the other hand, each state is responsible for its own debt (no-bailout clause), some provision for possible orderly default needs to be established.

The political issue at hand largely exceeds the technicalities. 'Commonality of destiny' is an important, often omitted, political variable making the difference between an area being an OCA or not.

As an example, the German monetary union came about as the result of a strong national sense of common purpose and an intense feeling of belonging to the same nation. EMU is different as this deep political driver of integration is at best, only weakly developed, at the European level.

The long-run success of the euro zone depends on the continuing process of political unification. Such political unification is needed to reduce the scope for the emergence of asymmetric shocks and to embed the euro zone in a wider system of strong political ties, which are needed to take care of the inevitable divergent economic movements within the Euro zone.

### References

Acemoglu, D. and Robinson, J., 2012. *Why Nations Fail. The Origins of Power, Prosperity and Poverty*. New York: Crown Publishers - Random House.

Agur, I. and Sharma, S., 2013. *Rules, Discretion, and Macro-Prudential Policy*. IMF Working Paper, WP/13/65, March 2013.

Ahokpossi, C., 2013. *Determinants of Bank Interest Margins in Sub-Saharan Africa*. IMF Working Paper, WP/13/34, January 2013.

Allen, F., Otchere, I. and Senbet, L.W., 2010. *African Financial Systems: A Review*. [pdf] Working Paper 10-11, University of Pennsylvania: Wharton Financial Institutions Center. Available at <<http://finance.wharton.upenn.edu/~allenf/download/Vita/Africa%20Financial%20Systems%20Mar%202010-final.pdf>>

Anayiotos, G.C. and Toroyan, H., 2009. *Institutional Factors and Financial Sector Development: Evidence from Sub-Saharan Africa*. IMF Working Paper, WP/09/258, November 2009.

Artis, M. J., 2006. *What Do We Now Know About Currency Unions?* CEPR Discussion Paper No. 5677, London: Centre for Economic Policy Research, May 2006.

Atoyan, R., Manning J. and Rahman, J., 2013. *Rebalancing: Evidence from Current Account Adjustment in Europe*. IMF Working Paper, WP/13/74, March 2013.

Baldwin, R., 2006. Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade. [pdf] *The World Economy*, 29(11), pp. 1451-1518. Available at <<http://graduateinstitute.ch/webdav/site/ctei/shared/CTEI/Baldwin/Publications/Chapters/Regionalism/Multilateralising%20Regionalism.pdf>>

Baldwin, R. and Wyplosz, C., 2009. *The Economics of European Integration*. 3rd ed. McGraw-Hill.

Baldwin, R., Gros, D. and Laeven, L. eds., 2010. *Completing the Eurozone Rescue: What More Needs to Be Done?* London: A VoxEU.org Publication, CEPR, June 2010.

Bank for International Settlements (BIS), *Annual Report*, various years.

Beetsma, R. and Giuliodori, M., 2010. The Macroeconomic Costs and Benefits of the EMU and Other Monetary Unions: an Overview of Recent Research. *Journal of Economic Literature*, 48(3), pp.603-41.

Beretta, S., 2012. *Global Finance After the Crisis; Which 'Rules of the Game'?* In: S. Beretta and R. Zoboli eds., 2012. *Crisis and change. The Geopolitics of Global Governance*. Milano: Vita e Pensiero.

Berger, H. and Nitsch, V, 2010. *The Euro's Effect on Trade Imbalances*. IMF Working Papers, WP/10/226.

Canales-Kriljenko, J. I., Gwenhamo, F. and Thomas, S., 2013. *Inward and Outward Spillovers in the SACU Area*. IMF Working Paper, WP/13/31, January 2013.

Claessens, S., Mody, A. and Shahin, V., 2012. *Paths to Eurobonds*. IMF Working Paper, WP/12/172, July 2012.

Cooper, R. N. et al., 1989. *Can Nations Agree? Issues in international economic Cooperation*. Washington D.C.: The Brookings institutions.

Corsetti, G., 2008. *A Modern Reconsideration of the Theory of Optimal Currency Areas*. [pdf] CEPR Discussion Paper no. 6712. London: Centre for Economic Policy Research. Available at: <<http://www.cepr.org/pubs/dps/DP6712.asp>>.

Davoodi, H. R., Dixit, S. and Pinter, G., 2013. *Monetary Transmission Mechanism in the East African Community: An Empirical Investigation*. IMF Working Paper, WP/13/39, February 2013.

Debrun, X., Masson, P. R. and Pattillo, C., 2010. *Should African Monetary Unions Be Expanded? An Empirical Investigation of the Scope for Monetary Integration in Sub-Saharan Africa*. IMF Working Paper, WP/10/157, July 2010.

## Monetary Integration: the Choice of the Right Policy

Debrun, X., Masson, P. R. and Pattillo, C., 2005. Monetary Union in West Africa: Who Might Gain, Who Might Lose and Why? *The Canadian Journal of Economics*, 38, pp. 454-81.

De Grauwe, P., 2006. What have we Learnt about Monetary Integration since the Maastricht Treaty? [pdf] *Journal of Common Market Studies*, 44(4), pp. 711-30. Available at: <[http://www.econ.kuleuven.be/ew/academic/intecon/Degrauwe/PDG-papers/Recently\\_published\\_articles/JCLS-2006.pdf](http://www.econ.kuleuven.be/ew/academic/intecon/Degrauwe/PDG-papers/Recently_published_articles/JCLS-2006.pdf)>.

De Grauwe, P., 2009. *Economics of Monetary Union*. 8th ed. Oxford University Press.

De Grauwe, P., 2011. *The Governance of a Fragile Eurozone*. [pdf] Available at: <[http://www.econ.kuleuven.be/ew/academic/intecon/Degrauwe/PDG-papers/Discussion\\_papers/Governance-fragile-eurozone\\_s.pdf](http://www.econ.kuleuven.be/ew/academic/intecon/Degrauwe/PDG-papers/Discussion_papers/Governance-fragile-eurozone_s.pdf)>.

Directorate-General for Economic and Financial Affairs, 1990. *One market, one money. An evaluation of the potential benefits and costs of forming an economic and monetary union*. *European Economy*, 44.

Dullien, S. and Fritsche, U., 2009. How bad is divergence in the euro zone? Lessons from the United States and Germany. *Journal of Post Keynesian Economics*, 31(3).

ECA, 2007. *Regional Economic Integration*. in: *Africa. Multilateralism, Regionalism and Bilateralism in Trade and Investment: 2006 World Report on Regional Integration* In collaboration with the United Nations Conference on Trade and Development et al. United Nations University Series on Regionalism, vol. 1. Dordrecht: Springer, pp.127-157.

Eichengreen, B.J., Hausmann, R., and Panizza, U. 2003. *The Mystery of Original Sin*. Reprinted in: Eichengreen, B.J. and Hausmann, R. eds., 2004. *Other People's Money: Debt Denomination and Financial Instability in Emerging Market Economics*. University of Chicago Press.

Eichengreen, B. J., 2008. *Globalizing Capital: A History of the International Monetary System*. 2nd ed. Princeton University Press.



Emerson, M. et al., 1988. *The economics of 1992. An assessment of the potential economic effects of completing the internal market of the European Community*. Directorate-General for Economic and Financial Affairs. European Economy, 35.s

European Commission, 2011. *Green Paper on the feasibility of introducing Stability Bonds*. Brussels, 23.11.2011.

European Financial Stability Fund (EFSM), 2011. *FAQ*. [pdf] Available at: <[http://www.efsf.europa.eu/attachments/faq\\_en.pdf](http://www.efsf.europa.eu/attachments/faq_en.pdf)> [Accessed 20 May 2011].

Fischer, S., 1999, *On the Need for an International Lender of Last Resort, Speech* [pdf] American Economic Association and American Finance Association, New York, January 3, 1999, Available at <<http://www.imf.org/external/np/speeches/1999/010399.HTM>>

Frankel, J. A., 1999. *No Single Currency Regime is Right for All Countries or at All Times*. Princeton: Princeton University, International Finance Section.

Frankel, J.A. and Rose, A.K., 1998. The endogeneity of the optimum currency area criteria. [pdf] *The Economic Journal*, 108, pp. 1009-25. Available at <<http://onlinelibrary.wiley.com/doi/10.1111/1468-0297.00327/abstract>>

Gersbach, H. and Hahn, V., 2009. Voting Transparency in a Monetary Union. [pdf] *Journal of Money, Credit and Banking*, Blackwell Publishing, 41(5), pp. 831-53. Available at <<http://ideas.repec.org/a/mcb/jmoncb/v41y2009i5p831-853.html>>

Gu, X., 2012. *Structural Power. The Rise of China and the US*. In: S. Beretta and R. Zololi eds., 2012. *Crisis and change. The Geopolitics of Global Governance*. Milano: Vita e Pensiero.

IMF, 2012. *Sub-Saharan Africa. Maintaining Growth in an Uncertain World, World Economic and Financial Surveys, Regional Economic Outlook*, Washington, October 2012

IMF, 2013a. *European Union: Financial System Stability Assessment. IMF Country Report*, 13/75, Washington D.C.: IMF.

## Monetary Integration: the Choice of the Right Policy

IMF, 2013b. A Banking Union for the Euro Area. Prepared by Goyal, R., Koeva Brooks, P., Pradhan, M., Tressel, T., Dell'Ariccia, G., Leckow, R. and Pazarba-sioglu, C., Washington D.C.

Iossifov, P. et al., 2009. *Improving Surveillance Across the CEMAC Region*. IMF Working Paper, WP/09/260, November 2009.

Jeanne O., Wyplosz C., 2003, *The International Lender of Last Resort. How Large Is Large Enough?* [pdf] in: Michael P. Dooley and Jeffrey A. (eds.), *Managing Currency Crises in Emerging Markets*, Chicago: University of Chicago Press, 2003. Available at <<http://www.nber.org/books/dool03>>

Kalemli-Ozcan, S., Papaioannou, E. and Peydró, J.L., 2010. What lies beneath the euro's effect on financial integration? Currency risk, legal harmonization, or trade? *Journal of International Economics*, 81, pp.75–88.

Karras, G., 2007. Is Africa an Optimum Currency Area? A Comparison of Macroeconomic Costs and Benefits. *Journal of African Economies*, 16(2), pp. 234-58.

Maehle, N., Teferra, H. and Khachatryan, A., 2013. *Exchange Rate Liberalization in Selected Sub-Saharan African Countries: Successes, Failures, and Lessons*. IMF Working Paper, WP/13/32, January 2013.

Manasse, P., 2007. *Deficit Limits and Fiscal Rules for Dummies*. IMF Staff Papers, 54(3).

Mongelli, F.P., 2010a. *On the benefits and costs of participating in a monetary union*. CEPR Policy Insight, 46.

Mongelli, F.P., 2010b. *Some observations on 'political' in EMU*. CEPR Policy Insight, 47.

Mu, Y., Phelps, P. and Stotsky, J. G., 2013. *Bond Markets in Africa*. IMF Working Paper, WP/13/12, January 2013.

Obstfeld, M., 2013. *Finance at Center Stage: Some Lessons of the Euro Crisis*. Berkeley: University of California, NBER and CEPR, January 2013.

Obstfeld, M., Shambaugh, J. C. and Taylor, A.M., 2005. The Trilemma in History: Tradeoffs among Exchange Rates, Monetary Policies, and Capital Mobility. *The Review of Economics and Statistics*, 87(3), pp. 423-38.

Pisani-Ferry, J., 2012. The Euro Crisis And The New Impossible Trinity. *Bruegel Policy Contribution*, Issue 2012/01, January 2012.

Rodrik, D., 2000. How Far Will International Economic Integration Go? *Journal of Economic Perspectives*, 14, 1, pp.177-186.

Tavlas, G., 2009. The Benefits and Costs of Monetary Union in Southern Africa: A Critical Survey of the Literature. *Journal of Economic Surveys*, 23(1), pp. 1–43.

Tsangarides, C. G., Ewencyk, P. and Hulej, M., 2006. *Stylized Facts on Bilateral Trade and Currency Unions: Implications for Africa*. [pdf] IMF Working Paper 06/31. Available at: <<http://www.imf.org/external/pubs/ft/wp/2006/wp0631.pdf>>.

Wyplosz, C., 2006. European Monetary Union: The Dark Sides of a Major Success. *Economic Policy*, 46, pp. 207-47.

Yabara, M., 2011. *Capital Market Integration: Progress Ahead of the East African Community Monetary Union*. IMF Working Paper, WP/12/18.



*Terhemba Ambe-Uva*

## ***The European Experience of a Common Currency: Lessons Learned***

### ***Introduction***

Since the end of the Second World War, European integration has been divided between a desire for integration and a reluctance to cede national control over key issues (Hembruff, 2011:7). Despite this, the European Union (EU) has become a key player internationally and its currency the euro, has become second in international usage, only to the US dollar (Dominguez, 2006: 68). The large size of the euro-area economy and the stability attached to the euro, both demonstrate how the success and/or failure of the euro would impact the global market. However, the European Monetary Union (EMU) is now in the doldrums, perhaps facing its greatest challenge in the form of sovereign debt crisis, which has affected Portugal, Italy, Greece, and Spain (PIGS), later even called PIIGS, with the rather arbitrary inclusion of Ireland. As John Quiggin succinctly pointed out, "The real problem came when this analysis was extended to the rest of the heavily indebted periphery - commonly referred to in such accounts as the PIGS (Portugal, Italy, Greece, and Spain) group. Ireland was sometimes thrown in as a second 'I'. This was unfair and inaccurate, particularly as regards Spain and Ireland, which had been running budget surpluses leading up to the crisis" (Quiggin, 2012:229). The crises appear poised to undermine the entire euro zone. The recent fears of the sovereign debt crisis spreading within the zone, has brought to the fore the inherent challenges associated with constructing a monetary union.

