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Abbreviations

AfDB	African Development Bank
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest
BEAC	Banque des Etats de l'Afrique Centrale
CEMAC	Communauté Economique et Monétaire de l'Afrique Centrale
CFA franc zone	Coopération Financière en Afrique Centrale / Communauté Financière Africaine
CMA	Common Monetary Area
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
FDI	foreign direct investment
HIPC	heavily indebted poor countries
IFC	International Finance Corporation
GDP	gross domestic product
GNP	gross national product
IMF	International Monetary Fund
MDG	Millennium Development Goal
NEPAD	New Partnership for Africa's Development
ODA	official development assistance
REER	real effective exchange rate
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADCC	Southern African Development Coordination Conference
SDR	special drawing right
UN COMTRADE	United Nations Commodity Trade Statistics Database
UN/DESA	United Nations Department of Economic and Social Affairs
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UEMOA	Union Economique et Monétaire Ouest Africaine
WAMZ	West African Monetary Zone
WTO	World Trade Organization

REGIONAL COOPERATION AND INTEGRATION IN SUB-SAHARAN AFRICA

Martina Metzger

Abstract

Africa has a long tradition of regional cooperation, its trade and monetary integration schemes being the oldest in the developing world. This paper analyses the state of regional integration with respect to trade and financial relations in selected regional schemes in Central, Southern and West Africa. The paper concludes that in particular regional monetary integration offers advantages in terms of monetary stability, growth, competitiveness, deepening of financial markets and ownership compared with an indiscriminately integration of individual countries into the global economy. Thus, great significance must attached to cooperation between Member States. Although trade and financial integration can be mutually enforcing, a minimum level of regional activities is required to set this process in motion. Until the necessary threshold is achieved, Member States have a vital role in organizing and delivering regional activities, e.g. the development of bond markets or the promotion of production networks.

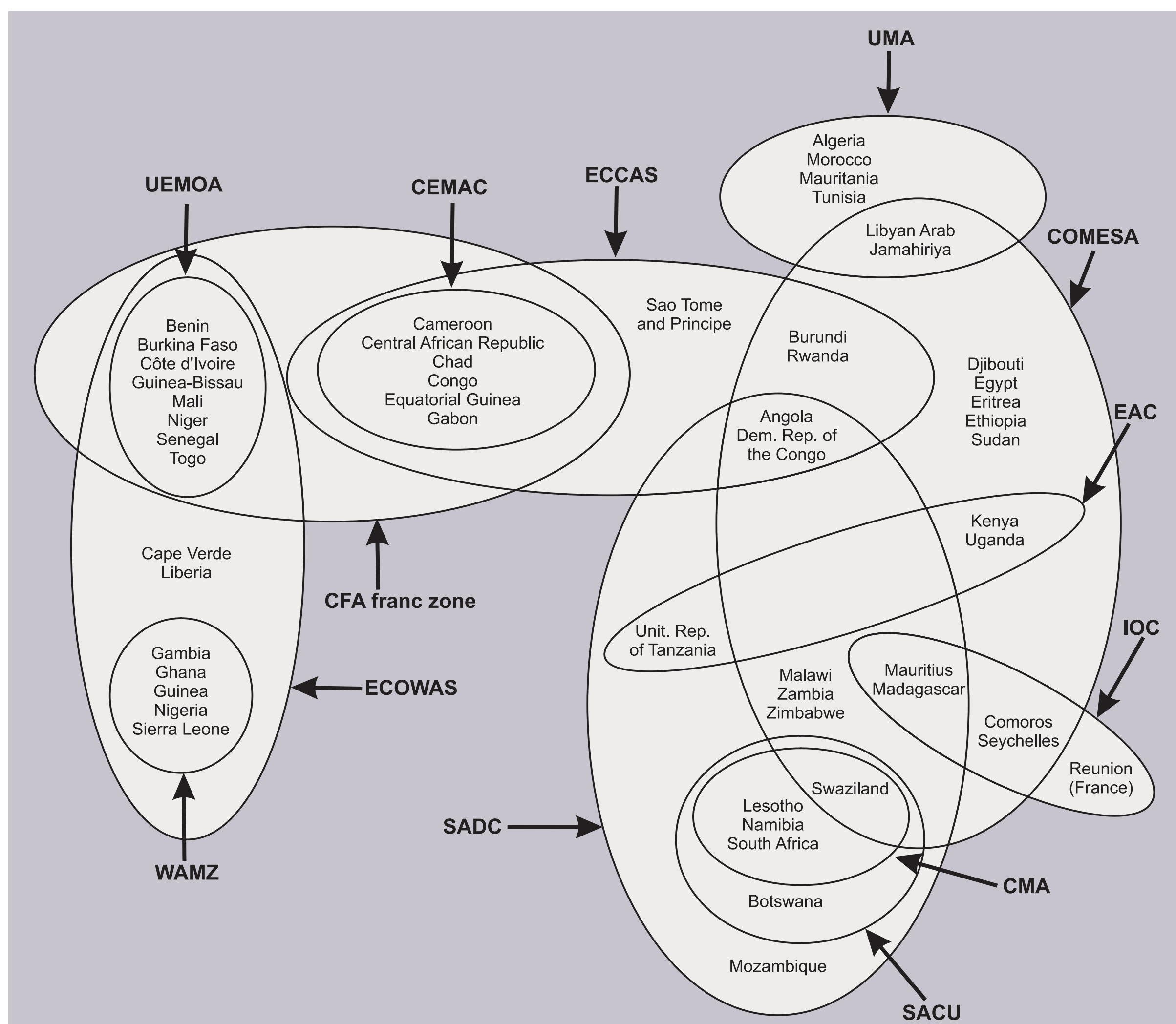
I. INTRODUCTION

Africa has a long tradition of regional cooperation, its trade and monetary integration schemes being the oldest in the developing world. Since the beginning of the 1990s, African regional cooperation has been revitalized due to two main developments. First, the abolition of the apartheid regime in South Africa began a normalization of political and economic relationships in Southern Africa which led to a deepening of already existing regional integration. Second, with the transformation of the Organization of African Unity into the African Union and the launching of the New Partnership for Africa's Development (NEPAD) initiative in 2001, the old idea of a common African currency has been revitalized. NEPAD considers regional economic communities as building blocs for pan-African cooperation and integration (NEPAD 2002); a process which would enlarge already existing subregional groups and finally result in a pan-African political and economic area with an African Parliament, an African Central Bank, an African Monetary Fund and a common African currency.

The purpose of this paper is to qualitatively assess the contribution of cooperation between Member States to regional integration and development. The two leading questions underlying this paper are: First, to

Figure 1

Africa: Overlapping membership in regional integration groups



***Source**:* UNCTAD (2007a: 99).

what extent has regional integration actually developed? To this end, selected integration schemes in Southern, Central and West Africa will be highlighted; thereby the paper focuses on the evolution of trade and financial relations between member countries. Second, whether and to what extent did regional cooperation contribute to economic development in terms of growth and monetary stability? To answer this question, the development of exchange rates and interest rates, but also the ongoing process of monetary and fiscal convergence will be analysed.

With regard to Southern Africa, attention is first given to the unusually long-standing monetary coordination efforts of the Common Monetary Area (CMA). The members of the CMA are also part of the oldest existing customs union in the world, the Southern African Customs Union (SACU), which succeeded the Customs Union, arrangement dating back already to 1910. All SACU countries are also members of the Southern African Development Community (SADC), comprising 14 members, which has launched an ambitious programme for regional integration towards a common market and monetary union.

The two major groupings of the CFA franc zone in francophone Africa are presented next. The CFA franc zone is the oldest North-South monetary arrangement, which is deeply embedded in the colonial past.

The longest unaltered nominal exchange-rate peg with the euro (formerly with the French franc) links the Communauté Economique et Monétaire de l'Afrique Centrale (CEMAC) and the Union Economique et Monétaire Ouest Africaine (UEMOA) with France. Thus, in contrast to the CMA, which applies a free float vis-à-vis extraregional currencies, CFA franc Member States have not only abolished the foreign exchange market between each other, but also apply a fixed parity to an international currency.

Finally, the Economic Community of West African States (ECOWAS) is reviewed. Regional integration within ECOWAS, with its economic heavyweights of Côte d'Ivoire and Nigeria, each belonging to two different sub-groupings, has been stagnating for most of its 30 years of existence; however, regional cooperation has gained momentum since the turn of the millennium and a currency union is envisaged.

Availability of comprehensive data for some African countries is a problem; in general, data on intraregional migration and remittances are fairly limited, and data on bilateral trade flows within SACU is moderate. A second factor restricting empirical research is the volume of unrecorded activities, in particular for trade and migration. Historically, cross-border activities have been high in Africa, and informal movements of labour and goods are still significant. Thus, the official figures used in this paper are likely to underestimate the actual level of trade and migration activities. A third factor making an empirical-based argumentation difficult is the widespread phenomenon of overlapping memberships in various regional blocs in Africa (fig. 1). Thus, it is not always possible to definitely attribute certain integration effects to coordination activities within one specific integration scheme.

II. REGIONAL COOPERATION IN SOUTHERN AFRICA

A. The Common Monetary Area

1. Objectives and instruments

The Common Monetary Area (CMA) is based on an agreement signed in 1986 between Lesotho, South Africa and Swaziland (Namibia joined in 1992).[1] The agreement formalized the existing, de facto monetary integration, as the South African currency had been serving as legal tender in Lesotho and Swaziland since the 1920s. Hence, unlike most other regional cooperation schemes, the creation of the CMA was not accompanied by far-reaching, long-term objectives. The CMA agreement provides for fixed exchange rates among its members and common bloc floating vis-à-vis other currencies, as well as intraregional capital account liberalization, the distribution of seigniorage and intraregional financial transfers. Both the Lesotho loti and the Namibian dollar are pegged at par to the South African rand; and although Swaziland legally withdrew from this commitment in 1986, it is still honouring its de facto. Botswana participated in the CMA negotiations in the 1970s, but it opted out in favour of a managed floating of its currency, the pula. Since then, Botswana has pegged the pula to a trade-weighted basket of rand and SDR whose specific composition is not disclosed; however, the South African rand has a large weight in the basket. Each of the four members has its own central bank, which issues its currency and is formally responsible for monetary policy within its respective country.[2] However, as the rand functions as the regional anchor

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[1] The arrangement between Lesotho, South Africa and Swaziland was initially known as the Rand Monetary Area, which came into effect in 1974. For a more in-depth discussions, see Central Bank of Lesotho (2006a); Metzger (2006); Kalenga (2005); Grandes (2003); van Zyl (2003); Okeahalam (2002); Bank of Namibia (2001); Central Bank of Swaziland (2001) and van der Merwe (1996).

[2] Botswana and Swaziland began to issue their own currencies, the pula and the lilangi in 1974, and Lesotho issued the loti in 1980, while the Namibian dollar came into existence only in 1993, following the country's independence in 1990.

currency, the South African Reserve Bank determines de facto monetary policy for the CMA member countries via its interest rate policy.

Under the CMA arrangement, South Africa shares the seigniorage of the rand with Lesotho and Namibia. Although the South African rand still serves as legal tender in both these countries, none of the other currencies are legal tender in South Africa or commonly used there.[3] Swaziland does not participate in the seigniorage as it abolished the legal status of the rand in 1986, although in practice, the South African currency is still widely used. Another important element of the arrangement is that the South African Reserve Bank acts as a lender of last resort for Lesotho and Namibia with a view to ensuring financial stability in the CMA. Moreover, member countries can draw on a pool of foreign exchange reserves that is managed by the South African Reserve Bank. Lesotho, Namibia and Swaziland may hold additional foreign exchange for direct and immediate needs, of which up to 35 per cent may be held in currencies other than the South African rand. Their central banks and authorized dealers have free access to the foreign exchange market in South Africa. Finally, while there are no restrictions on capital movements within the CMA, a common exchange control system vis-à-vis the rest of the world is administered by the South African Reserve Bank in cooperation with the central banks of the other members.

