

Four Instruments to Strengthen Financial Integration in Sub-Saharan Africa*

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Abstract

This paper proposes four tools to strengthen financial integration in sub-Saharan Africa. The first tool, “political commitment devices” can ensure steady progress on the road to an economic community. For instance, stronger regional institutions can monitor progress towards integration and encourage policymakers to respect their regional commitments. Second, the economic benefits from financial integration are better secured when countries achieve a number of “threshold conditions,” including minimum levels of financial development and governance. Third, full financial integration requires the “trinity” of equality of access, rules, and treatment. Policymakers have to eliminate entry barriers, and once foreign institutions enter domestic markets, refrain from discriminating against them. In addition, policymakers must harmonize regulations further and build capacity, especially in banking supervision. Fourth, improving the “plumbing” of financial integration -financial infrastructure- by reducing transaction costs, can provide quick gains. Innovation in mobile payments can help reduce such costs, and regulators need to balance the associated benefits and risks.

JEL : F36, F38, F65, G21, G28

Keywords: Africa, banking groups, financial integration, payments system

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1. Introduction and Political Commitment to Integration

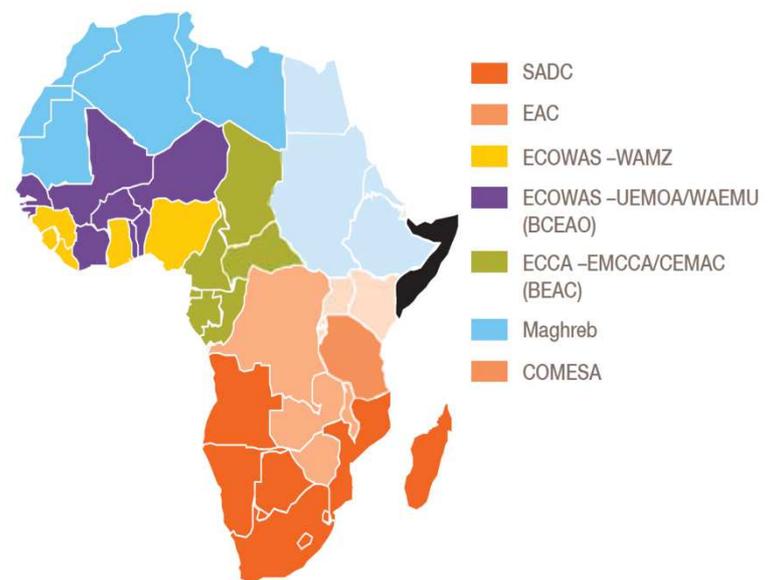
Over the past 10 years, sub-Saharan Africa grew 5 percent per year and, at this rate, the region's economy should double in size before 2030. Economic growth is projected to rise by at least 6 percent in 2014 and 7 of the world's fastest 10 economies in 2011-2015 will be from the region.

This "Africa rising" narrative should not mask the remaining challenges facing the continent. Indeed, rapid economic growth has not resulted in sufficient gains in terms of job creation and reduced inequality. Moreover, average continental growth rates mask an uneven progress among countries.

Without a doubt, financial integration can play an important role in helping achieve sustainable and inclusive growth in sub-Saharan Africa. Hoping for their countries to benefit from regional integration, 51 heads of state and government signed the Abuja Treaty in 1991. The treaty, which entered in force in 1994, establishes a roadmap toward an African Economic Community to be completed by 2028. The roadmap included six stages starting with the creation of regional blocs (regional economic communities or RECs, see Figure 1) and the strengthening of intra-regional integration and the harmonization between the blocs.

Figure 1. Regional Economic Communities

African regions



The remaining four stages plan for the consecutive establishment of free trade areas and customs unions in each bloc, the creation of a continental customs union, the creation of an African common market, and, finally, the establishment of an African economic monetary union and a parliament (Figure 2 lists remaining stages).

Although the first stage has been completed, the second stage, which was supposed to be finalized by 2007, is not fully complete because progress by regional blocs and the countries within them has been uneven (Sy, 2014).

Figure 2. Overall Deadline for the Establishment of the African Economic Community 2028



In addition to the planned integration of the regional blocs, the African Union has launched a number of integration programs and initiatives, including the African Central Bank, the African Monetary Fund and the African Investment Bank.

Reduced political appetite for increased financial integration can slow down the process towards the remaining stages of the African Economic Community. Strong common institutions can give policymakers the right incentives to foster integration. Indeed regional integration, especially monetary integration, requires independent institutions with the relevant expertise. In addition, common institutions should be able to monitor and evaluate the integration process on a timely basis, and be able to apply sanctions to countries that fail to respect their regional obligations. Measuring the degree of financial integration will be necessary and efforts to collect quality data are needed.² Regional integration often involves trade-offs between short-term costs such as the loss of customs revenues and long-term gains such as access to larger markets, which often causes delays in integration. A compensation mechanism can give incentives to governments to remain engaged to the integration agenda.

“Political commitment devices” include therefore strong common institutions able to track the integration process and propose remedial actions when it goes off-track. These devices include a sustainable funding mechanism for common institutions such as the RECs’ secretariats and commissions. A pre-requisite of surveillance will be the measurement of the degree of financial integration achieved. They also include regional projects in infrastructure and other sectors that require financing. Current progress towards a European Banking Union underscores the importance of institutions and mechanisms that aim at strengthening financial stability in a monetary union.

The rest of this paper discusses three additional tools to strengthen financial integration in sub-Saharan Africa. The first section discusses “threshold conditions” for financial integration to yield economic benefits. The second section then discusses the aspects and importance of the “Integration Trinity,”—similarity of access, rules, and treatment to foster integration. Finally, the last section discusses ways in which financial infrastructure—“the plumbing”—is key to lowering transaction costs in trade and finance, thereby facilitating the integration process.