The ongoing sovereign debt crisis remains complex, with far reaching repercussions (Kirkegaard, 2011) and offers invaluable lessons for countries contemplating a common currency union. Academic literature on the current

## The European Experience of a Common Currency: Lessons Learned

crisis, although not monolithic, sees the structure and governance system of the European Economic and Monetary Union (EMU) as the root cause of the crisis. UNECA/AU (2012:2) supports this argument and remarked that "the Euro is viewed as an incomplete currency, because the 1992 Maastricht Treaty established an economic and monetary union without a political union, as a result of which the common European Central Bank lacks a common treasury". It is also contended that even though members share a common currency, they issue and manage sovereign debt individually. Thus, the gap between monetary integration and political integration should offer important lessons for Africa on how to manage its own agenda for achieving monetary union, as is envisaged in the 1991 Abuja Treaty.

This background paper reviews the common currency architecture of the euro zone and the likely lessons that the West African sub-region can learn from the structure and the continuing crisis in the euro zone. The lessons for the sub-region are poignant and illuminating in a number of ways. First, the desire for and planning of monetary union in West Africa, has strongly been influenced by Europe's integration experience. This is based on a linear model of a gradual movement, through consecutive stages in the integration of goods, labor and capital markets and finally monetary and fiscal integration. Second, the disproportional power relations and hegemonic position of some member states is also similar. Lastly, the recent challenges experienced by the euro should further provide the West African sub-region with important lessons in constructing a monetary economic union (McCarthy, 2012).

The paper is organized in the following way. In the first section, a general background to the study is provided. The next section discusses Africa's growing interest in monetary integration, followed by highlights of the progress made towards the adoption of a common currency in West Africa. The subsequent section presents the arduous road taken by the European Union (EU) towards the introduction of a common currency and the lessons that the West African sub-region can learn from the European common currency. The last section concludes the previous findings.

## ***Africa's Interest in Monetary Integration***

Interest in regional integration - including monetary integration - has been high on the agenda of African countries since independence and various regional groupings have been formed. At the heart of these efforts, are attempts to overcome the problems of small and fragmented economies, as well as the desire to counteract perceived economic and political weaknesses in order to play an important role on the world stage (Rusuhuzwa and Masson, 2012). The *le franc des Colonies Francaises d'Afrique* (CFA franc) of the West African Economic Monetary Union (WAEMU), the Economic and Monetary Community of Central Africa (CEMAC) and the Common Monetary Area (CMA) in Southern Africa are notable examples of monetary integration already in place in Africa. Further regional monetary union projects are in well underway in the Economic Community of West African States (ECOWAS), the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC) and in the East African Community (EAC). At the continental level, the African Union's long term goal is a common currency for the entire African continent (Masson and Pattillo, 2004).

An overview of several academic contributions concerning optimum currency area (OCA), shows that the benefits of a monetary union are potentially enormous, as are the potential disadvantages. It is therefore important that various regional groupings in Africa carefully weigh the costs and benefits of monetary union in light of their historical, political, economic and geostrategic experience, as well as their level and depth of integration. Theoretically, the major benefits of a monetary union are the reduction of transaction costs, economies of scale due to the pooling of international reserves, the elimination of exchange rate risk (Bartram and Karolyi, 2006) and region-wide price harmonization (Rusuhuzwa and Masson, 2012). A common currency is expected to eliminate price parity as determined by the law of one price, or price convergence (Fritsche, Lein and Weber, 2009). It is also expected to promote macro-economic stability, decrease/stabilize inflation (Angelini and Lippi, 2007), promote trade (Chintrakarn, 2008), increase investment (Skrekas, 2010), enhance financial integration (Coeurdacier & Martin, 2009) and decrease interest rates (Lane, 2006).

In spite of its obvious merits, the costs of monetary union are related to loss of sovereignty over monetary and exchange rate policy. This is challenging, especially in the case of asymmetric shocks which may make the union's single

## The European Experience of a Common Currency: Lessons Learned

monetary policy inappropriate for some member countries. As Colin McCarthy (2012) has observed, in a monetary union, member countries lose direct control over instruments of monetary and exchange rate policy, that may be useful for dealing with country-specific macroeconomic shocks. This is perhaps a Rubicon that monetary integration efforts in Africa must transcend.

Five principles are generally considered indispensable in enabling countries to benefit from a monetary union, including meeting some or all of the following criteria, which contribute to mitigating the effects of asymmetric shocks: (a) flexibility of prices and wages (b) intra-regional factor mobility (c) openness to trade (d) product diversification and (e) fiscal integration (Masson and Taylor, 1993). Apart from meeting these macroeconomic policies, it is equally important that these macroeconomic policies are strongly anchored in credible political commitment. Political will is instrumental in the pursuit of sound monetary policies and public support has been identified as being indispensable for the construction of a common currency (Masson and Pattillo, 2012).

The goal of ECOWAS is to introduce a common currency by 2020, by integrating the CFA franc, currently in use by Francophone countries and the Eco of the Anglophone countries of West Africa. However, there have been formidable setbacks to the implementation of a common currency in the sub-region. For instance, soon after the decision to create the Eco was reached in December 2000, the disjointed economic conditions of the member countries instantly relegated the initiative to that of a cherished policy paper, resulting in the repeated postponement of implementation dates. A clear example of disinterest and foot-dragging was noticeable from Ghana during the presidency of John Kufor, whose skeptical attitude towards a common currency virtually grounded the West African Monetary Zone (WAMZ) project. At the global level, the recent crisis in the euro zone area has cast doubt upon the approach of introducing the Eco, which is similar to the introduction of the euro within the European Union (Agyapong, 2012).

### ***Progress Towards The Adoption Of A Common Currency In West Africa***

When looking at the conditions and criteria defined by economic theory for the establishment of an OCA, or joining one, the chances of the conditions



being met is relatively lower in the case of West Africa compared to that of the European Union countries. Although desirous of a common currency, the possibility of its realization in West Africa continues to be out of reach and skeptics continue to argue that such a moment will never come, not in the near future. Since the founding of ECOWAS in 1975, the idea of a common currency for the region and an Africa-wide currency has remained high on the integration agenda. In April 2000, ECOWAS adopted a two-track strategy of creating a common currency in the region. In the first track, non- WAEMU members of ECOWAS were required to form a monetary union called WAMZ by July 2005. The second track is the subsequent merger of WAEMU and WAMZ to form a single currency union. This marriage would lead to the adoption of the Eco (Ekong and Onye, 2012).

The WAEMU is made up of eight francophone countries in West Africa (Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal, and Togo) and Guinea Bissau which have agreed to adopt and use the French Franc (CFA), the currency of their colonial masters. Since the CFA currency area was created without specific criteria or prerequisites to be met beforehand, this model is obviously viewed as less stringent and less complicated than the EMU. Created on 10th January 1994 by the Dakar Treaty, WAEMU became operational on 1st August 1994 following ratification by seven member countries. This model of monetary union resembles that of the USA, where a treaty was first signed to introduce a common currency, before the decision to create a common central bank and a common regional parliament. Similarly, this model does not consider the issue of financial market integration prior to single currency adoption.

As a common monetary zone, the WAEMU was created to achieve greater economic competitiveness through open and competitive markets, along with the rationalization and harmonization of the legal environment. Further goals include: the convergence of macroeconomic policies and indicators, to create a common market, to coordinate sector policies and to harmonize fiscal policies (Agyapong, 2012). Although WAEMU, as a common monetary zone, remains shallow in terms of financial and economic integration, it has been able to implement macroeconomic convergence criteria and has institutionalized an effective surveillance mechanism. In addition, the zone adopted a customs union and a common external tariff in early 2000, harmonized indirect taxation regulations and initiated structural and sectoral policies in the region. Not surprisingly, a survey of the International Monetary Fund (IMF) in September

## The European Experience of a Common Currency: Lessons Learned

2002, cited WAEMU as "the furthest along the path toward integration" of all the regional groupings in Africa (IMF Survey, 2002:1). As Masson and Pattillo (2001) report, since the inception of the WAEMU currency, the area has been able to reduce inflation within its member countries, however has not been effective in promoting intra-area trade. More than a decade after its formation, the WAEMU is still struggling to achieve most of its objectives as set out in the Dakar Treaty of 1994.

Considering the inherent difficulties in meeting the WAMZ criteria, there have been calls for the WAMZ to employ the approach adopted by the WAEMU, which does not consider financial integration to be the basis for common currency adoption *ex ante* (Adam, Agyapong and Gyamfi, 2010). Unlike the euro and the proposed Eco, meeting the convergence criteria was rather an *ex post* than an *ex ante* consideration.

In terms of macroeconomic performance, the evidence of growth is not convincing, although the CFA franc zone has lowered inflation rates more than other currency regimes in Africa. It is also argued that the success of the CFA franc may be due to exogenous factors such as the support from France, particularly the French Treasury's guarantee of convertibility embodied in the operations account.

In order to achieve the first track of monetary union as envisioned by ECOWAS, leaders of five West African countries namely: The Gambia, Ghana, Guinea, Nigeria and Sierra Leone, declared their intention to proceed with a monetary union amongst the non-WAEMU countries of the region, following the Accra Declaration and the Bamako Accord of 2000. Liberia joined the zone on the 16th February 2010, bringing the membership to six.

The body statutorily empowered to recommend to Heads of State of ECOWAS to commence the issuance of the Eco is the West African Monetary Institute (WAMI). It has determined convergence criteria, whereby each member country of WAMZ is required to attain: single digit inflation, central bank financing of government deficit is to be less than 10 per cent of the previous year's revenue,, a government budget deficit of 4 per cent of gross domestic product (GDP) by 2003 and accumulated foreign exchange reserves that cover at least three months of imports. The WAMI has also created a Convergence Council to help coordinate macroeconomic policies and has set up a common central bank, the

West African Central Bank. The first track was realized in 2005, while efforts are still ongoing in order to achieve the second track.

Towards achieving the second track, the ECOWAS Convergence Council, comprising of the Ministers of Finance and Governors of the Central Banks of member states, approved a revised road map for the realization of a single currency for West Africa by 2020, on the 25th May 2009. The roadmap articulates a clear, concise and comprehensive strategy for the realization of a single currency for the region. The map further outlines activities to be undertaken ahead of the 2015 date earmarked for the introduction of the Eco, including the review and harmonization of the convergence criteria, the harmonization of statistics, domestic policies and the legal, accounting and statistical frameworks of public finance (Niyiraga, 2012).

The new convergence and harmonization criteria reflect the introduction of the euro and the recent crisis befalling the euro zone. Between 2009 and the first quarter of 2013, the map envisaged the harmonization of the regulatory and supervisory framework for banking and other financial institutions, the establishment of a payment system infrastructure for cross border transactions, the completion of payment system infrastructure in Guinea, The Gambia and Sierra Leone and the completion of integration of the financial markets of the region. By 2014, it is expected that the legal instruments for the creation of the WAMZ will have been ratified, followed by the creation of the bank of the WAMZ, the WAMZ secretariat and the West African Financial Supervisory Agency in the same year. Monetary union for the countries in the zone is scheduled to be realized on or before 2015. This is to occur before the introduction of Eco, the common currency, in January 2015, followed by the withdrawal of the national currencies of the five constituent member states (Niyiraga, 2012).

It is anticipated that the processes for the merger of the two currencies will begin (including the introduction of a supplementary act to the revised ECOWAS treaty to provide a legal instrument for the preceding monetary union) three years before the launch of the single currency. The consummation of a monetary union will be achieved in 2020 with the introduction of a regional currency, preceded by the launching of monetary union, the establishment of a regional central bank and finally the withdrawal of national currencies.

Although the initiative for a single economic space and monetary union in the

## The European Experience of a Common Currency: Lessons Learned

ECOWAS sub-region has been around for the past 12 years, the feasibility of wider monetary unification in ECOWAS still poses several economic and institutional problems (Tsangarides and Qureshi, 2008; Masson and Pattillo, 2005). Even now, the second monetary zone of the region (WAMZ) is yet to introduce the Eco, due to relevant institutions being non-operational and the inability of member countries to meet the convergence criteria.

On several occasions, the introduction of the Eco currency has been postponed. In brief, this is due to the political dependence of most monetary authorities in ECOWAS on their national governments, central banks are often under pressure to finance government deficits and to undertake over-expansionary monetary policies. Challenges to implementing a common currency include: Firstly, fiscal problems (resulting from undue dependence of the monetary authorities on their national governments) are much more severe in West Africa and the credibility of monetary institutions is much more fragile. Secondly, if the unification of WAMZ and WAEMU and the adoption of the Eco are realized, it is unclear whether the French Treasury guarantee of the convertibility of WAEMU's currency (the CFA franc) to the euro, at a fixed parity, would continue for a monetary union of the expected size.