The only intraregional institution, apart from a technical committee, is the Common Monetary Area Commission. It is composed of one representative and advisers from each Member State, and provides a formal consultation mechanism on monetary and financial policies. It meets prior to the Monetary Policy Committee of the South African Reserve Bank, which determines interest rates for South Africa and, via the peg, also for the other CMA countries. In 2005, a study under the auspices of central bank governors of the region discussed costs and benefits of a common central bank for the CMA countries. However, no decision has yet been taken, and it is likely to depend on the performance of the common institutional structures recently created in SACU (discussed below).

2. Intraregional trade and financial relations

Since 2000, the composition of CMA exports has shifted towards manufactures and more technology-intensive products (fig. 2). In 2005, manufactures accounted for around 70 per cent of intraregional exports and for two thirds of all CMA exports to Africa. The share of CMA manufactured exports in total exports to developing countries and to the world as a whole is slightly lower. The stability of this share since 2000 indicates a successful technological upgrading of exports. Rising world demand and prices for the region's considerable mineral exports have generated a tendency towards a rise in the share of primary products in the total exports of most developing countries. In contrast, CMA countries were able to increase their manufacturing exports in parallel with their exports of primary products so that the respective shares have remained constant.

Exports from all CMA members, with the exception of Swaziland, are overwhelmingly directed to the rest of the world, in particular the EU and the United States. With regard to imports, however, Lesotho, Namibia and Swaziland are highly dependent on South Africa, which accounts for 70 per cent or more of each of these countries' total imports (Metzger, 2006: 52). High imports from South Africa are induced by its higher industrial level and the fiscal regime of SACU (see below). Since the three smaller CMA members are net exporters to the rest of the world and net importers from South Africa, their export revenues are mainly in foreign exchange other than rand, while their imports are invoiced in rand. Given that there is no exchange rate risk due to the peg and liberalized capital movements, this favourable currency mismatch rules out the risk of balance-of-payments crises in Lesotho and Namibia, and to some extent also in Swaziland. On the other hand, from the point of view of South Africa, which accounts for

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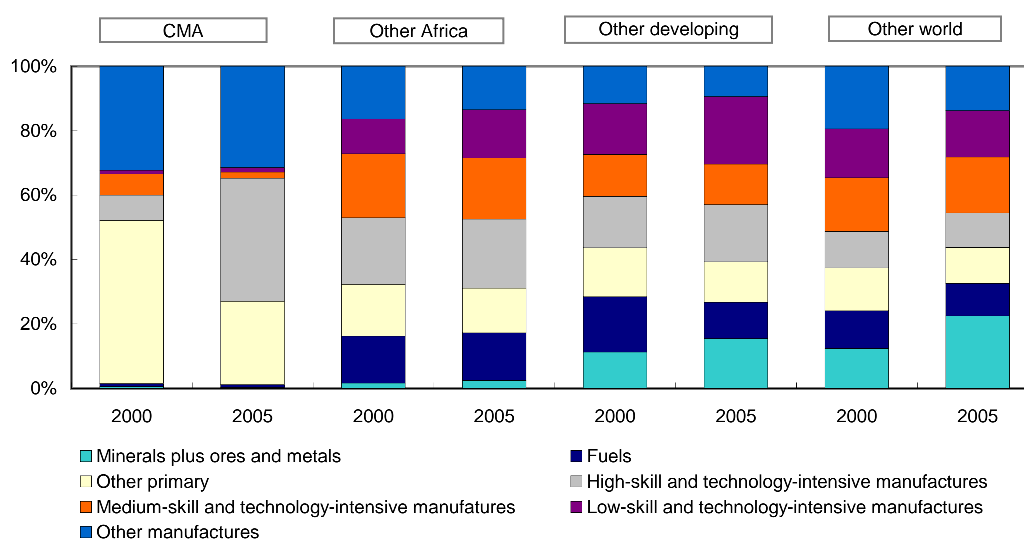
[3] However, there is anecdotal evidence that the currencies of the smaller CMA members are used within South African border areas (Foulo, 2003 and van Zyl, 2003).

Figure 2

CMA: Export structure by broad product category, 2000 and 2005

(Per cent)



Source: UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

over 95 per cent of regional GDP, the market share of goods and services from and to Lesotho, Namibia and Swaziland is marginal (UNCTAD, 2006a).

Due to the currency peg and to instruments akin to those of a monetary union, the financial sector within the CMA is highly integrated. However, financial relations are organized in a hub-and-spoke system both in terms of banking institutions and their clients, with South Africa at the centre. The banking sector, in particular, which accounts for a major part of the financial sector, is highly concentrated in terms of ownership. The South African banking sector is dominated by four South African commercial banks with a combined market share of about 90 per cent. A similar concentration exists in Lesotho, Namibia and Swaziland, the only difference being that ownership of the major banks is mainly South African.[4] A capital flows survey conducted by the Central Bank of Lesotho (1996) revealed that one quarter of all customers of commercial banks in that country also had bank accounts in South Africa, and that more than 40 per cent of households intended to open such accounts; another 20 per cent of domestic firms and households disclosed that they were holding financial assets in South Africa. Although the three countries might find it difficult to issue bonds or raise loans in domestic currency at home due to the low liquidity of their financial markets, they have free access to the South African money and capital market, where they are able to issue bonds and raise loans denominated in rand.

[4] The South African Exchange Control Regulations even state that “Namibia, Lesotho and Swaziland should be treated as part of the domestic territory and not as foreign” (*Orders and Rules under the Exchange Control Regulations,* 1998), Section Instructions, as published in Government Notice R1112 of 1 December 1961 and amended up to Government Notice R. 791. *Government Gazette* No. 18970, 5 June 1998. See also Okeahalam, 2002. As a result of these structures, the banking sector in all CMA countries complies with international banking standards and regulations.

On the other hand, South Africa is the biggest foreign investor in its CMA partner countries.[5] South African FDI in the region is mainly in infrastructure, mining and financial services (Kalenga, 2005: 29). One major infrastructure investment is the Lesotho Highland Water Project, a joint venture of the Governments of Lesotho and South Africa, which involves the building of dams and water tunnels to transport water to industrial areas in South Africa. Lesotho is guaranteed regular revenues in the form of royalties from this project, whether or not the water is delivered. Yet, overall, South Africa is a net debtor vis-à-vis the other member countries of the CMA (South African Reserve Bank, 2007). Net liabilities are due to deposits in the South African banking sector, as in the case of Lesotho and Swaziland, or due to holdings of South African debt securities by Namibian investors.

3. The role of cooperation for regional integration

It is widely acknowledged that CMA membership has resulted in a process of convergence both in monetary and real terms. With regard to monetary convergence, the most important is reducing inflation to the South African level. The central banks of the three smaller member economies adjust their interest rates to defend the nominal exchange-rate peg and thereby “import” price stability. Although the deepening of the financial sector in Lesotho, Namibia and Swaziland is limited due to absolute small market size,[6] since 2000 the latter two middle-income countries have either the same or, even slightly lower, nominal short-term central bank interest rates than that prevailing in South Africa, while Lesotho’s nominal interest rate level has been converging to the South African benchmark only since 2005 (table 1).

Short-term real interest rates within the CMA are positive in the range of 4 per cent to 6.5 per cent since 2000 (table 2). During the 1990s short-term real interest rates of the leading currency display a high variety between 0.3 per cent (1992) and 12.4 per cent (1998). Low real interest rates in the first half of the 1990s are due to the then still existing dual exchange rate regime in South Africa, which separated current account and capital account transactions; with the unification of the foreign exchange market in 1995 and the steady dismantling of capital controls the task to fine-tune capital flows passed on to the South African monetary policy and interest rates on average increased. However, jumps in South African short-term real interest in 1995/1996 and 1998 are a reaction on financial crises in Mexico and South-East Asia.

Namibia (with the exception of one year) and Swaziland have throughout the new millennium lower real interest rates than their anchor currency area. This is exceptional; usually, the country which pegs its currency to a key currency has to keep up a positive real interest rate spread to defend the peg and thereby has to restrain domestic investment. One reason for the negative real interest rate spread could be the bilateral character of the monetary agreement with South Africa, including its lender of last resort of function. Another reason might be that Namibia and Swaziland display a limited liquidity with regard to extraregional capital flows; thus, their domestic financial markets ‘lack’ the sufficient volume of international financial flows which only could destabilize the regional peg. These factors, the bilateral character of the agreement and the absence of destabilizing external capital flows, have allowed an uninterrupted development of domestic financial markets. One remarkable result is the lengthening of maturities; average maturity of domestic debt is in Namibia higher than in Mexico and in South Africa and Swaziland higher than in Brazil (Kahn, 2005: 81). On the other hand, Lesotho’s real interest rates exceeded in 6 of the 7-year period since 2000 the South African level and displayed a markedly higher variability due to the variability of its inflation rates and nominal short-term interest rates.

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[5] The FDI stock owned by South African investors in 1998–2002 was equivalent to 5 per cent of the GDP of Swaziland, 10 per cent of that of Namibia and 12 per cent of that of Lesotho (Kalenga, 2005: 14).

[6] However, compared to the average financial sector depth in sub-Saharan Africa measured as the ratio of M2 to GDP Namibia is an out-performer, while Lesotho hits the average (Kahn, 2006: 80).

Table 1

SADC: Nominal short-term interest rates[a], 2000–2006

(Per cent)

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
SADC	**40.7**	**42.4**	**30.2**	**48.6**	**29.2**	**68.4**	**56.9**
SACU	**12.7**	**11.1**	**14.2**	**10.6**	**10.0**	**9.7**	**10.6**
Botswana	14.3	14.3	15.3	14.3	14.3	14.5	15.0
Lesotho	15.0	13.0	16.2	15.0	13.0	13.0	10.8
Namibia	11.3	9.3	12.8	7.8	7.5	7.0	9.0
South Africa	12.0	9.5	13.5	8.0	7.5	7.0	9.0
Swaziland	11.0	9.5	13.5	8.0	7.5	7.0	9.0
Non-SACU	**60.6**	**64.7**	**41.5**	**75.7**	**45.2**	**117.3**	**95.5**
Memo item:							
Non-SACU excluding Zimbabwe	**61.1**	**65.9**	**43.5**	**38.3**	**32.2**	**32.8**	**14.6**
Angola	150.0	150.0	150.0	150.0	95.0	95.0	14.0
Congo, Dem. Rep. of	120.0	140.0	24.0	8.0	n.a.	n.a.	n.a.
Madagascar	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Malawi	50.2	46.8	40.0	35.0	25.0	25.0	20.0
Mauritius	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Mozambique	10.0	10.0	10.0	10.0	10.0	10.0	10.0
United Republic of Tanzania	10.7	8.7	9.2	12.3	14.4	19.3	20.1
Zambia	25.7	40.1	27.9	14.4	16.7	14.8	8.8
Zimbabwe	57.8	57.2	29.7	300.0	110.0	540.0	500.0

Source: UNCTAD secretariat calculations, based on IMF, *International Finance Statistics* database; and Central Bank of Nigeria.

a End of the period.

Since the 1970s, there has been a clear trend towards business-cycle assimilation among CMA countries, indicating a process of real convergence. Variations in real GDP growth rates have been reduced, not only across CMA countries but also over time within each country (fig. 3).[7] Typically, it is intraregional trade flows that serve as the main transmission channel of real convergence in terms of GDP growth. In the CMA case, however, remittances from migrant workers appear to have played a more important role, in addition to financial flows. South Africa receives many migrants from CMA countries, especially in mining and agriculture. When the South African mining industry experiences growth, the demand for migrant workers increases quite rapidly; whereas in a downturn, such workers are dismissed, albeit with a time lag; they have only fixed-term labour contracts and temporary resident permits that will not be extended in a period of slowdown or recession. Reliable, comprehensive data on labour migration for all CMA countries are lacking, but empirical evidence suggests that Lesotho depends heavily on remittance inflows from South Africa. Although such inflows are not as important as they were in the early 1990s,

[7] Grandes (2003) provides an econometric estimate for the synchronicity of business cycles in Southern Africa. Jenkins and Thomas (1997) show a long-term convergence in GDP per capita over a 30-year period. However, neither of these studies takes into account the influence of labour migration and remittance flows.

