

**AN ANALYSIS OF THE EXPERIENCES OF
FINANCIAL AND MONETARY COOPERATION IN
AFRICA**

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1. INTRODUCTION

The last decade has witnessed a growing interest among African nations in developing financial and monetary cooperation arrangements that help to strengthen their own financial institutions and complement their efforts to reach out to a fast globalizing world. The new arrangements are intended not only to help improve the mobilization of resources, both domestic and foreign, but also to help in improving the regulation of institutions in order to avert crises in the financial and exchange rate systems. The realization that strong financial systems are important in providing access to greater financial resources from more varied sources, particularly as countries pursue macroeconomic reforms, is certainly now more widespread.

The new interest is not surprising, considering that one of the most significant developments in global finance has been the growth in capital flows between industrialised and developing economies in the last decade, but which has eluded Africa. Africa's share of the significantly expanded private capital flows to developing countries has averaged only 1.6% in the last decade. There are also indications that private capital flow to Africa slowed down in the wake of the East Asian crisis, even if this was considered to be far less significant than the slow down in East Asia. (See Tables 1 and 2). These developments have been partially blamed on the fragility of financial markets in the region (Aryeetey and Senbet 1999) despite financial sector reforms in many countries.

The interest in greater financial and monetary cooperation for the purpose of enhancing resource flows and regulating such flows is partially linked to the turmoil that the world saw in the 1990s in relation to financial crises in Asia and other parts of the world. The crises led to discussions for a new international financial architecture that was pinned on strengthening the surveillance of financial markets through requirements for greater transparency and the flow of information; strengthening financial regulation and supervision; assisting countries to overcome difficulties in the implementation of international standards and regulations through capacity-building; improving liability management on the part of borrowers; encouraging the avoidance of dogma in exchange rate determination; sharing responsibility between private creditors, the international community and debtor authorities in crises resolution; and finally a number of measures for dealing with emergencies, including imposing reserve requirements on short-term capital flows, withholding taxes on such short-term inflows and expansion of country reserves. The new architecture also involves the need for greater transparency in the functions of the international financial institutions. While the new measures are generally

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regarded as essential for bringing sanity into the operations of financial markets and limit the occurrence of crises, it is not clear whether such measures necessarily attract and sustain private capital.

Table 1: Private Capital Flows in Selected Countries

Country	Net Private Capital Flows		Foreign Investment		Direct Investment		Portfolio Investment		Bank and Trade-Related Lending	
	\$ millions		\$ millions		Bonds \$ millions		Equity \$ millions		\$ millions	
	1990	1998	1990	1998	1990	1998	1990	1998	1990	1998
Cote d'Ivoire	57	181	48	435	-1	-23	0	6	10	-237
Ghana	-5	42	15	56	0	0	0	15	-20	-29
Indonesia	3235	-3759	1093	-356	26	-141	312	250	1804	-3512
Kenya	124	-57	57	11	0	0	0	4	67	-72
Korea	1056	7644	788	5415	168	1220	518	4096	-418	-3087
Malaysia	769	8295	2333	5000	-1239	-314	293	592	-617	3017
Nigeria	469	1028	588	1051	0	0	0	2	-121	-25
Senegal	42	24	57	40	0	0	0	0	-15	-16
South Africa	--	783	--	550	--	303	0	619	--	-689
Thailand	4399	7825	2444	6941	-87	-632	449	2341	1593	-826
Uganda	16	198	0	200	0	0	0	0	16	-2
Zimbabwe	85	-217	-12	76	-30	-30	0	3	127	-266

Source: World Bank (2000), World Development Indicators.

Table 2: Capital Flows to Developing Countries (In billions of U.S. dollars)

	1970	1990	1996
Developing Countries			
Total net capital inflows*	8.1	60.2	196.9
Net foreign direct investment	2.3	19.3	90.7
Net Portfolio Investment	0.2	18.5	44.6
Other	5.5	22.4	61.1
Africa			
Total net capital inflows	1.4	7.3	15.4
Net foreign direct investment	0.6	1.4	5.1
Net Portfolio Investment	0.1	-1.6	0.7
Other	0.7	7.5	9.6
Asia			
Total net capital inflows	1.8	33.8	101.9
Net foreign direct investment	0.3	10.0	54.8
Net Portfolio Investment	0.0	0.3	9.2
Other	1.5	23.5	37.4

Source: IMF, World Economic Outlook Database * Not including reserve assets.

It is important to note also that the emergence of the European Monetary Union has raised considerable interest in the development of similar arrangements in various parts of Africa. (Honohan and Lane 2000). Thus, beyond the issue of fitting properly into an international financial architecture sub-regional integration bodies have considered

financial cooperation as part of a broader framework to achieve greater regional integration, including greater monetary cooperation. Thus, in West Africa, for example, the ECOWAS monetary co-operation program adopted in 1987 was intended to achieve, in the medium-long term, the convertibility of West African currencies and the creation of a single currency by the year 2000. What has been achieved so far is much more modest. The West African Clearing House (WACH) has been transformed into a West African Monetary Agency (WAMA), a Credit Guarantee Fund for the WAMA clearing and payments mechanism has been introduced and West African travelers' cheques have been issued since late 1998. Further progress in achieving a common currency has been constrained by the severe macroeconomic conditions in member states.

Among the several objectives of the newly established East African Co-operation agreement is the creation of a common market, subsequently a monetary union, and ultimately a political federation. Achieving these goals is predicated on progress in policy harmonization, macroeconomic stability, and development of infrastructure. It has not moved as fast as the West African nations on the monetary cooperation front. The treaty steered clear of customs union and common market issues, having only two articles on safeguards.

Financial and monetary cooperation in Southern Africa is dominated by the role of South Africa which drives both the regional currency areas in the Common Monetary Area (CMA) and the Southern African Development Community (SADC). Indeed there are various regional integration initiatives involving the southern African region, each with its own program of action. The Declaration and Treaty establishing the SADC in 1992 does not specifically refer to a regional currency area. But it is generally considered in the region that monetary integration may be one way in which economic integration could be furthered, culminating in the creation of a regional monetary union. For the moment however, monetary integration in SADC may be regarded as a long-term objective, and not as urgent as in West Africa.

While different parts of Africa may be moving at different paces towards financial and monetary cooperation, it may be important to note that there have been some assessments of how such arrangements relate to similar developments in other parts of the world. Following the introduction of the Euro, Honohan and Lane (2000) analyzed the prospects for greater monetary integration in Africa in the wake of the European Monetary Union. They argued that even though the structural characteristics of African economies are quite different from those of European economies, much could be gained from monetary cooperation, with the European Union acting as an external agency of restraint and for promoting stability in the financial sector. They conceded, however, that one should not expect too much from such arrangements. They observed that there was little evidence of contagious attacks on African currencies requiring the coordination of exchange rate policies. And economies of scale in the prudential regulation of financial systems could be achieved through international cooperation without the need for a common currency. They also suggested that the same was true of enhanced risk-pooling through the financial system. In their study, the European Monetary Union has only a marginal impact on the net benefits of monetary cooperation, but the euro would be a natural

anchor for any African monetary union, especially if the United Kingdom and the sterling were to join the European Monetary Union. The promoted strongly the idea that “the most likely route to new monetary cooperation in Africa is through a common peg to the euro”.

Interest in financial and monetary cooperation is certainly growing. The World Bank’s support for regional cooperation, including monetary cooperation, is based on the premise that, it can lead to poverty reduction by strengthening the links between the poorer land-locked countries and their more prosperous coastal neighbors, and thereby help in achieving faster economic growth in central Africa. The World Bank has a five year assistance program designed to support such integration and cooperation efforts. The core activities of interest here are banking sector monitoring, microfinance development and the development of a bills and bonds market (World Bank 2003). In addition, the World Bank Institute (WBI), in support of regional cooperation, offers learning programs in Sub-Saharan Africa. These include the securities market development program that focuses mainly on the development of stock exchanges in West and Central Francophone Africa regions. The objective of the program is to assist responsible policy makers in creating an enabling environment for the orderly development of financial markets. It is also expected to assist public and private market participants to improve their knowledge of market concepts through a series of skills building and market simulation courses.

Considering the various pressures and dynamics for financial and monetary cooperation in Africa, this paper discusses the scope of these and the experiences of different parts of the region. It is intended to draw attention to factors underlying current initiatives in the region and assess their prospects for achieving set objectives. In section 2, the paper discusses various concepts of regional financial cooperation starting with the theory of optimal currency areas and then focusing on the fact that underlying the various arrangements for financial cooperation is a goal of addressing the risky nature of financial markets reflected by the thinness and illiquidity of the markets, including the capital markets. It will show how the pooling of resources through regional cooperation and the development of capital markets is expected to enhance the mobilization of both domestic and global financial resources to fund regional companies. Section 3 is used to discuss the current state of African financial systems after reform with a view to showing how regional cooperation is expected to enhance its performance. In section 4, the paper discusses African experiences in regional financial and monetary cooperation. This review section looks at the presence of the different types of cooperation arrangements and how they are linked to the structure of financial markets. Section 5 of the paper assesses the outcomes of cooperation efforts and looks at the potential for enhanced financial and monetary cooperation in parts of Africa. Section 6 provides a brief summary and conclusions.