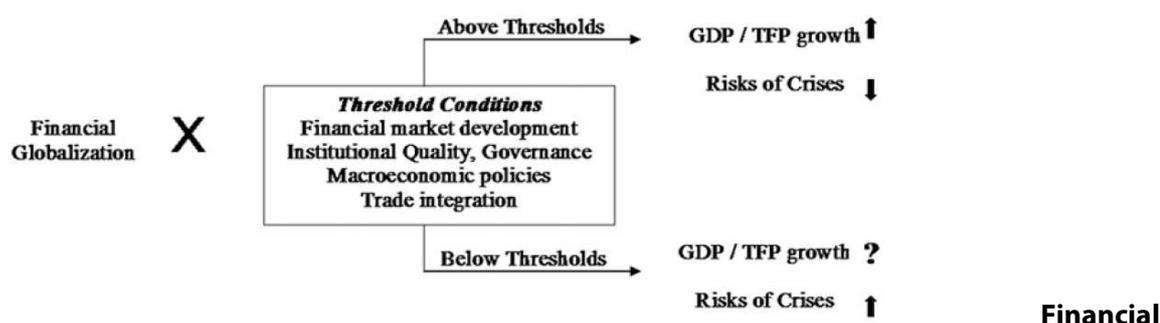
² As in the annual European Financial Stability and Integration Reports, European Commission (2013).

2. Threshold Conditions for Financial Integration

The literature on international financial integration points to a set of policies for countries to benefit from financial openness and reduce the vulnerability to crises. These policies should target achieving a number of preconditions found to be the most important as in Kose, Prasad, and Taylor (2011). In particular, these policies include:

- A deep and well-supervised financial sector able to intermediate efficiently foreign finance into productive investments. It can also help manage better the volatility of capital flows.³
- The quality of corporate and public governance, the legal framework, level of corruption and the degree of government transparency, which can affect the allocation of resources in an economy.
- Trade openness, which reduces the probability of crises associated with financial openness and mitigates the costs of crises if they do occur.
- Capital account liberalization, which is more likely to be successful if it is supported by good fiscal, monetary and exchange rate policies.

Figure 3. Threshold Conditions for Financial Integration



Thresholds in the Process of Financial Integration. Source: Kose et al. (2009).

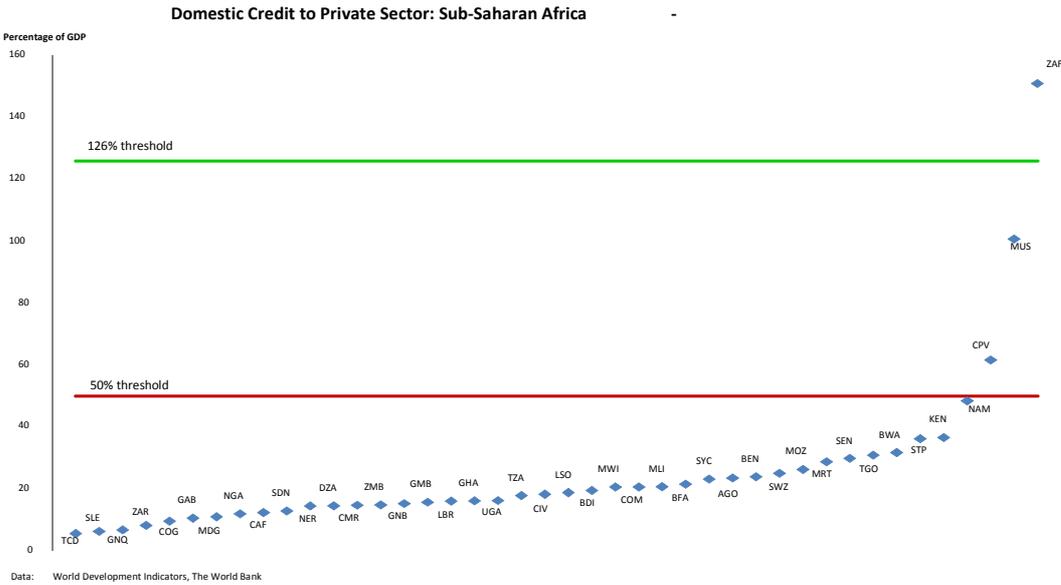
Development

As noted by Kose, Prasad, and Taylor (2011), countries that meet a minimum number of threshold conditions achieve a better balance of the benefits and risks associated with financial globalization. In particular, financial depth, the quality of supervision of the financial sector and institutional capacity appear to be the most important factors. The authors find an inverted U-shape relationship between ratios of credit to GDP and the benefits of financial openness. In particular, ratios of credit to GDP ratios of above 50 percent and below 126 percent are associated with positive marginal benefits of increasing financial openness.⁴

³ See Annex I for the preconditions for effective banking supervision recommended by the Basel Committee on Banking Supervision.

⁴ Thresholds are lower for foreign direct investment and portfolio equity liabilities compared to those of debt liabilities.

Figure 4

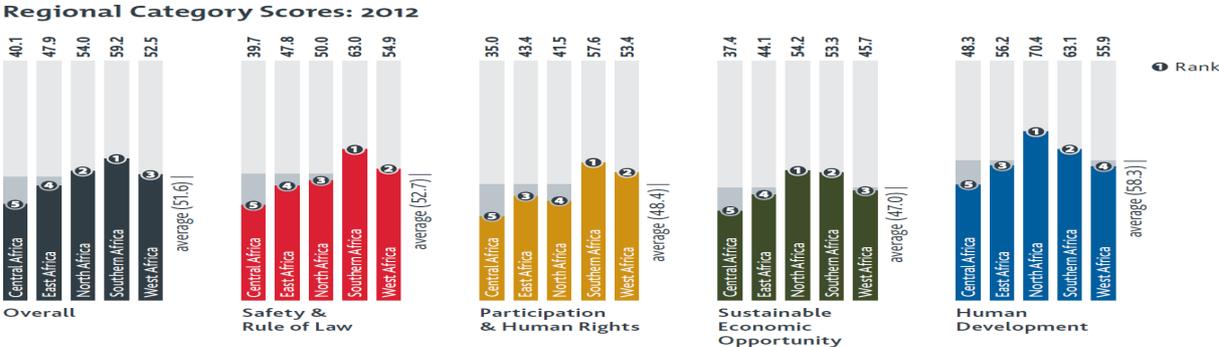


Governance

African countries are at different levels of progress relative to these preconditions. Credit-to-GDP in most countries is below the 50 percent threshold and only three countries (Cape Verde, Mauritius, and South Africa) have a higher financial depth (Figure 4). Countries such as Botswana, Kenya and Namibia are closing the gap.