Table 2

SADC: Real short-term interest rates, 1990–2006

(Per cent)

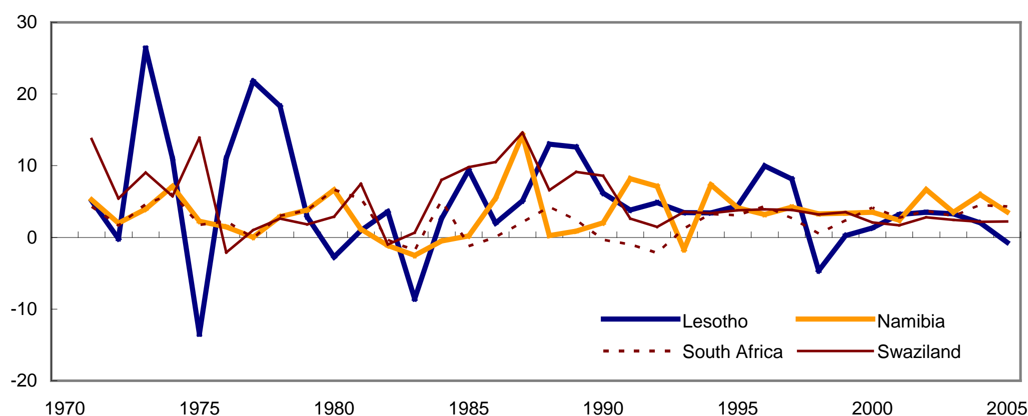
	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
SADC	**0.1**	**-126.0**	**-202.8**	**-120.5**	**-789.5**	**-70.1**	**-143.4**	**-5.5**	**8.7**	**-2.5**	**-15.7**	**-3.7**	**3.0**	**3.8**	**6.4**	**12.3**	**0.0**
SACU	**3.5**	**1.5**	**0.2**	**2.1**	**4.1**	**6.2**	**9.5**	**7.3**	**12.2**	**6.7**	**6.5**	**3.8**	**4.3**	**2.3**	**6.1**	**3.7**	**4.3**
Botswana	-2.9	-0.6	-2.3	-0.2	2.9	2.5	2.9	3.1	6.3	6.0	5.8	7.7	7.3	5.0	7.4	5.9	3.7
Lesotho	3.8	0.7	-3.1	2.8	5.2	5.8	8.1	7.2	11.3	11.2	10.5	6.1	3.7	7.7	8.0	9.6	4.7
Namibia	n.a.	8.6	-1.2	6.0	4.7	7.5	9.8	7.2	12.6	2.9	2.0	-0.1	1.5	0.6	3.4	4.7	3.9
South Africa	3.7	1.4	0.3	2.1	4.2	6.3	9.7	7.4	12.4	6.8	6.6	3.8	4.3	2.2	6.1	3.6	4.3
Swaziland	-1.1	4.1	4.4	-1.0	-1.8	2.7	10.4	7.9	10.5	6.1	3.8	2.0	1.8	0.6	4.1	2.2	3.9
Non-SACU	**-17.5**	**-865.8**	**-1210.4**	**-684.5**	**-4955.3**	**-427.7**	**-733.1**	**-52.1**	**-4.7**	**-36.4**	**-99.0**	**-29.1**	**-0.7**	**9.7**	**8.2**	**49.2**	**-14.6**
Memo item:																	
Non-SACU excluding Zimbabwe	**-24.1**	**-1373.7**	**-1590.1**	**-874.5**	**-6602.2**	**-541.7**	**-939.5**	**-68.9**	**-7.3**	**-45.8**	**-116.6**	**-31.2**	**14.6**	**18.8**	**25.3**	**39.6**	**3.0**
Angola	n.a.	n.a.	n.a.	n.a.	n.a.	-2512.2	-4144.0	-173.5	-49.4	-128.2	-175.0	-2.6	41.1	51.7	51.4	72.0	0.7
Congo, Dem. Rep. of	-36.3	-2099.4	-4074.2	-1891.9	-23628.1	-416.8	-379.0	-186.0	-7.1	-164.9	-430.0	-217.3	-1.3	-4.8	n.a.	n.a.	n.a.
Madagascar	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Malawi	2.1	4.8	-3.2	2.2	5.3	-33.1	-10.7	13.9	13.2	2.2	20.6	19.6	25.1	25.4	13.4	12.7	11.0
Mauritius	1.3	-1.5	5.4	-1.5	5.0	4.7	5.5	3.8	10.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Mozambique	n.a.	n.a.	n.a.	n.a.	6.6	3.4	-16.5	5.6	8.5	7.1	-2.8	0.9	-6.9	-3.6	-2.7	3.6	-3.3
United Rep. of Tanzania	n.a.	n.a.	-7.4	-9.1	30.4	23.9	-1.5	0.8	4.4	11.2	4.5	3.6	4.6	7.9	10.3	14.9	14.3
Zambia	n.a.	n.a.	-118.7	-110.8	-34.1	5.3	3.9	-6.7	n.a.	6.1	-0.4	18.4	5.7	-7.1	-1.3	-3.5	-0.3
Zimbabwe	-7.2	-4.0	-12.1	0.3	7.3	7.0	5.4	12.7	8.2	16.4	2.2	-16.2	-103.6	-65.0	-240.0	302.2	-516.7

Source: UNCTAD secretariat calculations, based on IMF, *International Finance Statistics* database; and *World Economic Outlook* database; and *UNCTAD Handbook of Statistics* database.
Note: Calculations based on the discount/bank rate (end of the period).

Figure 3

CMA: Real GDP growth, 1970–2005

(Annual change in per cent)



Source: UNCTAD secretariat calculations, based on *UNCTAD Handbook of Statistics* database.

they were estimated to constitute 20 per cent of that country's GNP in 2005 (Foulo, 1991; Central Bank of Lesotho 2005 and 2006b).[8]

Given the geographical context and the dominance of the South African economy in the region, regional integration between these four countries would most likely have occurred in some form even without formal regional cooperation agreements. As noted earlier, the CMA agreements formalized what was already a relatively high degree of integration. However, the formal agreements have allowed Lesotho, Namibia, and to a lesser extent, Swaziland to share the benefits of this integration along with the dominant economy in the subregion; to those benefits belong, as explained above, a lender of last resort, the seignorage, the common foreign exchange pool of the CMA and the unlimited access to the South African financial market. Moreover, without a formal agreement, these economies would most likely have experienced an uncontrolled process of "randization", similar to "dollarization" in Latin America or "eurozation" in many of the transition economies of Central and Eastern Europe. Such processes expose countries to the risk of serious liquidity crises.

Without the regulatory framework for monetary and financial relations created by the CMA agreements, the smaller countries would have been obliged to resort to restrictive monetary and fiscal policy to defend their currencies and check capital flight to South Africa, a policy that has proved harmful for development in many other developing and transition countries (UNCTAD 2006b, chap. IV). Furthermore, intraregional competitive devaluations are ruled out by the common bloc floating vis-à-vis the rest of the world. Thus, negative balance sheet effects for the rand-denominated debt of Lesotho, Namibia and Swaziland are structurally prevented. Consequently, the region displays an unusually high degree of monetary and

[8] Although not part of official CMA policy, immigration to South Africa from the other CMA countries is widely accepted. However, increasingly, labour migration has led to social friction between residents and migrants, to which the South African Government has reacted by tightening immigration laws. For more details and background information on migration issues, see the website of the Cape Town-based South African Migration Project (SAMP) at: http://www.queensu.ca/samp/. Founded in 1996, SAMP is an international network of organizations that aims at raising awareness of the migration-development link within Southern African countries.

exchange-rate stability, which has allowed Lesotho, Namibia and Swaziland to gradually grow out of a net debtor status to one of net international creditor.

B. The Southern African Customs Union

1. Objectives and instruments

The four CMA members together with Botswana constitute the Southern African Customs Union (SACU), established in 1969. In 2002, a considerably revised agreement was concluded, which entered into force in 2004. The original objective of the customs union was to facilitate the collection and redistribution of revenues from customs duties (Kalenga, 2005). The key instrument of SACU is the application of a common trade policy, including customs duties, excise duties, trade remedies and rules of origin, until recently set unilaterally by the South African Department of Trade and Industry. As the SACU agreement also contains provisions to encourage the development of the less advanced members and diversification of their economies, two more instruments were incorporated into the agreement (SACU Agreement, 1969). South Africa has made compensatory payments to the governments of the other four SACU Member States through a common revenue fund, which pools all tariff revenues of the five countries. On the other hand, the agreement contains provisions for the use of instruments in support of industrialization and diversification, taking into account the specific circumstances of the smaller and less advanced Member States and their needs in terms of financial support and development policy space.

Distinct from the practice in other customs unions, the distribution of customs duties among member countries has been based on their respective shares in both extraregional and intraregional imports. While South Africa has a much higher propensity for extraregional imports than the other SACU members, the latter have a higher propensity for intraregional imports. For example, in fiscal year 2005/2006 South Africa accounted for 85 per cent of total SACU imports, whereas only 12 per cent of intra-SACU imports went to South Africa (Flatters and Stern, 2005: 2f). Thus, under the SACU agreement of 1969, the smaller SACU members benefited from a more than proportional participation in the revenue. The rationale for this redistribution was to compensate the smaller economies for the disadvantage of entering into a customs union with an economically advanced partner (e.g. polarization and price-increase effects), and for the loss of some fiscal and policy autonomy (Hansohm and Adongo, 2006; Flatters and Stern, 2005; Kalenga 2005). Moreover, the 1969 agreement allowed the smaller SACU members to protect their nascent industries by imposing restrictions on certain imports, whether from South Africa or non-SACU countries.[9] With the new SACU agreement of 2002, the revenue-sharing formula for the smaller Member States has become less favourable, while the instrument for the protection of infant industries has been retained. The 2002 agreement brought a number of institutional reforms. It is based on a one-country, one-vote formula and major decisions of the various intergovernmental and regional institutions require consensus. A dispute settlement system has been introduced, with an ad hoc tribunal that is supposed to balance different interests in case of conflict. Implementation of the agreement, the performance of the new regional institutions and the way interests are reconciled will certainly provide a benchmark for both the CMA and SADC integration processes.

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[9] All SACU members are WTO members. In a 2003 report on SACU, the WTO secretariat expressed some concerns relating to the imposition of duties using a formula based on reference prices, which may undermine SACU countries' compliance with their tariff bindings and with their obligations under the Customs Valuation Agreement. Concerns were also expressed about differences in tariff bindings among SACU countries, and about the extensive use of anti-dumping and other contingency trade remedies by South Africa on behalf of the customs union (WTO secretariat, 2003: ix).