2. CONCEPTS OF FINANCIAL AND MONETARY COOPERATION

The discussion of financial and monetary cooperation may be linked to the concepts of optimal currency areas, even though it is possible to achieve considerable cooperation in the absence of such a union. The relevance of the literature on optimal currency areas is drawn from the fact that African countries' search for additional financial resources from global sources and the need to protect themselves against any adverse side effects makes the need for bolstering confidence in their currencies important. In the past the search for confidence bolsters often led to aligning currencies with one of the major currencies of the world, usually the US dollar. But our understanding of the short and long run consequences of monetary and exchange rate policies has grown remarkably, while there has been a trend towards greater independence of monetary authorities around the world. And this has improved confidence in many currencies, to the extent that the decision of which currency to be aligned with is becoming less influenced by concerns about confidence. In the absence of concerns about confidence, the thinking regarding currency alignments revolves around the fundamental economic natures of the different economies. That means 'birds of the same feather would have to flock together', and this is influencing today many of the financial and monetary cooperation attempts being made throughout Africa. In effect, how can countries with similar interests support one another?

The literature on optimal currency areas provides some limited help in answering the question of how countries can support one another. It must be pointed out that, to enter a monetary union, countries should not only think about the benefits of such a union but should also consider the economic effects on the different members. The optimal currency area theory that tends to examine the benefits and costs of monetary unions is generally associated with Mundell (1961). The optimal currency area (OCA) theory emerged out of the debate over the relative gains and costs of flexible versus fixed exchange rates. The optimal currency area was defined as the "optimum geographical domain having as a general means of payment either a single common currency or several currencies whose exchange values are immutably pegged to one another with unlimited convertibility for both current and capital transactions, but whose exchange rates fluctuate in unison against the rest of the world" (Kaboub 2001) It is intended to achieve the macroeconomic goal of maintaining internal and external balance.

There has been considerable interest in identifying the special characteristics of an OCA, as well as the benefits and costs of the participation in it. The first characteristic of an OCA is the price and wage flexibility, which was the basis for Friedman's argument in favor of flexible exchange rates. A second characteristic of an OCA is that of financial market integration, suggesting that a successful currency area must be tightly integrated in financial trading. The third characteristic mentioned by Mundell (1961) is that of factor market integration. This includes internal factor mobility, both inter-regional and inter-industry mobility. The fourth is the integration of the goods market, suggesting that a successful currency area must have a high degree of internal openness that could be measured by the marginal propensity to import or the ratio of tradable to nontradable goods in production or consumption.

Another major characteristic of an OCA is political integration. It requires a close coordination of national monetary authorities or even the creation of a supranational central bank, such as the European central bank, which implies the surrendering of the national sovereignty over the conduct of monetary policy. It therefore implies that before a country decides to join a currency area, it has to evaluate the benefits and costs of its participation from a purely nationalistic point of view.

On the benefits and costs of participating in an OCA, it has been observed that a financially unstable country could benefit from joining a more financially prudent currency area and enjoy a high liquidity value of money. All countries will also benefit from the risk-sharing domain, the reduction in the official reserves, and the elimination of speculative capital flows. However, the major cost attached to joining a currency area is the loss of monetary independence, which may force member countries to depart from an internal balance for the sake of external balance. This cost could be high if the country has a low tolerance for unemployment and is facing a strong price and wage pressure from monopolistic industries, labor unions and long-term contracts.

The European experience with a common currency is probably the most relevant to answer the question of how countries may support one another. It may be observed that twelve European countries initially adopted a common currency which they have called the Euro. Now six West African countries are considering the creation of the Eco by 2005, in addition to the existing monetary union of the CFA zone in the same region. In southern Africa there is talk of creating a Rand zone, and yet other discussions of adopting the dollar as a common currency.

The theory of optimal currency area has been used by many economists to evaluate the costs and benefits that may be derived for forming monetary unions in Africa. One such study is by Fielding and Shields (1999) who applied the theory to the two francophone monetary unions. Their paper aimed at identifying and comparing the macro economic shocks to different members of the CFA and to Kenya. They focused on shocks to aggregate output growth and to aggregate price inflation by constructing a structural VAR representation of the macro economy of each member of the CFA and Kenya. The dependent variables used are real interest rate, nominal money stock, income and inflation in domestic consumer prices. The results showed that if a lot of weight was put on the importance of initial output shocks in assessing the cost and benefit of the monetary union and less on price shocks, then the CFA area should be re-organized and that Cote d'Ivoire and Mali should form one monetary union, with other CFA member states coming together to form another union. The cost of CFA membership in terms of lost monetary autonomy would be larger than in a world where a monetary response to a shock is immediate. They therefore concluded that the cost of monetary union membership will depend on the extent to which price and output shocks are correlated across countries and the degree of similarity in the long run effect of the shocks on the macro economy.

In analyzing the cost and benefit of the common monetary area in South Africa, Grandes (2003) applied the two-step econometric exercise based on the theory of generalized purchasing power parity (G-PPP). This study emphasized two aspects of the monetary integration process in southern Africa in the light of G-PPP theory and checked whether the monetary area (CMA) including Botswana constituted an optimal currency area in the classic sense, using a two step econometric approach and concluded that the common monetary area including Botswana formed an optimal currency area given the existence of common long run trends in their bilateral real exchange rates. It was also observed that further macro efficiency gains could still be accrued if these countries went all the way to develop a full fledged monetary union. This was because there was evidence of similar production structures, higher output correlation and risk hedging possibilities, and the periphery countries were able to resort to South Africa's capital markets and overdraft facilities at the reserve bank. However difficulties that had to be overcome were certain divergence in terms of trade shocks, lack of export diversification and pre-dominance of inter-industrial trade patterns.

Other relevant works on optimal currency areas for Africa include that by Anyanwu (1999). He estimated the macroeconomic effect of monetary unions with respect to trade and output and suggested that a monetary union is beneficial to bilateral trade and economic growth. In his study he used panel economic indicators for individual members of UEMOA as well as non-UEMOA ECOWAS counterparts to determine whether the monetary union has brought price and output, fiscal and trade stabilization during the period 1990-2001. The panel data contained both a time component and a cross sectional component, trying to answer the question of the magnitude of expected change in one country as a result of a unit change in any variable. The results suggested that economic growth stability was greater in the WAEMU countries than in non-WAEMU countries during the period of the analysis but the same was not observed in terms of inflation. Inflation instability in the WAEMU region was higher than in the non-WAEMU region. He suggested that more needed to be done in the areas of price stability, fiscal discipline and greater intra-regional trade to make the union meaningful. He also suggested that important benefits from the monetary union can come through central bank credibility.

Following from the above scenario, cooperation within a currency union can be looked at in four main areas. These relate to the extent to which

- the cooperation arrangement fosters the development of an agency of restraint to the government,
- the extent to which the arrangement deepens the financial system,
- the extent to which the arrangement reduces the probability of speculative pressures, and
- whether the arrangement leads to international integration of economies.

The issue of developing an agency of restraint for African countries first gained prominence following the work of Collier and Gunning (1994). They suggested that many of the past ills of African economies were caused by bad policies as a result of unrestrained fiscal programmes in many countries, and the fact that no internal agencies existed to restrain governments. They then argued that an integration arrangement with

northern partners will generate all the gains from global liberalization. Such a union is also expected to enhance the credibility of African economic liberalization and generate the desired investment inflows. It is argued further that integration with the North has effective sanctions incorporated in it, which current African regional arrangements do not have. This is because they guard against policy reversals. In this arrangement the European Union acts as the agency of restraint for African economies. Thus, the discussion has focused largely on external agencies of restraint that may not have similar structural characteristics but may have a common interest. This is certainly quite different from an external agency of restraint that is built around a collective of similar economies.

On the deepening of financial systems, Senbet (1998) has pointed to the increasing interest in the linking up of financial institutions regionally. He has argued that one way to address the thinness and illiquidity of African capital markets is for the various countries to pool resources for regional cooperation in banking and capital market development. Well-functioning markets can position a country competitively in markets for global capital. This promotes the inflow of international capital and subjects a country to international discipline. Furthermore, accessing global markets for capital reduces reliance on foreign aid. The regionalization of African stock markets is expected to enhance mobilization of both domestic and global financial resources to fund regional companies, while injecting more liquidity into the markets (Senbet 1998). For this to work, the tax treatment of investments must be harmonized, since tax policy is an important incentive or disincentive both for issuers and investors. Ultimately, the regulations, accounting reporting systems, along with clearance, settlement and depository systems, should conform to international standards. The establishment of regional securities and exchange commissions, regional self-regulatory organizations, regional committees to promote harmonization of legal and regulatory schemes, and coordinated monetary arrangements (e.g., via currency zones) are among the mechanisms for such financial integration.

Honohan and Lane (2000) suggest that the regionalization of banking could offer some potential for risk-reduction through “better international diversification of loan portfolios”. The internationalization of the banking sector is seen as an effective way of minimizing the vulnerability to financial crisis as multi-country banks are perceived to be more diversified and less vulnerable to a downturn in any one country.

With respect to containing speculative pressures, it is the view of Honohan and Lane (2000) that African economies, by virtue of not being present on the radar screens of the world’s holders of private capital, are not very much in danger of being swamped by speculative attacks. They point out that one way in which African countries may suffer from contagion is by virtue of the fact that the financial system is largely dependent on European banks, a fact which ensures that the banks are likely to view different countries in the same way, and which may lead to countries being treated similarly even when it is unnecessary. There is nevertheless little evidence of countries’ exchange rates being the subject of contagion. Were the likelihood of contagion high, a monetary cooperation arrangement is expected to have both negative and positive sides to the likely impact.

There is also little evidence that the creation of monetary cooperation arrangements will eventually lead to greater economic and political integration of economies. While a number of African countries appear to be pursuing higher degrees of financial and monetary cooperation, particularly in West Africa with the view that it will accelerate the process of regional integration, the experience from other places tends to be the reverse, as in the European Union.

