Chapter 3: EXPERIENCES FROM OTHER REGIONS
3.1 Background

3.1.1 African RECs have generally looked to the experience of the EMU in formulating their fiscal convergence programs as part of their efforts to establish monetary unions. However, conditions, and circumstances of Africa do not replicate those of Europe. The EMU experience, although relevant, may not provide them with a complete example to follow, and African RECs may wish to learn from the experiences of Asia and other developing regions that have fostered economic and financial integration and draw appropriate lessons.

3.1.2 Accordingly, this chapter aims to provide background information on the fiscal policy coordination and surveillance towards and in monetary unions in other regions with the objectives of: (1) gaining insight into their modalities and experiences in promoting fiscal discipline and conducting surveillance of the observance of fiscal convergence criteria in member countries; and (2) drawing possible lessons for East and Southern African RECs, COMESA in particular. To that end, this chapter reviews the experiences of fiscal policy design, implementation, convergence and surveillance in the existing monetary unions such as the euro zone, CEMAC and WAEMU, and those RECs moving towards monetary unions such as WAMZ and others in Latin America and Asia. Additionally, this chapter also reviews the role and modalities of the IMF in conducting multilateral and regional surveillance, particularly examination of policies pursued under currency unions, and the more recent G-20 Mutual Assessment Program (G-20 MAP).

3.2 Euro Zone Experiences

3.2.1 Policy Design, Coordination, and Implementation

3.2.1.1 Economic and Monetary Union (EMU) can be roughly designed as a regional governance framework. In the words of one policy analyst, “EMU is a system of economic governance in which the different elements – monetary policy, fiscal policy and supply-side policies – have been brought together in a policy framework that differs markedly from those of Member States. Because of political imperatives that have resulted in a delicate balance of power between Member States and the supranational level, EMU has also had to establish means of coordinating a range of national policies in an explicit and ordered manner. The Treaty explicitly requires the European Central Bank (ECB) to assure price stability. Fiscal policy remains with Member States, but there are obligations to maintain the soundness of public finances, backed up by the Stability and Growth Pact (SGP) rules.” The constraints on national policies are particularly significant in the fiscal field where the EU laws oblige member states to respect specific convergence criteria and to eschew monetary financing and privileged access to credit facilities, while prohibiting bail out financing by partner countries. This system of policy coordination reflects the conviction that the normal function of an economic and monetary union, with its single currency and single monetary policy, requires supportive union-area fiscal stance and convergence.

3.2.1.2 In the EMU, specific provisions have been made towards that requirement, both for countries that are already members of the EMU and for other countries of EU aiming to enter the euro zone. EU fiscal rules are aimed at creating right incentives for fiscal policy makers; and creating room for budgetary manoeuvre within prudent deficit limits; and preventing adverse spill-over of higher interest rates from borrowing by member countries. Adherence toEU fiscal rules is monitored through multilateral surveillance under EU laws and regulations. The formal framework comprises of three components: the Lisbon Treaty, the Stability and Growth Pact, and Economic and Financial (ECOFIN) Council’s Regulations.

3.2.1.3 The EU Lisbon Treaty forms the primary regional law for enforcing multilateral fiscal surveillance over the Euro Zone. It is based on seven building blocks: (1) Excessive Deficit Procedure (Article 126); (2) Protocol on the Excessive Deficit Procedure (EDP) with the reference values of 3% of GDP for government deficit and 60% of GDP for gross debt; (3) the relevant provisions underpinning aggregated fiscal discipline; (4) coordination of economic policies (Article 121); (5) no monetary financing of governments by ECB or national central banks (no overdraft or any other credit facility, Article 123); (6) no privileged government access to financial...
institutions (Article 124); and (7) no bail out (no mutual financial support, Article 125).

3.2.1.4 The EU Stability and Growth Pact is worked out as the secondary law to operationalize the primary regional law. According to the SGP, stability programs need to be submitted annually by Euro area Member States, outlining macroeconomic projections and fiscal policy plans for the next three years. The SGP also stipulates the Medium-Term Objective (MTO) for EU member countries which requires that member countries achieve “close to balance or surplus” in their respective budgets.