There is also ample room to improve governance indicators across all regions. The Ibrahim Index of African Governance (Figure 5) measures progress in how countries ensure safety and the rule of law, encourage participation and defend human rights.⁵ It also measures opportunities for sustainable economic opportunity and human development. Although there has been some progress over the years, governance indicators show that there is scope for significant improvements.

Figure 5. Ibrahim Index of African Governance



⁵ See <http://www.moibrahimfoundation.org/iiag/>

Macro Policies

Macroeconomic policies in Africa have improved but performance remains uneven across regions. Ten-year average inflation rates are below double digit in most RECs (Figure 6).⁶ However, average ratios of government revenue-to-GDP remain low (Figure 7).

Figure 6

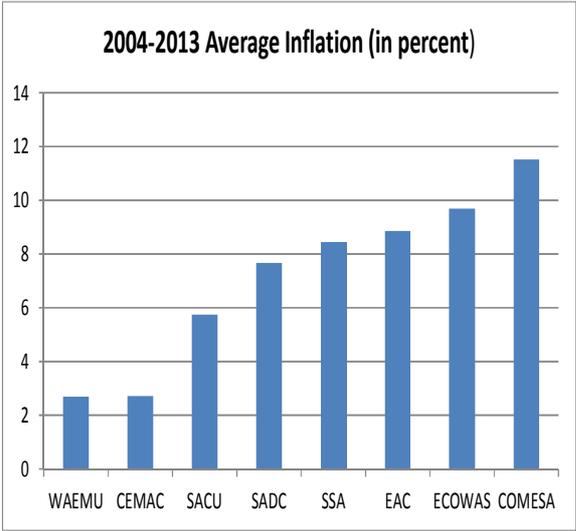
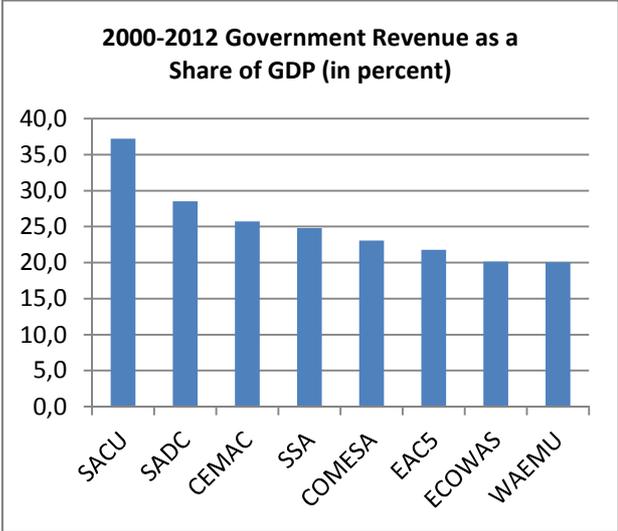


Figure 7



Trade

Intra-regional trade has increased but remains low and non-tariff barriers are high. While the European Union and, more recently, China and other emerging markets remain the continent’s largest trading partners, intra-African trade, especially with Nigeria and South Africa, is increasing rapidly. Intra-African trade increased more than fivefold to \$148.9 billion in 2012 from \$27.9 billion in 1995. Yet intra-African trade was the lowest in the world at 12 percent in 2012 compared with 25 percent for ASEAN, and 17 percent for MERCUSOR. Efforts to eliminate tariffs and non-tariff barriers, which remain high and implement the roadmap to free trade areas and customs unions will need to be strengthened. For instance, in its initial phase, the U.S. initiative with the East African Community (EAC)—Trade Africa—aims to double intra-regional trade in the EAC, reduce by 15 percent the average time needed to import or export a container from the ports of Mombasa or Dar-es-Salaam to landlocked Burundi and Rwanda, and decrease by 30 percent the average time a truck takes to transit selected borders.

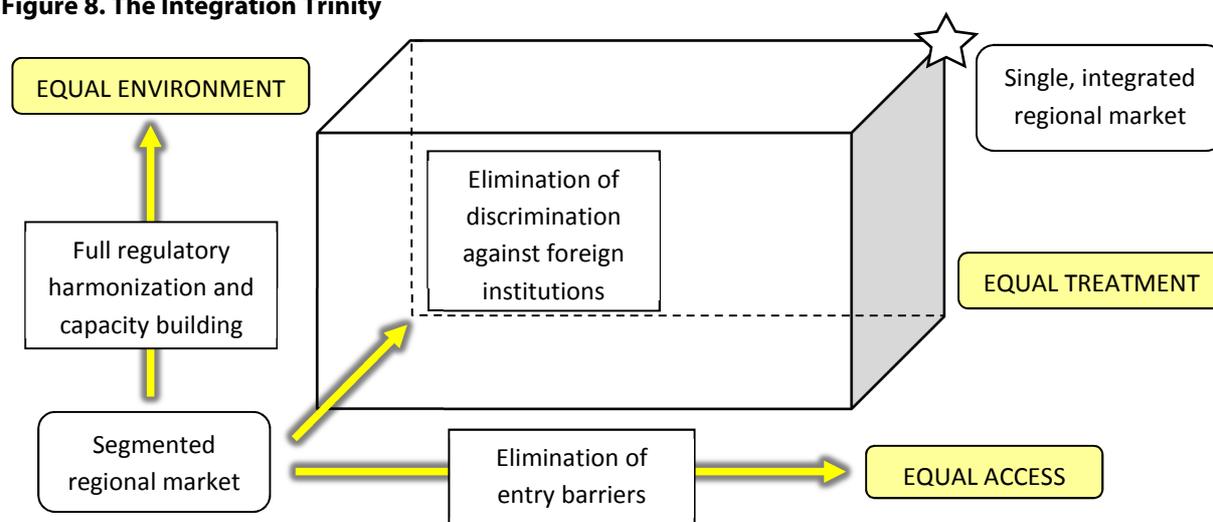
⁶ The low inflation in the WAEMU and the CEMAC can be attributed in part to their pegged exchange rate regimes.