Thirdly, the low level of West African intra-regional trade remains a perennial source of worry. Trade amongst EU member countries is more than 60 percent of total trade, whilst in West Africa it still languishes at about 10 percent. The euro zone's success is partially due to the trade integration which took place prior to monetary integration. The literature on optimal currency area emphasizes trade as the main channel through which benefits from a common currency will be enjoyed. The more countries trade with each other, especially in a particular region, the more they will value regional exchange rate stability. However, the low level of intra-regional trade has meant that the West African region may not enjoy the benefits of a currency union. Currency unions are expected to enhance welfare, as they reduce potential disruptions to intra-regional trade brought about by relative price fluctuations and disturbances in bi-lateral exchange rates (Chuku, 2012:10).

Fourthly, the membership of the relatively large Nigerian economy (and the effects of its fiscal/monetary activities), has implications for monetary integration in the region. The WAMZ economy has a combined GDP of US\$390.6 billion, representing 73.3 percent and 19.1 percent of ECOWAS' and Africa's GDP,

respectively. Nigeria is by far the most dominant economy, with 77 percent of the population and 85.6 percent of the zone's GDP. Ghana follows with only 9.2 percent of GDP. A worrisome scenario related to Nigeria's dominance, is that unlike in Europe, where bigger countries such as Germany and France act in a financially responsible manner and watch what is going on in weaker countries such as Portugal, Italy, Ireland, Greece and Spain, - in Africa, bigger countries such as Nigeria are often the most irresponsible ones, in terms of financial management. Nigeria has never properly managed its budgets and its balance sheet is cyclical, being a nation where more than three-quarter of its foreign earnings come from hydrocarbons. Its population dominates the ECOWAS region. In any scenario, trade shocks which are experienced in Nigeria will slowly affect the whole ECOWAS region under a regional economic community.

Fifthly, compared to the European Union, there is low labor and factor mobility within the ECOWAS sub-region. The economic literature, derived largely from Robert Mundell's theory of optimum currency areas, argues that an OCA is a group of countries in which labor and factor mobility is relatively high (Mundell, 1961). If for example, a member of an OCA is hit by negative asymmetric demand shocks, then labor and other factors of production will move from this country to other member countries, thereby restoring employment to its original level. This mobility functions to equalize wages and factor prices from areas with excess supply, to areas with deficit supplies. Although there is hardly reliable data on labor movement across the region, anecdotal evidence shows that there are serious variations among countries. For example, while labor mobility is relatively high between Nigeria and Benin, partly explained by the porous borders between the two countries and their relative proximity, there is very little mobility between most other economies. At the extreme level of immobility in the region is Ghana. The country's recent status as an important port of destination for West African countries is also a threat to employment opportunities and social security among Ghanaians. The government has therefore introduced very tough measures for West African migrants, especially from Nigeria in participating in the labor market in Ghana.

### ***The Arduous Road to a Common Currency in Europe***

Even though the European Monetary Union was proposed as early as 1969, its institutional roots are only to be found in the 1979 European Monetary System

## The European Experience of a Common Currency: Lessons Learned

(EMS), which introduced fixed but adjustable exchange rates between the major European economies (Dominguez, 2006: 69). However, the first formal steps of European monetary integration can be traced almost as far back as October 1962, coinciding with the development of an OCA theory; defined as the optimal geographical area for a single currency, or for several currencies, whose exchange rates are irrevocably pegged. The memorandum issued by the Commission, known as *Marjolin Memorandum* in 1962, kicked off the discussion on a common currency and prompted several measures in the field of monetary cooperation.

The Werner Report, published in 1970 was geared towards improving the growth prospects and well-being of European countries by exploiting the benefits of a monetary union and a common monetary policy. The Werner Report proposed the process of reforming the European currency and set out a blueprint for the step by step realization of economic and monetary union. It proposed a three-phase program to: (a) eliminate intra-European exchange rate movements, (b) centralize EU monetary policy decisions and (c) lower remaining trade barriers within Europe. However, the proposals of the Werner Report were never implemented, as they were overshadowed by other world events (Hämäläinen, 2000).

In 1972, after the demise of the Bretton Woods system, the ‘*currency snake*’, an exchange rate arrangement for European countries, was created for the progressive narrowing of the margins of fluctuation between the currencies of the Member States. A milestone towards European integration was witnessed in March 1979, with the emergence of the European Monetary System (EMS) which significantly contributed to the establishment of the euro, by starting to maintain member state currencies within the acceptable exchange rate limit (EU Facts, 2012).

The Delors Report of 1989 further laid the foundations for the single currency. The emergent Economic and Monetary Union (EMU) was intended to create a “European Union in which national currencies are replaced by a single EU currency managed by a sole central bank that operates on behalf of all EU members” (Petsas, 2003:Slide 20). The three-pronged approach for realizing this objective began with all EU members joining the EMS exchange rate mechanism (ERM). Second, exchange rate margins were to be narrowed and certain macroeconomic policy decisions placed under more centralized EU control. Third, the replacement of national currencies by a single European

currency and vesting all monetary policy decisions in the European System of Central Banks (ESCB).

In 1992, the EU was able to put in place durable mechanisms to strengthen and converge economies and establish an economic and monetary union including a single and stable currency as part of the Maastricht Treaty (EU, 1992). Although there was a crisis in fixed exchange rates in 1992, the European Central Bank (ECB) was created in 1998 and the euro was introduced electronically in 1999 and physically in 2002 (Dominguez, 2006: 70). The Maastricht Treaty, which led to the creation of the euro, includes a number of restrictions on the fiscal policies of EMU member states. The euro was intended to increase international price transparency, as this would ideally foster competition, locational arbitrage and cross-border trade (Frankel and Andrew, 2002), which should result in price convergence (Bris and Micola, 2008).

The member states of the euro area have assigned the task of framing monetary policy to the European Central Bank (ECB). As a common monetary authority, the ECB is set up as a highly independent central bank to insure that it will be able to ensure price stability (Bordo, Jonung and Markiewicz, 2011:2). Both the Maastricht Treaty and the Stability and Growth Pact (SGP), have exclusively reserved the powers of fiscal policy within the European Union (EU) for national governments. These rules, pertaining to the Economic and Monetary Union (EMU), cover euro area member states as well as member states that have not adopted the euro. As Bordo, Jonung and Markiewicz (2011:2) pointed out; these sets of rules pertaining to the fiscal system are monitored centrally by the Commission in a policy dialogue with member states. This system represents the existing fiscal policy framework of the euro area, which complements the monetary union and its single currency, the euro.

Although the idea of an institutional design for framing fiscal policies and for preserving the fiscal sustainability of the monetary union, had been the subject of heated debate even before the introduction of the euro (European Economy, 2008), the recent crisis in the euro zone has further polarized the debate and added a normative view of 'proper' fiscal policy arrangements within the European Union. African leaders are closely following the debate in order to avoid the mistakes in the economic governance structure of the EU.

## The European Experience of a Common Currency: Lessons Learned

Even though the crisis has confirmed the need for a restructuring and strengthening of the European Union, the direction the restructuring should take remains problematic. While some argue for an extension of the fiscal powers of 'Brussels', others argue that the present institutional set-up is proper and that the fiscal policy framework should solely be the business of member states (Mckay, 2005). Some commentators argue that the monetary union is not in need of any central fiscal coordination across member states, or at least of less coordination than at present. Another group recommends improvements in the quality of the fiscal policy process and fiscal institutions across the EU, as a promising way to improve fiscal policy governance in the EU.

That the debate is far from conclusive is not surprising. Bordo, Jonung and Markiewicz (2011:2) have argued that the "euro area is the first monetary union where monetary policy is set up at the central (European) level while fiscal policy is carried out at the sub-central (national) levels". Thus, it is evident that there is hardly any testable institutional set-up which can rescue the euro zone from the economic doldrums.

### ***Lessons West Africa Can Learn from the European Common Currency***

As mentioned earlier, the African Union and the majority of African regional integration arrangements explicitly aim at monetary union as part of the final destination of integration. The Abuja Treaty of 1991, called for the establishment of the African Economic Community by 2027. The Treaty envisages an African central bank, a common currency, complete mobility of production factors and free trade in goods and services in the community. In the case of ECOWAS, a roadmap exists that envisages comprehensive monetary union, incorporating a single currency and a regional central bank in 2020.

In their study of a single currency in Africa, Masson and Pattillo (2004:10) reached several conclusions on the benefits of a common currency in Africa vis-à-vis the euro area. First, they argued that since euro area countries have better communication and transportation links than African countries, Africa cannot expect the same gains from economies of scale and reduction of transaction costs, even in proportion to its economic size, that resulted from European monetary union. Second, considering the fact that African countries



are highly specialized, they suffer greatly in terms of trade shocks, which often do not involve the same commodities and hence do not move together. Third, even though labor mobility in some African regions is higher than in Europe, it is still limited and politically sensitive. Lastly, there is a conspicuous absence of intra-African fiscal transfers. In West Africa, no official fiscal transfer mechanism exists in the region, except for some official and military aid provided by Nigeria to some other countries in the region. It is essential that this issue is addressed before the commencement of the common currency regime.

Most analysts agree, that the desire for and conception of monetary union in Africa has strongly been influenced by Europe's integration experience and the eventual introduction of the euro. The initial success of the euro has served as a role model that can be replicated in Africa to reap the benefits of a single currency, encapsulated in the special contribution it makes to trade and investment. Apart from the elimination of the cumbersomeness of currency conversion and variation in the nominal exchange rate, a common currency, it is argued, would provide immense benefits for trade creation and micro economic stability (McCarthy, 2012). However, the sovereign debt crisis in the euro zone has persuaded observers to move away from the 'fallacy of transposition,' to consider the salient lessons about the shortcomings in the architecture of the zone.

The first lesson that the European common currency offers West Africa, is the need for a feasible space to develop an economic union. The EU experience clearly underscores the need to build consensus between political and economic factors, as well as amongst various actors in the project of regionalization. Within this context, not just politicians are expected to push for monetary integration, but also the active involvement of different lobby groups such as employers' associations, the media, labor unions, students and others is required. The involvement and commitment of different actors and political institutions at the local and regional level remains the key factor towards achieving an integrated currency market, as demonstrated in the EU. Furthermore, the role of political leadership and strong institutions remains pivotal in this process.

The second lesson, emanating primarily from the crisis, is the need to go beyond macroeconomic objectives when constructing a common currency. The crisis has amply demonstrated that macroeconomic indicators such as the rate of inflation, current account balances and government budget deficits -

## The European Experience of a Common Currency: Lessons Learned

though being important preconditions for a common currency - are not enough. Macroeconomic convergence (in Europe, the meeting of the Maastricht criteria) at the point of entry into the monetary union is not sufficient to ensure success. The crisis has thus turned the spotlight on other factors - such as discipline, transparency, political commitment and a number of others - that need to be considered when monetary union is included in regional integration planning (McCarthy, 2012).

The third lesson, related to the preceding, is the challenges associated with bringing disparate economies together to form a common currency. The euro zone crisis demonstrates that although macroeconomic convergence is desirable, economic convergence is equally important. If a monetary union brings together a number of disparate economies, which are characterized by large differences in competitiveness, this could be an albatross around the neck of the monetary union. Here, it is imperative to note that the root cause of the euro's problems is that the euro zone covers a group of disparate economies, operating at substantially different levels of competitiveness. The former president of France, Nicolas Sarkozy, acknowledged this challenge when he remarked that « *there can be no common currency without economic convergence without which the euro will be too strong for some, too weak for others, and the euro zone will break up* » (Bremner, 2011:59). Similarly, a Financial Times columnist aptly captured the situation: "Today's crisis is structural, stemming from euro's flawed design and particularly the misguided notion that a common monetary policy would work without integration of other policies – and not just fiscal policy...lashing 17 disparate economies together monetarily and expecting them to march in step is ludicrous" (Rattner, 2011:59).

In ECOWAS, the disparity created by Nigeria, as a much larger economy, will have serious implications for monetary union. Moreover, as a major oil exporter, Nigeria's economy differs greatly from its neighbors, which export different primary commodities and are thus subject to different shocks (Masson and Pattillo, 2012:13). The importance and influence of the continent's most populous nation can not be underestimated. Despite Nigeria's demographic and economic dominance in the zone, the country still finds it difficult to meet the harmonization convergence criteria, let alone pushing other member countries to comply with it. The numerous conflicts facing the country, as well as weak governance structures have meant that the country has not been able to lead by example. Unlike the euro zone where countries like Germany serve as mentors

to minor ones, like Portugal, the shaky nature of almost all economies in the WAMZ does not bode well (Somed, 2012).