3.2.1.5 The MTO is technically defined as structural balance (cyclically-adjusted balance, net of one-off and temporary measures). Minimum benchmarks have been set for EU member states: (1) staying at distance from 3% deficit limit (depending on real GDP growth volatility and budgetary elasticities); (2) making progress towards fiscal sustainability (reduction of high debt ratios), thus leaving room for budgetary manoeuvre through automatic stabilisers; and (3) moving on to an adjustment path to the MTO: 0.5% of GDP structural adjustment per year. The MTO is aimed at maintaining sound fiscal positions. When EU member states’ budget balances are in line with the MTO and thus safely below the deficit limit of 3% of GDP, automatic stabilisers can operate freely in a cyclical upturn/downturn (but in an economic crisis, they have to be capped, as shown in Figure 3-1).

3.2.1.6 Article 99 of the Lisbon Treaty also stipulates the issuance of annual Broad Economic Policy Guidelines (BEPGs) as the overarching policy framework for member countries. The BEPGs are at the heart of the co-ordination process of which SGP is only one component along with others. The BEPGs are politically but not legally binding; no sanction mechanisms are foreseen. Compliance is voluntary and based on peer pressure. At the outset, the BEPGs were very general in scope, but recommendations became more concrete and specific over time, and country-specific recommendations gradually gained in importance, until broadly providing a mirror image of Community-wide guidelines; The Broad Economic Policy Guidelines also set parameters for fiscal policy and some Member States have internal rules as well. In particular, the effectiveness of the BEPGs as a tool for multilateral surveillance was improved in 2000, with the introduction of an annual Implementation Report that provides ex post surveillance by assessing the extent to which Member States have followed the recommendations set by the BEPGs. The Implementation Report is presented shortly before the BEPGs of the following year and helps sharpen the focus of the latter.

3.2.1.7 In the case of member countries, the fiscal surveillance mechanism operates with two arms: the preventive arm, and the corrective arm. The annual stability programs of member countries are the centrepiece of the European Commission that initiates deficit procedure by preparing a report whereas the ECOFIN Council acts by majority (excluding the country concerned). The ECOFIN Council, in conducting a “peer review” of the case, exercises some discretion in assessing whether or not the reported deficit (over 3% of GDP) exists: if in its judgment exceptional and temporary factors have worsened the fiscal situation, or if the actual deficit is close to 3% of at an overall macroeconomic policy orientation. One consequence of this arrangement is that opportunities for normative input into the choice of policy are severely circumscribed, so that the underlying “stability” model is not subject to challenge.”

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32 I. Begg, op cit classifies various coordination policy components in the EU as firm rules (surveillance and dialogue- ECOFIN) that are substantial and disciplinary, and loose agreements (macroeconomic dialogue on structural policies) that are procedural and largely advisory. His assessment of coordination in EU is summarized as follows: “What is conspicuously missing however, is any formal means of coordination between fiscal and monetary policy, the conventional notion of the policy mix; ... there is provision for dialogue between monetary policy and other policy domains, but no overt channels for joint decision making, although there are the two mechanisms shown for exchanges of views, including the political forum of the Euro group. Thus, on one of the key issues of policy management, it is soft procedures which dominate and which, in practice, represent the sole means of arriving
33 I. Begg, op cit.
GDP, it may decide that a decision that such a deficit exists is not warranted. On the other hand, if it concurs with the EC’s finding, then it issues a recommendation to correct the deficit; and sets a deadline for correction (usually the year after identification) and the correction path (minimum annual adjustment of 0.5% in structural terms). The concerned member country is expected to implement corrective measures under regular monitoring. If the deficit is corrected, ECOFIN Council will abrogate (i.e. revoke the EDP decision). However, if the deficit situation is not corrected, the Council issues new recommendation with new a deadline, and may take further steps to tighten the procedure. Further steps, among others, include making recommendations public; giving notice; imposing sanctions (non-interest bearing deposit; ultimately fine).

3.2.1.8 The European Commission assesses annually the progress of EU candidate countries with respect to the Copenhagen Agreement (i.e., Membership criteria). Based on the annual progress report and the related recommendations, EC adopts a list of Accession Priorities (for the Candidate Countries) and European Priorities (for potential Candidates, i.e., currently Western Balkan countries). Those priorities define certain measures that the related national authorities should address, e.g., property right protection, rule of law, trade liberalisation, stricter banking supervision, and so on). It may be noted that these measures go well beyond fiscal or, indeed, economic and financial, measures, and are intended to foster convergence in socio-political domains, too. In order to facilitate the implementation of these measures, the EU offers financial support (currently called IPA, Instruments for Pre-Accession).