3. The Integration Trinity

The Three Dimensions of the Single Market: Equality of Access, Rules and Treatment

Policies that aim for a similarity of access, rules and treatment strengthen financial integration (Figure 8). More specifically, financial instruments and services can be considered fully integrated if all potential market participants with the same relevant characteristics (1) have equal access to the above-mentioned set of financial instruments and services (equal access); (2) face a single set of rules when they decide to deal with those financial instruments and services (equal rules); and (3) are treated equally when they are active in the market (equal treatment) (see Baele, Ferrando, Hördahl, Krylova, Monnet, 2004).

Figure 8. The Integration Trinity



Source: Asian Development Bank, (2013)

African RECs are at different levels of integration. At one end of the spectrum, countries in the Maghreb lag in the integration process for political reasons. At the other end, countries in the West African Economic and Monetary Union (WAEMU) have achieved a relatively high degree of financial integration.

Common Institutions in the WAEMU⁷

The structure of the financial sector and common institutional arrangements indicate that financial integration in the West African Economic and Monetary Union is well-advanced (see Sy, 2006). In addition to a common currency (the CFA franc), the WAEMU boasts a common legal and regulatory framework, a single licensing regime, common regulators and supervisors, and a common financial infrastructure. Over time, initiatives to promote regional financial integration in the WAEMU have included:

- Since 1962, the West African Economic and Monetary Union treaty has laid the basis for a monetary union with a single currency and regional central bank (Banque Centrale des Etats de

⁷ The CEMAC in central Africa has a comparable set-up and has also achieved a high level of institutional integration.

l'Afrique de l'Ouest—BCEAO) responsible for the conduct of monetary policy. There are no capital controls within the WAEMU.

- A single banking commission (Commission Bancaire de l'UMOA) was created in 1990 to strengthen regional banking supervision. The commission is managed by a secretary general and headed by a president, who is also the governor of the BCEAO. Since 2004, a single banking license is sufficient to set up banking operations in the WAEMU. The decision to grant or withdraw a banking license involves both the banking commission and the relevant national finance minister.
- There are no cross-border restrictions on banking and other financial services except insurance. Approval is granted on a nondiscriminatory basis. However, for "prudential" reasons, countries will not be prevented from taking certain measures, such as requiring approval by the minister responsible for finance or the central bank and/or any other measures, which have or may have a prudential effect.
- Insurance contracts for residents or for property located in a given WAEMU country can only be concluded with entities that have been approved for such purpose in that country. The minister responsible for insurance grants approval after consultation with the Insurance Control Commission.
- The 1995 PARMEC law (Projet d'Appui à la Réglementation sur les Mutuelles d'Epargne et de Crédit) for savings and credit institutions laid the basis for a regulatory framework for cooperative financial institutions in the region. In 1994, the BCEAO introduced a microfinance monitoring system (Decentralized Financial Systems (DFS) monograph).
- The regional capital market includes a common interbank market and a single market (Bourse Régionale des Valeurs Mobilières—BRVM) for both bond and stock trading, and fund management (SICAV), which is supervised by a regional securities commission (Conseil Régional de l' Epargne Publique et de Marchés Financiers—CREPMF). In addition, pension funds have been supervised since 1996 by a regional body, Conférence Interafricaine de la Prévoyance Sociale—CIPRES.
- Insurance companies are supervised under the 1992 Inter-African Conference on Insurance Markets (Conference Interafricaine du Marché des Assurances—CIMA) treaty among the African franc zone countries by a single regional authority (Commission Régionale de Contrôle des Assurances—CRCA). There is a regional reinsurance company (CICA-RE).
- Since 1996, a regional commercial legal framework (Organisation pour l'Harmonisation du Droit des Affaires en Afrique—OHADA) has been in place.

Accounting standards for financial institutions have been modernized to bring them in line with international standards. Similarly, accounting standards for corporations have been harmonized in the context of the West African Accounting System (Système Comptable Ouest Africain—SYSCOA). Moreover, a balance sheet center (centrale des bilans) is maintained at the BCEAO and includes balance sheet information for a number of borrowing firms.

- A reform of the payment system has led to a regional real time gross settlement (RTGS) system and a regional automated clearing house (ACH). A centralized database tracking unpaid checks (centrale des incidents de paiement) is also maintained by the BCEAO.
- Government securities markets are integrated and cross-border purchases of Treasury bills and bonds have grown very rapidly (Sy, 2010).

Pan-African Banking Groups

Financial integration has increased through the geographic expansion of pan-African banking groups across the continent (see Lukonga, 2010). In particular, South African banks expanded their cross-border operations starting in 1995. This first wave was followed by the rapid expansion of Nigerian, Moroccan and other banks headquartered in Mali and Togo. This trend is continuing with the recent entry of Standard Bank in Cote d'Ivoire as part of a broader plan to expand its service offerings across the rest of francophone Africa. The main driver of this expansion is the expected growth in foreign direct investment in mineral wealth and economic growth.

The rapid expansion of pan-African banks comes with both benefits and challenges. Recent financial crises point to the importance of adequate regulation and supervision of systemically important financial institutions (SIFIs). Although pan-African banking groups are not large enough to fall in the category of global SIFIs, the current regulatory and supervisory frameworks in many countries need to take into account the risks they entail, including the risk of moral hazard. Cross-border regulation is still fragmented and the prudential framework needs to follow the pace of rapid developments. Supervision is not on a consolidated basis except in a few countries such as South Africa. There is a need to set up more colleges of supervisors for more intrusive supervision, crisis management and cooperation for bank resolution.

Regional Securities Markets

Regional exchanges can benefit countries but domestic exchanges dominate, partly for "nationalist" reasons. The EAC scorecard notes that in 2012, nine out of 43 countries with a GDP less than \$5 billion operated their own exchange. Not surprisingly, such exchanges are small, with a limited number of issuers and a shallow investor base. In contrast, six countries participated in regional exchanges hoping to benefit from larger scale and improved access to capital markets.