The fourth lesson relates to the need for more fiscal and economic integration. This requires member countries to give up a significant amount of sovereignty (Norris, 2011). As mentioned in the introduction, the European Economic and Monetary Union suffer from structural weaknesses. UNECA (2012) posited that the crisis in the euro zone has been brought about by various discrepancies in the structure of the monetary union. The crisis has significantly revealed the challenges of the European Union's sui generis political status, which is no longer a mere assemblage of nation-states, yet is also not a fully-fledged federal entity. No monetary union has ever succeeded without a concurrent political union, including fiscal consolidation. However, the European Monetary Union remains a centralized monetary authority, without fiscal capacity. It has only a relatively weak set of political institutions and identities, making its operations and survival difficult. In order to avoid such consequences in West Africa, regional integration arrangements should strive to establish a single fiscal policy, as well as a single monetary policy. However, such a task is daunting, considering the fact that the region encompasses countries with diverse political, economic and social backgrounds. Establishing such a policy requires greater political will and policy coordination among individual countries. Just like most European member States, the leaders of African countries will want to maintain their sovereignty (UNECA, 2012).

The fifth lesson relates to the need to continually review and update political institutions and equip them with mechanisms to ease future financial and economic crises. As Robert Schuman aptly noted at the creation of the European Union in 1950, "Europe will not be made all at once, or according to a single, general plan. It will be built through concrete achievements, which will create a de facto solidarity" (Schuman, 1950:1). The history of the European Union demonstrates that most crises have led to further integration. Thus, it is likely that through political will and creativity, decisive innovation will help salvage the crisis facing the euro zone.

The last lesson emanating from the experience of the European common currency is the importance of collaboration and the building of cohesion between member states. The experience of the European Union shows that though regional integration arrangements are first and foremost motivated by

## The European Experience of a Common Currency: Lessons Learned

political objectives, they are primarily constructed using economic building blocks. Although the logic of the three dominant factors - economic, political and legal - in constructing the European Monetary Union is inherently distinctive: they interact with and even influence each other. It is imperative that politicians and policy-makers deal with the loss of policy space, whether economic, social or political, which results. In Europe, this fact has long been accepted, as there is a wide agreement that the current problems of the euro zone will have to be solved in the political domain. McCarthy (2012) opined that in Africa, it is important to find out if African political leaders will find it easier to cope with the challenges of monetary union and what this requires in terms of fiscal integration.

### ***Conclusion***

Despite the recent crisis in the euro zone, European integration has been a remarkable success and provides a model of linear integration, which is characterized by incremental, deeper integration, in parallel with the expansion of membership. The movement from monetary integration to monetary union and a single currency, has demonstrated the resilient structures put in place by the European Union 50 years ago. The question, as it relates to this background paper, is what lessons the West African sub-region can learn from the EU's experience in constructing a monetary union and the introduction of a common currency?

However, an important point to note is that it took about 50 years, from the signing of the European Coal and Steel Community Treaty in 1951, for Europe to achieve the introduction of the euro. Meanwhile, the possibility of deeper economic and financial integration in Africa, especially in the West African sub-region, has continued to generate both academic and policy interest, both within and outside the continent.

It is therefore clear from the discussion in this paper that even though ECOWAS is at a different stage of integration, the European Union's common currency and the ongoing crisis in the euro zone offer invaluable experiences for West Africa on its march to monetary integration. The study has brought to the fore a number of lessons West Africa can learn from the EU's common currency and the ongoing crisis. The paper identifies the need for strong and committed

leadership and a credible space for dialogue among the different actors in the regionalizing process. It also highlights the importance of building resilient and innovative structures to address unforeseen crises. Such structures must take cognizance of the often contradictory interaction between the economic, political and legal elements of the integration process. Similarly, these structures are expected to address asymmetries in the logic of political discourse, which are not restricted to the economy, but also affect the political and legal elements which manifest both at the local and regional levels. The European Union's experience clearly shows that regional integration processes, structures and mandates are not given and static and therefore must continuously be assessed in light of the integration experience. Therefore, decisive political leadership is needed to respond to the ups and downs of a monetary union.

### References

Adam, M. A., Agyapong, D and Numapau, E.G., 2010. Dynamic Macroeconomic Convergence in WAMZ. *International Business and Management*. 1(1) , pp.85-110.

Agyapong, D., 2012. The Eurozone Currency Crisis: A Lesson for the West Africa Monetary Zone. *Asian Journal of Business and Management Sciences*, 1 (11) pp.11-25.

Angelini, P. and Lippi, F., 2007. Did prices really soar after Euro cash changeover? Evidence from ATM withdrawals. *International Journal of Central Banking*. 3(4), pp.1-22.

Bartram, M. S and Karolyi, K. A. 2006. The Impact of the Introduction of the Euro on Foreign Exchange Rate Risk Exposures. *Journal of Empirical Finance* 13, pp.519–549.

Bordo, M. D., Jonung, L. and Markiewicz, A., 2011. *A Fiscal Union for the Euro: Some Lessons from History*. NBER Working Paper 17380, Cambridge, MA: NBER.

Bremner, C., 2011. Sarkozy and Merkel demand Relaunch of European Ideal with 'Treaty of Solidarity', *London Times*, 2 December, 2011, pp.59.

Bris, A. and Micola, R. A., 2008. *Separated by a Common Currency? Evidence from the Euro Changeover* March 3, 2008.

Chintrakarn, P., 2008. Estimating the Euro Effects on Trade with Propensity Score Matching. *Review of International Economics*, 16(1), pp.186-198.

Chuku, A. C., 2012. The Proposed Eco: Should West Africa Proceed With a Common Currency? Paper presented at the *Conference on Economic Development in Africa* at the Centre for the Study of African Economies (CSAE) Oxford: Oxford University, 18-20 March 2012.

Coeurdacier, N and Martin, P., 2009. The Geography of Asset Trade and the Euro: Insiders and Outsiders. *Journal of the Japanese and International Economies*, 23(2), pp.90-113.

Dominguez, K. M. E., 2006. The European Central Bank, the Euro, and Global Financial Markets. *The Journal of Economic Perspectives* 20 (4), pp. 67-88.

Ekong, C. N. and Onye, K. U., 2012. On the Feasibility of a Common Currency in West Africa: Evidence from a Multivariate Structural VAR. *Current Research Journal of Economic Theory* 4(4), pp.120-131.

EU, 1992. *The Maastricht Treaty: Treaty on European Union*. [pdf] Available at <<http://www.eurotreaties.com/maastrichteu.pdf>> [Accessed 7 February, 2013].

EU Facts, 2012. *European Monetary System*. [pdf] Available at: <<http://www.civitas.org.uk/eufacts/FSECON/EC9.htm>> [Accessed 03 August 2012].

European Economy, 2008. *The EU's Response to Support the Real Economy During the Economic Crisis: An Overview of Member States' Recovery Measures*. Occasional Papers 51, Brussels: European Commission/ DG ECFIN, July 2008.

Frankel, J. and Andrew, R., 2002. An Estimate of the Effect of Common Currencies on Trade and Income. *Quarterly Journal of Economics*, May 2002.

Fritsche, U., Lein, S. and Weber, S., 2009. *Do Prices in the EMU Converge (Non-linearly)?* DEP Discussion Papers 4/2009, Macroeconomics and Finance Series, Hamburg

Hämäläinen, S., 2000. The Single Currency and European Integration. Speech delivered at the Seminar *EMU Experience and Prospects - A Small State Perspective*, Institute of European Affairs, Dublin, 16 October 2000.

Hembruff, J., 2011. European Son: Neoliberal Integration, the European Monetary Union and the European Sovereign Debt Crises, *Inquiry and Insight*, 4(1), pp.6-19.

IMF, 2002. *IMF Survey Supplement on the Fund*. [pdf] Volume 31 September 2002 Available at <<http://www.imf.org/external/pubs/ft/survey/sup2002/index.htm>> [Accessed 7 January 2013].

## The European Experience of a Common Currency: Lessons Learned

Kirkegaard, J. F. (2011). Painful Euro Crisis and Lessons for the World – Part I. [pdf] Yale Center for the Study of Globalisation. *Yale Global Online Magazine*. Available at <<http://yaleglobal.yale.edu/content/painful-euro-crisis-and-lessons-world>> [Accessed 03 December 2012].

Lane, P. R., 2006. Global Bond Portfolios and EMU. IIS Discussion Paper No. 168. SSRN. Available at <<http://ssrn.com/abstract=925858> or <http://dx.doi.org/10.2139/ssrn.925858>> [Accessed 03 November, 2012].

Masson, P. and Taylor, M., 1993. Fiscal Policy within Common Currency Areas. *Journal of Common Market Studies*, 31 (1).

Masson, P. and Pattillo, C., 2001. *Monetary union in West Africa (ECOWAS) - Is it desirable and how could it be achieved?* Occasional Paper No. 204 Washington: International Monetary Fund.

Masson, P. and Pattillo C., 2004. A Single Currency for Africa. *Finance and Development*. December, 2004.

Masson, P. and Pattillo, C., 2005. *The Monetary Geography of Africa*. Washington, DC: Brookings Institution Press.

McCarthy, C., 2008. The Roadmap towards Monetary Union in Southern Africa – is the European experience commendable and replicable? *Third GARNET Annual Conference*, Bordeaux, September 2008.

McCarthy, C., 2012. *A Comment on the Lessons the Euro Crisis holds for African Monetary Integration*. SADC: Trade Law Centre.

McKay, D., 2005. Economic Logic or Political Logic? Economic theory, federal theory and EMU, *Journal of European Public Policy* 12, pp.528-544.

Mundell, R. A., 1961. A Theory of Optimum Currency Areas. *American Economic Review* 53, pp.657-664.

Niyiragira, Y., 2012. *Revised Plan of Single Currency for West Africa*. *African Union Monitor*. [online] Available at <<http://www.pambazuka.org/aumonitor/comments/2421/>> [Accessed 01 September, 2012].



Petsas, I., 2003. *Optimum Currency Areas and the European Experience*. New Jersey: Pearson Education, Inc.

Quiggin, J., 2012. *Zombie Economics: How Dead Ideas Still Walk among Us*. New Jersey: Princeton University Press.

Rattner, S., 2011. Look to Africa for Lessons in Sharing Currency. *London Financial Times*, 21 October, 2011.

Rusuhuzwa, T. K., and Masson, P. R., 2012. *Design and Implementation of a Common Currency Area in the East African Community*. Working Paper 451, University of Toronto Department of Economics.

Skrekas, N., 2010. Greek GDP Revised Down. *Wall Street Journal*. Available at <<http://online.wsj.com/article/SB10001424052748703453804575479162284898390.html>> [Accessed 05-01-2013].

Somed, M., 2012. *Euro's Lessons For the Eco – WAMZ on High Alert*. [online] Available at: <<http://www.ghanabizmedia.com/ghanabizmedia/march-2012-banking-a-finance/574-euros-lessons-for-the-eco--wamz-on-high-alert.html>> [Accessed 13 February 2013].

Tsangarides, C. and Qureshi, M., 2008. Monetary Union Membership in West Africa: A Cluster Analysis. *World Development*, 36 (7), pp.1261-1279.

UNECA, 2012. Common Currency: Why events in Europe should not derail attempts to form a single currency in East Africa. *Bulletin of the Sub-regional Office for Eastern Africa (SRO-EA) of the United Nations Economic Commission for Africa (ECA)*, Issue No 8, January 2012.

UNECA/AU, 2012. The Impact of the European Debt Crisis on Africa's Economy: A Background Paper. Presented at the *5th Joint Annual Meetings of the AU Conference of Ministers of Economy and Finance and ECA Conference of African Ministers of Finance, Planning and Economic Development*, Addis Ababa, Ethiopia, 26–27 March 2012.



*Paulina Mendes*

## ***The Experience of Guinea-Bissau's Integration in WAEMU: Lessons for the Euro Zone***

### ***Introduction***

Interaction between actors is one of the preconditions to achieve a public good. This condition justifies the actors' grouping in institutions such as family, community, state and regional blocks at the highest level in order to satisfy their political and/or economic interests.

Thus, regional integration is one of the solutions found by political leaders of this time to increase exchange and to promote economic growth and development. This perspective was reinforced by economic integration theorists, especially Balassa (1961) and Robson (1985), who prescribe the regrouping of developing countries into economic regional blocks to have a stronger probability to work in close political synergy, what contributes to the value of their interests within the international market and to increase their competitiveness.

The grouping of countries with varying levels of development in regional blocks needs the explicit and voluntary consent of participating countries on the challenges which occur within the process of regional integration. This includes the respect of solidarity principles and compensation to mitigate economic imbalance between countries in order to foster regional integration.

This is the case, for example, within the West African Economic and Monetary Union (WAEMU), where a country like Ivory Coast, which covers the largest and most diverse economy of the union, shares the same space of integration with Guinea-Bissau, a small economy which is highly focused on a single product which is cashew nuts.

## The Experience of Guinea-Bissau's Integration in WAEMU

Guinea-Bissau differs from the rest of the Union's member countries because it is the only country which had been colonized by Portugal and which withstood fought an armed struggle that lasted eleven years., Notably after its independence, it has experienced successive periods of socio-political instability, which has contributed to the weak political and economic structures in the country.

On the one hand, this article aims at the integration of Guinea-Bissau within WAEMU and to underline its impact on social and economic development. On the other hand, it highlights the experiences of monetary integration the euro zone could learn from the WAEMU zone. To achieve these objectives, the following questions have been formulated to guide the elaboration of this work:

1. What are the reasons that led Guinea-Bissau to integrate with an organization which was traditionally designed to respond to the requests of the old French colonies in West Africa?
2. Has the integration of Guinea-Bissau within WAEMU been translated into improved national macro-economic indicators and changes in the socio-cultural values of the people?
3. Which lessons of WAEMU's experience could help mitigate the crisis in the Euro zone?