3.2.1.9 In order to prepare Candidate Countries and potential Candidate Countries for their reporting obligations, once they are EU members, the EU Council in 2000 established the so-called Pre-Accession Fiscal Surveillance Procedure. This procedure includes the Pre-Accession Economic Programme (PEP) and the Fiscal Notification. Currently, each candidate country presents their PEPs to the Director General of Economic and Financial Affair Committee by the end of each January. Each PEP comprises four main sections: a review of recent economic developments, a detailed macroeconomic framework, public finance developments and prospects, and structural reform plans. The program ought to provide a coherent and consistent macroeconomic framework, and identify the main objectives of macroeconomic policy with the corresponding intermediate goals. The Director General of Economic and Financial Affair Committee then provides an evaluation of the programme and puts forward the related requirements for potential member countries to progress towards actual membership. The framework of analysis comprises developments in prices, fiscal balances, debt ratios, exchange rates and long-term interest rates as well as other factors.

3.2.2 EU Experiences in Fiscal Convergence and Surveillance: Lessons Learnt

3.2.2.1 Despite a fairly comprehensive MFSF, including reporting, assessment, review, and the EDP, overall the system has failed to instil fiscal discipline or fiscal convergence, as is evidenced by budget deficits (compared to the 3% limit) in many countries, including Germany and France, during 2001-03, the persistent existence of debt ratios over the limit of 60% of GDP in several countries, and (more dramatically) the present Greek crisis and vulnerable fiscal situation in Ireland, Portugal, and Spain. The Greek-generated crisis for the Euro Zone has led the authorities to undertake an in-depth review of the surveillance system and they have recently agreed to further tighten the surveillance system, including the operation of the EDP34.

3.3 Sub-Saharan African Experiences

This section reviews the experience of Sub-Saharan African experiences with a focus on Central and West African RECs. Since Sub-Saharan African experiences is discussed in details in the Bank Working Paper on Supporting Macroeconomic Convergence in African RECs (AfDB, 2011), this section will focus on two existing African monetary unions (WAEMU and CEMAC) and one (WAMZ) projected to be moving towards a monetary union. WAEMU is made up of seven West African countries; CEMAC consists of five central African countries, and WAMZ of six countries. Most members of these three arrangements are either or both HIPC and MDRI Initiative (Figure 3-2) and budget support eligible countries.

34 In contrast to member counties, the EMU’s fiscal surveillance mechanism has served well in guiding reforms in other countries of the EC that aspiring to join, or have joined, the Euro Zone.
3.3.1 WAEMU and CEMAC

3.3.1.1 The West African Economic and Monetary Union (WAEMU) and the Central African Economic and Monetary Union (CEMAC) share a similar history. Both the unions were established by Treaties, and replaced the former monetary unions (WAMU and CAMU) in the aftermath of the economic crisis (resulting in the devaluation of their currencies in early 1990s) experienced by their predecessors with their respective common currency and common central bank. Realizing that the macroeconomic imbalances within the region that led to the devaluation were caused mainly by the increasingly large fiscal imbalances and public debt, and accumulation of domestic and external arrears, the two arrangements include, as their central feature, the aim of achieving sustainable fiscal balance and convergence among member countries through a mechanism of multilateral surveillance based on quantitative performance criteria. In both the unions, convergence criteria include various primary criteria and secondary criteria, with emphasis on fiscal criteria; for example, in the case of WAEMU, six of the eight total convergence criteria relate to fiscal policies35.

3.3.1.2 The WAEMU Treaty also requires harmonization of budget legislation and procedures in order to ensure their synchronization with multilateral surveillance procedures. Accordingly, during 1997-2000, the WAEMU Commission issued six public finance management (PFM) circulars to be implemented in its member countries. The directives were related to: (i) annual budget laws for the preparation, presentation, and approval of annual budgets, (ii) public accounting regulations, (iii) budget classification, (iv) the chart of accounts, (v) presentation of the summary of the budget, and (vi) fiscal transparency. In June 2009, the Council of Ministers approved revised directives that were prepared by the Monitoring Commission in consultation with the IMF. The revisions have three main objectives: (i) harmonize the rules for the entire budget process in all member countries, (ii) promote effective and transparent PFM in all member countries and (iii) enable comparability of public finance data for effective multilateral surveillance and national budgetary policies.