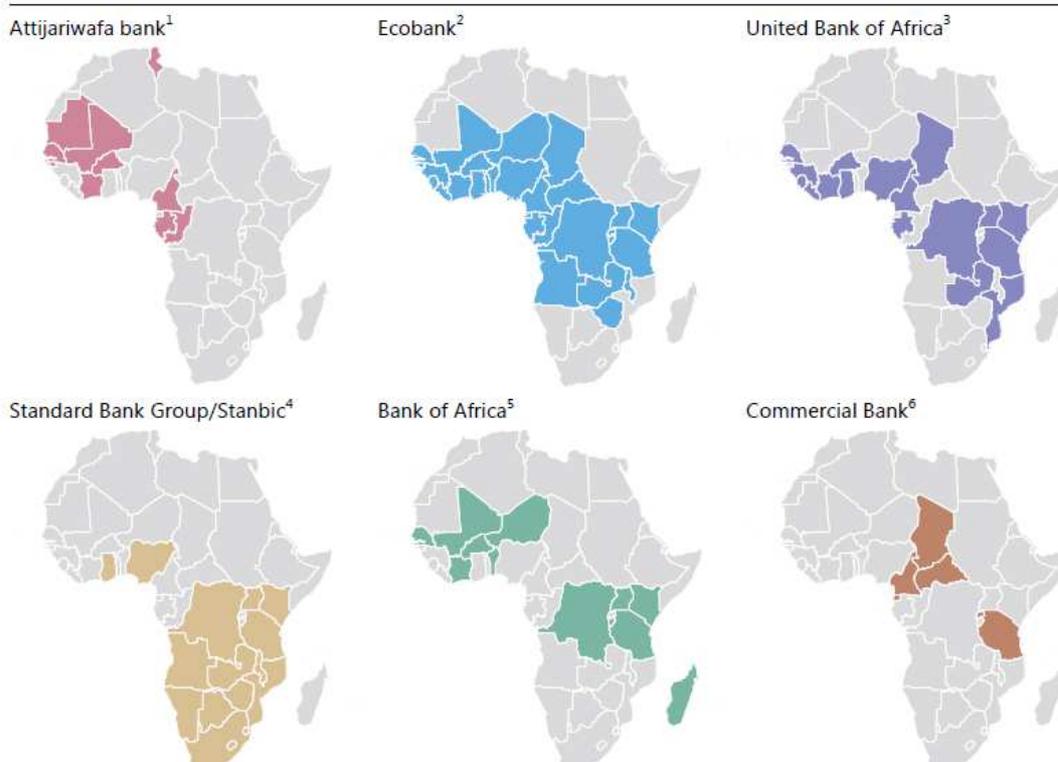
Although efforts are underway to harmonize laws and trading platforms, capital controls restrict participation in regional markets. Since 2013 in the EAC, central depository systems have been interlinked and a few companies are cross-listed. The regional commodity exchange (the East African Exchange, EAX) based in Rwanda is set to trade products from the region.⁸ However, capital controls restrict Burundian and Tanzanian investors from investing in EAC markets, and the Tanzanian regulatory framework restricts access to its stock exchange for investors from the EAC region. Removing such controls would give investors and firms in Burundi access to the other exchanges in the EAC that have a \$35.5 billion market capitalization and 101 listed companies.

⁸ See <http://www.ea-africaexchange.com/about-us-2/company-overview/>. Other more domestically focused exchanges include the Ethiopia Commodity Exchange (ECX) and the JSE Agricultural derivatives.

Figure 9

Geographical distribution of pan-African banking

Graph 5



¹ Burkina-Faso, Cameroon, Congo, Côte d'Ivoire, Gabon, Guinea-Bissau, Mali, Mauritania, Senegal and Tunisia. ² Angola, Benin, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of Congo, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Malawi, Mali, Niger, Nigeria, Republic of Congo, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, Togo, Uganda, Zambia, Zimbabwe. ³ Burkina Faso, Cameroon, Chad, Côte d'Ivoire, Democratic Republic of Congo, Gabon, Ghana, Guinea, Kenya, Liberia, Mozambique, Nigeria, Senegal, Sierra Leone, Tanzania, Uganda and Zambia. ⁴ Angola, Botswana, Democratic Republic of Congo, Ghana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. ⁵ Benin, Burkina Faso, Burundi, Côte d'Ivoire, Democratic Republic of Congo, Mali, Niger, Kenya, Madagascar, Senegal, Tanzania and Uganda. ⁶ Cameroon, Central African Republic, Chad, Equatorial Guinea, Rwanda, São Tomé and Príncipe and Tanzania.

Sources: IMF, *Regional Economic Outlook*, April 2011; Attijariwafa bank website.

African institutional investors could play an important role in integrating securities markets through cross-border investments. But African countries are at different level of development of their pension and insurance industries. In some countries, pension reform is still ongoing, and in others the life insurance industry has not yet picked up. Asset allocation by many pension funds is limited to real estate assets and domestic government securities, often because of regulation and the dearth of investable assets. The recent decision by the \$150 billion South African public pension fund, the Public Investment Corporation (PIC), to start investing in the region is a good start. Listing requirements for exchange-traded funds (ETFs) and depository receipts (DRs) in African stock exchanges are also promising.

Investment

Intra-African investment into new FDI projects is growing rapidly. At a 32.5 percent annual growth rate since 2007, investments by African countries in the region are growing four times faster than FDI from developed markets (EY, 2014).