2. Intraregional trade and financial relations

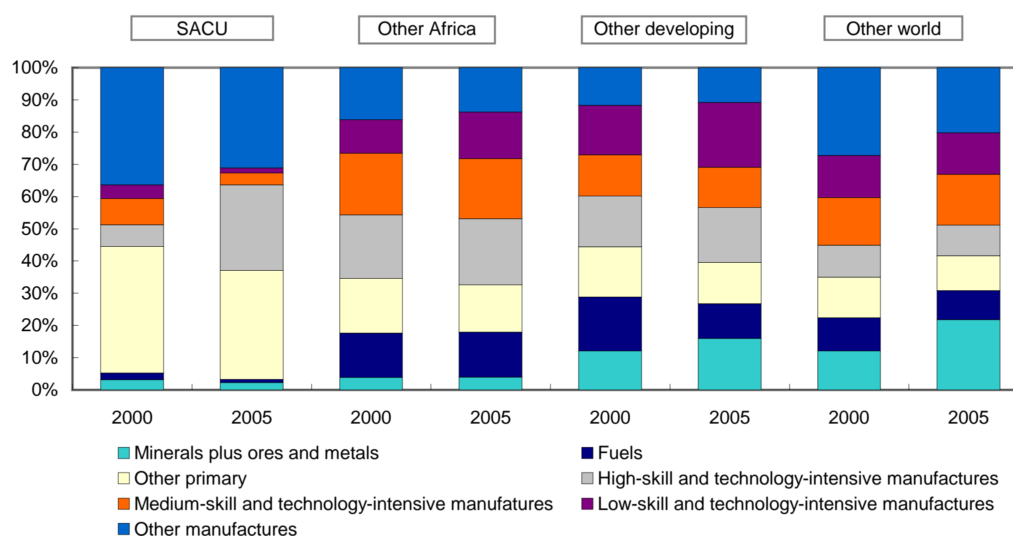
The SACU trade pattern is similar to that of the CMA, although Botswana's share of intraregional exports and imports is lower than that of Lesotho, Namibia and Swaziland. Moreover, its exports comprise fewer manufactures and technology-intensive products than those of its SACU partners, which is reflected in the lower share of those products in total SACU exports compared to CMA exports (fig. 4). Intraregional exports in SACU consist mainly of manufactures from South Africa. According to several observers, this is due not only to the relative size of the South African manufacturing sector, but also to the protection of the South African market by restrictive local content requirements within SACU on the one hand, and South Africa's granting of unilateral tariff rebates on a number extraregional imports on the other (Gaomab and Hartmann, 2006: 54–55; Kalenga, 2005: 19–20; WTO secretariat, 2003: x). South Africa's protection of certain industries, such as clothing and textiles that are important for Lesotho and Namibia, or the automotive industry that could have become important for Botswana, has limited the ability of the smaller SACU countries to take advantage of the regional market (Gaomab and Hartmann, 2006: 54–55; Kalenga, 2005: 19–20). However, these countries have rarely used the policy space at their disposal in support of industrialization, and consequently have not followed a dynamic strategy of creating manufacturing capacities and actively penetrating the South African market.

Botswana's financial sector is less interlinked with the financial sector of its neighbouring countries of the CMA than those among each other. Both supply of and demand for tradable financial assets are limited in Botswana. The borrowing requirements of Botswana's public sector have been small due to its recurrent fiscal surpluses. Moreover, demand for its most important short-term assets, such as the Bank of Botswana Certificate, is restricted to residents. Other obvious disadvantages for Botswana of not being a member of CMA are higher real interest rates (table 2), higher capital adequacy ratios, a greater proportion of non-performing loans, and larger net interest margins and service fees in the banking sector (Baumgartner and Bio-Tchané, 2007; Central Bank of Lesotho, 2003).

Figure 4

SACU: Export structure by broad product category, 2000 and 2005

(Per cent)



Source: UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

3. The role of cooperation for regional integration

Effective regional integration within SACU has been limited due to its mainly fiscal character and the economic dominance of South Africa within the region. The development of a regional network of industries with forward and backward linkages between member countries as a preparatory step for the creation of a common market did not figure prominently on the original agenda of the customs union. The new SACU agreement of 2002 calls for the development of a common industrial policy and for cooperation in agriculture and competition policy, but so far few concrete steps appear to have been taken in this direction.

Although South Africa dominates economic relations within SACU, the other members have nevertheless benefited from a highly redistributive revenue-sharing formula. In 2002, public sector revenues from SACU import tariffs amounted to 4.5 per cent of GDP in Botswana, 7.8 per cent in Namibia, 12.9 per cent in Swaziland and 19.8 per cent in Lesotho, compared to only 1.2 per cent in South Africa (Flatters and Stern, 2005; Iyambo et al., 2002). However, the SACU agreement of 2002 resulted in a considerable reduction in the shares of Botswana, Lesotho and Namibia, the reduction amounting to 25 per cent for the latter (Gaomab and Hartmann, 2006). Nevertheless, the redistributive effect is still considerable, albeit weaker than in the original agreement.

C. The Southern African Development Community

1. Objectives and instruments

The Southern African Development Community (SADC) was founded in 1992 as successor to the Southern African Development Coordination Conference (SADCC). It comprises 14 members: in addition to the five SACU countries, the other nine members are: Angola, the Democratic Republic of the Congo, Madagascar, Malawi, Mauritius, Mozambique, the United Republic of Tanzania, Zambia and Zimbabwe.[10] SADC Member States consider regional integration as a means of alleviating poverty and redressing regional imbalances. With a trade protocol that came into effect in 2000 and a memorandum of understanding on macroeconomic convergence, an ambitious programme for regional integration towards a Free Trade Area (2008), a customs union (2010), a common market (2015) and finally a monetary union (2016) and the introduction of a common currency (2018) has been initiated.

SADC Trade Protocol envisages zero tariffs on 85 per cent of intraregional trade by 2008. The agreed tariff phase down seems to be sufficient so that the Free Trade Area can be officially launched in August 2008 as scheduled.[11]. SADC liberalization agenda adopts an asymmetric approach that takes into account the ability of the economically stronger members, such as South Africa and its SACU partners, to liberalize faster than the economically more vulnerable members. However, most products that have some intraregional trade potential, such as consumer products (e.g. beverages, tobacco, leather and furniture, foodstuffs, textiles and clothing), have been declared import-sensitive and their trade liberalization has been postponed (Kalenga, 2005). Furthermore, widespread use of non-tariff barriers between SADC countries has limited the trade-increasing impact of tariff reductions.

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[10] Nine of the 14 members of SADC were founding members of SADCC that was formed in 1980. The objective of SADCC was to increase self-reliance so as to reduce dependence on the apartheid regime of South Africa. It therefore focused on cooperation for food security and the development of a common transport and communications infrastructure and agricultural research, rather than on harmonizing intraregional policies on industry, trade or finance. The transformation of SADCC into SADC was accompanied by institutional reform which somewhat strengthened the role of the SADC secretariat in the design of sectoral cooperation activities.

[11] See Press Statement on the Outcome of the 6th Meeting of the SADC Ministerial Task Force of 13 July 2008 (http://www.sadc.int/index/browse/page/56).

The Committee of Central Bank Governors of SADC, established in 1995, has been active in its surveillance over monetary and fiscal policy. It has initiated processes that should lead not only to greater macroeconomic stability in the region and the development of regional financial markets, but also to a more conducive environment for intraregional trade flows. For example, considerable efforts have been made to harmonize national payments and clearing and settlement systems, and to define a regional approach to cross-border payments (Committee of Central Bank Governors in SADC, 2006; SADC secretariat, 2006 and SADC Payment System Project, 2006). In August 2006, the Protocol on Finance and Investment was signed, which seeks to harmonize financial and investment policies. It aims at facilitating cross-border flows and preventing uncoordinated changes in investment policies of member countries in their efforts to attract FDI through fiscal and other incentives (SADC, 2006). Thus, effective implementation of the protocol would prevent a fiscal race to the bottom.

Furthermore, SADC is working towards full currency convertibility between Member States to enable liberalization of capital and financial account transactions (SADC, 2006: Annex 4, Art. 2–4). Regional coordination of the financial sector with regard to banking institutions, non-banking financial institutions, stock exchanges and development finance institutions is also envisaged. The Protocol on Finance and Investment establishes committees on tax, exchange control and payment settlement issues. However, it provides member countries with considerable discretionary powers. For example, while the Protocol requires Member States to accord equal treatment to intraregional and extraregional investors, it allows discrimination in the form of preferential treatment for certain investments and investors in order to achieve national development goals (SADC, 2006, Annex 1, Articles 6 and 7). At this stage of regional integration, the strength of the Protocol is that it increases coherence in regional policies as it brings together finance- and investment-related issues, which so far had only been discussed or developed separately.

2. Intraregional trade and financial relations

SADC intraregional exports increased fourfold between 1990 and 1995, and almost doubled between 2000 and 2005 (IMF, 2006). The sharp rise in the first half of the 1990s reflected a normalization of regional economic relations in the post-apartheid era, whereas the latter increase has been attributed to accelerated trade liberalization within SADC (AfDB, 2004). However, the share of intraregional exports in total exports has risen only slightly since 2000.[12] The sharp rise in commodity prices, in particular of minerals and oil products, has boosted the total export value of goods from SADC countries and increased the shares of these products in their total world exports (fig. 5). Even so, intraregional trade shares have remained stable, implying further progress in regional trade integration. Between 70 and 80 per cent of SADC intraregional exports originate from South Africa and the other SACU members. In the period between 1992 and 2000, SACU countries as a group were even able to increase their market share in SADC (AfDB, 2004: 9). The trend of technological upgrading in intraregional exports is thus similar in SADC and SACU (fig. 4 and 5). By contrast, SACU countries account for only a small share of SADC's intraregional imports, not exceeding 15 per cent (AfDB 2004). Hence, SACU countries realize a significant trade surplus with non-SACU members of SADC.

With the proposed establishment of a free trade area in 2008 and a customs union in 2010, there are increasing concerns that investment and industrial development might become concentrated even more in SACU, and in particular in South Africa, thereby strengthening its already dominant position in the

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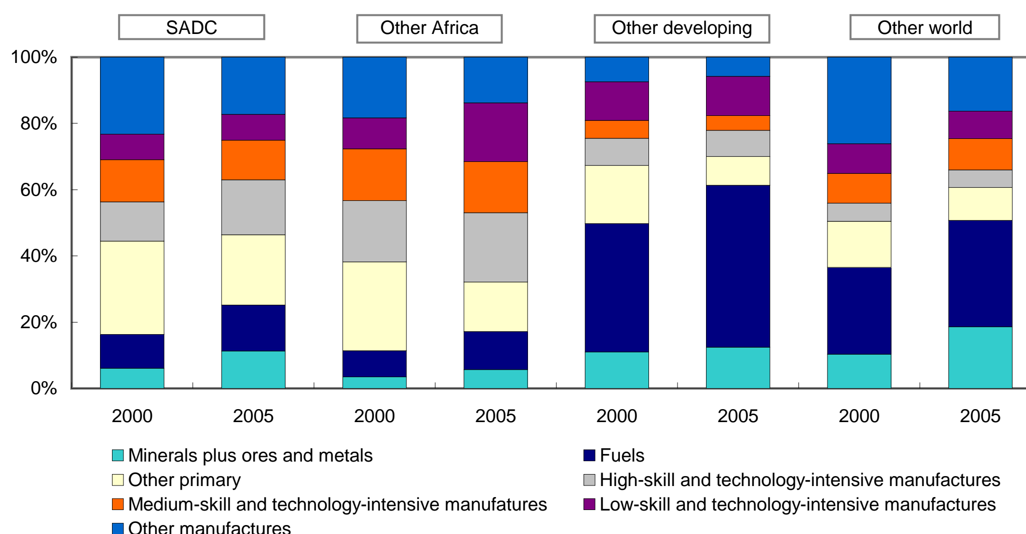
[12] In 1998 and 1999, the share of intraregional exports in total exports rose considerably, but this increase was mainly due to declining exports from South Africa. Although the rand depreciated in both years by a two-digit rate, this was insufficient to compensate for the loss of competitiveness of South African exports caused by the huge devaluations of the currencies of South-East Asian countries during the Asian financial crisis in 1997 and 1998. Thus, total absolute exports of South Africa and therefore of SADC declined, which induced a (mere statistical) rise in the share of intraregional exports in these years.

Figure 5

SADC: Export structure by broad product category, 2000 and 2005

(Per cent)



Source: UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

region (Visser and Hartzenberg, 2004: 17). The three major intraregional exporters in SADC are already now all SACU members: South Africa, Swaziland and Namibia. Primary commodities dominate the export structure of Namibia, accounting for 50 per cent of its total exports, while they constitute 25–30 per cent of the share of regional exports of South Africa and Swaziland.[13] However, while the share of primary commodities in South African exports has risen since 2000, it has fallen considerably in the case of Swaziland in favour of skill- and technology-intensive products, which have come to dominate Swaziland's exports.

For some SADC countries, in particular Mozambique, Zambia and Zimbabwe, SACU Member States are not only the major sources of their imports, but also account for 30 per cent, 25 per cent and 20 per cent, respectively, of their total exports (AfDB, 2004). These strong trade links are, however, due mainly to *bilateral* trade agreements between these countries and South Africa rather than to trade liberalization within SADC (Visser and Hartzenberg, 2004: 8–10).