Risk and African Financial Systems Development: A Functional Perspective

The available evidence is fairly strong that well-functioning financial markets promote long-run economic growth (Levine 1997). In the case of the stock markets, for instance, studies have found that indicators of stock market development, such as market liquidity, capitalization, turnover, efficiency of pricing of risk, etc., are positively correlated with current and future economic growth, capital accumulation, and productivity improvements. These studies are mainly in the context of advanced economies, but the implication for African economies is encouraging. In particular, the linkage between finance and economic development suggests a linkage between capital market development and poverty alleviation, as well as employment creation.

The channels through which financial markets contribute to economic growth can be understood through a functional perspective. Consequently, the depth of the capital market reform and development must be judged on the basis of the efficiency with which the various functions of capital markets are carried out. For instance, the mere erection of stock exchanges is inconsequential, if the environment is hostile to opportunities for risk sharing and liquidity provision and transformation. Moreover, the mere existence of banks is of little value, if their existence is merely to purchase government securities at the expense of commercial lending. In fact, the demise of commercial lending prevents banks from serving as informed agents or intermediaries on behalf of the society, and hence building information capital that is vital for efficient allocation of resources. Unfortunately, there is a prevalence of dysfunction in the African financial systems, and it is expected that financial cooperation will help to reduce these.

Aryeetey and Senbet (1999) took a functional perspective in studying the characteristics of the African financial markets. This approach is important for understanding why regional cooperation helps to mitigate some risks. The functional perspective departs from the dominant development thinking which has viewed the financial sector as a mere conduit for savings (capital) mobilization (McKinnon 1973; Shaw 1973). Under the functional approach, it is understood under uncertainty that, beyond capitalization, risk allocation and sharing are vital functions of financial markets. In other words, both the quantity and quality of capital need to be considered in the functioning of financial markets. Unfortunately, the traditional view focuses only on quantity of capital (Haque, Hauswald, and Senbet 1997). Also, in an imperfectly informed environment characterized by agency problems, incentive problems are likely to prevail among various stakeholders (Barnea, Haugen, and Senbet 1985). However, the traditional view ignores the role of market imperfections in information dissemination and incentive problems, particularly the role of capital markets in providing efficient contracting among

conflicting parties and disciplining corporate insiders through markets for corporate control. A well-functioning economy allows for active contests for corporate control so that resources are controlled by those who create the most value for the stakeholders, and ultimately for the society at large. Well-functioning capital markets provide control mechanisms for the correction of inefficiencies arising from incentive conflicts between decision-makers and other stakeholders.

It is also important to emphasize that financial systems provide multiple functions. For instance, the broad functions of capital markets extend beyond mobilization of domestic financial resources (savings mobilization). They extend to such other functions as risk pooling and sharing among market participants, as well as governance and control. In a private economy with incentive conflicts among contracting parties (stockholders, debt holders, management, etc), capital markets facilitate the design of incentive compatible contracts that promote alignment between management, shareholders, and bondholders. In the case of managerial agency conflicts, capital markets facilitate the design of incentive contracts and optimal compensation structure that aligns management with capital contributors. Such incentive features include equity participation by management, executive stock option plans, retirement plans that allow for participation in capital markets and fortunes of companies that are being managed. An active capital market serves as a valuation benchmark in evaluating these incentive schemes, as well as in assessing the impact of these incentive contracts on corporate investments through observed price signals. The ultimate question is whether financial cooperation provides the opportunities for making financial systems play these roles. The growing view is that it does.

3. CHARACTERISTICS OF AFRICAN FINANCIAL SYSTEMS: CHALLENGES TO REFORMS

The serious impediments and challenges facing the African financial systems can be summed up as follows: fragmentation, illiquidity, informational inefficiency, limited size and capacity, underdevelopment of human capital, inefficient regulatory schemes, excessive risk factors, dearth of risk-sharing and hedging mechanisms, legal and contract enforceability issues. The problems of the banking systems in Africa remain severe after financial sector reforms. Many economies are characterised by systems with a heavy concentration of their assets in the short end of the market, the prevalence of non-performing term loans (Nissanke and Aryeetey 1998). Moreover, the main dysfunctions of the banking systems in Africa manifest themselves in a lack of information production and facilitation of governance and control for the commercial sector. There is limited monitoring of the activities of borrowers, poor enforcement of collateral, and lack of enforcement of lender's rights for fuller disclosure of financial information about borrowers.

The information and enforceability problems, along with prevalence of financial distress and bank failure, have serious consequences. In particular, they result in adverse selection, where weak banks attract disproportionately high risk and weak enterprises (e.g., state-owned companies) which see no downside in borrowing at high interest rates and bet on a small probability of good outcomes. Such a weak banking system breeds instability and even undermines government policies, such as the conduct of monetary policy (Camen, Ncube, and Senbet 1996).

In view of the nature of the problems that financial systems faced into the 1980s, several governments, with support from the World Bank instituted several reforms. In broad terms, the reforms have produced a more liberal environment, even though the pace and extent of policy reform varied considerably from country to country². The reforms have been based on the two fundamental premises of liberalisation and balance-sheet restructuring, which have seen interest rates and credit allocation being decontrolled; while some effort has been made in a number of countries to strengthen the regulatory framework (see Table 3). In many cases, the full extent of reforms has been influenced by the portfolio position and the asset quality of financial institutions, as well as by government financing requirements and the general fiscal profile. In some cases, extensive restructuring and re-capitalisation operations were mounted for distressed banks.³ With reforms, the limited privatization of a number of banks has taken place. Indeed, state control over many banks in a number of countries has been reduced somewhat.

Table 3: Financial Sector Reforms in Sub-Saharan Africa

Liberalization and/or rationalization of interest rates	Restructuring of Banks	Privatization of Banks	Liquidation of Banks
Benin	Cameroon	Cameroon	Benin
Burundi	Cote d'Ivoire	Cote d'Ivoire	Cote d'Ivoire
Congo	Ghana	Guinea Bissau	Guinea
Cote d'Ivoire	Guinea	Madagascar	Niger
The Gambia	Kenya	Mauritania	Rwanda
Ghana	Madagascar	Senegal	Senegal
Kenya	Mali		
Madagascar	Mauritania		
Malawi	Rwanda		
Mauritania	Senegal		
Mozambique	Tanzania		
Rwanda	Uganda		
Tanzania			

Source: World Bank (1994)

² Tanzania's financial sector reforms are characterized by gradualism, rather than by the hasty deregulation accompanied with ad-hoc corrective measures seen in Nigeria.

³ Popiel (1994) estimates that, between 1984 and 1993, the cost of bank restructuring operations in about 20 countries in Sub-Saharan Africa was often equivalent to between 7% and 15% of their GDP.

As we have indicated, the primary object of financial sector reforms was principally to improve on financial service delivery and facilitate the development of monetary policy. However, the outcomes have often been far less successful than anticipated. I discuss here the extent to which these objectives were achieved in terms of sector performance and then explain the developments later. The situation can be summed up as follows: financial product development continues to be slow and narrow in many countries and the delivery of such products is unsatisfactory; savings mobilisation efforts have yielded inconsistent outcomes; credit delivery remains the Achilles heel of financial systems; failing banks and banks in distress continue to be common.

While there may be some diversity in the outcomes of the restructuring efforts in various economies, the differences are not very significant. Essentially, the functions of savings mobilisation and financial intermediation have not fully recovered since reforms were initiated (Nissanke and Aryeetey 1998; Haque, Hauswald, and Senbet 1997). Nissanke and Aryeetey (1998) suggest that widespread objective risk continues to be a major feature of the markets and the infrastructure for financial service delivery has not significantly improved, with the environment for regulation and supervision remaining inadequate. Even in Ghana and Malawi, where reforms have been relatively orderly, most banking institutions have not developed the capacity of risk-management and still operate with an inadequate information base. In Nigeria and Tanzania, banks' net worth deteriorated in the adjustment period through imprudent asset management. These varying trends fit the description by Caprio (1994) as characteristic responses to liberalization attempts, where banking institutions had been previously shielded from market forces by government intervention. He predicted two different possible responses from banks: The first is to avoid all but the lowest risk. The second is a reckless expansion of lending, even to insolvent clients. Recent experiences from Uganda and Ghana confirm both types of behavior.

Financial Deepening

In the four countries that Nissanke and Aryeetey (1998) studied, they observed that expected positive effects from liberalisation, in savings mobilisation and credit allocation had been slow to emerge. Both the M2/GDP ratio and the private credit/GDP ratio to measure financial deepening showed no clear upward trend in any of those countries. In Nigeria, both indicators worsened considerably in the reform period. Indeed, in most countries, credit as a proportion of GDP declined in the reform years, even if the share of credit to the private sector rose. Among the better performing African nations are Kenya and Zimbabwe which had credit/GDP ratios that exceeded 30 percent in 1996. The low credit/GDP ratios for the African countries may be compared to 50 percent in Indonesia and 75 percent in Malaysia at that time. There has not yet been a clear upward trend in the indicators of financial deepening since the implementation of liberalisation measures and bank restructuring to restore banks' commercial viability. See Tables 4 and 5.

Table 4: Money and Quasi Money (M2) as % of GDP

Country	1980	1990	2000	2001
Benin	17	24	29.9	31.0
Botswana	26	26	26.8	31.7
Cameroon	21	23	17.3	18.3
Cote d'Ivoire	27	29	21.8	24.1
Ethiopia	...	37	41.3	45.2
Ghana	16	13	26.8	17.4
Kenya	30	27	43.1	39.3
Malawi	18	18	16.8	15.5
Mozambique	...	40	30.4	30.7
Nigeria	24	19	24.8	28.6
Senegal	27	23	25.4	26.5
South Africa	50	54	56.2	59.7
Tanzania	...	19	19.2	20.0
Uganda	13	6	16.9	16.5
Zambia	28	20	24.1	21.0
Zimbabwe	31	28	24.8	36.4

Source: World Bank, 1998, 2003 World Development Indicators, Washington DC.