To respond to these questions, the article is structured in four points: The first one looks at Guinea-Bissau as a Portuguese speaking country in the midst of a francophone community; the second one demonstrates the historical antecedents of WAEMU, in terms of a regional organization that is a member of the Franc zone. The third point deals with the experience of Guinea-Bissau's integration in WAEMU and its impact on the socio-economic development of the country. Finally, the focus lies on the lessons which the Euro zone could draw from the experience of WAEMU.

### ***Guinea-Bissau: A Portuguese Speaking Country Within The Francophone Community***

The Portuguese arrived in Guinea-Bissau in 1446 with the aim to dominate and exploit the country. However, this aspiration for colonial power encountered the

resistance of the Guinean people. This resistance is reflected in the short period of Portugal's dominance over this country, less than 60 years on the continental part and 37 years on the archipelago of Bijagos (Mendy, 1997:22).

In contrast to Angola and Mozambique which were colonies of settlement, Guinea-Bissau, was a colony for exploitation. Being colonized by Portugal granted Guinea-Bissau the privilege to join the Communauté des Pays de Langue Portugaise (CPLP, i.e. Community of Portuguese-speaking countries), created in 1996, which includes Angola, Brazil, Cape Verde, Mozambique, Portugal, Sao Tome and Principe and East Timor.

In terms of geographical location and compared to its counterparts that share the same colonial past, Guinea-Bissau is far away from the other colonized countries of Portugal with the exception of Cape-Verde.

It shares physical boundaries only with francophone countries, former French colonies. It is bounded on the North by Senegal, and in the South by Guinea. With respect to culture<sup>1</sup>, Guinea-Bissau is closer to its francophone neighbors in the sub-region, which makes the integration of Guinea-Bissau within WAEMU a sort of reunion between siblings who were separated against their will by colonial forces during the Berlin Conference in 1884.

In terms of monetary policy, unlike other member countries of WAEMU, Guinea-Bissau decided to create its own national currency, the Peso, after its independence on 24 September 1973, to substitute the Portuguese currency, the Escudo. To achieve this, the Banco Nacional da Guiné (BNG) was established, which operated as central bank, treasury and universal bank.

Following monetary reform in March 1976, the Guinean Peso was created to substitute the Portuguese Escudo. Since 1902, the Portuguese Escudo had circulated in the territory which later became Guinea-Bissau.

Unfortunately, the monetary history of the country was characterized by the constant depreciation of the Guinean Peso, which consequently resulted in pri-

1 Guinea-Bissau differs from its counterparts, regarding the official language of communication within the institutions of the state, and the currency used.

## The Experience of Guinea-Bissau's Integration in WAEMU

ce instability. If these factors are added to the fact that the currency was inconvertible, one can easily imagine the difficulties that the country was confronted with, especially in areas such as international trade and foreign investment.

On 2 May 1997, Guinea-Bissau adopted the Franc de la Communauté financière africaine (CFA franc, ie. Franc of the African Financial Community), upon signing the Dakar agreement, and was integrated in WAEMU which included former French colonies such as Benin, Burkina Faso, Ivory Coast, Mali, Niger, Senegal and Togo. Since the official working language of this community is French, this involves enormous efforts for Guinea-Bissau to be able to participate in the activities that are realized and implemented by this organization.

### *Historical Overview Of WAEMU*

The creation of WAEMU is part of a political cooperation between French-speaking, West African countries including Upper Volta (today: Burkina Faso), Ivory Coast, Dahomey (Benin), Guinea, Mauritania, Niger, Senegal and French Sudan (today: Mali), advocating an efficient control of the territories by the adoption of common monetary, commercial and legislative policies (Barry, 2006).

To specify these objectives, the Afrique Occidentale Française (AOF, i.e. French West Africa) was established in June 1895, with the aim to coordinate the administrative and financial territories composing this area in order to reconcile their interests and ensure financial solidarity, and to strengthen their investments (Fernandes, 2007:122).

The evolution of monetary emission resulted in the creation of the franc for the French Colonies in Africa (CFA franc) in 1945, which was renamed to franc de la Communauté Financière Africaine (CFA franc) and was issued by the Banque Centrale des États de l'Afrique de l'Ouest (BCEAO, Central Bank of the West African States), after independence in 1960 (Mendes, 2012: 6).

In 1959, the AOF federation has been created by integrating Dahomey (today: Benin), French Sudan (today: Mali), Senegal, and Upper-Volta (today: Burkina Faso). In the end, only Senegal and Sudan stayed therein. However, this federation has had hard times in regard to ideological differences between the presidents of the two countries: Modibo Keita, who supported Guinea and was

influenced by communism, aimed to establish a unitary federal state, while the pro-Western president of Senegal at that time, Léopold Sédar Senghor, opted for a flexible federation to strengthen the influence of France within the region. This federation broke apart after the independencies of both countries (Fernandes, 2007:125).

At the same time, the council of the Entente or the Sahel-Benin Union emerged which included Upper Volta (today: Burkina Faso), Ivory Coast and Dahomey (today: Benin). In 1966, Togo joined these countries. However, the project was not followed up because of the opposition of Ivory Coast against the introduction of the principle of free movement. In 1961, in the capital of Niger, several AOF countries expressed their interest to maintain the currency that they were using since colonial times via an agreement.

In 1962, Benin, Burkina Faso, Ivory Coast, Mali, Mauritanian, Niger, Senegal and Togo signed a treaty in Paris that established the monetary union. One year later, Mali withdrew, followed by Mauritanian eleven years later.

In the seventies, reforms were made, not only with the intention to Africanize the staff of BCEAO and to move the headquarters of the bank to the African continent, but also to reduce France's role of a guardian of its former colonies (Mendes, 2012:7). Likewise, the Banque Ouest Africaine de Développement (BOAD, i.e. West African Bank of Development) was created in 1973.

In 1984, Mali signed the contracts to rejoin the Union in order to benefit from the common currency which facilitates trade among member states, guarantees the convertibility of the currency by the French Treasury and the existence of a common issuing institution (Fernandes, 2007:142-143).

After the economic crisis which affected the union's countries since 1985, resulting from the falling prices of main export commodities on the international market, the members were obliged to devaluate the CFA Franc by 50% on 10 January 1994. In the same year, it was decided to strengthen the monetary union by adding to the economic dimension with the creation of WAEMU with a multilateral surveillance mechanism for economic and financial politics, a common external tariff, and the free movement of people, goods and capital, as well as the harmonization of sector policies.

## The Experience of Guinea-Bissau's Integration in WAEMU

In January 1999, with the Euro entering into force, the cooperation stemming from colonial times was maintained. The decision of the European Council no. 98/683/CE on 23 November 1998 which authorized the French to pursue their cooperation with the Franc zone came to an end with the recognition of the budgetary nature of the cooperation. This decision has caused the automatic anchorage of the CFA Franc to the Euro at a fixed parity of 1€ for 655,9570 CFA Franc (Mendes, 2012:7).

In December 2007, the institutions of WAEMU adopted institutional reforms which came into force on 1 April 2010. On one hand, the reforms sought to modernize the institutional framework of WAEMU and BCEAO in order to be able to adapt to the new requirements of specific missions of the Central Bank. On the other hand, they strengthened the stability of the banking and finance system and modernized the rules that governed external financial relations with member countries of the EU. In monetary terms, this reform has given BCEAO greater independence whose top priority is price stability. However, the operations' account, opened on the books of the Treasury of the French Republic, remains the linking of the African member countries of the CFA zone and France (EU). Through this account, France guarantees the unlimited convertibility of the CFA Franc. In return, African countries deposit 50% of their exchanging reserves there and respect a set of principles, especially the free movement of capital within the franc zone, the maintenance of a fixed exchange rate, and the sharing of exchange reserves (Mendes, 2012:8).

### ***WAEMU: A Strategic Lever For Guinea-Bissau***

WAEMU is a regional economic organisation, which was traditionally created to guide the destinies of West African countries that were colonised by France in order to realize their socio-economic development. Thus, the realisation of the expected development can be reached by the harmonisation of economic politics, the unification of national markets and the implementation of common sector policies. It also needs to strengthen the competitiveness between member countries in economic and financial activities, the harmonization of the juridical framework and the supervision of the multilateral institution to assure macro-economic convergence.



Guinea-Bissau has felt the necessity to integrate within WAEMU in order to try to solve its economic problems, particularly the remarkable macro-economic imbalances, the depreciation of the peso, an unsound financial system, persistent external account and public finance deficits, a market which is not very attractive for investors and with not very diversified production structures, centered on which cashews constitute 90% of the total value of the countries' exports. Also, the non-convertibility of the currency put a strain on Foreign Direct Investment (FDI) and the weak economy (Mendes and Sall, 2012).

Even though the international context has contributed to the stagnation of an important part of the economies of Sub-Saharan African countries', particularly in the case of Guinea-Bissau, its socio-political instability has added to this, as an element which contributed to the degradation of the main macro-economic indicators and its delay in development.

These elements led Guinea-Bissau to look for a solution to its macro-economic imbalance in WAEMU through the privileges that integration provides to its member countries and in the respect of the boundaries to its francophone countries in the North and the South. However, the Republic of Guinea had ceased to be a member of this block from the colonial era after independence in October 1958.

Another possible reason for the integration of this country in the regional block is related to the delay of Portuguese-speaking African countries to conceptualize a similar organisation as the WAEMU. This delay can partly be explained by the late independence of these countries and their geographical dispersion.

### ***WAEMU: A Lifeline For The Economy Of Guinea-Bissau***

The integration of a country in a monetary zone produces advantages resulting from the utilization of a single currency between the countries which contributes to the reduction of uncertainties in the development of the exchange rate. Mendes and Sall (2012) argue that insecurities can represent an obstacle regarding economic activity, essentially in a country with weak revenues and without access to financial markets, such as Guinea-Bissau. Indeed, the reduction of exchange rate risks allows ameliorating the decision of principal economic actors on the one hand. On the other hand, it allows the reduction of the real interest rate, which can reflect

## The Experience of Guinea-Bissau's Integration in WAEMU

the selection of appropriate projects and the improvement of banks' performance. The integration of Guinea-Bissau in the WAEMU is based on the criterion of cost-benefit analysis that the country conducts when integrating in the Union (Mendes and Sall: 2012) and not by the criteria as it is the case for the euro zone. To evaluate the macro-economic impacts of Guinea-Bissau's integration within WAEMU, a study conducted by Mendes and Sall (2012) showed clearly that the macro-economic situation of the country has improved since the accession of Guinea-Bissau to the Union. The table below shows the evolution of different indicators before and after the accession. Thus, the real growth rate increased from 3.5% between 1990 and 1996 to 4.1% between 2008 and 2011, inflation considerably decreased from 45.7% to 4.1%, public expenditures as share of GDP have increased progressively, from 16% to 21.3%, the investment rate increased from 2.1% to 6.6%. Grosso modo, the majority of the indicators has improved, including the period of the military conflict in 1998-99.

Table1. Principal macro-economic indicators

Indicator	Average within the period				
	1990-1996	1997-1999	2000-2003	2004-2007	2008-2011
Real growth rate	3,5%	-7,2%	0,2%	3,1%	4,1%
Inflation	45,7%	18,3%	2,9%	2,7%	4,1%
Public expenditures/ GDP	16,0%	16,8%	19,9%	21,1%	21,3%
Public investment/ GDP	6,6%	4,2%	5,8%	3,5%	4,1%
Payroll / Tax Revenue	72,7%	88,2%	83,6%	96,6%	80,6%
Fiscal deficit/GDP	-10,9%	-11,1%	-5,0%	-4,7%	-0,1%
tax burden	2,1%	3,0%	4,9%	5,4%	7,2%
investment rate	2,1%	3,0%	9,1%	7,0%	6,6%
% of imports covered by exports	32,9%	79,4%	76,9%	59,0%	62,4%
Current account balance / GDP	-16,0%	-6,9%	0,0%	-2,6%	-4,8%

Source: BCEAO

## ***Guinea-Bissau: Between Macro-Economic Convergence And Socio-Cultural Convergence***

The integration of Guinea-Bissau within WAEMU has not only influenced the macro-economic framework of the country, but also its socio-cultural context. The ways Bissau-Guineans dress and paint, particularly women, have changed progressively due to their interactions with the citizens of other countries within the union, in seminars, workshops, conferences or exchanges.

The meetings between the traders of the countries forming this regional bloc on the principal weekly markets called *lumos*, have contributed to the increasing interdependency of values and cultural adjustment. This acculturation is reflected in the culinary domain, especially the incorporation of several receipts of these countries in the Guinean kitchen.

The impact of the accession of Guinea-Bissau to WAEMU can also be recognized in the linguistic domain, in terms of a large utilization of the national languages of each country in other countries, because migrants have a tendency to conserve the language of their home country, while learning the language of the host country. In this way, the inhabitants of the host country teach their language and learn the one of the newly arrived. For example, Wolof is widespread in Guinea-Bissau because of the presence of many Senegalese in the market of Bandim and the temporary displacements of Bissau-Guineans to Senegal. Also, the language creole is propagated in Senegal because of the relation between Bissau-Guinean clients and Senegalese merchants in the markets of Ziguinchor and Dakar, making the latter learning creole even without knowing Guinea-Bissau.