Financial relations between SACU and non-SACU SADC Member States are mainly limited to FDI flows and display a similar pattern as within the CMA and SACU. In seven SADC countries, South Africa is the leading source of FDI, ahead of Europe, North America and Asia; and in five of these seven countries more than 50 per cent of all FDI originates from South Africa (UNECA, 2006a). Since many affiliates of South African firms use most of their inputs from South Africa, the increase in intraregional trade in SADC is partly linked to South African FDI in the region, which, in principle, could lay the basis for the development of regional production networks (Visser and Hartzenberg, 2004: 13f).

[13] UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

3. The role of cooperation for regional integration

Apart from Zimbabwe, which has exhibited severe monetary instability and fiscal disorder, a process of monetary convergence can be observed among SADC members, again led by SACU countries (Bank of Namibia, 2006; Banço de Moçambique, 2005; Bank of Mauritius, 2004). Since 2000, inflation rates and nominal short-term central bank interest rates (table 1) have been converging towards a lower level. However, real short term interest rates within SADC are highly volatile; in the new millennium they vary from negative to positive two-digit rates (table 2). If SACU is excluded the variation is even more extreme, ranging from minus hundred to plus fifty per cent; this is due to Angola and the Democratic Republic of the Congo which after years of hyperinflation have undergone disinflation processes from the beginning of the millennium and the more recent hyperinflation in Zimbabwe.

Monetary convergence is expected to facilitate intraregional trade flows in two respects: intraregional exchange-rate volatility will be reduced and hence middle-term reliability of prices be increased which is a necessary ingredient for boosting trade flows; in addition, real appreciations of bilateral exchange rates of SADC countries vis-à-vis the rand can be reduced, which have frequently distorted intraregional trade flows. Since 1990, 7 out of 11 SADC countries for which longer time-series data were available have experienced real exchange rate appreciations vis-à-vis the rand, in particular the four smaller members of SACU (table 3), which is due to the currency peg and higher inflation rates than the South African one during the 1990s. Convergence in inflation since 2000, however, stopped the real appreciation, although it was not reversed. Non-SACU countries which displayed higher real appreciations until 2000 like Mauritius, the United Republic of Tanzania or even Madagascar, have considerably reduced their real overvaluation by nominal depreciations of their currency, thereby increasing their competitiveness.

Further regional integration in SADC is envisaged through the setting of a number of convergence criteria, including phased targets starting with a current-account deficit of 9 per cent of GDP and a budget deficit of 5 per cent of GDP by 2008, and becoming increasingly tighter thereafter (Bank of Namibia,

Table 3

SADC: Real exchange rate against the South African Rand[a], 1990–2006

(1990=100)

	1990	*1995*	*2000*	*2005*	*2006*	*1990-2000*	*2000-2006*	*1990-2006*
Country[b]	*(Index numbers, 1990=100)*					*(Average annual change, per cent)*		
Malawi	100	170	125	180	187	2.1	11.1	2.4
Mozambique	100	180	111	143	136	-1.6	4.0	-0.5
Madagascar	100	123	85	111	105	-2.5	8.5	-1.7
Zimbabwe[c]	100	127	96	249	n.a.	-0.1	30.5	-1.0
United Rep. of Tanzania	100	110	58	96	99	-6.4	12.5	-2.3
Mauritius	100	97	74	96	97	-3.0	6.6	-1.5
Swaziland	100	102	97	93	92	-0.7	-1.3	-0.9
Botswana	100	100	85	85	86	-1.4	0.6	-1.8
Namibia	100	99	88	85	84	-1.1	-1.1	-1.3
Lesotho	100	94	87	83	82	-1.2	-1.5	-1.1
Zambia	100	113	79	66	48	-3.8	-4.6	-4.5

Source: UNCTAD (2007a: 154).

a The real exchange rate is the product of the nominal exchange rate (national currency to rand) and the price level in South Africa, divided by the national price level. Calculations are based on period averages. An increase/decrease means a depreciation/appreciation of national currency to the rand.

b Due to lack of long-term data availability, Angola and the Democratic Republic of the Congo are not considered.

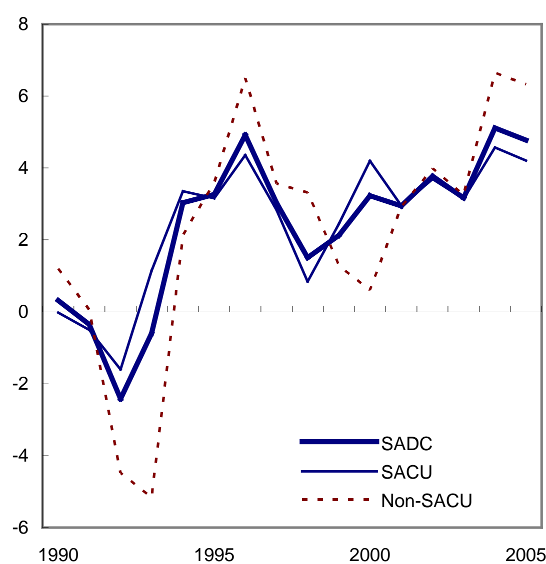
c Annual average changes refer to 2000–2005 and 1990–2005.

2006; Rossouw, 2006). A degree of flexibility is provided for countries that fall victim to external shocks from international commodity markets or bad harvests. In recent years, the commodity price boom and debt relief for Malawi, Mozambique, the United Republic of Tanzania and Zambia under the Heavily Indebted Poor Countries Initiative (HIPC initiative) of the World Bank and IMF have eased budgetary constraints and assisted efforts at convergence of budget deficits and public debt targets. The improved budgetary situation could also help overcome the reluctance to lower customs duties, which is partly motivated by fiscal considerations, thus facilitating intraregional trade liberalization.

Figure 6

SADC: Real GDP growth, 1990–2005

(Annual change in per cent)



Source: UNCTAD secretariat calculations, based on *UNCTAD Handbook of Statistics* database.

Note: Calculations are based on GDP at constant 2000 dollars.

Another convergence target is towards a GDP growth rate of 7 per cent per annum by 2008, reflecting an ambition to reach the Millennium Development Goals (MDGs) in parallel with faster integration. Since the beginning of the new millennium, GDP growth has accelerated in most SADC countries (fig. 6), but this positive development is largely the result of favourable external factors, especially the commodity price boom, rather than the result of closer regional cooperation, effective integration, or changes in national development policies. In addition, GDP growth rates of SADC members have been converging since 2001, although SACU countries have displayed a lower variation in these rates over the period 1990–2005. However, there has been no discernible degree of GDP *per capita* convergence. The share of SACU in total SADC GDP in 2005 was the same as it had been 15 years earlier; it was slightly under 75 per cent.[14]

One area of cooperation that has an indirect bearing on agricultural and industrial development, as well as on the MDGs, is related to water resource management. All continental SADC members share at least one crossborder river basin with other member countries; Mozambique alone shares nine such basins with its neighbours. However, the region is experiencing large imbalances between water availability and water consumption (AfDB, 2004). For example, South Africa accounts for more than 80 per cent of regional water consumption but has only 10 per cent of the region's water resources. SADC is the only regional cooperation scheme in Africa with a protocol on water issues that provides a framework for harmonizing national water laws and policies (UNECA, 2004; 2006b). Legal instruments have been introduced and a common vision on water-sharing is being developed for the region. The SADC Regional Strategic Action Plan for Integrated Water Resources Development and Management has given its approval to at least 31 projects, with considerable financial support from cooperation partners in Europe and the United States (AfDB, 2004; UNECA, 2004).

[14] UNCTAD secretariat calculations, based on *UNCTAD Handbook of Statistics* database.

III. REGIONAL COOPERATION IN CENTRAL AND WEST AFRICA

A. The CFA franc zone

1. Objectives and instruments

The establishment of the CFA franc zone dates back to 1945. The creation of a common currency, the CFA franc, for the former French colonies was intended to protect these African countries from the effects of the depreciation of the French currency vis-à-vis the dollar under the Bretton Woods arrangements. The CFA franc was pegged to the French franc until 1999, and thereafter to the euro. In the more than 60 years of the arrangement, the parity has changed only twice: in 1948, the CFA franc was revalued by more than 17 per cent against the French franc, and in 1994 it was devalued with the effect that the parity increased by 100 per cent.[15] The economic deterioration that occurred before the latter devaluation led to the formation of two sub-groupings in 1994, each with its own common central bank: the Communauté Economique et Monétaire de l'Afrique Centrale (CEMAC) and the Union Economique et Monétaire Ouest Africaine (UEMOA).[16] As a result, two currencies are circulating in the CFA franc zone: the franc of the Communauté Financière d'Afrique in West Africa and the franc of the Coopération Financière en Afrique Centrale in Central Africa. The two currencies are set at parity to each other, but the use of each is restricted to their respective sub-region. The two sub-groupings intended to deepen regional integration and to strengthen harmonization between the policies of their member countries.[17] However, each of them belongs to different regional integration schemes: CEMAC forms the major part of the Economic Community of Central African States (ECCAS) and all UEMOA States are members of ECOWAS (discussed in greater detail below).

The CFA franc zone has adopted three main instruments.[18] First, France guarantees the convertibility of the CFA franc, which is issued by the central bank of each sub-group. In exchange, the central banks of CEMAC and UEMOA deposit at least 50 per cent[19] of their foreign exchange reserves, converted to euro (formerly to French francs), in an account at the French Treasury. Second, the French Treasury compensates CFA franc zone members for any depreciation of the euro (formerly the French franc) against the SDR and pays interest to the central banks of the countries of the CFA zone on their deposits. Third, in order to maintain financial stability, the Banque de France acts as a lender of last resort. In principle, the French Treasury gives all zone members unlimited overdraft facilities with progressively increasing interest rates. In exchange, CFA franc zone member countries are required to have foreign exchange reserves at their disposal equivalent to at least 20 per cent of their base money; furthermore, credit from the two respective central banks of CEMAC and UEMOA to a member country must not exceed 20 per

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[15] See factsheet *Histoire du franc CFA* of the BCEAO.

[16] CEMAC comprises Cameroon, the Central African Republic, Chad, Congo, Equatorial Guinea and Gabon; UEMOA is composed of Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo. Both CEMAC and UEMOA had predecessors. For more detailed information, see www.bceao.int/internet/bcweb.nsf/English.htm and www.beac.int/index.html. The Comoros is also part of the CFA zone, but does not belong to either of these two sub-groupings.

[17] See Traité modifie de l'Union Economique et Monétaire Ouest Africaine (2003); Traité instituant la Communauté Economique et Monétaire de l'Afrique Centrale (1994); and Traité de l'Union Economique et Monétaire Ouest Africaine (1994).

[18] For a more detailed discussion of the features of the CFA franc zone, see Wang et al., 2007; Veyrune, 2007; Yehoue, 2007; Nnanna, 2006; Fielding, 2005; Stasavage, 2003; Banque de France, 2002; and Chang, 2000; as well as the websites of Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), at: www.bceao.int, and Banque des Etats de l'Afrique Centrale (BEAC), at: www.beac.int.

[19] Formerly the minimum share of foreign exchange reserves to be deposited in the *compte d'operation* with the French Treasury had been 65 per cent. For the BCEAO and the BEAC, the share was reduced in September 2005 and January 2007 respectively, whereas the requirement remained at 65 per cent for the Comoros (Comité de Convergence, 2007).

cent of that country's public revenues of the preceding year. Though crucial for the sustainability of the exchange rate, bilateral aid from France is not an instrument agreed upon between CFA franc zone member countries and France, but it is at the unilateral discretion of France.