Table 5: Credit to Private Sector (% of GDP)

Country	1980	1990	2000	2001
Benin	29	20	12.1	11.1
Botswana	11	10	15.9	16.2
Cameroon	30	27	9.3	9.6
Cote d'Ivoire	41	36	15.2	15.9
Ethiopia	...	24	22.8	23.5
Ghana	2	5	14.0	11.9
Kenya	29	33	26.6	22.7
Malawi	21	12	5.0	4.2
Mozambique	...	32	18.7	2.5
Nigeria	12	9	13.9	17.8
Senegal	42	27	20.0	19.4
South Africa	60	85	71.9	80.1
Tanzania	...	16	4.6	4.9
Uganda	4	...	6.6	5.9
Zambia	20	9	8.5	7.2
Zimbabwe	33	30	20.0	20.7

Source: World Bank, 1998, 2003 World Development Indicators on CD-ROM, Washington DC.

Although the public sectors' share in domestic credit declined in many countries, government and public enterprises for long continued to receive the largest proportion of bank credit.

Macroeconomic Management

The expected impact of a liberal interest rate regime on the monetary situation was seldom achieved as the ability of the monetary authorities to achieve set targets was often compromised by an ineffective broader policy environment (Roe and Sowa 1994; Nissanke and Aryeetey 1998). In the presence of shallow financial markets and a poor development of money markets, rising interest rates often quickly led to a credit crunch, and in many instances to considerable excess liquidity, i.e., situations in which banks voluntarily increased their holdings of liquid assets on a large scale. Indirect monetary management has been difficult in many countries, with some improvements only being observed in the last year. Most countries showed considerable difficulty in the handling of inflation in the reform years, the most interesting exception being Uganda.

Table 6: Inflation, Consumer Prices (annual %)

Country	1980	1990	2000	2001
Benin	4.2	4.0
Botswana	14	11	8.6	6.6
Cameroon	10	1	-2.1	4.5
Cote d'Ivoire	15	-1	2.5	4.3
Ethiopia	4	5	0.7	-8.1
Ghana	50	37	25.2	32.9
Kenya	14	16	10.0	5.7
Malawi	...	12	29.6	27.2
Mozambique	...	47	12.7	9.0
Nigeria	10	7	14.5	13.0
Senegal	9	0	0.7	3.1
South Africa	14	14	5.2	4.8
Tanzania	30	36	5.9	5.1
Uganda	...	33	2.8	2.0
Zambia	...	107
Zimbabwe	5	17	55.9	76.7

Source: World Bank, 1998 World Development Indicators on CD-ROM, Washington DC.

It is apparent that an unstable macroeconomic environment will not be very helpful to financial sector reforms and indirect monetary management. In a number of countries, the macroeconomic environment has remained quite fragile. This continues because various external shocks and political pressures often lead to a breakdown of fiscal and monetary discipline. Unable to restrain inflation, which until recently exceeded 20 percent annually in many countries, achieving positive real interest rates has been difficult, despite rising nominal rates? The rising interest rates have not led a marked growth in deposits in countries with considerable macroeconomic instability, such as Ghana. Indeed, it is the fiscal imperatives that have often created difficulties for the monetary and financial sector.

Interest Rates and Spreads

The financial sector reforms and liberalization sometimes yielded a desired outcome – the emergence of *positive real interest rates* (as expected). However, the desired results of increased investments and savings have not been in abundance in Africa. Indeed, the financial systems are characterized by exorbitantly high real rates of interest and shrinkage of commercial lending by banks, in favor of bank holdings of government securities. In addition, the lending – savings margins have been dramatically high. The prevalence of exorbitantly high *real* lending rates and continuing increase in the lending-deposit rate margins is particularly disappointing [See Table 7].

Under the reform programs, an initial increase in the spread between lending and deposit rates was anticipated, as banks needed time to reshape their cost structures within the changing environment. The spread was expected to narrow as more efficient business practices were adopted following increasing competition and as credit demand stabilised. But more than a decade after reforms were started, the spread between the two continue to widen in many countries. The issue of steady rises in lending rates and low deposit rates under different monetary and fiscal regimes continues to be one of the most interesting outcomes of financial sector reforms in Africa.

Table 7: Interest Rate Spread (lending rate minus deposit rate)

	1980	1990	2000
Benin	8	9	..
Botswana	3	2	4
Cameroon	6	11	..
Cote d'Ivoire	8	9	..
Ethiopia	..	4	5
Ghana	8	9	10
Kenya	5	5	16
Malawi	9	9	19
Nigeria	3	6	..
Senegal	8	9	..
South Africa	4	2	5
Tanzania	8	..	24
Uganda	4	7	10
Zambia	3	9	12
Zimbabwe	14	3	13

Source: World Bank, 1998, 2003 World Development Indicators, Washington DC.

Restructuring of Banks and Bank Distress

The balance sheets of many banks saw some growth in shareholders' funds in the reform years. This growth in shareholders' funds reflected the re-capitalization of those banks. In Ghana, for example, average shareholder capital has been well above the 5% minimum (but usually below 15%) since 1988. State-owned development banks have averaged a relatively high 12%, as a result of government re-capitalization schemes.

The portfolios of banking institutions continue, however, to be dominated by an extremely high incidence of non-performing loans and excess liquidity. In Nigeria, while there has been little sign of real progress for deposit mobilisation and credit allocation to productive investment since liberalisation measures were first adopted in 1987, distress among banks has been one of the most severe in the whole region. Thirty-seven Nigerian banks, accounting for one third of commercial and merchant banks, were identified as distressed with non-performing assets in 1994. Distress among banks is evidently growing among African banks as evidenced by recent occurrences among Kenyan commercial banks. In Ghana, even though the World Bank (1998) has identified as many as three state-owned banks as distressed since 1995, the government has not allowed them to go under after all attempts to recapitalize them failed.

The persistence of these conditions, despite radical changes in the policy environment, can be explained by constraints that prevent improvement in banks' operational practice. Operational practice is a function of many parameters, such as risk-averseness, net worth, asset quality and intermediation efficiency measured in terms of loan transaction costs. In addition, it is affected by externally imposed factors, such as a poor information capital base and policy uncertainty and credibility. And these have not changed much under recent reform programs.

Money and Capital Markets Development

A major reason for the poor functioning of money markets is government financing approaches. The current practice of governments issuing in large quantities very high-yielding bills to meet fiscal requirements needs to be seen as a problem. Indeed, so long as banks have access to inexpensive and unlimited loans through central bank discount facilities, inter-bank borrowing and lending are unlikely to be attractive.

On the other hand, the reforms have yielded a positive outcome in terms of growth of the number of stock markets. There are about sixteen stock markets, and they have become a basis for the commensurate introduction of Africa – based funds trading in New York and Europe. The stock markets have emerged as a real potential for integration of Africa into the global economy. However, the markets remain the smallest of any region in terms of capitalization, except South Africa and are very illiquid (Senbet 1997).

Explaining Difficult Reform Outcomes

A number of explanations have been put forward for the apparent failure of financial liberalisation programs to address the problems of African financial markets. The most frequent explanation is the *incompleteness of the reforms*. The World Bank (1994) for a long time subscribed largely to this view and suggested that the continued poor financial performance was due to lack of progress on some of the reform measures. Blame was placed on the continued use of financial systems to finance public sector activities, which was made possible by the continuing public sector ownership of a large part of the financial system.

In Nigeria, *incorrect pace and sequencing* in the initial reform years led to the crisis and eventual collapse of the financial system, necessitating several policy reversals (Soyibo 1996). The crisis made policy consistency and credibility critical issues. It is obvious that Nigeria's difficulty in sustaining a consistent policy stance was partly attributable to unstable general economic and political conditions. Stein and Lewis (1996) have attributed the failure of financial liberalisation in Nigeria largely to the *political and institutional setting* of reforms. The argument for this position is that the abrupt financial liberalisation led to the development of opportunities for speculative rent seeking that replaced traditional forms of rent-seeking that are based on political patronage. In sum, the faulty design of the reform program, with respect to timing, pace and sequencing led to instability.

But we have seen that such countries as Uganda, Ghana, Kenya and Malawi with more comprehensive reforms have not necessarily fared much better. For these, a World Bank Report (1994) has suggested that the design of reforms sometimes placed too much faith in "quick fixes". They must have over-emphasised the benefits of restructuring balance sheets and the re-capitalisation of banks under specific projects. Another suggestion is it takes much longer to improve the financial infrastructure in an environment where the main borrowers, i.e., government and public enterprises, are financially distressed and institutionally weak. That has certainly been the case in Tanzania.

Were the countries ready for interest rate liberalisation? The World Bank has argued in a Policy Review Note (1994) that complete interest-rate deregulation should only be attempted when certain stringent criteria are satisfied. Thus, in addition to stable macroeconomic conditions and adequate regulatory and supervisory systems, it is essential that more sophisticated and solvent banking institutions with positive net worth in contestable financial markets are present. It is expected that interest rate deregulation will be ineffective where these conditions are not met. In the absence of such an environment, interest rates may be managed in the interim, moving to market-determined rates within a longer time frame. It is obvious that very few African countries satisfied these conditions for full-scale liberalisation and deregulation.