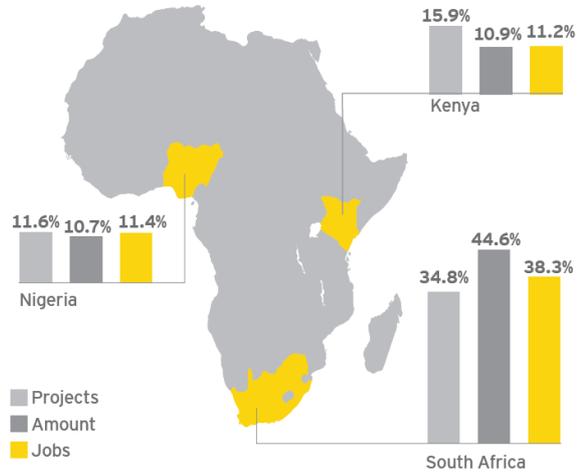
Financial Openness

There is, however, scope to reduce barriers to the free movement of capital. The Chinn-Ito index, a commonly used measure of the extent of the openness in cross-border financial transactions, indicates that most African countries remain relatively closed. Out of the 52 African in the sample, only 12 had a positive index as of 2011 (about 23 percent), and 16 countries (about 30 percent) had an index above the average value (the index values range from a minimum of -2.0 to a maximum of +2.5) (Figure 11). These figures indicate the large scope available for reducing barriers to the freedom of movement of capital. Of course, the sequencing and scope of capital account liberalization will have to balance the associated benefits and costs, and the threshold effects discussed earlier. The example of current developments in the EAC provides a good illustration of the challenges of opening capital flows regionally.

Figure 10

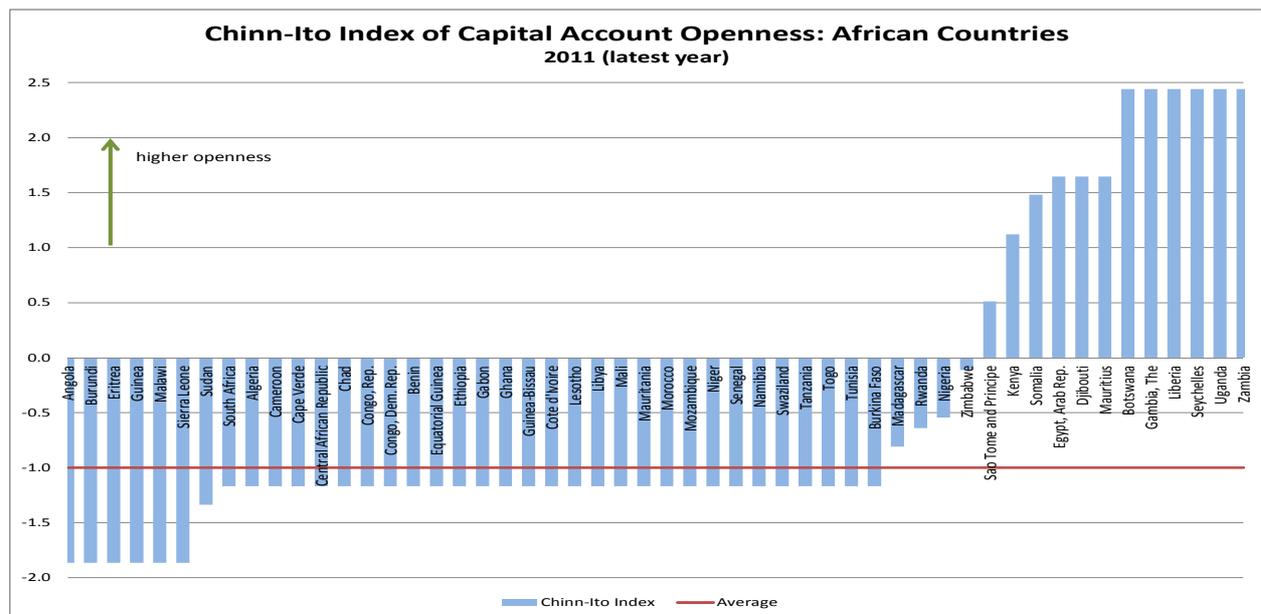
Largest intra-regional investors in Africa

(Share of FDI projects from Africa as source region)



Source: fDi Intelligence.

Figure 11



The East African Community Common Market Scorecard

Article 24 of the EAC Common Market Protocol requires the elimination of restrictions on the free movement of capital, including restrictions based on nationality, place of residence, current payments and where capital is invested. [The EAC Common Market Scorecard 2013](#) (World Bank, 2014) measures the degree of Partner States' legal compliance with their obligations to liberalize the cross-border movement of capital.⁹ It also considers barriers to the free movement of services and goods. The operations covered include securities and credit operations as well as direct investments and personal capital transactions. Financial services such as legal and accounting services as well as telecommunications services are also considered.

The 2014 scorecard indicates that barriers to the free movement of capital and services among partner states include different laws and regulations, membership in multiple RECs and capital controls. The scorecard stresses that progress to eliminate restrictions has been slow. Some Partner States have introduced new measures despite their obligations under the EAC Common Market Protocol.

Recommendations to eliminate entry barriers include the need for:

- The EAC Secretariat and Partner States to create a transparent and credible system for monitoring the free movement of capital in the EAC by enforcing the existing notification mechanism.
- Partner States to impose restrictions on the movement on capital only on a temporary basis.
- The EAC to rollback laws, regulations and investment codes that impede investment.
- Capacity building by countries and partners, including the development of market intermediaries, stronger coordination of securities markets, and more investment in public awareness.

Interestingly, the EAC Scorecard notes that entry barriers are not the only restrictions. Several forms of discrimination persist even after entering the market, such as different fees for transactions and government services, ceilings on the value of transactions, limits on the type and length of projects for service providers and higher taxes for foreign firms.