2. Intraregional trade and financial flows

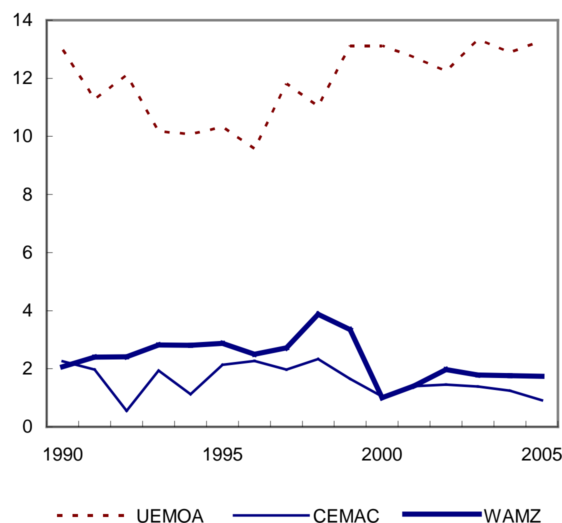
CEMAC displays the lowest intraregional trade share of all regional integration schemes in Africa, at less than 2 per cent (fig. 7). Cameroon has been the only Member State to export more than 1 per cent of its goods and services to other CEMAC countries, its intraregional share varying between 4 and 5 per cent during the period 1990–2005 (IMF, 2006). As five of the six CEMAC members (Cameroon, Chad, Congo, Equatorial Guinea and Gabon) are oil exporters, this sub-grouping realized trade surpluses with the rest of the world in the recent period of high oil prices, while export shares to both Central Africa and the rest of Africa are declining. Given this pattern of trade, it is not surprising that there has been little progress with financial integration, except for regional harmonization of some financial sector regulations. Cross-border financial flows are negligible, and inter-bank and capital markets are non-existent (Saab and Vacher, 2007).

By contrast, intraregional trade in UEMOA has recovered since 1995, following a relative decline in the first half of the 1990s: during the period 2003–2005 intraregional exports exceeded 13 per cent (fig. 7). Togo and Senegal, in particular, increased their regional shares in total exports to more than 40 per cent and almost 25 per cent, respectively, in 2005 (IMF, 2006).[20] Although UEMOA displays a trade deficit with all groups of trading partners, ECOWAS and other African regions have been gaining in importance in its external trade**.** In 2005, 26 per cent of UEMOA's exports went to ECOWAS and 32 per cent to Africa as a whole, while 23 per cent of its imports originated from ECOWAS and 28 per cent from Africa (IMF, 2006). As in Southern Africa, the product composition of intraregional exports in UEMOA has shifted towards a greater share of manufactures and technologically more sophisticated products (fig. 8). The share of manufactures rose from less than 30 per cent in 1995 to over 40 per cent in 2005. However, unlike SACU, such upgrading has not occurred in UEMOA's extraregional exports.

Figure 7

Central and West African regional groups: Share of intraregional exports in total exports, 1990–2005

(Per cent)



Source: UNCTAD secretariat calculations, based on IMF, *Directions of Trade Statistics* database.

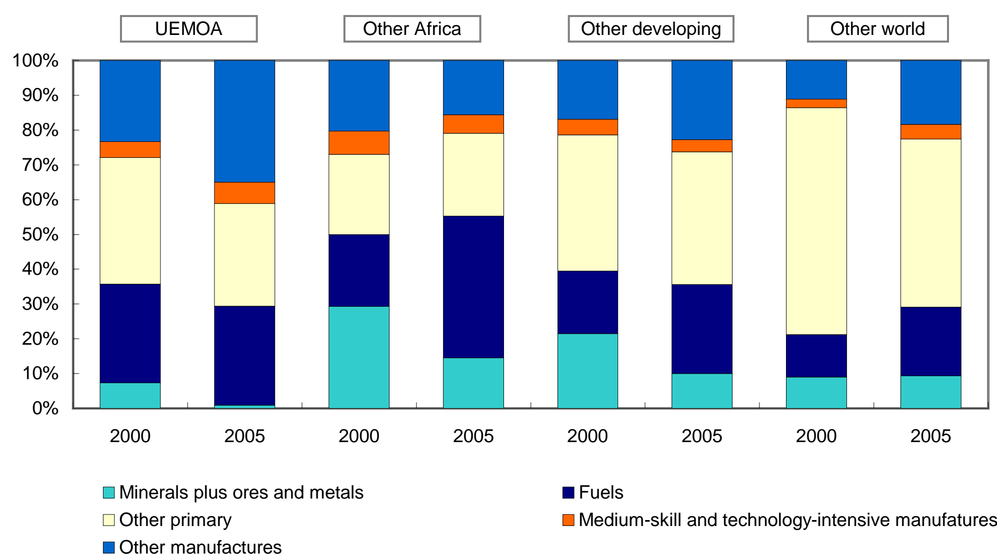
Financial integration within UEMOA has been limited mainly to cross-border transactions in the growing government bond market, to which commercial banks channel much of their excess liquidity (Sy, 2006). In 1998, the Bourse Régionale des Valeurs Mobilières was created and from 2000 on UEMOA Member States began increasingly to issue domestic bonds with stocks reaching 1.5 per

[20] In 2000, Togo's share of intraregional exports in total exports was 12 per cent (IMF, 2006). The rapid increase after 2000 is partly due to a sharp increase in transit trade in response to the political upheaval in Côte d'Ivoire and resulting trade disruptions.

Figure 8

UEMOA: Export structure by broad product category, 2000 and 2005

(Per cent)



Source: UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

cent of GDP at end of 2006 (Banque de France, 2006). Although the traded volume of public bonds is still small in comparison to domestic debt issuance in other sub-Saharan countries, maturities of public debt of member countries could be increased on average to 22 months and to a maximum of five years (Banque de France, 2006). Besides the West African Development Bank, which regularly issues bonds in the regional market with maturities even up to eight years, external actors have been attracted; in late December 2006, the International Finance Corporation (IFC) has issued its first local currency bond (Banque de France, 2006).

The regional capital market, however, is small and the regional inter-bank market rudimentary. Although French presence in the regional banking market is still strong, subsidiaries of French banks have been losing market shares to African banks with an explicit regional approach; for example, ECOBANK, which has branches in 13 countries of the region, has become the largest transnational bank operating in the CFA franc zone. However, as with GDP and trade volume, 50 per cent of regional banking assets in UEMOA are concentrated in Côte d'Ivoire and Senegal (Sy, 2006).

Within the CFA franc zone, the economically more powerful members appear to have benefited more from intraregional trade than the other members. Côte d'Ivoire and Senegal in UEMOA and Cameroon in CEMAC have realized trade surpluses with the other members of their sub-group since 1980. All three countries export mainly primary products, not only to the rest of the world, but also to the other countries in their respective subregions. Although exchange-rate risk is ruled out, trade between CEMAC and UEMOA is almost non-existent. However, intraregional trade in the entire CFA zone still amounts to 30 per cent of total trade, if trade linkages with France are taken into account (IMF, 2006).

3. The role of cooperation for regional integration

The monetary performance of CFA franc zone members has been far superior to that of most non-CFA franc zone countries in Africa which can be attributed to the exchange rate peg. Annual consumer price inflation averaged 8 per cent during the period 1960–2004, and its variation within the CFA franc zone

Table 4

UEMOA, CEMAC and France: Real effective exchange rate, 1990–2006

(2000=100)

	1990–1993[a]	*1994*	*1995–1999[a]*	*2000*	*2001–2005[a]*	*2006*
France	111	112	111	100	105	108
CEMAC[b]						
Cameroon	154	97	109	100	108	113
Central African Rep.	152	94	107	100	118	129
Equatorial Guinea	137	97	111	100	129	151
Gabon	173	103	111	100	102	105
UEMOA[b]						
Côte d'Ivoire	144	89	103	100	112	116
Togo	132	87	104	100	108	112

Source: UNCTAD (2007a: 134).
a Period average.
b Data was not available for remaining member countries of CEMAC and UEMOA.

averaged 10 per cent, compared to non-CFA franc zone Africa where average annual inflation was 75 per cent and the inflation rate variation was more than 230 per cent (Yehoue, 2007; Nnanna, 2006). However, as France introduced a resolute "*franc fort*" policy in the early 1980s, in an attempt to converge with the most stable economies in the EU, these low inflation rates by developing-country standards at the time were not low enough to prevent overvaluation vis-à-vis the French franc and other Western European currencies. Similarly, given the rigidity of the peg, the countries of the CFA franc zone have tended to suffer in recent years from real appreciation vis-à-vis the euro, as well as from the real appreciation of the euro against other major currencies in recent years (table 4).

Although most CFA franc zone countries are mainly exporters of primary commodities, for which the impact of exchange rate adjustments is more limited than for manufactures, the loss of competitiveness has certainly contributed to weaken their growth performance since the mid-1980s. Only two years after the maxi-devaluation of the CFA franc in 1994, Member States slashed their inflation rates down to almost European level and have displayed even negative inflation differentials with France in most of the years since 1999 (table 5). However, the advantage levelled out in 2000 and from then on overvaluation increased ever since with the notable exception of Gabon.

With the exception of 2001 and 2005 for UEMOA, real interest rates have been constantly higher up to five percentage points within CEMAC and UEMOA than in France since 1996 (table 5). This is in remarkable contrast to the experience of Namibia and Swaziland of CMA which on average have lower real interest rates than their anchor countries. Thus, hit by the triple whammy of an overvaluation against the euro (formerly French franc), the appreciation of the euro against other key currencies, and relatively high real interest rates, it should come as no surprise that economic performance of CFA franc zone member countries in terms of GDP growth and global competitiveness was modest from the mid-1980s until the mid-1990s. And it is mainly due to the maxi-devaluation in 1994 and to recent price increases of oil and mineral and mining products exported from the region that CFA franc zone growth has recovered to comparable countries (fig. 9).

A process of regional surveillance over macroeconomic convergence was set in motion when UEMOA agreed upon a Convergence, Stability, Growth and Solidarity Pact in 1999. Both UEMOA and CEMAC adopted convergence criteria, including an inflation target of 3 per cent, a balanced budget (excluding official development assistance), and a maximum limit for total public debt set at 70 per cent of GDP

Table 5

CEMAC and UEMOA: Inflation and real interest rate differentials with France, 1993–2005

(Percentage points)

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
							Inflation differential with France						
CEMAC	-3.8	34.5	8.2	2.3	3.5	2.4	-0.8	-1.1	2.2	0.7	-0.4	-2.0	0.3
UEMOA	-1.0	28.3	10.3	1.4	1.8	3.0	-0.9	-0.6	1.9	0.7	-0.7	-1.6	2.9
							Real interest rate differential with France						
CEMAC	9.0	-31.7	-4.2	2.2	0.7	1.6	4.1	2.4	0.0	1.8	3.4	5.0	1.9
UEMOA	0.8	-27.3	-8.9	1.4	0.9	0.0	2.9	0.8	-0.2	1.6	2.2	2.6	-2.2

Source: UNCTAD secretariat calculations, based on IMF, *International Financial Statistics* database; and *UNCTAD Handbook of Statistics* database.

Note: Inflation and interest rate of Euro zone was applied to France since 1999. The interest rates are the discount rates (end of the period) for CEMAC, WAEMU and France from 1999 (Repurchase agreement before 1999).

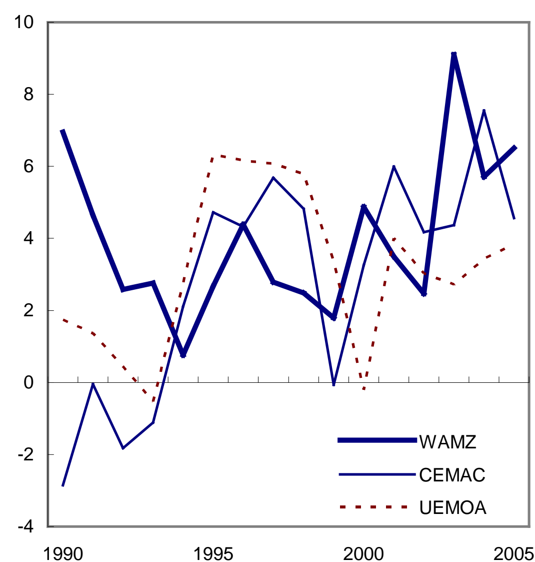
(Banque de France 2005; Comité de Convergence, 2007; Comité de Convergence, 2006). Although there has been some success in convergence with regard to formal criteria, convergence in terms of GDP growth rates and reduction of regional, social and economic disparities has been limited between UEMOA member countries, and is almost non-existent within CEMAC.