3.3.1.3 Both monetary unions have also set up a regional surveillance mechanism to monitor and enforce progress towards satisfying the performance criteria. The WAEMU’s Solidarity Pact requires member countries during the transition period from the date of entry into force of the Pact (2002) to prepare convergence

35 The convergence criteria to be observed by member countries included four primary criteria and four secondary criteria pertaining to public finances, real sector, balance of payments, and common currency. The primary criteria are composed of: (i) basic fiscal balance as percentage of GDP (zero or positive), (ii) public debt as ratio of GDP (not to exceed 70%), (iii) average annual inflation rate (not greater than 3%), and (iv) non-accumulation of domestic arrears. The secondary criteria prescribe: (i) the ratio of wage bill to tax revenues should not exceed 35%; (ii) ratio of domestically financed investment to tax revenue must be at least 20%; (iii) ratio of current external deficit, excluding grants, to nominal GDP should not exceed 5%; and (iv) the ratio of tax to GDP must be 17% or more. Given that monetary policy for the region is determined by the independent common central bank, the emphasis of the convergence criteria is on ensuring fiscal stability and sustainability.
programs with annual objectives of ensuring compliance with the convergence criteria. Semi-annual reports on the implementation of policies are prepared and reviewed by the Council of Ministers, which is charged with monitoring progress towards convergence. A member country not satisfying one or more of the primary criteria is so notified by the Council of Ministers and is required to prepare, in cooperation with the WAEMU Commission, a program of corrective measures. The WAEMU Commission is charged to verify that the proposed measures are consistent with the resolution of the Council of Ministers on the non-performance and the Union’s economic objectives. If the program of corrective measures fails to achieve the desired result, a new set of appropriate measures is prepared by the WAEMU Commission to be approved by the Council of Ministers and implemented by the member country. In 2004, CEMAC also adopted a regional surveillance framework, which is conducted by the CEMAC Commission to prevent occurrence of fiscal deficits.

3.3.1.4 Both monetary unions have also included a sanctions mechanism, as part of the surveillance framework, that activates when a member country, whose performance has deviated from the prescribed convergence criteria and is required by the Council of Ministers to prepare and implement a program of corrective measures, has not implemented that program. In the case of WAEMU, the sanctions mechanism ranges from moral persuasion to the withdrawal of West African Development Bank financing to the outright suspension of central bank financing.

3.3.1.5 Despite the above fiscal convergence mechanism, both the unions have failed to make progress towards fiscal stability or fiscal convergence. Thus, notwithstanding the fulfillment of the revised 2008 fiscal convergence criteria that aimed at reducing the impact of the variations in oil prices in the budget balance, by all member countries except Chad during the period since 2004, an IMF staff study demonstrated that, taking into account broader aspects of fiscal policy in terms of fiscal stance (measured as the deviation of actual budget balance from a “cyclically neutral budget balance”) and fiscal impulse (measured as the change in the fiscal stance from the previous year), the present fiscal convergence criteria do not serve the regional objectives of preserving fiscal sustainability adequately. In the case of WAEMU, on the other hand, another IMF staff study concluded that the magnitude of fiscal adjustment implied by the convergence criteria would require additional adjustment in nearly all the countries, and that these additional measures are not equal in all the countries, in part reflecting different initial conditions.

3.3.1.6 Apart from the above conceptual problems, actual performance in terms of convergence of member countries in both the unions has been unsatisfactory. For example, the IMF’s Surveillance Report of WAEMU 2008 shows that “overall progress on macroeconomic convergence continued to stagnate, and all but one country missed the fiscal convergence criterion.” In that year, the overall region’s budget deficit, excluding grants, amounted to about 6% of GDP, as did the current account deficit. The original PFM directives were also not fully implemented in any of the countries. Many member countries could not, or did not, transpose the directives into national laws, or if they did they did not implement them fully. There were also some inconsistencies within and between the directives, detail, and obsolescence of several provisions and omissions that may have hindered their implementation.

3.3.1.7 The above discussion highlights the weaknesses in the surveillance framework of the two Monetary Unions. It would seem that the framework at present is not properly designed in terms of either appropriate fiscal criteria (choice and quantification), provides little or no incentive or sanctions for member countries to fulfill fiscal criteria, and witnesses weak country-level PFMs that are either not addressed or are being addressed only recently, and weak review and follow-up mechanism.