In addition to the co-existence of citizens of WAEMU countries, the provision of the organisational statute which established the free movement of people in this community space has allowed certain citizens of these countries to choose Guinea-Bissau as a country of residence and to develop their activities there. Some of them can subsequently marry Bissau-Guineans which will contribute to strengthen the interdependency between values and acculturation in Guinea-Bissau.

## **The Experience of Guinea-Bissau's Integration in WAEMU**

The placement of citizens of Guinea-Bissau in the different structures of WAEMU working in these countries, also contributes to a socio-cultural convergence in this regional space.

Another sector which reflects the cultural convergence is the sector of the higher education, with the alignment of curricula of the Amílcar Cabral University with other WAEMU countries. The elements described above foster the acculturation and the strengthening of the shared community values within WAEMU.

### ***WAEMU: Which Lessons To Draw For The European Union? Reasons For The Crisis In The Euro Zone***

The crisis in the Euro zone which started in 2010 with the Greek debt crisis followed by the ones in Ireland and Portugal in 2011, has revealed a lack of optimality in the euro zone in terms of a monetary zone and its mechanisms to prevent and handle crises, according to Mendes (2012). Indeed, the failure of the multi-lateral surveillance mechanism of economic policies, which was implemented in the Euro zone, did not allow to discover and/or to correct the macro-economic imbalance in the different member countries. Likewise, the insufficiencies of solidarity policies, as well as its late manifestation have contributed to exacerbate distrust and speculation at financial markets.

Furthermore, the definition and the implementation of the single currency policy in the Euro zone is entrusted entirely to the European Central Bank with the only purpose to promote price stability, while each country conserves its prerogatives in terms of budgetary and fiscal policy. This is a problem as this situation did not foster a better determination of the optimal policy mixture for the entire zone.

### ***What Are The Lessons For The Euro Zone?***

WAEMU countries are all exporters of basic products, with the highest probability of asymmetric shocks due to price instability of primary products on the international market and difference in their export structure. However, asymmetric shocks may not represent the downside of monetary union, insofar that affected countries can be helped by non-affected countries. Within this framework, Ossa (2000) emphasized the solidarity between member countries to be the criteria

of optimality. In the very same sense Mendes (2012) underlines that “for a monetary union to be an ‘umbrella’ for every country, the existence of an effective solidarity between all the countries is necessary, even if internal sanctions might have been activated towards states, which have voluntarily allowed macro-economic imbalances” (Mendes 2012:13, original in French).

The recommended solution of the crisis in the Franc zone in 1994 is an example of solidarity *sui generis* in that sense that countries were not affected in the same way, but decided, in solidarity, to support the 50% devaluation of the CFA Franc.

In the Euro zone, the failure of a solidarity policy between other member states and the delay in its expression have led to the mistrust of financial markets and thus, fuelled speculation and contagion on to other countries of Southern Europe. This crisis shows the importance of strong political leadership as one of the necessary conditions for the stability of a single currency, because, in history, the currency and the sovereignty have always been together (Messiha 2011).

However, for this solidarity to be efficient there has to be a centralized coordination of macro-economic policies, a coordinated management for the use of centralised exchange reserves. It also requires a certain extent of political integration between the member states, because in its absence, it is hard to maintain solidarity between member countries in the long-run (Mendes, 2012:13).

## ***Conclusion***

The search of macro-economic stability has led Guinea-Bissau to abandon its national currency to join other West African countries within WAEMU. Although the result is ambivalent, it turns out that the consequences of military-political instabilities which followed this accession could have been more severe in economic and social terms. In fact, regarding the consequences of post-accession to WAEMU, which turned out in mastering inflation, a broader opening to international trade and a consolidation of the financial system, the accession has contributed to mitigate the unfavourable effects of the socio-political climate on economic activities since the military-political conflict of 1998/1999. Guinea-Bissau, even though a Portuguese-speaking country, felt the need to integrate with this Union because it shares physical boundaries with the other countries of the union.

## **The Experience of Guinea-Bissau's Integration in WAEMU**

The impact of the integration of Guinea-Bissau within WAEMU is not restricted to the macro-economic convergence in the region, but also to the socio-cultural convergence.

The Euro zone could take into account certain aspects regarding WAEMU, especially the standardization of legislation and banking supervision as well as the expression of solidarity. However, for a further deepening of the integration process within WAEMU, these countries continue to be inspired by the European experience.

## References

- Alesina, A., Barro, R. and Tenreyro, S., 2002. *Optimal Currency Areas*. Working Papers 1958, Harvard Institute of Economic Research.
- Balassa, B., 1961. *Teoria de Integração Económica*. Translated by M.F. Gonçalves and M.E. Ferreira. Lisbon: Livraria clássica.
- Banny, C., 2000. Problematique de l'integration monetaire en Afrique de l'Ouest. *Second Conference of the West African Presidents of Parliament*, Ouagadougou, 28 - 31 March 2000
- Barry, B., 2006. *Senegâmbia: o desafio da história regional*. [pdf] SEPHIS – Center of African-Asian Studies. Available at: <<http://www.sephis.org/pdf/barry.portuguese.pdf>>
- BCEAO, 2010. *Annual Report, summarized version*. [pdf] Available at: <[www.bceao.int](http://www.bceao.int)>.
- Commission of WAEMU, 2002. *Le rapport d'activités de l'année 2002 de la Commission l'UEMOA*. [pdf] Available at: <<http://www.uemoa.int/Publication/RapportCom2001.pdf>>
- Fernandes, J.A., 2007. *Integração económica como estratégia do desenvolvimento do continente africano: Proposta de fusão entre a Comunidade de Estados da Africa Ocidental (CEDEAO) e a União económica e Monetária da África Ocidental (UEMOA)*. Master Thesis in Law, Florianópolis: Universidade Federal de Santa Catarina.
- Gomes, P.G., 1997. *Aspectos monetários da adesão versus integração da Guiné-Bissau na UMOA/UEMOA*. Bissau: Bulletin of the Faculty of Law.
- Mendes, D., 2001. *A Problemática da Integração Monetária na África Ocidental: Europeizar ou Africanizar?* Master Thesis in Economics. Coimbra: Universidade de Coimbra.

## The Experience of Guinea-Bissau's Integration in WAEMU

Mendes, D., 2012. Programa da moeda Única da CEDEAO: Que Lições da Crise na Zona Euro. *8th Conference of Portuguese speaking Economists, Reflection on the Economic Crisis in Portuguese speaking Countries as a Conclusion to the Conference Rio+20*. Brasil, Belo Horizonte, 12-15 September 2012.

Mendes, D., Sall, C. and Tidiane, A., 2012. Les impacts macroéconomiques de l'adhésion de la Guinée-Bissau à l'UEMOA. *Economic Review of West Africa*, 1(1).

Mendy, P.K., 1997. A Relevância do Pensamento Ckeikh Anta Diop na África Lusófona: O Caso da Guiné-Bissau. *Soronda: revista de estudos guineense*. Bissau: INEP, New Serie 1, pp. 13-29.

Messiha, J., 2001. *Souveraineté et zone monétaire optimale: construit, coïncidence ou causalité? Du franc à l'euro: changements et continuité de la monnaie*. Poitiers.

Ossa, O. 2000. *Zone monétaire et crise de change : le cas de la zone franc africaine*. Libreville: Applied Economics Laboratory.

Robson, P., 1985. *Teoria económica da integração internacional*. Translated by C. Laranjeiro, Coimbra.

UNDP, 1996. *Préparation du dossier d'adhésion à la zone franc et l'UEMOA*. Records of WAEMU, Bissau: Ministry of Economy and Finance.



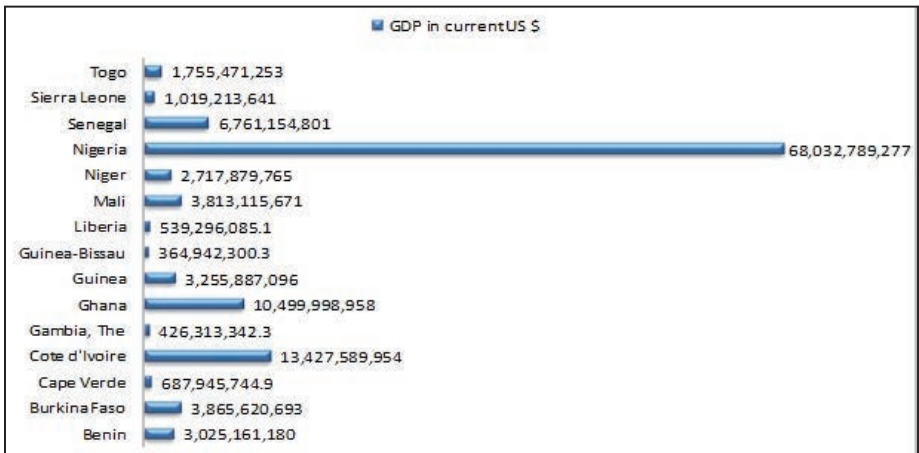
## Appendix

Appendix 1: Total estimated population living in an ECOWAS member country in 2010 (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	6,517,810	6,721,337	6,997,985	7,164,976	7,397,985	7,633,757	7,871,707	8,112,573	8,355,980	8,601,771	8,850,000
Burkina Faso	12,294,012	12,648,474	13,015,435	13,395,599	13,789,736	14,198,463	14,622,202	15,061,127	15,515,258	15,984,479	16,468,000
Cape Verde	437,238	445,096	452,740	460,031	466,784	472,883	478,267	483,023	487,371	491,621	496,000
Cote d'Ivoire	16,581,653	16,892,864	17,180,649	17,455,501	17,731,840	18,020,946	18,325,979	18,646,734	18,987,007	19,350,026	19,738,000
Gambia, The	1,297,084	1,335,674	1,376,035	1,417,818	1,460,493	1,503,678	1,547,259	1,591,357	1,636,107	1,681,734	1,729,000
Ghana	19,165,490	19,632,265	20,114,361	20,610,897	21,119,911	21,639,806	22,170,556	22,712,403	23,264,176	23,824,402	24,392,000
Guinea	8,344,486	8,472,339	8,604,936	8,743,954	8,889,321	9,041,448	9,201,941	9,373,619	9,559,110	9,761,217	9,982,000
Guinea-Bissau	1,240,655	1,264,855	1,289,526	1,314,795	1,340,814	1,367,695	1,395,492	1,424,191	1,453,757	1,484,120	1,515,000
Liberia	2,847,290	2,939,296	2,996,082	3,037,412	3,092,721	3,182,539	3,313,718	3,477,197	3,658,460	3,835,929	3,994,000
Mali	11,295,324	11,639,798	12,001,887	12,380,104	12,772,264	13,176,642	13,592,796	14,020,786	14,459,990	14,909,813	15,370,000
Niger	10,922,421	11,308,134	11,706,182	12,118,322	12,546,945	12,993,884	13,460,138	13,945,662	14,450,007	14,972,257	15,512,000
Nigeria	123,688,536	126,704,722	129,832,447	133,067,097	136,399,438	139,823,340	143,338,939	146,951,477	150,665,730	154,488,072	158,423,000
Senegal	9,505,862	9,758,841	10,023,194	10,297,956	10,581,316	10,871,908	11,169,549	11,474,661	11,787,123	12,106,865	12,434,000
Sierra Leone	4,143,115	4,303,850	4,505,515	4,730,020	4,952,134	5,153,435	5,327,364	5,478,289	5,612,129	5,739,293	5,867,000
Togo	4,793,504	4,926,142	5,050,919	5,170,252	5,288,273	5,408,044	5,529,908	5,652,811	5,776,837	5,901,859	6,028,000

Source: World Development Indicators 2012

Appendix 2: Average GDP in current US \$ for the period 1986 - 2010



Source: World Development Indicators 2012

Appendix 3: GDP per capita (current US \$)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Benin	346.00	352.90	404.60	496.60	547.10	561.60	601.50	683.70	799.80	771.70	749.50
Burkina Faso	212.40	222.40	252.70	318.80	370.50	382.30	394.70	449.30	518.60	509.30	535.60
Cape Verde	1,233.30	1,265.00	1,371.60	1,769.40	1,980.20	2,055.40	2,316.50	2,756.00	3,181.50	3,227.90	3,322.80
Cote d'Ivoire	628.20	624.20	668.60	787.00	873.10	908.00	947.70	1,061.60	1,233.20	1,150.80	1,154.10
Gambia, The	324.50	312.90	268.70	259.00	274.40	306.60	328.50	409.00	502.40	436.10	466.50
Ghana	259.70	270.40	306.20	369.90	420.10	495.40	919.60	1,084.50	1,226.20	1,050.40	1,324.60
Guinea	373.00	341.40	354.80	394.10	412.40	324.80	306.60	449.10	395.30	426.70	451.90
Guinea-Bissau	173.70	157.40	157.90	361.40	389.80	418.80	414.60	485.00	582.50	562.40	579.90
Liberia	197.00	184.70	186.70	135.00	148.70	166.60	184.60	211.40	230.30	229.30	246.90
Mali	214.50	225.90	278.50	352.40	381.60	402.60	431.60	509.70	604.30	601.30	601.90
Niger	164.60	172.00	185.40	225.40	243.30	262.10	270.80	307.70	371.60	351.30	357.70
Nigeria	371.80	378.80	455.30	508.40	644.00	802.80	1,014.60	1,129.10	1,374.70	1,091.10	1,278.40
Senegal	493.60	499.80	532.20	666.00	758.90	799.10	838.80	986.50	1,135.70	1,054.70	1,033.90
Sierra Leone	153.50	187.20	207.70	209.50	211.30	240.50	266.90	303.70	348.30	323.50	324.70
Togo	277.30	269.60	292.20	340.20	389.70	391.10	398.30	446.40	547.60	534.90	523.10