Remittance flows serve as an important channel of convergence among UEMOA members, as in SACU discussed above. Although no comprehensive data are available that differentiate between intra- and extraregional remittance flows to UEMOA Member States, it is possible to identify some individual countries for which intraregional remittances have been substantial. Over 40 per cent of workers' remittances to Burkina Faso originate in other UEMOA member countries, in particular Côte d'Ivoire (Banque de France, 2005), and around 30 per cent of the total Ivorian population comprises non-Ivorian residents, of which more than 80 per cent come from other UEMOA countries, in particular Burkina Faso and Mali (van den Boogaerde and Tsangarides, 2005). Whereas UEMOA is a net recipient of remittances, there is a net outflow of remittances from CEMAC countries to the rest of the world due to numerous skilled employees from industrialized and other developing countries working in their oil industry. Accordingly, intraregional remittances have a low significance for CEMAC countries; e.g. in 2005, the year for which most recent data is available, intraregional remittances accounted for only 10 of per cent of total gross remittances in CEMAC in 2005 (Banque de France, 2005).

Figure 9

Central and West African regional groups: Real GDP growth, 1990–2005

(Annual change in per cent)



Source: UNCTAD secretariat calculations, based on *UNCTAD Handbook of Statistics* database; and *World Development Indicators* database (Nigeria).

Experience with the role of formal cooperation and regional institutions in effective regional integration can at best be considered as mixed. Various common regulatory frameworks on a regional level to facilitate intraregional trade and financial flows have been initiated and economic actors seem to partly pick up these opportunities; e.g. UEMOA member countries introduced a customs union with a common external tariff and liberalized intraregional trade in 1999 and from then on intraregional trade shares have been increasing; similarly, the creation of regional rules for bonds induced increased issuance of regional bonds denominated in regional currency, albeit mainly by the public sector. Hence, the mixed experience does not refer to non-commitment to regional agreements or lack of implementation of common frameworks; it refers rather to two instruments vigorously implemented by the two sub-groupings and their respective impacts on the regional economy.

First, the exchange rate peg is responsible for long-term overvaluation to which the maxi-devaluation in 1994 gave some relief, however it was not sufficient to support diversification of production. Without devaluation CFA franc zone members will lastingly have to adjust their inflation rates under the Euro zone level of 2 per cent to reduce the accumulated overvaluation vis-à-vis the European market. Alternatively, exporting firms in those countries will have to achieve faster productivity growth than their competitors in these markets, which is rather difficult on a broad scale in the short run. Moreover, because of being pegged to the Euro, CFA franc zone member countries are exposed to substantial exchange rate adjustments against the dollar. To isolate exporters and importers from these exchange rate fluctuations, comprehensive hedging would be necessary, but at the current level of financial deepening no appropriate hedging instruments on the domestic markets are available. In case of Euro appreciation and with no possibility for hedging, compensation for the loss of competitiveness on Asian markets or within the dollar area could even entail region-wide deflation – a non-starter for any economy, but in particular for low-income countries seeking to develop their manufacturing capacities. Thus, CFA franc zone countries have suffered from the drawbacks of rigid nominal exchange rates vis-à-vis their European trading partners and the rest of the world. At the same time, they have derived few benefits from internal exchange stability due to the low level of intraregional trade, especially in manufactures and services, which are more exchange-rate sensitive than primary products.

Second, apart of its pro-cyclical character, difficult fiscal convergence criteria, such as a balanced budget (without ODA) or even a budget surplus, however, have not been conducive to the process of financial integration within the CFA franc zone either. This is because financial markets in both sub-groups of the CFA franc zone consist mainly of public entities and commercial banks, with the former issuing domestic debt and the latter purchasing treasury bills and other public bonds. If the governments of the CFA franc zone countries were to permanently abstain from borrowing in their domestic or regional capital markets, the possibility of developing financial markets would be severely curtailed, unless those governments used their fiscal surpluses to buy bonds and equities of private companies, thereby assuming the risk of financial intermediation.

More generally, the choice of convergence criteria and quantitative targets should be done very carefully, because they are based on expectations formed under specific macroeconomic conditions. Targets that initially appear to be quite easily within reach could be difficult or even impossible to meet, as was experienced by members of the euro zone which is otherwise known for a high degree of macroeconomic discipline. The Convergence, Stability, Growth and Solidarity Pact of UEMOA envisaged that an initial convergence phase would be followed by a stabilization phase, which was originally scheduled for the period 2000 to 2002. However, the end of the convergence phase has already been postponed twice. Thus, instead of enhancing credibility in regional institutions and in the process of regional integration, the Pact might even considerably damage the credibility of the whole project and of member countries' governments.

B. The Economic Community of West African States

1. Objectives and instruments

The Treaty of Lagos of 1975, which established the Economic Community of West African States (ECOWAS) with 15 members, had as its main objectives the promotion of trade, cooperation and self-reliance. The Treaty was revised in 1993 with a view to accelerating the process of economic integration and strengthening political cooperation. Its long-term objectives are to establish an economic and monetary union between all Member States. In the process towards economic union, the revised Treaty envisages the traditional sequencing, the intermediate stages being a free trade area, a customs union and a common market. However, the creation of a monetary union is scheduled before the final stage of economic union is achieved, in order to facilitate integration of the real economy (Obaseki, 2005; Ojo, 2005). With this objective in mind, a second sub-group within ECOWAS, besides UEMOA, was formed in 2000, when Gambia, Ghana, Guinea, Nigeria and Sierra Leone signed the Accra Declaration establishing the West African Monetary Zone (WAMZ). Once achieved, the monetary union between these countries is expected to merge with UEMOA.[21] The deadline for WAMZ Member States to introduce a common currency, the ECO, is set for the end of 2009, having already been postponed twice, while the date for the merger with UEMOA remains to be determined.

While UEMOA is a customs union, WAMZ has liberalized its internal trade only partially, and trade and financial flows between the two sub-groupings have not yet been liberalized. Hence, ECOWAS as a whole does not qualify as a free trade area or a customs union. Its main instruments include progressive intraregional trade liberalization with strict rules of origin (ECOWAS, 2002a), the common external tariff of UEMOA, which, for reasons of simplification, will eventually be adopted by WAMZ, and a community tax of 0.5 per cent on imports of goods from third countries. This tax is to be used to finance regional institutions such as the ECOWAS Commission or the planned Economic and Social Council. The Fund for Cooperation, Compensation and Development offers financial assistance to Member States that suffer revenue losses due to intraregional trade liberalization. Such financial assistance was to be provided degressively over a period of four years until the end of 2005 (ECOWAS, 2002b).

2. Intraregional trade and financial relations

Trade integration in ECOWAS has advanced very slowly and intraregional trade has been highly concentrated in a few countries. In 2005, the shares of intraregional exports and imports were the same as those of 1980. Three countries (Nigeria, Côte d'Ivoire and Senegal) account for almost 90 per cent of all intraregional exports, more than half of which is realized by Nigeria alone (IMF, 2006); these same countries also account for 48 per cent of all intraregional imports (IMF, 2006). The low level of intraregional trade is explained by the high dependence on commodities of most member countries, and by a trade liberalization scheme with very strict rules of origin, which at the beginning of 2000 were met by only 17 manufacturing firms (Shams, 2003). Access to the regional market is especially difficult for those firms and sectors that are at an early stage of development, given the low degree of internal integration. Such firms have to rely on imported inputs, and the content of domestic value added in their products is often too small to satisfy strict rules of origin. Another factor inhibiting intraregional trade are non-tariff barriers, such as road charges, transit fees, administrative delays at borders and ports, and multiple checkpoints and roadblocks, all of which raise transport costs and make deliveries unreliable.[22]

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[21] Cape Verde and Liberia belong to ECOWAS, but are not members of either of the two subregions; however they participate in WAMZ meetings as observers.

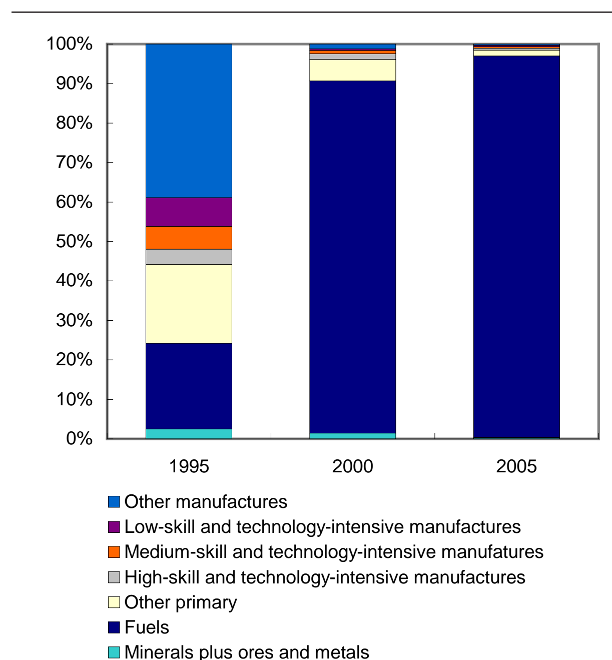
[22] There are frequent checkpoints in West Africa. For example, in some countries, road transporters are obliged to stop rather involuntarily at intervals between 14 and 65 kilometres (UNCTAD, 2007b).

Since 2000, the share of intraregional to total exports of WAMZ has been in the order of 2 per cent, which is slightly higher than that of CEMAC (fig. 7); only Ghana is realizing a significant proportion of imports (15.4 per cent 2005) from its WAMZ partners. However, for two of the five WAMZ member countries (Gambia and Sierra Leone) ECOWAS is a significant supplier and a relevant export market. In 1995, 55 per cent of WAMZ intraregional exports consisted of manufactured goods, but subsequently this share dropped sharply, in absolute and relative terms (fig. 10). One reason for this dramatic change has been the price hike in raw materials, which has not only inflated the share of non-manufactured goods in total trade, but also served as a disincentive for resource-rich countries to expand their industrial sectors more vigorously. More than half of the intraregional exports of the three major countries in ECOWAS consist of primary products, with fuel accounting for 30 per cent of Senegal's exports and 97 per cent of Nigeria's.[23] Even Ghana's regional export profile is dominated by primary commodities though coming down from over 60 per cent now still covering more than 50 per cent. The volume of traded parts and components is negligible and hence indicates that there are no significant forward or backward production linkages.

Figure 10

WAMZ: Intraregional export structure by broad product category, 1995, 2000 and 2005

(Per cent)



Source: UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

Interestingly, Côte d'Ivoire (UEMOA) is reported to export fuel products to Nigeria (WAMZ), which is the worlds eighth largest and Africa's first oil producer (Synge and Hodgekinson, 2007; UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE). Côte d'Ivoire is re-exporting processed crude oil from Nigeria back to Nigeria and due to geographical reasons to other WAMZ countries like Sierra Leone, Guinea and the Gambia. Apart from shipping, there is no direct way from Nigeria to these WAMZ countries without crossing at least one border of UEMOA countries. Nigeria is importing refined petroleum products from Côte d'Ivoire due to insufficient capacities of Nigerian refineries for its domestic market. At the same time, Côte d'Ivoire is importing crude petroleum as it has not sufficient crude petroleum production for its own consumption and its exports (Van Buren, 2007). Statistically, this is reflected in a doubling of the share of UEMOA exports in total exports to WAMZ in the period 1999 to 2005 (from 6.4 to 13.1 per cent) and an increase in UEMOA fuel exports to African countries.[24]

Financial integration between WAMZ Member States is rather limited; although the informal use of regional currencies on a cash basis in intraregional activities is not infrequent, formal financial linkages are negligible due to the lack of an official market for regional currency trading and a cross-border payments system (West African Monetary Institute, 2006).

[23] UNCTAD secretariat calculations, based on UN/DESA estimates and UN COMTRADE.

[24] UNCTAD secretariat calculations, based on IMF, *Directions of Trade Statistics* database, UN/DESA estimates and UN COMTRADE.

