

Robert Triffin International



MONETARY ASPECTS OF THE AFRICAN CONTINENTAL FREE TRADE AREA

October 2018



CENTRO STUDI SUL FEDERALISMO



A watch on the international financial and monetary system

The **Robert Triffin International** (RTI) is an international organization created with the support of the Catholic University of Louvain (UCL), which hosts its seat and documentation centre, and the Compagnia di San Paolo, an Italian foundation based in Turin.

RTI aims to preserve the intellectual heritage of the Belgian economist Robert Triffin (1911-1993) with the creation of a documentation centre and continuing his action directed to the reform of the international monetary system.

The RTI Secretariat and Research Centre in the monetary and financial fields are based in Turin, in collaboration with the Centro Studi sul Federalismo, founded by the Compagnia di San Paolo and the Universities of Turin, Milan and Pavia.


The RTI brings together more than 50 personalities who have held important roles in European and global institutions and active in the economic, social, academic world. It is sustained for its activity by public and private institutions.

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INDEX

Preface by Elena Flor	5
Monetary Aspects of the African Continental Free Trade Area	6
1. The Free Trade Agreement	7
2. The Monetary Problem in Africa	7
3. The SDR as a Standard for Africa	8
4. The Role of the Mediterranean Countries	9
5. The Banking System's Contribution	9

Preface

The 2006 financial crisis forced international financial institutions to become stronger, first and foremost, the International Monetary Fund, which doubled quotas from 238 to 477 billion SDRs and redistributed them to emerging countries: the first ten IMF quota holders, in addition to China, also include India, Russia and Brazil.

Robert Triffin International contributed to the debate on the future of the international monetary system with its Report “Using the SDR as a Lever to Reform the International Monetary System” published in 2014 and – along with its Joint Report with the Shanghai Development Research Foundation, published in 2015 on occasion of the G20 held in China – to the debate on including the Chinese renminbi in the SDR basket, then decided in the following year.

The way was opened to set up a multicurrency reserve system and create monetary areas. In this perspective, Robert Triffin International participated in the initiative held in Moscow in November 2017 with the Eurasian Economic Cooperation Organisation with its study “The Triffin Dilemma on a Russian Perspective. The Fixing of Oil Price: Dollar, Euro, Ruble or SDR”.

The recent launch of the African Continental Free Trade Area makes reflections on the continent’s participation in the evolution of the international monetary system particularly relevant.

This paper aims to define a research and debate programme to identify the possible evolution of Africa’s full participation in international financial institutions.

Elena Flor
Secretary General, Robert Triffin International

Monetary Aspects of the African Continental Free Trade Area

The long road to African unity has perhaps taken a major step forward with the recent decision – under ratification – by 49 countries to create the AfCFTA, African Continental Free Trade Area, along with the Free Movement Protocol, signed by 32 countries. The AfCFTA is one of the flagship projects of the African Union’s Agenda 2063 that also provides for the introduction of a common passport and a single currency.

The African Union, which was established in 1963 as the Organisation of African Unity and thus renamed in 2002, includes all the countries on the continent and is headquartered in Addis Ababa. So far, the security sector has been its main scope of action with the creation of its “blue helmets”, which have intervened on a number of occasions to help stabilise several countries troubled by inextricable tribal crises.

The new AfCFTA agreement can provide the same impetus to Africa as the creation of the Common Market did in 1957 to the European unification process.

Reflecting on the African unity issue, the most significant experience to look at is probably India. China has been able to count on a unification that took place over two thousand years ago, in particular with the concentration of the Seven Kingdoms, and on the creation, under the emperor, of a high-level administrative structure (the mandarins), of which the Chinese Communist Party is, in a way, a continuation. In the last thirty years, the fact that China has again begun to play a key role in the world economy has been facilitated precisely by its historic unification.

The Indian Union was instead the result of the British imperial rule that left local power to the existing dynasties (the Maharajas) and only through Gandhi’s action has the current configuration taken shape, by giving an important role to local entities: the Union is divided into 27 states and 16 territories. There are 14 official languages (including English) and only the currency (the rupee) and the army actually are federal competences, while there is still broad autonomy in the field of trade, without even taking into consideration the political structure, wherein, in many states, alongside the two big federal parties, local political forces prevail.

Based on the Indian experience, strengthening the role of the African Union in the security and monetary sectors is an essential step in the African integration process.

1. The Free Trade Agreement

This agreement, to the extent that it will be implemented, may bring about a decisive turning point in the economy of the African continent.

The economic system of many African states is built on the export of energy resources and raw materials, as well as on the import of consumer goods.

Dependence on the prices of raw materials – subject to sharp fluctuations in relation to the evolution of the world economy – and on indebtedness in “hard currencies” explain the recurrent financial crises which have plagued many African countries, forcing them to request IMF support (with the application of the related monetary and financial policies) and, in the most dramatic cases, debt restructuring and even cancellation.