There have been attempts to improve banking regulation and supervision in several countries in order to regain stability in the markets. But it is also obvious that the restructuring requirements for better credit analysis, portfolio management and capital adequacy have made most banks more reluctant to take risks. The outcome is that lending

has become highly selective. The current regulatory and supervisory system in most countries cannot be described as effective for prudential purposes (Popiel 1994). Supervision and regulation over financial institutions have remained grossly inadequate, while infrastructural support systems such as the legal framework, are deficient, and banks' balance sheets remain problematic, even if better than they were a decade earlier. Of course, effective regulation and supervision are essential since transactions within banking systems involve a significant externality through the act of offering deposits and money creation. Maintaining the solvency of deposit institutions and the stability of the monetary system through regulations of reserve requirements or risk-adjusted capital adequacy ratios or supervision of the quality of banks' assets and portfolio is crucial to the process.

Despite the considerable investments made in the development of human capital in the banking sector in reforming countries, daunting problems remain with capacity. In Ghana, many banks have indicated that they were not comfortable with the capacity of their credit operations staff to make the key judgements involved in determining whether small and medium-size enterprise projects were viable and capable of repaying the credit out of cash flow (Steel et.al. 1994). Areas in which bank management in Ghana acknowledge deficiency include methods for assessment of the quality and accuracy of project analysis as part of credit analysis. The staffs is seen to lack the skills in cost analysis and project sensitivity analysis, testing project resilience to changes in market share, cost and prices. This was especially important because of the poor quality of available information.

Many banks in Africa lack the capacity to market financial services in an increasingly competitive market. Having come out of total government-ownership only recently, marketing skills are particularly scarce among such banks, since they previously did not face competition or analyse projects on the basis of more than simple cash flows. The need to diversify their portfolios, especially those that previously concentrated on particular sectors remains paramount; but they have not been sufficiently equipped to deal with them. Thus, on hindsight, financial reform is clearly a lengthy process that requires critical progress in institution-building. To make reforms effective, there must be a deeper understanding of banks' operating environment and their resulting behavioural characteristics.

Another area of immense capacity inadequacy remains the regulation of informal and semi-formal financial activities in order to protect depositors while making contracts more transparent. Within the BCEAO countries, attempts have been made to register all such activities as well as regulate the entire sector.⁴ In Ghana, while a law passed on non-bank financial activity technically covered informal finance and micro-finance activities, such agents were excluded in the enforcement of the law as the enforcing agency realised that it was not equipped to handle that assignment. There is indeed very limited experience in Africa with regard to specific approaches to regulation.

⁴The attempts to introduce an umbrella law by BCEAO for informal financial institutions was extensively discussed at the Donor-CGAP Mali Forum on Microfinance in Africa, 1996.

4. AFRICAN FINANCIAL AND MONETARY COOPERATION EXPERIENCES

In view of the continuing difficulty with financial management in several countries despite reform, it is not surprising that countries should seek refuge in supra-national arrangements. But we may note that arrangements that seek to achieve financial and monetary cooperation among different countries in Africa date back to the colonial days. These cooperation arrangements were widespread in both the French and the British colonies, and a lot of what is observed today is derived from those early experiences.

Financial and Monetary Cooperation in West Africa

Financial and monetary co-operation among many ECOWAS⁵ countries started long before post-independence economic integration efforts began in the sub-region. The arrangements, according to Honohan and Lane (2000), were originally driven by administrative convenience and seignorage considerations. Thus, exchange rate policy and fiscal restraint were not an issue. An essential part of the colonial economic arrangements was the institution of an orderly financial and monetary system. In British West Africa, following legislations that effectively established a currency⁶, the monetary policy of the four colonies was expected to be administered by the West African Currency Board (WACB), which was established in 1912 and had its headquarters in London. The Currency Board was established “to provide for and to control the supply of currency in the British West African Colonies, Protectorates and Trust Territories.” In practice, however, the WACB was no more than an automatic money exchange organisation issuing as much local currency as the banks wanted to buy for sterling and vice versa. It definitely did not function as a monetary authority and its effectiveness as a currency board has been questioned (Honohan and Lane 2000). Uche (2001) has also argued that the prime motivation for their creation was to facilitate greater efficiency in the management of the financial affairs of the colonies. “It made economic sense to administer these geographically proximate colonies through one currency board which was head-quartered in London. Inter colony integration therefore could only have been an incidental benefit of the currency board system and not its objective” (Uche 2001).

Commercial banking in British West Africa was also developed along regional co-operative lines, cutting across country borders. This led to the establishment of Bank of British West Africa as the first bank in the region. The bank maintained offices in all four colonies where it adopted similar administrative and operational policies. The fact that

⁵ ECOWAS embraces over 200 million people in all 15 states in West Africa, ten of whom have parallel allegiances to other groupings, and (until 1999) Mauritania. Thus, the now dormant Mano River Union (MRU) embraced Guinea, Liberia and Sierra Leone; the erstwhile West African Economic Community (CEAO) pulled together Benin, Burkina Faso, Côte d’Ivoire, Mali, Mauritania, Niger and Senegal; and the remaining six ECOWAS states (Cape Verde, Gambia, Ghana, Guinea Bissau, Nigeria and Togo) belonged to no other grouping until Guinea Bissau and Togo joined other Francophone countries and the members of the Mano River Union to establish UEMOA in 1994.

⁶ The British colonial currency was pegged to and fully backed by the pound sterling, and the currency board was modeled in the currency arrangements embodied in the British Bank Act of 1844.

only modest economic exchange occurred in these colonies is argued by Uche (2001) as an indicator of the fact that the sub-regional institutions were not designed for the purpose.

With political independence in the 1950s and 60s, the role of the WACB system began to change. Governments adopted a more interventionist and nationalistic ideology, and having a national currency became a symbol of sovereignty. This led to the abandonment of the currency board arrangement by most participants. Various countries began to establish their own central banks. The first to pull out was Ghana in 1957, followed by Nigeria in 1959. Sierra Leone and Gambia however operated their own currency board-type arrangement for a few more years and Gambia was the last African country to leave the sterling peg in 1971. Honohan and Lane (2000) have documented the extent to which national central banks were used to finance extensively government budgets in the early post-independence years, completely unrestrained by the usual regulations of central banks.

More recent integration efforts in the Anglophone part of the sub-region have been driven by the ECOWAS agenda. Thus, as in other parts of Africa, the experience of West Africa with formal regional integration has been largely driven by the desire to overcome the constraint of small economic size, which was hampering their ability to industrialize efficiently, by extending the logic of protected and state-led economic development to a larger number of countries. Indeed, the preamble to the 1975 ECOWAS Treaty noted that the community was being created in view of the “... overriding need to accelerate, foster and encourage the economic and social development of member states in order to improve the living standards of their peoples” (ECOWAS 1975). ECOWAS saw regional integration as a multi-step process eventually leading to a customs union and then a common market integrating states in the West African sub-region politically and culturally. Both the original Treaty and the subsequently revised version of 1992 (complemented by more than 30 protocols and supplementary protocols) include initiatives to promote co-operation and development in industry, transport, telecommunications and energy, agriculture, natural resources, commerce, monetary and financial matters, as well as social and cultural affairs. The principal areas of operation have been:

- expanding the regional market;
- harmonizing agricultural and industrial policies through production integration;
- ensuring the harmonious integration of physical infrastructures;
- promoting monetary and financial integration to facilitate trade;
- maintaining regional peace, stability, and security; and
- ensuring free movement of persons, including rights of residence and establishment.

It is important to note that ECOWAS exists alongside other sub-regional integration arrangements. By 1975, there were over 40 inter-governmental organizations (IGOs) that co-operated with either the countries of ECOWAS, the erstwhile Communauté des États de l’Afrique de l’Ouest (CEAO), or the Mano River Union (MRU)

The creation of a West African Monetary Union has been high on the agenda of ECOWAS since its inception in 1975, but due to the slow nature of realizing that objective, some West African countries have considered forming a second monetary zone, the West African Monetary Zone (WAMZ) under the umbrella of ECOWAS. The creation of WAMZ is seen as a mechanism that can accelerate the arrangement for the formation of a unified West African Monetary Union. Monetary cooperation is very important to the non-CFA ECOWAS members because their francophone counterparts with a common currency are perceived to be relatively stable and intra-regional trade in that region is also seen to be larger than in the remaining ECOWAS region.

A time table was set for a select number of countries comprising Gambia, Ghana, Nigeria, Guinea and Sierra Leone to meet the policy convergence criteria set by the union. These conditions are economic stability, budgetary discipline, and inflation rate of not more than five percent and a healthy forex reserve, once these are met the monetary union would be introduced by the new date of July 2005. There are also ongoing efforts to set up institutions such as the convergence council, technical committees and the West African Monetary Institute.

While some believe that the varying socio-economic conditions that exist in the various countries will make it difficult for the member countries to attain the set inflation level of under 5% and also build enough foreign exchange reserves, others think that these can be achieved by the end of 2004 thus paving the way for a common currency (eco) to be introduced. Tables 8 and 9 show the status with respect to the convergence criteria at the start of the endeavor.