Based on the UEMOA convergence criteria WAMZ countries have adopted a process of macroeconomic surveillance and a peer review mechanism. The monetary and fiscal performance of the two subregions has differed considerably, and there is a long way to go before convergence between them is achieved. While UEMOA countries are outstanding for their monetary discipline displaying an annual inflation rate averaging 1.7 per cent during 1999–2003 and no central bank financing of budget deficits, their fiscal performance is less impressing: the tax base is still very narrow and the possibility of financing public investment from internal sources remains limited (ECOWAS, 2007). By contrast, the average annual rate of inflation in the members of WAMZ exceeded 14 per cent during the same period, and central banks have frequently financed public budgets in several countries (ECOWAS, 2007). However, compared to UEMOA, the tax base of WAMZ is much broader, thus enabling greater use of internal resources to finance public investment.

UEMOA's real effective exchange rate (REER) closely follows the Euro. Between 1999 and 2003, UEMOA members experienced an average annual real appreciation of 4 per cent (ECOWAS, 2007). In contrast, WAMZ members use mainly the dollar as an anchor currency since most of their trade is denominated in dollars. Thus during the period 1999–2003, WAMZ countries witnessed significant annual depreciations of their REERs, ranging from 5 per cent in Sierra Leone to 35 per cent in Ghana (ECOWAS, 2007). Although several options have been discussed, an important question that remains to be resolved is which exchange rate regime a merged WAMZ and UEMOA would apply, and whether they should maintain an anchor currency (West African Monetary Institute, 2001).

3. The role of formal cooperation for regional integration

As effective regional integration is rather limited, it is difficult to assess whether the relative comprehensive formal cooperation within ECOWAS since 1975 had a positive impact on integration. What can be said is that despite considerable efforts to strengthen formal cooperation, the process of regional integration has been slow: regional cooperation in ECOWAS and its two sub-groupings has so far generated very modest results. Both Nigeria within WAMZ and Côte d'Ivoire within UEMOA for their sheer economic potential serve as core economies in their respective sub-groupings; and any deepening or acceleration of regional integration critically depends on the policies and economic development of these two countries. ECOWAS had been aiming at the creation of a second monetary union (in addition to UEMOA) since 1975, but it was only in 1999, when Nigeria made a firm commitment to regional integration following presidential elections, that regional monetary cooperation gained momentum and WAMZ was created. Regional cooperation would receive a major push if Côte d'Ivoire and Nigeria overcome the well-known antagonism between English speaking and French speaking West Africa and develop the same vision for regional integration within ECOWAS. However, for the time being, opportunities for intensifying such integration are largely circumscribed by similarities in the production structures of the different economies, in particular the lack of a manufacturing network. Rather than waiting for such a network to evolve quasi-automatically, the countries in the region, including the leading economies, may be well advised to make the creation of such a manufacturing network itself an objective of regional cooperation, and to equip themselves and the regional institutions with the necessary policy instruments for making this possible.

In this regard, initial steps have been taken within ECOWAS for formal cooperation on regional energy supply. Energy infrastructure is important for industrial development, and thus for economic diversification and structural change, but it is very capital-intensive and requires large-scale public investment, in particular in developing countries. It is therefore a starting point for regional industrial cooperation, which may also serve to leverage external financial support. In the ECOWAS region, energy resources (petroleum and gas) are concentrated in coastal or offshore areas. In 2000, member countries launched the West African Power Pool project to be implemented over a period of 20 years, which aims at increasing and stabilizing energy supply. So far, ECOWAS has been able to obtain commitments of $350 billion from international organizations, donors and private investors (EIA, 2006). In addition, ECOWAS plans

to set up a fund of $50 billion by end 2007 to finance access to energy services by remote regions and social groups that so far have lacked such access, as part of efforts to reduce poverty in line with the MDGs (EIA, 2006).

Albeit not of developmental character, but considerably shaping the developmental agenda of the region are the conflicts and civil wars within ECOWAS member countries. Security cooperation has been developed under the ECOWAS umbrella with peace-keeping forces; ECOWAS Cease-fire Monitoring Group (ECOMOG) was involved in Guinea, Liberia, Sierra Leone, and recently in Côte d'Ivoire, though with mixed results (Shams, 2003; Nieuwkerk, 2001).

IV. CONCLUSIONS

Monetary and exchange-rate policy has been by far the most developed area of regional cooperation and integration in Africa. With the two currency unions of CEMAC and UEMOA, nominal exchange-rate stabilization within CMA, and the prospective currency unions of SADC and WAMZ, Africa has taken the lead in the developing world in terms of regional monetary integration. Nominal pegs seek to establish price stability at the level of the anchor currency and to import credibility in exchange-rate stabilization. This has already materialized for the members of CEMAC, CMA and UEMOA. SADC and WAMZ countries are on their way to achieving price level convergence, though with mixed results due to the application of different exchange-rate regimes by Member States. The first lesson offered by the African experience of regional monetary cooperation is that the adoption of a common exchange-rate regime in the form of a nominal peg results in a reduction both of the domestic inflation rate and of its variation between individual countries. However, the converse does not hold, in the sense that harmonization of inflation does not necessarily lead to stable nominal intraregional exchange rates. Thus, inflation convergence via monetary and fiscal policy is no substitute for the stabilization of exchange rates by a nominal peg or a monetary union.

The greatest handicap of exchange-rate pegs is the risk of an appreciation of the real exchange rate due to positive inflation differentials between the domestic and anchor currencies. A deviation from the anchor currency inflation rate may occur rather frequently, i.e. during the convergence phase, in times of asymmetric shocks or non-perfect harmonization of business cycles. Such real appreciation results in the shrinking of net exports and in a deterioration of the current-account balance. This can easily put the nominal anchor at risk, as experienced by many developing countries in Asia and Latin America. In contrast, intraregional overvaluation among CMA countries, as well as between CEMAC and UEMOA has been moderate. However, although inflation rates in CFA franc zone countries have been strikingly low compared with other developing countries, overvaluation vis-à-vis the rest of the world has been devastating. The peg to the French franc, and subsequently the euro, resulted in a major disincentive for CFA franc zone countries' exporters of both raw materials and processed goods. Exporters of raw materials, which are priced in dollars, experienced a fall in export revenues denominated in domestic currency whenever the French franc and euro appreciated in relation to the dollar, while manufacturers could not compete even against European products on the regional market. In times of oil price hikes, overall overvaluation has the only advantage of limiting an increase in energy costs and dampening inflationary tendencies, but this does not benefit CEMAC members, which are mainly oil exporters. Thus, a second lesson from the African experience is that a peg to a regional currency seems to offer more advantages than a peg to an international key currency. The difference between the two kinds of pegs is that with the former there is a lower inflation differential, which results in lower adjustment costs in terms of growth during inflation assimilation and lower losses in terms of competitiveness with regard to the rest of the world.

Stabilization of nominal intraregional exchange rates and common bloc floating with the rest of the world as practised by CMA countries implies a high degree of vulnerability to extraregional factors. South Africa has become extremely vulnerable to instability in international financial markets following the dismantling

of capital controls. Whenever a financial crisis hits one or several emerging market economies, South Africa is affected negatively. Either it is faced with large capital outflows in a generalized emerging market crisis, such as the East Asian crisis in 1997–1998, or it is confronted with large capital inflows because South Africa serves as a safe haven in crises that are perceived by financial market actors to be limited to a specific country, such as the Argentinean and Brazilian crises of 1999 and 2002. Hence, the exchange rate of the rand is highly volatile, and so are the exchange rates of the smaller CMA countries vis-à-vis the rest of the world. A nominal peg to an international key currency is expected to reduce vulnerability to extraregional factors and lead to less exchange rate variability. However, the experience of CFA franc zone countries has shown that they too are subject to high exchange rate volatility due to strong swings in the euro exchange rate vis-à-vis the dollar. Thus, a third conclusion that can be drawn from the African experience with regional integration is that the two different pegs are almost equally disadvantageous with regard to exchange rate volatility caused by extraregional factors.

Global competitiveness and thereof derived growth performance of the whole regional group depend decisively on the (implicit) exchange rate target of the key currency and the applied exchange rate regime via the rest of the world. An international key currency will hardly take into account the needs of developing countries far off its own borders – the *Franc fort* policy may serve here as a compelling example. In contrast, a regional key currency is rather suitable to consider the economic and social situation of neighbouring countries due to their relatively higher economic relevance for its own economy, both in good times and in bad times. Thus, a fourth lesson of the African experience is that in terms of ownership a peg to a regional key currency seems superior to a peg to an international key currency due to geographical proximity, higher homogeneity and a lower development gap between the key currency country and the pegging states.

African regional integration does not provide clear insights into the relationship between financial integration and trade integration. In CMA and SACU, substantial financial integration has been accompanied by a high degree of trade integration, whereas in CEMAC and WAMZ trade integration is strikingly low, and the level of financial integration is limited, despite the fact that CEMAC is a currency union. The CMA and SACU experiences suggest that increasing financial integration, including the development of regional capital and banking markets, fosters the use of local currencies in regional activities, and facilitates the development of both trade and production networks. On the other hand, increasing trade integration requires a minimum of financial services such as insurance, cross-border payment systems or banking services. Thus, trade and financial integration seem to be mutually enforcing within CMA and SACU. However, the disappointing results for CEMAC and WAMZ suggest that there must be a minimum level of regional activities which has to be achieved before this self-enforcing process can begin and private actors pick up opportunities. UEMOA with constant two-digit intraregional trade shares has envisaged further initiatives to deepen financial integration by developing a regional government bond market; increasing the size and liquidity of regionally traded bonds not only resulted in favourable conditions for issuing government securities, e.g. lengthening of maturities, but also attracted external agencies like the IFC. Thus, a fifth lesson of the African experience is that formal cooperation, including the creation of the necessary legal and institutional framework – be it in trade or in finance – as itself is not enough; the state has a vital role in organizing and delivering regional activities until the minimum threshold is realized.

Many factors have hampered trade integration in African cooperation schemes in general, including insufficient price competitiveness, high dependence on primary commodity exports, in particular minerals and fuels, similar production structures and an inadequate transport infrastructure. Nevertheless, the African experience with regional integration suggests that enlarging the relevant market for domestic producers through effective regional integration and increasing the possibilities for realizing economies of scale are conducive to strengthening and even creating non-traditional production in the region.

If market size is a relevant factor for technological up-grading in production and exports, why then focus on regional integration and not on the integration of individual countries into the global economy? The

African experience with general liberalization is not supportive to the development of a non-traditional production base. Production in an infant industry stage cannot always compete with mature suppliers without substantial subsidies or other forms of promotion. As with nominal pegs discussed above the regional market sets less exclusive benchmarks so that even production in infant industry stage can be successfully broadened. The most successful formal cooperation agreements in Africa, in terms of both the share of manufactured products in intraregional exports and the increase of this share over time, are CMA and SACU. This success is based on common regional rules and standards, and on slow liberalization of their market vis-à-vis the rest of the world. In contrast, other African regional groupings undertook faster and broader liberalization vis-à-vis the rest of the world, but introduced various non-tariff barriers against their regional neighbours – a tendency that is reflected in their low intraregional trade shares. Thus, a sixth conclusion based on the African experience is that broadening of production and increasing regional production networks requires that the regional market is not opened up indiscriminately.

For all regional groupings, except UEMOA, the share of manufactures in total exports to other African countries is higher than the share to developing countries outside Africa. Exports to developing countries outside Africa are dominated by traditional products, especially minerals and fuels. For Africa, this may carry both advantages and risks. An advantage lies in the expansion of South-South trade, which is not directly linked to the business cycles of developed countries. As some large developing countries in Asia are themselves increasingly becoming engines of growth, this structure may be beneficial for Africa by presenting opportunities for increasing exports of primary commodities and resource-based products. On the other hand, a renewed focus on non-processed, traditional products entails the risk of a slowdown in industrialization and diversification, and in some cases, even a reversal. Thus, efforts to support the development of manufacturing industries, including through intensification of regional trade, should not be neglected.

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