Source: World Development Indicators 2012

Appendix 4: Agriculture Value Added (% GDP)

nty	Benin	Burkina Faso	Cape Verde	Cote d'Ivoire	The Gambia, The	Ghana	Guinea	Guinea-Bissau	Liberia	Mali	Niger	Nigeria	Senegal	Sierra Le
80	35.4	29.4	..	25.9	30.8	60.1	..	44.3	35.9	48.3	43.1	..	20.1	33.0
81	32.7	30.7	..	26.5	34.4	55.3	..	53.3	31.6	45.7	45.7	..	22.3	52.3
82	32.5	43.8	..	24.1	43.8	59.4	..	46.8	32.2	44.1	44.3	..	18.6	35.8
83	33.2	28.2	..	21.9	37.1	..	..	42.4	33.8	41.4	41.6	..	20.1	38.1
84	33.3	29.1	..	24.1	31.2	51.9	..	41.3	35.5	44.2	35.8	..	20.1	40.1
85	31.5	34.9	..	26.5	31.2	44.4	..	46.5	36.5	40.3	36.7	..	23.2	45.1
86	33.7	30.4	16.0	28.5	34.5	48.0	23.9	45.3	37.4	42.4	34.7	..	24.1	38.0
87	33.3	28.5	16.6	29.2	35.0	50.7	24.7	57.6	38.1	45.2	35.2	..	24.9	45.0
88	34.4	29.6	17.6	32.0	31.1	49.7	23.5	58.1	38.1	45.0	35.4	..	21.2	46.0
89	37.9	28.5	16.2	32.7	30.8	49.4	24.1	50.2	38.7	47.8	34.1	..	22.6	46.0
90	36.1	28.8	14.4	32.5	29.0	45.1	23.8	60.8	54.4	45.5	35.3	..	19.9	46.9
91	36.3	30.9	13.4	33.3	27.8	45.6	18.8	54.1	55.6	45.1	39.2	..	20.3	38.8
92	36.0	29.8	11.8	34.0	26.2	45.0	17.1	48.4	51.3	45.1	38.8	..	18.6	37.9
93	33.8	31.0	13.7	28.2	25.2	41.4	18.0	55.2	50.6	44.5	38.5	..	20.6	43.1
94	33.5	35.2	12.8	25.3	27.5	42.0	20.9	55.6	52.4	46.4	40.8	..	19.0	39.4
95	34.0	35.4	13.6	24.7	30.0	42.7	19.3	55.1	81.8	49.5	40.2	..	21.0	42.9
96	37.7	38.0	13.5	24.6	29.8	43.9	17.8	57.6	94.0	51.8	38.9	..	19.9	47.5
97	37.5	36.4	12.2	23.3	29.5	40.1	20.9	54.6	77.0	44.5	38.9	..	19.8	58.6
98	38.2	39.2	11.6	24.1	28.4	40.2	22.0	62.4	78.6	45.5	42.6	..	19.4	61.8
99	37.8	34.6	11.8	22.0	34.1	39.9	22.5	58.7	76.2	46.5	40.7	..	19.0	62.0
00	36.5	29.0	12.9	24.2	35.8	39.4	20.3	56.4	72.0	41.6	37.8	..	19.1	58.4
01	35.5	38.6	11.4	24.7	36.3	39.3	22.0	51.4	73.3	37.8	40.0	..	18.5	47.1
02	33.8	34.9	10.4	25.7	27.6	39.2	22.5	57.3	75.5	39.6	39.6	48.6	15.5	47.8
03	32.1	35.6	10.2	25.6	31.1	40.2	22.3	..	71.6	38.8	39.6	42.7	17.6	46.7
04	32.1	32.9	9.9	23.2	33.7	41.5	25.1	..	68.2	36.4	..	34.2	15.9	44.9
05	32.2	34.1	9.0	22.8	32.1	40.9	22.8	..	65.8	36.6	..	32.8	16.7	51.6
06	..	33.3	8.3	22.9	30.3	30.4	23.6	..	56.9	36.9	..	32.0	14.8	51.1
07	..	..	7.2	23.9	28.7	29.0	25.3	..	55.0	36.5	..	32.7	13.4	49.9
08	..	..	6.6	25.0	28.5	31.0	24.9	..	61.3	..	..	..	15.6	50.2
09	..	..	9.2	24.7	27.5	31.8	16.9	..	..	..	..	..	17.2	52.3
10	..	..	10.3	22.9	26.9	29.9	13.0	..	..	..	..	..	17.4	49.0
H8	34.7	32.3	12.0	26.1	31.2	43.0	21.5	52.8	56.2	43.2	39.1	37.2	19.3	46.0

Source: World Development Indicators 2012

Appendix 5: External Debt Stock (% GNI)

Year	Cape Verde	Cote d'Ivoire	Gambia	Ghana	Guinea	Guinea-Bissau	Liberia	Mali	Niger	Nigeria	Senegal	Serra Leone	Togo
1980	77.1	57.7	31.7	..	131.1	73.8	41.1	35.0	14.6	44.5	48.9	102.4	
1981	102.9	81.8	36.6	..	97.6	89.0	56.9	48.8	19.6	54.5	51.5	109.3	
1982	127.5	98.8	36.9	..	104.3	101.9	67.3	49.4	24.6	62.1	48.4	121.5	
1983	144.0	106.1	41.4	..	121.8	133.0	78.2	55.2	51.2	77.6	66.6	126.9	
1984	134.6	129.1	44.9	..	183.5	133.8	95.9	69.5	64.9	85.2	58.0	118.9	
1985	133.4	112.5	50.7	..	200.2	154.8	113.1	87.5	68.1	90.3	85.4	128.9	
1986	135.2	172.3	49.0	99.6	288.2	208.0	105.4	76.5	118.2	80.3	152.7	104.6	
1987	147.6	144.2	66.5	108.1	291.4	233.9	107.2	76.1	137.9	83.4	154.0	102.9	
1988	143.4	119.6	60.4	100.5	366.5	218.2	105.1	76.1	132.6	81.7	102.6	91.9	
1989	177.0	126.4	64.2	96.3	296.5	319.2	..	69.5	138.4	69.6	121.8	89.6	
1990	187.3	126.7	64.7	98.4	297.7	..	103.6	72.5	130.7	68.0	202.9	80.1	
1991	199.2	126.4	64.2	92.1	311.3	..	107.3	66.7	134.9	66.2	173.8	86.0	
1992	189.1	117.9	67.2	84.3	357.9	..	103.1	66.9	97.5	62.7	226.4	81.2	
1993	197.0	117.7	78.2	89.2	355.1	..	108.3	99.5	151.7	69.3	210.8	107.2	
1994	230.7	118.2	95.7	94.0	383.6	..	154.9	100.6	153.3	99.0	191.5	156.3	
1995	188.7	113.0	86.9	90.0	379.4	..	121.3	87.6	131.7	82.9	149.0	116.7	
1996	174.0	117.2	85.3	85.9	371.6	..	117.0	79.3	95.0	75.8	133.3	103.4	
1997	141.9	105.8	84.6	96.1	362.8	911.7	130.2	87.4	83.7	82.7	140.5	91.5	
1998	123.6	115.9	86.2	102.6	504.5	794.2	125.9	82.1	103.3	81.9	200.9	94.1	
1999	112.2	113.1	85.1	94.4	446.7	761.2	126.5	85.2	87.5	78.4	195.4	99.1	
2000	124.9	120.7	126.6	101.0	466.5	718.7	123.7	95.9	77.9	78.7	193.1	110.0	
2001	116.9	123.6	121.9	104.6	492.6	743.0	116.0	83.9	70.4	76.5	154.5	108.4	
2002	109.0	166.0	115.4	102.7	499.6	717.1	89.3	86.0	57.8	78.2	150.0	108.9	
2003	95.5	189.3	101.5	99.3	229.3	1022.7	72.6	78.2	57.7	64.5	158.7	98.7	
2004	89.4	183.9	81.4	92.5	215.6	1021.0	69.8	66.3	48.4	49.1	157.4	89.7	
2005	76.2	157.9	64.0	109.0	180.6	934.2	52.8	59.4	22.3	44.8	148.9	91.4	
2006	76.9	154.5	16.4	122.1	182.0	926.8	28.8	22.7	5.4	20.5	108.0	89.1	
2007	73.3	116.0	19.8	82.3	158.8	664.7	25.5	26.8	5.5	22.7	32.1	89.0	
2008	56.0	47.0	19.0	93.2	130.3	464.9	24.1	18.7	5.8	21.4	31.7	58.0	
2009	45.8	53.0	24.5	79.0	135.6	225.4	24.1	21.2	4.9	27.4	37.8	58.1	
2010	54.3	52.6	27.2	69.1	124.8	283.3	26.1	20.5	4.5	28.5	40.8	61.1	

Source: World Development Indicators 2012

## Appendix 6: Merchandise exports (in '000 US\$)

Year	Benin	Burkina Faso	Cote d'Ivoire	Gambia, Th	Ghana	Guinea	Guinea-Bissau	Liberia	Mali	Niger	Nigeria	Senegal	Sierra Leone
2000	352,000	209,000	11,000,000	3,888,000	15,000	1,671,000	666,000	62,000	329,000	54,300	283,000	20,975,000	950,000
2001	374,000	223,000	10,000,000	3,946,000	10,000	1,716,000	781,000	65,000	127,800	723,000	272,000	18,045,000	1,003,000
2002	448,000	246,742	10,340,421	5,275,000	13,000	1,850,000	709,000	54,000	176,100	874,000	279,000	17,975,000	1,067,000
2003	541,000	320,344	12,742,000	5,788,000	8,000	2,324,296	609,000	69,000	108,800	928,000	392,000	24,031,000	1,237,000
2004	568,568	479,287	13,094,000	6,919,000	10,002	2,450,000	744,230	76,000	103,800	976,433	437,000	38,651,000	1,509,000
2005	578,234	468,000	17,613,256	7,697,339	8,000	2,802,207	832,690	89,484	131,500	1,100,920	489,000	50,487,000	1,578,103
2006	716,000	588,000	30,651,000	8,477,000	11,464	3,736,690	103,300	74,000	157,800	1,570,000	507,946	58,735,000	1,953,970
2007	1,046,339	623,000	19,219,000	8,665,865	12,318	4,194,720	1,203,000	107,036	200,200	1,536,232	665,286	66,605,990	1,673,829
2008	1,232,233	693,159	31,982,000	10,390,000	13,670	5,269,726	1,342,010	128,181	242,400	2,097,118	910,000	84,118,000	2,170,481
2009	1,190,844	900,492	35,226,000	10,996,302	15,000	5,639,710	1,049,720	119,444	148,690	2,120,000	860,000	93,000,000	2,017,386
2010	1,200,000	1,288,134	44,379,397	10,310,000	13,000	6,250,230	1,250,000	123,000	231,119	2,250,000	930,000	82,000,000	2,161,128

Source: World Development Indicators 2012

## Appendix 7: Merchandise imports (in '000 US\$)

Year	Benin	Burkina Faso	Cote d'Ivoire	Gambia, Th	Ghana	Guinea	Guinea-Bissau	Liberia	Mali	Niger	Nigeria	Senegal	Sierra Leone
2000	562,933	453,316	237,350,842	2,753,765	330,523	2,864,379	52,796	303,337	3,566,767	1,290,213	776,805	3,923,419	1,462,357
2001	622,381	353,845	247,310,438	2,794,300	392,243	2,676,707	468,764	302,983	4,413,205	1,400,014	325,028	7,931,469	1,727,112
2002	720,914	377,407	269,691,063	2,994,220	409,277	3,008,232	677,300	302,392	5,013,317	1,381,679	394,688	8,737,681	1,997,334
2003	886,076	773,630	390,007,383	3,983,283	503,523	3,943,098	664,020	339,796	4,273,678	1,331,800	484,930	14,835,989	2,368,458
2004	897,238	1,034,246	428,883,643	4,709,647	574,628	5,220,473	1,160,238	353,906	4,867,788	1,882,543	587,936	20,496,269	2,893,487
2005	892,849	1,101,315	432,309,690	5,671,437	633,332	5,919,400	1,903,814	231,189	5,698,885	2,067,028	831,570	24,498,714	3,216,790
2006	3,643,283	1,290,193	540,466,663	5,616,229	707,273	6,959,618	1,309,272	200,338	7,937,333	2,372,977	985,046	29,166,901	3,422,346
2007	5,113,794	1,386,793	746,340,436	6,672,893	829,364	9,483,479	2,956,927	290,423	8,783,029	2,839,493	1,066,389	38,876,334	4,429,364
2008	6,694,201	2,036,645	836,328,139	7,901,304	872,811	12,211,956	3,922,020	286,461	11,638,931	3,185,373	1,698,664	54,344,867	5,693,843
2009	6,014,662	1,772,892	707,767,172	7,004,116	833,794	10,338,682	2,679,448	364,903	11,862,614	3,046,404	1,368,072	43,468,086	4,964,800
2010	7,180,960	2,048,670	742,475,428	8,408,852	866,643	12,773,881	4,111,282	274,568	17,498,847	3,577,290	1,609,333	47,786,379	4,971,973

Source: World Development Indicators 2012

**Appendix:**  
***Institutional Structure of EU, UEMOA and ECOWAS Compared***

*ECOWAS*

The ECOWAS Investment and Development Bank (EBID) has become the financing institution for the New Partnership for Africa's Development (NEPAD) programme in West Africa following the appointment of ECOWAS as the implementing agency of the Plan of action in the Sub-Region.