Table 8
Table 2: The State of Primary Convergence Criteria: 2000

Country	Budget deficit/GDP ratio (excluding grants)	Inflation rate	Central Bank financing of Budget Deficit / y-1 tax revenue	Gross Reserves/Annual Imports in months	Number Of Criteria Satisfied
Benchmarks	≤5%	< 10%	≤10 %	≥3 months	
The Gambia	3.84 %	0.80 %	0.00 %	2.94	3
Ghana	10.74 %	40.50 %	8.20 %	0.53	1
Guinea	5.99 %	7.20 %	6.20 %	1.15	2
Nigeria	1.80 %	6.90 %	0.00 %	4.30	4
Sierra Leone	17.30 %	-2.75 %	1.87 %	1.26	2

Source: <http://www.ecowas.int/wami-imao/>

Table 9: Secondary Convergence Criteria

Table 3: The State of Secondary Convergence Criteria: 2000

Country	Domestic Arrears	Fiscal Receipts/GDP ratio	Salary Mass/ Total Receipts	Real Exchange Stability: PPP=DP Index / TPCP Index	Positive Real Interest Rate:(Interest Rate - Inflation Rate)	Public investments from within / Tax receipts	Number Of Criteria Satisfied
Benchmark	0%	≥20%	≤35%		+	≥20%	
The Gambia	n/a	3 000 000 000.00 %	233.33 %	75.61	12.00	0.00 %	2
Ghana	7.70	4.74 %	1 230.81 %	0.00	-3 626.00	1 273.34 %	1
Guinea	161.00	209.89 %	0.00 %	0.00	-175 470.00	0.03 %	2
Nigeria	n/a	28.10 %	14.20 %	0.00	0.00	22.00 %	3
Sierra Leone	0.00	191.16 %	16.29 %	0.00	-14 865.00	8.43 %	3

Source: <http://www.ecowas.int/swami-imaq/>

Tables 8 and 9 show that all the countries in the second monetary zone satisfied the criterion of central bank financing of budget deficit at the end of 2000 and all the countries met the conditions on inflation except Ghana. For many the conditions on budget deficit–GDP ratio and the gross foreign currency reserve were difficult to meet. Only Nigeria met that. The countries also found it more difficult to meet the secondary criteria. By 2004, the ability of the countries to achieve the convergence criteria had worsened significantly. Ogunkola (2001) has suggested that even if all the convergence criteria were met, it was still doubtful that a stable regional currency area would be achieved given the fact that economic restructuring was a long term phenomenon.

It is interesting that although the planned single currency for the zone is to serve the interest of local people and the business community, little is known about it in terms of public education. Most residents of the member countries have no idea what the issues are.

The current flurry of activity to accelerate the realization of a common currency for West Africa suggests that this may be an area in which policy-makers are prepared to relax their opposition to the “variable geometry” approach suggested by Collier and Gunning (1994). Opposition to the approach was based on the understanding that it run counter to the principles and ideals of the African Economic Community, which referred to the equality of nations and the shared purpose in integration. The fear was that variable geometry could lead to the exclusion of some countries and to the division of the continent into sub-regions dominated by external influences. The creation of UEMOA was seen as one such example. While supporters have referred to it as an attempt to quicken the pace of monetary union, opponents consider it instead as a tool to serve sectional interests (Lavergne and Daddieh, 1997).

Trends in the CFA Franc Zone

The early experience of francophone West African countries was not too different from that of Anglophone counterparts. Under French colonial rule, the colonies were organised under one colonial administration in a federation. France issued currencies in each colony and these were firmly pegged to the French franc, and were later consolidated into '*le franc des Colonies Francaises d'Afrique*' (CFA francs), issued by *Caisse Centrale de la France d'outre mer*, the Central Bank for Overseas France. In setting up the franc zone in Western Africa, the objectives of the monetary authorities included the achievement of (i) convertibility into French Francs at a fixed parity; (ii) free capital mobility throughout the zone; (iii) pooling of most foreign exchange reserves at the French treasury; (iv) the establishment of a common trade and financial policy *vis a vis* the rest of the world and; (v) guarantee of convertibility by France through the establishment of "operations accounts" for each colonial central bank with the French Treasury (Boughton, 1991, pp.1-2).

For most of the pre-independence period, many of these colonies remained only marginally autonomous within a French West African Federation. The degree of economic integration among them remained somewhat higher than among the Anglophone countries in the same region. With political independence in 1960, however, some barriers to trade and movement of factors of production began to emerge. Manu (1989) has argued that several attempts at forming a pan-francophone body in the region failed largely because France opposed the formation of a strong federation in the region that it did not have much influence over.

In the view of Uche (2001) it was "not surprising that all the regional bodies that emerged in the post independence francophone zone of the 1960s were either loose affiliations or simply non functional". These included the political association called *Union Africaine et Malgache (UAM)*, which was established in 1961, and which was later turned into the *Organisation Commune Africaine et Malgache (OCAM)*. Membership was open to all francophone African countries which had signed cooperation agreement with France. Uche (1999) also describes the *Union douaniere des etats de l'Afrique Occidentale (UDAO)* as being ineffective. This customs union comprised Cote d'Ivoire, Benin, Burkina Faso, Niger, Senegal, Mali and Mauritania. Their objective was to redistribute the customs duties which the coastal states collected on transit trade with the landlocked members (Bach, 1983). Uche (2001) and also Honohan and Lane (2000) have argued that France was not particularly interested in promoting intra regional trade among francophone West African countries, and therefore did nothing to facilitate it. "It was more interested in promoting its own trade with the various francophone countries in the region" (Uche 2001). And this is seen as having motivated France to support the establishment of BCEAO in 1962. The creation of BCEAO eliminated currency restrictions in the trade of francophone countries with France.

The regional central bank of the Central African Zone is called the BEAC. It was established in 1972 with the sole purpose of issuing currency. Like the Central Bank for

the eight West African countries BCEAO (The Central Bank of West Africa), the BEAC was to maintain a fixed exchange rate with the French Franc and manage monetary policy consisting of credit controls while currency convertibility was and still guaranteed through an “operations account” with the French Treasury.

It is remarkable that all the three integration organizations in West Africa (Anglophone and francophone) have promoted quite similar projects to advance their objectives, including the establishment of institutions for human development, agricultural and industrial development, and monetary cooperation. Despite a certain communality of purposes — liberalizing intra-area trade and achieving other forms of co-operation — there has been hardly any effective co-ordination among them. Considering the significant overlap in both goals and activities, it is indeed surprising that member countries found it necessary to maintain a multiplicity of institutions. Explanations include the ‘French factor’— i.e. the desire of successive governments in Paris to support organizations grouping their formal colonies in the region — as well as a lack of confidence by individual countries in the capacity of such institutions to protect their interests (Bundu 1997). In a sense it was a case of seeking double assurance without paying a higher premium.

In the 1980s, the survival of CEAO as a regional trade body had come under serious threat, largely as consequence of the malfunctioning of the trade arrangements put in place, which were largely perceived to work mainly in Côte d’Ivoire’s favor. The institution of a preferential regional co-operation tax (TCR) on manufactured exports from member countries worked largely to the advantage of Côte d’Ivoire and Senegal. Since the compensation mechanism did not work properly, the loss of revenue from member states was considered to be a serious setback to the integration effort. The absence of complementary industrial structures ensured that the number of industrial products registered under the TCR hardly changed. The poor functioning of the system of preferences and the inherent loss of revenue to several members led to difficult fiscal situations in those states. By 1991, arrears to the secretariat and to the compensation fund amounted to 45.5 million CFA francs, which was four times as much as the combined budgets of the institutions (Badiane 1997).

The governments used the banking system to finance these deficits. Thus, by the mid-1980s, the banking system had almost run to a halt due to the nature of the institutional mechanisms. Most of the banks were joint ventures between the national governments and one of four major banks based in France. Key senior management was provided by French nationals seconded from the parent banks in France. The French had a commercial interest in Africa for their French customers other than profit maximization. Although deposit mobilization has been low in the Franc zone, funds were secured from the two central banks, the Central Bank of West African francophone states (BCEAO) and (BEAC) Central Bank of Central African francophone states. For years governments in several member states directly or indirectly pushed the banks into lending to state-owned enterprises, or to regional and political groupings, or to some of the governments’ own suppliers who never paid. Although the central banks were freed by statute from any fiscal pressure, they were forced to lend through commercial banks for relief of fiscal

needs. The two central banks acted as if they were agents of the fiscal authorities and refinanced politically directed or government-inspired bank lending that was never paid back. A majority of the commercial banks failed because they gave bad loans, though some were rescued later. These problems coupled with others contributed to the banking crises in the CFA zone in the 1980s. Thus, by 1993, almost all of the countries in the zone were in deep recession. Capital movements were blocked and effecting current international payments became difficult.

The continuing fiscal problems of member states and the growing pressure they were coming under from international financial institutions to carry out macroeconomic reforms led to their decision in 1991 to meet in Ouagadougou and forge a program of activities to address the economic crises without necessarily having to devalue the CFA franc. The resulting programs for budgetary and fiscal policy harmonization led to the institution of several arrangements for regional banking commissions, the harmonization of legislative and regulatory frameworks to govern economic and social activities, including social insurance and business law, etc. The plan was to go further and develop a single financial market, a regional stock exchange and a free trade zone. Thus, the preparatory work for launching UEMOA took place between 1991 and 1994. By 1994, a number of the institutions agreed on in Ouagadougou had been established and had become functional, but the idea of avoiding devaluation had had to be abandoned in view of continuing economic crises and increasing pressure from multilateral development agencies. Thus, on the eve of the member states' meeting in Dakar in January 1994 to formalize the institutional developments that had taken place over the three-year period into a treaty, the 50 per cent devaluation announcement was made.

The creation of a regional financial market under the auspices of UEMOA was to comply with two main objectives: that all actors of the regional financial market must have equal opportunities where they are located and international standards with respect to settlement/delivery schedule, simultaneity of securities/cash exchanges and distinction between operations regulatory and supervision functions must be complied with. To address these needs, the regional stock exchange (BRVM) was established in September 1998 and its eight regional branches have been interconnected to the headquarters and other institutions. Also, the Regional Savings and Capital Market Board (CREMPF), which is in charge of supervising the regional stock exchange, has been established.