The free trade agreement should lead the economy of African states to facilitate import/ export with neighbouring countries, thus directing imports from developed countries to investment goods, using investments and aid to build infrastructures capable of breaking down the geographical and technological isolation of individual states.

The first steps in the European integration process after World War II moved along these lines, as it was facilitated by the implementation of the Marshall Plan, whose official name was the ERP (European Recovery Program). The first objective was to restore the production capacity destroyed by the war and, not surprisingly, the ERP required a single European plan that avoided duplication and relaunched trade between European states after the autarky phase.

The implementation of the European Payments Union was at the heart of the ERP, which allowed European countries to balance the settlement of trade between them, without using “hard currency”: it was the “dollar shortage” phase. Only the net balance of the European Payments Union had to be settled in dollars and the Marshall Plan provided that ERP funds could be used for this purpose. The aim was, in fact, to cover European countries’ deficit *vis-à-vis* the United States due mainly to the purchase of the capital goods needed for reconstruction.

2. The Monetary Problem in Africa

The need for monetary unification is particularly debated in Africa, which is, in fact, currently organised according to the old colonial areas, with the former French area pegged to the euro, the former British colonies looking for a currency peg and the Mediterranean countries shifting between pegging to the dollar and to the euro.

The African Union, under the 1991 Treaty of Abuja and then the Constitutive Act adopted at Lomé in 2000, decided to create an African Monetary Union, through the integration of the regional monetary zones and based on the “afro”, and the establishment of the African Central Bank (ACB) headquartered in Abuja (Nigeria), the African Investment Bank (AIB) based in Tripoli (Libya) and the African Monetary Fund based in Cameroon.

The process, despite being the subject of continuous political meetings and academic debates, will be long, but at least it is necessary to identify its direction.

Some steps are essential, especially in the initiation stage of the AfCFTA:

- The implementation, at least between groups of countries with stronger economic and proximity ties that are not part of regional monetary unions, of “payments union” agreements similar to those implemented in Europe after World War II;
- The choice of a “unit of account” as it was for the European Payments Union, when Robert Triffin obtained the first “European unit of account” that, albeit equal to the gold content of one dollar (the famous 35 dollars per ounce), after a long journey, was to become the euro;
- The choice of a borrowing currency to finance the necessary infrastructure endowment that does not undermine African countries’ monetary stability due to the monetary policies of the issuing countries.

3. The SDR as a Standard for Africa

African countries’ choice of the SDR as a “unit of account” may help them meet their needs since:

- it is a more stable “unit of account”, especially with reference to the price of raw materials and energy sources;
- it includes the euro and the renminbi, which represent the areas more interested in the development of Africa and its natural resources;
- it may bring the different areas of the continent closer together in relation to their past experiences.

Pegging the potential “afro” to the SDR “basket” would make the unit of account project more robust, as happened in Europe when the ECU “basket” was indicated to peg the future euro.

The launch, at least between groups of states, of forms of “common agricultural policy” will be necessary to fill the deficit in food product output. Europe thus managed to cover demand and today is facing the opposite problem: surplus. Agricultural pricing in a “common unit of account” was an essential step and a powerful boost to the next transition to the common currency: the most rational choice would be to use the SDR as the “African agricultural unit of account”.

The African Central Bank (ACB) can indeed perform the significant task – for the countries

wishing to participate – of organising the African Payments Union (APU). The ACB could, as was the case in Europe, conclude a technical assistance agreement for the functioning of the APU with the Bank for International Settlements in Basel. The ACB could also participate in the BIS – as is already the case at present for European countries with the European Central Bank – thus strengthening Africa’s role in international monetary cooperation.

African central banks could use the “official” SDRs held – given the lack of international currencies such as the dollar, euro and renminbi – both as capital contributions to the African Central Bank and as capital endowments of the African Investment Bank. In this case, the two institutions could be included in the SDR “Third Party Holders”, as provided for in the IMF’s Articles of Agreement.

4. The Role of the Mediterranean Countries

It is no coincidence that the SDR or similar formulas characterise the North African countries bordering the Mediterranean, namely Libya, Egypt and Morocco:

- Libya has formally continued to peg its currency to the SDR, originally wanted by Gaddafi, also in relation to his “African currency” plan;
- Egypt has continued to determine the Suez Canal tolls in SDRs, which was set at the time of nationalisation;
- Morocco has pegged its currency to a basket of euros and dollars (in fact, almost similar to the SDR).

Therefore, an area pegged to the SDR in the Mediterranean area could be developed and, over time, extended to other African countries, with whom economic relations will strengthen.

5. The Banking System’s Contribution

The European experience shows how the participation of commercial banks can provide a significant contribution to realising the monetary unification project, anticipating the creation of a common capital market in the area and encouraging the extended use of the “unit of account” in financial transactions.

In Europe commercial banks, starting with the Kredietbank in Brussels, have played a significant role in the use of the ECU unit of account that has culminated in the creation of the ECU Banking Association by more than thirty banks, including the European Investment Bank, with numerous ECU-denominated bond issues.

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