3.3.2 The West African Monetary Zone (WAMZ)

3.3.2.1 The WAMZ experience is interesting because its six member countries (the Gambia, Ghana, Guinea, Chad, Mali, and Senegal) have historically been characterized by chronic fiscal instability and structural imbalances, with large budget deficits and high levels of external debt. The union was established in 1988 with the goal of stabilizing the economies of its members and promoting economic growth through the implementation of macroeconomic policies consistent with the objectives of the African Union.

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36 J. Wiegand, Fiscal Surveillance in Petro Zone: The Case of CEMAC. IMF WP 04/08
37 D. Ousmane and J-C. Nachega, IMF WP 00/109
38 This section summarizes the paper by J.H. Tei Kitcher of the West African Monetary Institute, entitled “Multilateral Fiscal Surveillance in the WAMZ: What Have We Learnt?”, presented at a Joint ADB and COMESA workshop in Mauritius in December 2009.
Nigeria, Sierra Leone and Liberia\(^{39}\) in West Africa formally agreed in December 2000 on the launching of the Zone with the objective of establishing a common central bank and introducing single currency. Like COMESA, and other RECs in Africa, the establishment of WAMZ was to be implemented in stages, beginning January 2001, with the harmonization of macroeconomic policies through compliance with certain convergence criteria, the operationalization of an exchange rate mechanism, culminating in the introduction of the single currency.

3.3.2.2 The launch of the Union, however, has been postponed several times, but in the meantime WAMZ agenda has been expanded to transform it into a full economic and monetary union. A revised roadmap has now been adopted. This delay has occurred despite the incorporation in the initial program of the requirement to meet a set of convergence criteria, and address issues such as statistical harmonization and payments system development, financial contributions to the future common central bank and the establishment of a Stabilization and Cooperation Fund. A revised roadmap has been adopted that includes a review and harmonization of the convergence criteria\(^{40}\), the harmonization of statistics, domestic policies and the legal, accounting and statistical framework for public finance.

3.3.2.3 WAMZ Treaty envisages overseeing members’ compliance with the criteria and guidelines provided by the Convergence Council. It involves both off-site and on-site monitoring of developments in member countries’ economies. The on-site surveillance is undertaken through a questionnaire, followed by WAMI staff visits for discussions. The WAMI staff also maintains regular off-site monitoring and the two types of monitoring enable the staff to prepare Macroeconomic Developments and Convergence Reports on each country, semi-annually and annually. These report focus on the macroeconomic policy thrust, overview of macroeconomic developments, and status of convergence of each country and policy recommendations in all sectors of the economy.

3.3.2.4 The surveillance system in WAMZ is operated by the following organs:

- Convergence Council, comprising the Ministers of Finance, Foreign Affairs, Trade/Commerce, and Governors of the central banks;
- Committee of Governors of central banks that acts as the technical supervisory body;
- Technical Committee, comprising Directors of research of central banks and representatives of the Ministry of Finance, that reviews reports and makes proposals for consideration of the Committee of Governors and the Convergence Council;
- WAMI, which serves as secretariat to WAMZ organs. In discharging its surveillance functions, the Convergence Council provides both peer pressure (to correct the aberrations if persisting) and peer support by providing assistance and sharing relevant experience and practices from within the Zone and internationally. At the national levels, there are National and Zonal Committees to deal with WAMZ programs and obligations. These are the national Sensitization Committees, the national Payments System Development Committees, and the Zonal Payments System Development Committee.

3.3.2.5 An innovative feature of WAMZ is the attempt by WAMI to draw up, in 2003, a Program of Macroeconomic Convergence for each member country, based on the realization that member countries were at different levels of macroeconomic performance, and would require different timeframes to converge. These programs were discussed with country authorities, agreed upon and owned by them, and adopted by WAMZ authorities. These programs formed the basis of surveillance during 2003-2005. Although WAMZ has prescribed a total of

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39 On 16 February 2010, the Republic of Liberia acceded to the membership of the West African Monetary Zone, following the signing of the Protocol by the Chairman, Authority of Heads of State and Government of the WAMZ, H.E. Dr. Ebele Goodluck Jonathan, Ag. President of the Federal Republic of Nigeria, and the President of the Republic of Liberia, H.E. Ellen Johnson Sirleaf. Prior to the country’s accession, the WAMZ comprised five countries: The Gambia, Ghana, Guinea, Nigeria, and Sierra Leone.