The regional stock exchange (BRVM) has two main components, a primary market that deals with financial securities and a secondary market that deals with the liquidity and mobility of securities already issued. The main products traded at the market are bonds, debts and negotiable debt instruments. The exchange is a private limited company with a capital base of \$4.84 million, 87% of which is owned by private businessmen of the region and 13% owned by the member states. The regional exchange has 38 listed companies transferred from the Abidjan stock exchange with Ivorian companies dominating. The financial market project was made possible in the UEMOA region because there was already a highly integrated monetary and financial union built on harmonized monetary and banking regulations, successful restructuring of the union's

financial sector and a sustained effort aimed at restructuring the macroeconomic framework.

The formation of the EMU was however a significant factor in encouraging the CFA zone countries to stay with their arrangement at the time of the 1994 devaluation. The French system appears to have survived much longer after independence than the British colonial system, and at present two Franc-based monetary unions in West Africa are still functioning with most of the original members remaining participants. The BEAC like the BCEAO is still in existence and they continue to develop their programs and instruments of monetary policy, financial sector integration and capital market institutions. After the devaluation, monetary policy has moved from direct controls to market based instruments taking account of all relevant domestic and macroeconomic indicators. Direct advances by BEAC to governments were intended to be phased out by 2004, the year when the first Treasury bill by one or more governments was expected to be issued (World Bank 2003). So far monetary policy has been effective in pushing inflation down in the sub-region and interest rates are set by the central bank.

Financial and Monetary Cooperation in Eastern and Southern Africa

East Africa had an almost similar currency board as in West Africa. In East Africa three core members retained the currency board arrangement with a common currency until five years after independence. The old monetary cooperation (EAC) which existed from 1960 to 1977 was made up of the three East African countries namely Kenya, Tanzania and Uganda. In the old currency area, there was a free circulation of the national currencies at par and common external capital control as well as a free movement of capital within the union. The new East Africa community was however inaugurated in January 2001 in order to revive the old one that collapsed in 1977, with the long run objective of forming a monetary union. Articles 94 and 97 of the treaty that established the new union are on monetary cooperation and financial matters and maintenance of the convertibility of the various currencies. The new EAC is still made up of the old members with a main objective of establishing a monetary union and a unit of account for the community, known as the East African Currency unit (Ogunkola 1999).

The Rand Monetary Area (RMA) dates back to 1910 when the South African Customs Union (SACU) came into being. It was however established formally in 1974 with South Africa, Lesotho, and Swaziland signing an agreement on the clearing arrangements, bank supervision and the development of a forward exchange market. Botswana withdrew from the rand zone in 1974 before the agreement was signed. The RMA was transformed into a common monetary area in 1986.

Another cooperation that calls for some attention is the Southern African Development Community (SADC). This regional cooperation group was formed in the 1980s by nine countries in southern Africa with a main objective of making their economies less dependent on South Africa. Namibia, after independence, joined the union in 1990 with South Africa following after its democratic election that led to the formation of a

government of national unity in 1994. Among the objectives of SADC are the alleviation of poverty and the promotion of maximum utilization of resources of the region, among others.

The SADC financial and investment sector was formally established in 1995. The common currency area includes South Africa, Lesotho, Namibia and Swaziland. South Africa was given responsibility for the management and development of financial and investment protocol. There is a council of finance ministers under the chairmanship of the South African Minister of Finance, who meet from time to time to give guidance to any program that will ensure closer financial cooperation among the participating countries. There is also a committee of treasury officials and a committee of governors of central banks and their officials with specific duties. A number of technical sub committees and working groups are also drawn from among the officials of SADC central banks to work on specific projects. The Committee of Governors is required to encourage the establishment of sound and well-managed privately owned banking institutions to provide financial services in a competitive environment.

The responsibility of central banks has been restricted to the creation and maintenance of a stable financial environment conducive for sustainable economic growth and in addition, they must protect the value of the currency. The central bank governors were required to work together in a joint effort to develop inter-linkable national payments and clearing settlements system for financial transactions that are compatible with national systems linked to each other so as to provide more effective cross border settlement of inter-regional financial transactions. There is also a focus on capital market development in the sub-region.

With proper implementation of programs in the SADC region, presently a statistical data base for essential economic time series from the twelve countries is now available at the South African Reserve Bank to help the governors to understand the regional economic environment better and to help them learn from the experiences of one another, there has been an establishment of a data bank, where information on issues relating to legislation, relationships with governors, functions and responsibility for management, policy objectives, procedures and instruments of monetary policy and administrative structures for each central bank are compiled and made available to all governors.

The South African Reserve Bank has also introduced a specialized training institution which is providing specialized courses in central banking and financial management for its staff and officials of other central banks in the SADC region, There are also other training programs that aim at improving and developing banking skills in central banking.

To standardize bank regulation and supervision in the region, the central banks have formed an East and South African banking supervisors group to see to that purpose. The SADC formed a financial cooperation in the region based on the proposal made by some European advisors but because of the vast divergence of the various regions with respect to economic development, the committee of governors had to design a model that will be compatible to the regional situation.

Of the 12 twelve members, South Africa is the most advanced in the region. In the rand zone, Lesotho, Namibia and Swaziland hold their currencies at par with the South African rand and the central banks in these countries function as a currency board by issuing currencies that are backed by 100% foreign assets. The rand circulates alongside the local currencies, thus generating for South Africa seignorage opportunities.

The good arrangement of the cooperation system is judged to have impacted well on the various countries (Uche 1999). There is relative macroeconomic stability in the region, reflected by low inflation rates. In many countries, there is also clear evidence of convergence of fiscal and monetary policies.

5. AN ASSESSMENT OF FINANCIAL AND MONETARY COOPERATION IN AFRICA

In this assessment, we rely considerably on the assessments made by Honohan and Lane (2000), which focused largely on the CFA franc zone. They carried out a detailed review of why the CFA franc zone initially failed to achieve expected stability and mobilization of resources that had been anticipated.

5.1 Review of the CFA Zone Experience and its Relevance for the Rest of Africa

They suggest that even though the underlying structure established for the franc zone in West and Central Africa appeared to be solid, it had problems. “The underlying economic philosophy of the franc zone arrangements was always that of an open and competitive market.... The institutional arrangements are strikingly modern in appearance. In particular there have been multinational central banks (which are thus independent of any one national government), rules constraining monetary financing of fiscal deficits, an open capital account, widespread presence of foreign-owned banks and the lowest inflation rates in Africa. From some points of view the regime has looked like a precursor to EMU with its single currency, its freedom of capital movements and its multinational central bank. But any attempt to draw conclusions for the prospects of wider African monetary unions must pause to consider the 1980s crisis of the CFA zone”.

It is clear that until the mid-1980s, economic performance of the franc zone countries was acceptable and the fixed exchange rate with France appeared to remove macroeconomic uncertainty and encourage external investment. The relatively high growth rates that were achieved and the stable CFA franc notes ensured that the sub-region outshone such unstable countries as Ghana and Nigeria with inconvertible local currencies. And because some parts of the franc zone banking system appeared to function properly, the zone received substantial deposits of flight capital from their neighbors.

Honohan and Lane (2000) assess that “in the end, the inflexibility and brittle character of the system's institutional mechanisms proved to be its downfall, bringing the functioning

of the banking system almost to a halt in several of the countries from the mid-1980s". This led to the deep recession that they experienced all the way through 1993. There developed a parallel market in the CFA franc and capital movements became blocked, while the effecting of current international payments became difficult. As we saw earlier, a large number of the banks failed, despite some of them being recapitalized. "Depositors in some banks had gone without access to their funds for years. The banks that continued to function now tended to be highly selective in their clientele, both on the deposit and on the lending side. Interbank markets were operating on a very limited basis. Having lost heavily from the collapse of debtor banks, the central banks were close to being unable to cover their operating expenses."

It was these problems that eventually led to devaluation in 1994. But a lot of the blame for the situation is placed on the behavior of governments that used the banking system to finance projects they had interest in, even if indirectly. It is assessed that the banks agreed to make the kinds of loans that led to their collapse because of an unusual relationship that had developed between the governments and the French ownership of many of the banks. "Most were joint ventures between the national governments and one of four major French-based banks; sometimes the government was the majority shareholder, sometimes not. In either case, the key senior management was provided by French nationals seconded from the parent banks in France. But the objective of the French shareholders is unlikely to have been profit maximization. They had other interests, including the commercial interests in Africa of their French customers. They will not have been unconscious of the wider political agenda of the French government, which was owner of the French banks for at least part of the period, and a strong influence at all times." In the end, even though the central banks were apparently freed by statute from any fiscal pressure, they bowed to indirect pressure to lend through banks for relief of fiscal needs. Recapitalizing them through the central bank led to the eventual collapse of the system.

Honohan and Lane (2000) have argued that this particular rules-based system did not guarantee sound policy as it encouraged a false sense of security. The rules did not guarantee the correct incentives, and their rigidity induced a banking practice that subordinated both commercial and central banking to fiscal pressures. The three rules that have been judged to be problematic were

- the exchange rate rule- "it could not cope with the procyclical public sector wage policy and the optimistic policy of ratcheting official purchasing prices for the all-important cash crops (especially coffee and cocoa) to the highest figures attained to date."
- the rule that the banking sector could not lend the government more than a fraction of its annual revenue needs "merely diverted the pressures into indirect borrowing through public enterprises and other associated bodies and through government payments arrears"
- the rule that each national government was responsible for the debts to the central bank of any insolvent bank encouraged "insouciant lending by the central bank to unsound banks".

It is apparent that the rules could not operate within a political environment that was not being adapted quickly enough for the rigid arrangements. The need to ensure consistency of macroeconomic and financial fundamentals with a fixed exchange rate system was not given the appropriate importance. “This sorry story of implosion of the CFA zone financial system, culminating in the major devaluation of January 1994, serves as a cautionary tale for fans of monetary unions and indeed of rules-based monetary systems in general. The limitations of such rules must be recognized whether they be the specific rules adopted in the CFA zone, or those of a currency board.”