4. Trade, Finance & Plumbing

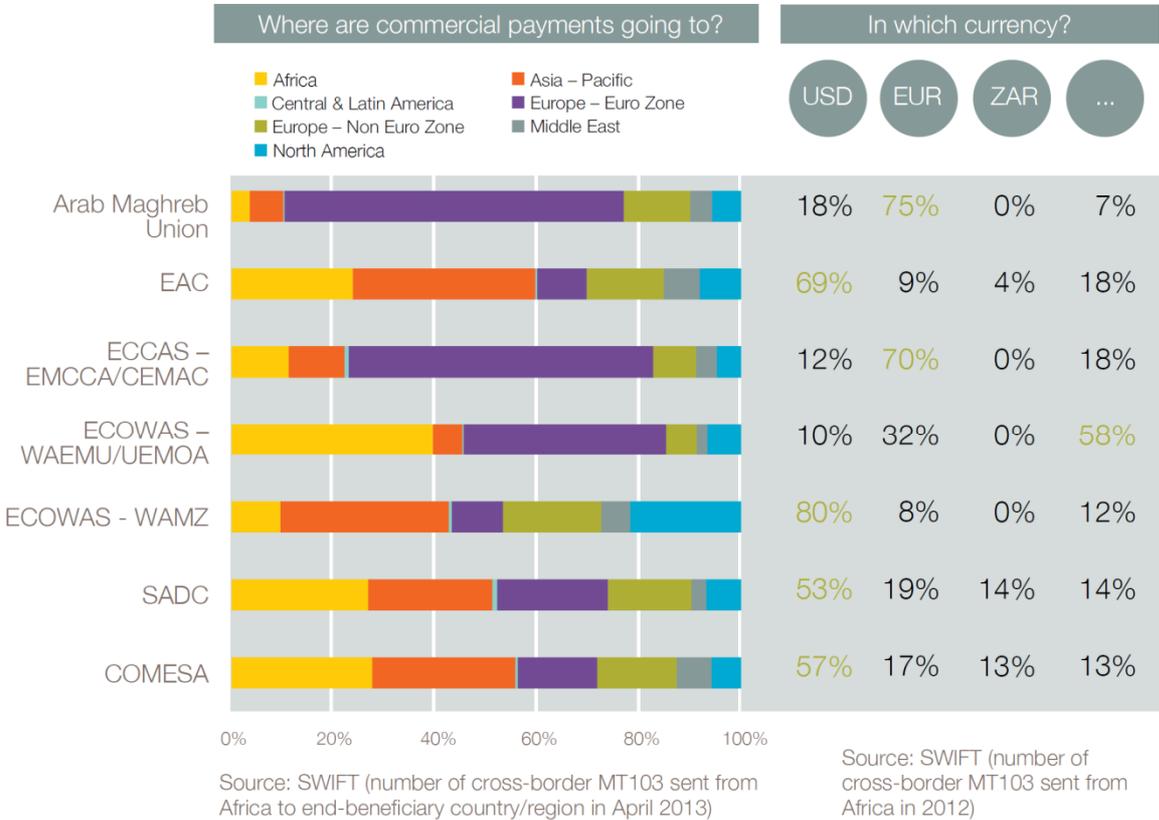
A financial system performs at least three main functions: (1) financing; (2) screening and monitoring; and (3) payments and settlements, the "plumbing." The last function, although often overlooked in high-level policy circles, plays a key role in facilitating financial integration. Well-functioning and cost-efficient payment and settlement systems help support intra-regional exchanges of trade and finance as well as remittances. Solutions to reduce the transaction costs that are due to foreign currency clearing and settlement; currency risk; and remittance transfers.

⁹ <https://www.wbginvestmentclimate.org/publications/eac-market-scorecard-2014.cfm>

Clearing and Settlement in Foreign Currency

Transaction costs arise when trade and investment is cleared and settled in foreign currency outside Africa. For instance, SWIFT figures (see Figure 12) indicate that about 50 percent of intra-African import and export settlements involve a bank outside Africa.¹⁰ In particular, U.S. dollar clearing banks are becoming more important as trade and investment within Africa (about 23 percent of total trade according to SWIFT data¹¹) and with China and other emerging markets is increasing. Know-your-customer (KYC), anti-money laundering and combating financial terrorism (AML/CFT) regulations also increase transaction costs. Financial integration can help reduce transaction costs and SWIFT figures show that intra-regional trade is higher in the WAEMU than in other RECs, reflecting the use of a common currency and a regional financial infrastructure, (RTGS and ACH).

Figure 12. Commercial Payments from RECs



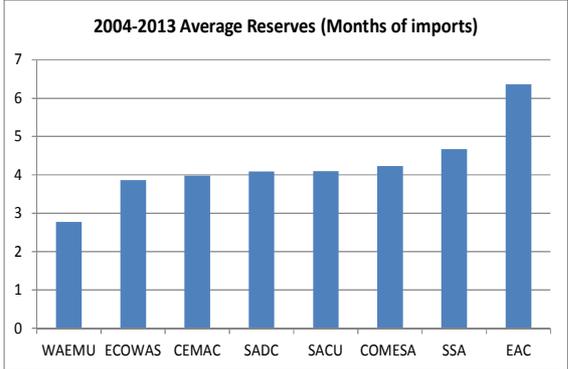
Currency Risk

There is also a need to reduce the transaction costs from trading in at least 30 different currencies in the region. High market volatility and administrative measures by central banks with, at times, low foreign exchange reserves remain an issue. Furthermore, the number of countries adopting more flexible exchange rate regimes has increased, resulting in higher market volatility as

¹⁰ SWIFT is the Society for Worldwide Interbank Financial Telecommunication.
¹¹ The data from SWIFT indicate larger cross-border volumes than balance of payments data...

exchange rates are a more frequently used tool to absorb external shocks. In addition, many countries rely on administrative measures in the foreign exchange markets and ration out foreign currencies when international reserves are low (Figure 13). Instruments to mitigate currency risks such as swap arrangements would help strengthen cross-border investments. In the absence of private sector involvement, considerations could be given to multilateral solutions. For instance, the World Bank’s private finance arm, the IFC, issues bonds in local currency such as the CFA franc and, more recently, Rwandan francs but typically swaps its positions back to U.S. dollars.

Figure 13 Foreign Exchange Reserves



Intra-Regional Remittances

Regional integration entails the free movement of people. Remittances can be an important source of foreign exchange for some countries and have exceeded 10 percent of GDP in Togo, Cape Verde, Senegal, Nigeria and Lesotho (AEO, 2013).¹² Intra-regional remittances, in particular from South Africa and Nigeria, indicate some degree of financial integration. However, transfer costs within Africa are the highest in the world. For instance, it costs about \$19.5 to \$21.0 to transfer \$200 from South Africa to Malawi, Angola, Mozambique, Botswana or Zambia. These costs are seven to more than 10 times higher than the cheapest transfers (from Singapore, the United Arab Emirates or Saudi Arabia) (Table 1¹³).