For further information about ECOWAS, see <<http://www.sec.ecowas.int/site-cedeao/english/institutions.htm>> and Treaty on <[http://www.iss.co.za/AF/RegOrg/unity\\_to\\_union/pdfs/ecowas/3ECOWASTreaty.pdf](http://www.iss.co.za/AF/RegOrg/unity_to_union/pdfs/ecowas/3ECOWASTreaty.pdf)>

*WAEMU*

As part of its regional integration process, WAEMU has set the following objectives: i) strengthening the competitiveness of financial and economic activities of the states, ii) the convergence of performance and economic policies of states by the establishment of a multilateral surveillance mechanism, iii) the creation of a common market based on the free movement of persons, goods, services, capital and the right of settlement, as well as on a common external tariff and a common trade policy, iv) coordination of national sector policies in order to implement joint actions and possibly common policies in the key areas of economic activity, v) the harmonization of legislation of member states to the extent necessary for the proper functioning of the common market.

For further information about WAEMU, see <<http://www.uemoa.int/organes/organisation.htm>> and <<http://www.uemoa.int/organes/consultatif.htm>>

## European Union (EU)

<b>Regional organisations</b>	<b>Commission</b>	<b>Parliaments</b>	<b>Court of Justice</b>	<b>Other organs</b>	<b>Regional Bank</b>
<b>European Union</b>	<b>European Commission</b> (represents interests of the EU) → <b>executive body</b>	<b>European Parliament</b> (elected by peoples of MS) [ <b>legislative Parliament</b> ] (together with the Council, adopts the laws = co-decision) Power : - legislative - budgetary - supervisory	<b>European Court of Justice (ECJ)</b> [ <b>legislative body</b> ] - upholds law of the Union (it is the supreme court of the EU) and adjudicates on matters of interpretation of European law/ <b>Court of First Instance</b> - hears disputes brought by employees of the EU and other matters	<b>European Economic and Social Committee</b> - the opinion of organised civil society on economic and social issues <b>Committee of the regions</b> - expresses opinion of regional and local authorities [ both advisory bodies ] <b>European Ombudsman</b> - deals w/ citizens complaints about maladministration by any EU institution or body	<b>European Central Bank</b> - responsible for EU monetary policy <b>European Investment Bank</b> - helps achieve EU objectives by financing investment projects
<b>Customs and monetary union + single market fully implemented</b>	<b>Council</b>	<b>Council of the European Union</b> (represents governments of MS) [ <b>decision-making body</b> ] - often, takes decision / pass EU laws on proposal from EC and in association with the EP, either through consultation procedure (agriculture, judicial, police cooperation, taxation) or through co-decision (e.g. internal market) - coordinates broad econ. policies of MS - concludes internat. agreements between EU + 3rd states + international organisations - approves budget together w/ EP - develop the EU's CFSP - coordinates the cooperation between nat. courts and police forces in criminal matters - work prepared or coordinated by COREPER (Permanent Representatives Committee)			
- 25 members	<b>European Council</b> - provides impetus for major pol. issues relating to EU integration. - sets guidelines and can issue declarations and resolutions on consensus basis				
- founded in 1956 by Treaty of Rome					
<b>All EU decisions and procedures are based on the Treaties,</b>					
agreed by all MS					

## Economic Community of West African States (ECOWAS)

<b>Regional organisations</b> ECOWAS (CEDEAO)	<b>Commission</b> <b>Commission</b> - executes decisions taken by Authority + applies regulations of the Council - prepares draft budgets and programmes of activity and supervises their execution upon approval by Council. - Submits reports on community activities	<b>Council</b> <b>Authority of Heads of State and Government</b> (supreme institution) - responsible for the general direction and control of the Community <b>Council of Ministers</b> - make recommendations to the Authority on any action aimed at attaining the objectives of the Community - issue directives on matters concerning coordination and harmonization of economic integration policies - approve the work programmes and budgets of the Community and its institutions	<b>Parliaments</b> <b>The Community Parliament</b> - consider issues concerning human rights and fundamental freedoms of citizens, information and communication - may be consulted on matters relating to public health, education, youth and sport, science and technology and environment policies.	<b>Court of Justice</b> <b>The Community Court of Justice</b> - ensure the observance of the law and of the principles of equity in the interpretation and application of the provisions of the Treaty - deal with disputes between MS, and between MS and the institutions	<b>Other organs</b> <b>Economic and Social Council</b> - advisory role	<b>Regional Bank</b> <b>ECOWAS Bank for Investment and development (EBID)</b> the two subsidiaries are to be known as ECOWAS Regional Development Fund (ERDF) and ECOWAS Regional Investment Bank (ERIB).
---	--	--	---	--	--	---



**West African Economic and Monetary Union (WAEMU)**

Regional organisations	Commission	Council	Parliaments	Court of Justice	Other organs	Regional Bank
UEMOA (WAEMU)	The Commission	Heads of States Conference	Inter-parliamentary Committee	Court of Justice	Regional Chamber	Central Bank of West African States
Union économique et monétaire Ouest-Africaine	- executive power - puts forward its recommendations + opinions to the Conference + Council	(Conférence des chefs d'Etat) - supreme organ of the Union <b>- final decision-maker</b> and decides on orientation of Union's policy - decides on future adhesion of members The Council of Ministers - ensures implementation of general orientations taken by the Conference - defines and look after the monetary policy of the Union	(Comité interparlementaire) <b>- consultative role + animates</b> debate on integration. - foreshadows the future Parliament that will be in charge of the democratic control of the Union bodies	- looks after uniform interpretation + application of Community law - arbitrates conflicts between MS or between Union and its agents <b>Court of Auditors</b> (Cour des comptes) - controls the accounts of the # bodies and checks the liability and efficiency of the Community resources = organs of control	(Chambre Consulaire régionale) <b>- consultative organ</b> <b>- chamber of dialogue between UEMOA + main economic actors</b>	- deals with macro-economic questions <b>West African Bank of Development</b> (Banque ouest-africaine de développement) - more involved in financing of development-related projects.

## **References Appendix – Composition of African Regions**

### **AMU (Arab Maghreb Union)**

Algeria  
Libya  
Mauritania  
Morocco  
Tunisia

### **Central Africa**

Cameroon  
Central African Republic  
Chad  
Congo, Republic of  
Equatorial Guinea  
Gabon  
São Tomé and Príncipe

### **EAC (East African Community)**

Burundi  
Kenya  
Rwanda  
Tanzania  
Uganda

### **North East Africa**

Djibouti  
Egypt  
Ethiopia  
Somalia  
Sudan, the

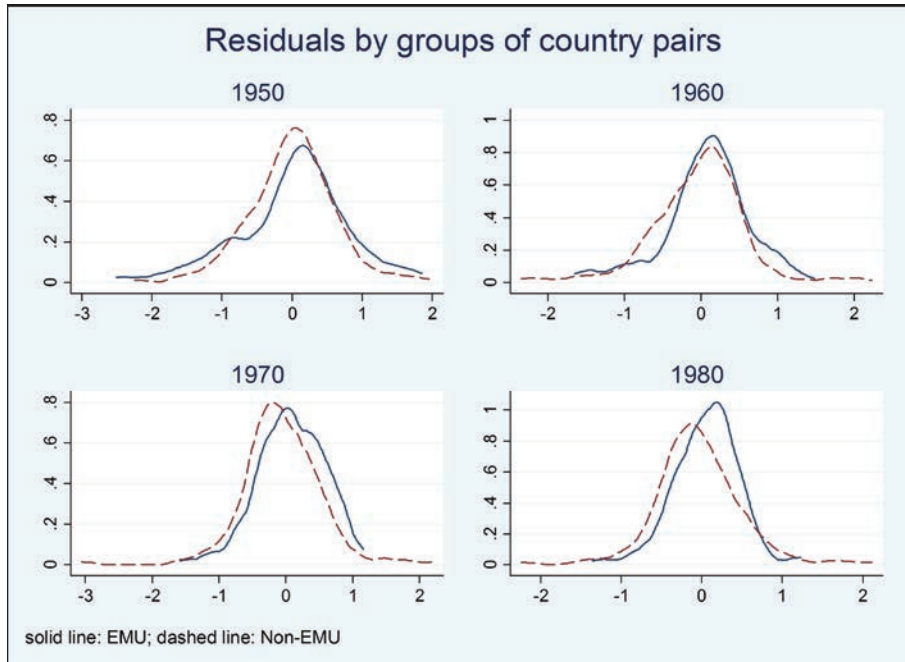
### **ECOWAS (Economic Community of West African States)**

Benin  
Burkina Faso  
Cape Verde  
Côte d'Ivoire/Ivory Coast, the  
Gambia, The  
Ghana  
Guinea  
Guinea-Bissau  
Liberia  
Mali  
Niger  
Nigeria  
Senegal  
Sierra Leone  
Togo

### **Southern Africa**

Angola  
Comoros  
Congo, Democratic Republic of  
Madagascar  
Malawi  
Mauritius  
Mozambique  
SACU  
Seychelles, the  
Zambia  
Zimbabwe

Appendix Figure: Kernel Densities of Gravity Residuals for Earlier Years



Appendix Table: Analysis of Gravity Residuals

Averages	1950	1960	1970	1980
EMU	0.008	0.068	0.085	0.058
Non-EMU	-0.005	-0.048	-0.058	-0.040
t-test (p-value)	0.88	0.13	0.04*	0.11
Kolmogorov-Smirnov (p-value)	0.40	0.24	0.02*	0.02*

Note: Residuals from a gravity model (as tabulated in Table 2; without an EMU dummy) are used. t-test denotes the absolute value of a t-test for the null hypothesis of equal means of residuals between EMU and Non-EMU countries. Kolmogorov-Smirnov denotes the probability for the Kolmogorov-Smirnov test for the null hypothesis of equality of distributions between EMU and Non-EMU countries.. \* denotes significance at the 5% level.



The **West Africa Institute (WAI)** is a research center offering research, capacity-development and social dialogue on regional integration in West Africa. WAI is promoted by the Economic Community of West African States (ECOWAS), the West African Economic and Monetary Union (WAEMU), ECOBANK and the Government of Cape Verde. WAI is based in Praia Cape Verde.

The **Center for European Integration Studies (ZEI)** is an interdisciplinary research and further education institute at the University of Bonn.

WAI-ZEI Papers are published in the framework of the research cooperation both institutes conduct on "Sustainable regional integration in West Africa and Europe" in the years 2013-2016. They are intended to stimulate discussion about regional integration processes in West Africa and Europe from a comparative perspective and about the development of European-West African relations in the political and economic sector. Papers express the personal opinions of the authors.

### **WAI-ZEI Papers**

#### **No. 1 2013**

Olusegun A. Omisakin: Regional Institutions and Policy Formulation. A Comparative Assessment of ECOWAS, the EU and ASEAN, Bonn/Praia 2013.

#### **No. 2 2013**

Denis Acclassato: Intra-West African Trade, Bonn/Praia 2013.

#### **No. 3 2013**

Djénéba Traoré, Will Africa be left behind on the Education for All (EFA) Trail? Bonn/Praia 2013.

#### **No. 4 2013**

Ludger Kühnhardt, L'Afrique et l'Europe Relations comparées et processus d'intégration régionale conjoint, Bonn/Praia 2013.

#### **No. 5 2013**

Kocra L. Assoua, The Nexus between Political Instability and Monetary Sustainability. The Case of a West African Monetary Union, Bonn/Praia 2013.



West Africa Institute

Avenida da Liberdade e Democracia,  
Nº 9 – 5º andar  
Praia  
Achada Santo António

BP 396- A  
Cape Verde

Phone: +238-(0)262-40-59  
[www.westafricainstitute.org](http://www.westafricainstitute.org)



Rheinische  
Friedrich-Wilhelms-  
Universität Bonn



Center for European  
Integration Studies

Walter Flex-Straße 3  
53113 Bonn  
Germany

Phone: +49-(0)228-73-1810  
[www.zei.uni-bonn.de](http://www.zei.uni-bonn.de)

**ISBN 978-3-941928-27-5**