Monetary Integration in Africa: Gains, Risks, Issues and Some Evidence from Africa

SUMMARY OF SPEECH TO THE ASSOCIATION OF AFRICAN CENTRAL BANK GOVERNORS' SYMPOSIUM

Peter Sinclair

August 20, 2003

Kampala, Uganda

1. *Arguments in favour of monetary union:*

- Saving in currency conversion costs in all trade with partners. This is a real resource saving
- Less foreign exchange rate uncertainty, hence maybe a boost to trade
- Gains from trade creation between partners
- Thicker financial markets within the union than inside each member
- Likely increase in potential competition inside member countries, real and financial
- As a result of previous four, some possibility of (persistently) faster economic growth
- Saving in foreign exchange reserves
- Economies of scale in central banking: opportunity for real resource saving
- Opportunity for improvements in monetary policy
- Possibility of earning overseas seignorage
- Might stimulate (intra-union and even broader) factor movements

2. Arguments against monetary union:

- Members' ideal inflation rates could differ
- Possibility of asymmetric shocks
- Difficulties in harmonizing/controlling fiscal policies of member governments
- Possibility of trade diversion
- Changeover costs
- Possible dispute over seignorage apportionment
- Issue of how to choose initial parities for legacy currencies
- Uncertainty aversion
- Reduced opportunities for currency substitution could make policy less time-consistent
- Short of political federation, difficulty of establishing accountability for supra central bank
- Possibility of intra union factor immobility

3. Factors making a partner promising or unpromising:

- Trade: actual and potential *large (neighbours?)* **(small)**
- Shock correlations *large* **(small)**
- Optimal inflation (and past actual inflation) *close* **(disparate)**
- Political systems *stable and/or similar* **(unstable or dissimilar)**
- Members willing to grant the supra central bank *similarly large* (**dissimilar and/or small)** degree of independence
- Public debt levels *small and similar* **(large or uneven)**
- Statistics and supervision arrangements *easily harmonized* **(different and hard to harmonize)**
- Income per head *similar and growing at similar rates* (**different and growing at different rates)** , so Balassa –Samuelson effects *small* **(serious)**

4. Case for monetary union strongest when:

- Countries small (or, perhaps, all but one small, with one natural "leader")
- Countries are very open to trade
- Export bases of members are diversified
- Individual firms and households can insure themselves easily against shocks
- Factor mobility within the union is high

- Previous inflation records very similar

5. ***Some issues for the bloc***

- External exchange rate regime: fix, float, what?
- Selecting starting parities
- Controlling member governments' fiscal policies
- Setting the common explicit or implicit inflation target; and defining it
- Linking/deepening/establishing financial markets
- Common statistics and supervision arrangements
- Establishing common policy to rescues, emergency liquidity assistance, deposit protection
- Establishing common policy towards overseas banks
- Accountability
- How to reach decisions – one vote per member, weighted by population, weighted by GNP?
- Establishing the way unified monetary policy will work

6. ***Some evidence from Africa: factors distinguishing members of the CFA and Rand areas from other countries (results from current work in progress by BOJAN MARKOVIC and PETER SINCLAIR)***

- *Effects on trade: for small countries, monetary integration (MI) has a small negative effect, which is falling over time, and will go positive on current trends within two decades; for more populous countries has a relatively more favourable effect*
- *Effects on the level of real income per head: significantly positive, and significantly increasing*
- *Effects on the growth rate of real income per head: significantly positive, but falling slightly over time, and, on current trends, will vanish by about 2045*
- *Effects on the variance of inflation over time: slightly positive level effect, which falls to near vanishing point when interaction between dummy and mean inflation rate is allowed for.*