Table 1. U.S. Dollar Cost of Transferring \$200 (World Bank Data)

5 Most Costly Corridors in USD	Average Cost	5 Least Costly Corridors in USD	Average Cost
South Africa > Zambia	21.06	Saudi Arabia > Pakistan	1.73
South Africa > Botswana	20.18	Singapore > Thailand	2.05
South Africa > Mozambique	19.81	UAE > India	2.68
South Africa > Angola	19.55	UAE > Sri Lanka	2.87
South Africa > Malawi	19.51	Singapore > Bangladesh	3.03

¹² http://www.africaneconomicoutlook.org/en/outlook/financial_flows/remittances/
¹³ See <http://remittanceprices.worldbank.org/en>

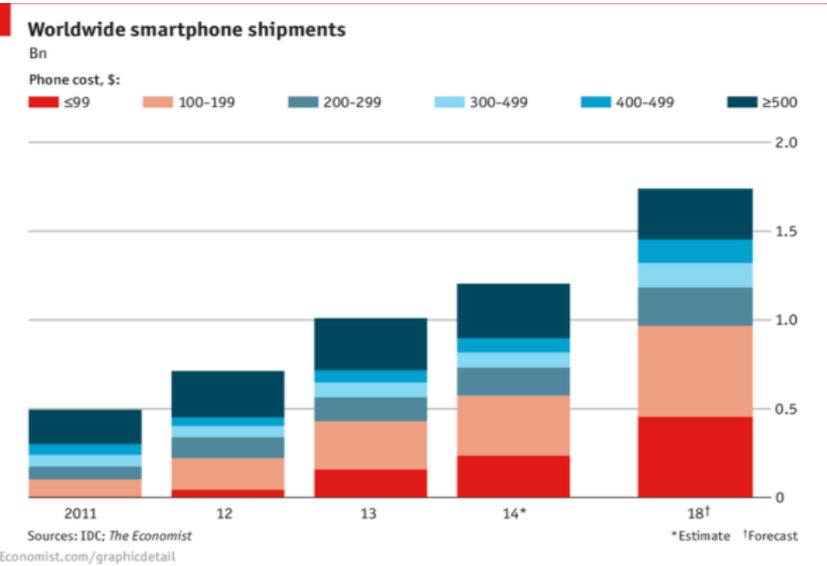
Mobile Payments

Mobile payments could help reduce transactions. For instance, Orange Money is present in 11 countries in sub-Saharan Africa and mobile-to-mobile payments in CFA francs are possible between some West African countries (Cote d'Ivoire, Mali and Senegal). Similarly, in East Africa, Tigo offers cross-border mobile money transfers with automatic currency conversion between Tanzania and Rwanda.

The unexpected rapid growth of mobile usage in sub-Saharan Africa suggests that there is a potential for mobile payments to increase. The number of mobile subscriptions in sub-Saharan Africa increased to about 650 million in 2011 from 16.5 million in 2000 (Figure 14). Efforts to increase internet usage coupled with the lower cost of smartphones could help reduce further the costs of mobile payments and other innovative solutions. Indeed, companies are increasingly targeting emerging markets with plans to manufacture smartphones that would sell at retail for \$20-25.¹⁴

Such developments could also increase financial inclusion. It will be important, however, to strike the right balance between regulatory objectives such as customer protection or KYC regulation and the pace of innovation. The African Mobile Phone Financial Services Policy Initiative provides a forum for regulators to discuss these issues and adapt regulations accordingly.¹⁵

Figure 14



¹⁴ See for instance <http://wallstcheatsheet.com/technology/arm-20-smartphone-will-be-here-soon.html/?a=viewall#ixzz31FkSiBCg>

¹⁵ AMPI web page and Brookings paper.

Conclusion

Economic and political integration is without a doubt proceeding in Africa but progress is uneven among regional economic communities. Financial integration is not just an important element of the integration process. It can be a key driver of integration given its role in facilitating further regional trade, investment and remittance flows.

This paper proposes 4 tools to strengthen financial integration. First, “political commitment devices” can ensure a steady progress on the road to an economic community. Stronger regional institutions staffed with the appropriate level of technical staff can monitor such progress and put pressure on laggards to respect their regional commitments. Regional projects such as infrastructure projects can also be an effective tool to garner political commitment from regional leaders. In short, the regional institutional set up should be strengthened to give incentives to policymakers to respect their engagement towards integration. Measurement of the degree of financial integration is a first step.

Second, the economic benefits from financial integration are better secured when countries achieve certain “threshold conditions.” The most important ones are minimum levels of financial development and governance.

Third, the road to a fully integrated financial region involves efforts to attain the “trinity” of equality of access, rules and treatment. Policymakers will have to eliminate entry barriers, and once foreign institutions enter domestic markets, refrain from discriminating against them. Policymakers will also have to harmonize regulations further and build capacity, especially in banking supervision.

Last but not least, the “plumbing” of financial integration can provide quick gains. Transaction costs are high in Africa. A U.S. clearing bank has to be involved when two African countries trade among themselves in U.S. dollars. Banks with corporate clients in different countries in the region need to deal with multiple currencies, and, at times, high market risk and exchange restrictions. African migrants pay the highest costs in the world to send remittances from one African country to another. Improvements in payments and settlement systems, and risk management systems can reduce such transaction costs. There is also a need to consider solutions such as swap arrangements or a multi-currency clearing center. In the meantime, innovation is proceeding at a rapid pace and mobile payments can now occur between some African countries with different currencies. Regulators will need to keep pace with such developments without stifling their benefits.

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“Sur quoi la fondera-t-il l'économie du monde qu'il veut gouverner? Sera-ce sur le caprice de chaque particulier? Quelle confusion! Sera-ce sur la justice? Il l'ignore.”

Pascal



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