It is reckoned that the CFA zone has recovered substantially from the troubles of the 1980s, following the devaluation and a restructuring of the regulatory arrangements of the zone. Following the banking crisis in the zone new institutional arrangements adopted include the centralization of responsibility for bank supervision in two regional banking control commissions. This provides a new multinational "agency of restraint" that fills a gap in the previous institutional arrangements, a development that is quite different from what prevails in the European Monetary Union where national central banks are still responsible for regulating commercial banks.

The CFA is now pegged to the Euro, and this is seen as providing greater nominal and real exchange rate stability. Honohan and Lane (2000) are not certain that there are obvious lessons to be drawn from the current arrangements for other African countries. They wonder if the EMU, together with the new focus on the use of a common currency as an insulator against contagious or correlated capital movements, and on the use of regional financial authorities as a quasi-external discipline on national financial policy, point to any increased likelihood of additional cooperative arrangements.

5.2 The Scope for African Monetary Unions

There is no doubt that the EMU has inspired a lot of discussion about the creation of monetary unions among groups of African countries. What is not yet clear is the extent to which they will seek to develop external agencies of restraint in the manner that the current CFA franc zone does. Honohan and Lane (2000) suggest that the issue may be assessed in a number of ways: as an agency of restraint on governments; as a bulwark against contagious speculation; as a way of achieving economies of scale in the financial sector, and finally in a traditional role as an OCA involving arguments related to the pattern of trade and to the degree of factor mobility.

Monetary Union as an External Agency of Restraint

There are two elements to this issue. These are the political considerations and the seignorage issue. While there have been for many years little interest in delegating the conduct of monetary policy to an external agency, there is clear indication from West Africa that countries are now more willing to entrust that role to a supra-national body.

The creation of the second monetary zone and the agreement on convergence criteria all go to underscore the fact that there is renewed interest in developing an external agency

of restraint. Ogunkola (2001) assesses however that the various elements of successful optimal currency areas are not present, particularly in view of wide divergences in production outcomes and potential. There is presumed to be little interdependence among the nations, and they face large common and idiosyncratic shocks. And it is this that will make it difficult for individual countries to entrust the preparation of monetary and exchange rate policies to external agencies, particularly in the face of mounting adverse shocks to their economies. He sees the fact that countries are struggling with the attainment of the convergence criteria as evidence of that difficulty.

Honohan and Lane (2000) however suggest that “the record of macroeconomic mismanagement in many African countries means that there is a strong case for delegation of monetary policy, if a suitable supranational monetary authority exists. Put differently, since policymaking resources are scarce in Africa, it may make sense to “outsource” monetary policy as one possible resolution to the search for “agencies of restraint”.

The major problem remains that a supranational monetary authority may require some degree of political integration, if it is to be accepted as democratically accountable. Political integration may be desirable also to minimize the “hold up” problem in the setting of monetary policy. And that is currently missing in the region, thus making it difficult to be very optimistic on the outcomes. The current initiative is to use monetary union to spearhead regional economic cooperation within a region where economic cooperation has so far been limited. Honohan and Lane (2000) suggest that if there were enough resources to support the union it might be possible for it to slowly lead to greater political integration. “This political and administrative process would likely be a more potent force for economic integration than the direct effect of achieving exchange rate stability across African borders”.

On the question of seignorage, it is the fear of loss of seignorage revenue that might hold back countries from abdicating responsibility for monetary policy. And many African countries rely extensively on seignorage, amounting to about 1.5% of GDP on average in the region. It is obvious that the countries will have to work out appropriate alternatives to high seignorage and find ways of distributing these equitably.

Deepening Financial Sectors and Fighting Contagion

With respect to the poorly developed banking and financial sectors, the opportunities exist for improvement. The most fundamental thing for countries contemplating membership in a monetary union or a currency area is whether it leads to greater financial resources for development. And these are linked to the extent to which it makes the resources of the rest of the world available; that is, the benefits of globalization. As seen earlier, Africa has been left out of the massive international capital that flowed to developing economies with the opening up of the world economy in 1980s. The good news is that it was bypassed by the global financial crisis associated with such massive capital flows. In its global marginalization, Africa stands to lose out on the potential benefits of globalization, although it is presumed to escape the risks of globalization.

Successful globalization is characterized by mutual gains for both global investors and emerging economies in Africa. While benefiting from globalization, Africa should also contribute to the improvement of the global risk-reward ratio faced by global investors. In terms of benefits to international investors, it may be noted that investors evaluate their investment portfolios on the basis of global risk-reward ratio, and the benefits from globalization include the following:

- **Diversification Benefits:** The competitiveness of Africa in attracting international capital depends on its role in improving the global risk-reward ratio faced by international investors. The potential benefits from international portfolio diversification stem fundamentally from diversity in economic cycles of countries. For instance, a combined strategy of investment in both non-US equities and the US market generally dominates investment in the US market alone. Can Africa contribute to the emerging markets portfolio, and ultimately to the global portfolio? To the extent that Africa's economies do not move in tandem with those of the advanced economies, there are opportunities for international investors to benefit from inclusion of African financial markets in the global portfolio.
- **Bargains in Africa and Stock Return Potentials:** There are indicators pointing to gross undercapitalization of Africa, suggesting potential bargains. Very low price-earnings multiples are currently observed in African stock markets, and hence suggesting high undervaluation, given an acceptable range of emerging market risks. Also, the recent performance of African stock markets is encouraging and indicative of high return potentials (Senbet, 1998).

There are considerable benefits to Africa as a recipient of global capital and/or integration into the global economy, and these include the following:

- **Access to Diversified Source of External Finance:** Access to *diversified* source of external capital lessens heavy reliance on sovereign debt and its attendant crisis and on official flows which are already shrinking.
- **Reduction in Cost of Capital:** Globalization allows for local securities market risks to be shared internationally. Global risk sharing leads to reduction in the local cost of capital (Errunza, Senbet, Hogan 1998). In other words, greater risk sharing in the local markets by international investors leads to reduction in the cost of capital for local firms, as risks of local shares are globally shared.
- **Discipline and Exposure to Best Practices:** Globalization enhances validation of the credibility of domestic capital market institutions, as foreign investors demand world class services. Governments will be under greater pressure to strengthen the rule of law, enforce contracts, and increase the growth of available information in response to international investor demands.

- Reversal of Flight Capital: The evidence from other regions, such as Latin America and East Asia, suggests that globalization of local markets leads to large reversals of flight capital. Given that Africa stands within the top tier of regions in terms of flight capital stock per GDP, there is a potential for significant reversal of flight capital, if the region is sufficiently integrated into the global economy.

The other side of the coin is that globalization engenders considerable risks, and the associated crisis as witnessed in East Asia. The global risks stemming from volatility of the global financial markets, the large unfavorable fluctuations in international exchange rates, and large unfavorable swings in international interest rates, manifest themselves in large *unfavorable swings* in international capital flows. For instance, countries that experienced large capital flows suffered commensurately large and sudden outflows. The sudden and large collapse of capital inflows can be enormously costly. Not only that there could be sudden withdrawals of deposits, leading to a credit crunch in the economy, But (a) there will be unwillingness on the part of creditors to supply short-term credit even for liquidity crisis, and (b) there will be default and *contagion* of the type experienced in East Asia (and earlier in Mexico). The damage associated with the financial crisis was evident in the dramatic declines in the asset and currency values of East Asia.

It may be noted that capital markets are relatively new to most of Africa. In West Africa, for example, with the exception of Nigeria and Côte d'Ivoire, other stock markets were set up only in the last few years. They may be seen as a natural outgrowth of the financial reforms that have taken place in these countries (Jefferis and Mbekewani 2001). International investors have begun paying attention to Africa, with the establishment of specialized investment funds since 1993, currently approaching eighteen in total, which are now trading in New York and Europe. Regionalization is emerging as a way of addressing the thinness and scarce liquidity problem of African capital markets. In particular, the Abidjan stock market has emerged as an anchor for the CFA countries, with an increased potential to serve other countries in West Africa. This effort has encouraged discussion between Ghana and Nigeria on setting up another sub-regional exchange for Anglophone West Africa. The Nigerian Stock Exchange and the Ghana Stock Exchange signed a memorandum of understanding in 1999 to ascertain the feasibility of a regionalized exchange. It is ironic, however, that while this discussion is taking place, there is new effort to start a second Nigerian exchange in Abuja. The establishment of regional securities and exchange commissions, self-regulatory organizations, and committees to promote harmonization of legal and regulatory schemes are among the mechanisms under discussion. The tax treatment of investments has to be harmonized, since tax policy is an important incentive or disincentive both for issuers and investors. Ultimately, the regulations, accounting reporting systems, along with clearance, settlement and depository systems, should conform to international standards.

6. SUMMARY AND CONCLUDING REMARKS

There is no doubt about the fact that there is still a long way to go before financial and monetary cooperation can be well established in Africa. Since the introduction of the Euro, the perceived pressure on African governments to set up similar arrangements has increased, despite the fact that the institutional and other structural conditions are quite different. In parts of Africa, there is certainly the tendency to view financial and monetary integration as the best possibility for bringing about faster political integration

The current struggles of the West African Monetary Zone to achieve convergence is ample indication of the difficulties facing the region as it seeks to achieve financial and monetary cooperation. On the other hand, the fact that the CFA franc appears to have achieved some stability following reforms and a peg to the Euro might suggest that having an external anchor might help. It is proposed to explore in the next edition of this paper the prospects for using an externally based peg to achieve financial cooperation among any group of African countries.

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