40 WAMZ convergence criteria, totaling 10, are also grouped under primary (4) and secondary (6) criteria. Two primary criteria and four secondary criteria concern the fiscal area. The criteria are: Primary-inflation ≤ 5%, ratio of budget deficit (excluding grants and on commitment basis) ≤ 4%, central bank financing of the budget ≤ 10% of previous year’s tax revenue, gross official reserves ≥ 3 months of imports; secondary: no new arrears and liquidation of old arrears, tax revenue ≥ 20% of GDP, wage bill/tax revenue ≥ 35%, public investment to tax revenue ≥ 20%. Positive real interest rates, real exchange rate stability vis-à-vis WAMZ ERM.
ten convergence criteria, only two (budget deficit, and domestic arrears) relate to fiscal position. Interestingly, no mention is made of public debt.

3.4 Asian Experiences
3.4.1 Regional Integration Trend

3.4.1.1 Asian regional arrangements have taken myriad forms, have been either principally market-driven or price-driven and either homegrown or promoted by external circumstances or by development partners. Whatever their origin and form, however, Asia has proved to be most successful in promoting regional integration. The existing regional arrangements fit into one or more of the permutations and combinations between various models: cooperation, integration, homegrown, externally inspired, market-driven, and policy-driven. Regional cooperation, as distinguished from regional integration, is a relatively recent phenomenon in Asia, though its expansion in recent years, particularly after the Southeast Asian financial crisis in 1997, has far outpaced that in other parts of the world. Presently, nearly every Asian country is a member of one or more regional arrangements. Indeed, intra-Asia cooperation is now the mainstream of national and regional policies of most Asian countries, and includes not only the public sector but also the private sector.

3.4.1.2 Amongst the formal treaty-based associations, ASEAN is the most successful and important organization. Since its formation in 1967, it has broadened its objectives to include economic and social development, and political security in the region. In the process, it has established and strengthened its institutions, and introduced innovative instruments and mechanisms to pursue those objectives. These developments have taken place within the overall guiding philosophy, which recognizes the voluntary participation of each of the member states and strives to build cooperation in the “ASEAN way” i.e. on mutually acceptable modes of behavior in order to maintain a conciliatory relationship among the participants.

3.4.1.3 During the first two decades of ASEAN, the arrangement was aimed at cooperation rather than integration, and the cooperation was project-based type rather than program or policy-based. During this period, it had been content with an incremental strengthening that was sectoral- and target-specific, setting the goals first and subsequently the mechanisms and initiatives to achieve those goals.42 However, this orientation of ASEAN began to change when the attention turned to fostering trade cooperation. After the 1997 East Asia financial crisis, it widened its horizon further to the objective of forging an ASEAN Community. Thus the 2003 Summit, meeting in Bali, adopted the Bali Concord II that committed the member countries to establish an ASEAN Community by 2020, “based on three pillars: the ASEAN Economic Community, the ASEAN Socio-Cultural Community, and the ASEAN Security community.”50 Currently, steps are underway to link other countries of Asia to ASEAN, and a lively debate is taking place in academic and policy corridors on whether and how quickly Asia should proceed to accomplish monetary union in the context of a common market and Asian Community.44

3.4.1.4 ASEAN economic integration has been market-driven, facilitated via trade and FDI channels that followed unilateral domestic trade and financial sector liberalization measures; there were few, if any, policy-driven moves toward regional financial and monetary integration. The comparison of Asian intraregional trade performance with other regions can be found in Table 3-1 and 3-2. It was only in the wake of the 1997 financial crisis, that there was a general assessment amongst ASEAN leaders that serious failures in key regional monetary and financial areas were a major reason for the crisis, and that regional cooperation should be intensified to address those weaknesses. By a series of steps, a comprehensive regional framework has been established that includes member countries providing direct financial support to other members in case of financial crisis, improved regional policy dialogue, surveillance, and financial cooperation, development of ASEAN capital markets, including enabling domestic investors to use their local stock exchanges to buy stocks on the stock exchanges of other countries. The new initiatives included: the Chiang-Mai Initiative (pooling of part of external reserves); the establishment of the Asian Bond Market; formal regional surveillance; and the Asian Cooperative Dialogue (ACD) mechanism.

41 This section draws from a report, titled “Intra-Asia Cooperation”, prepared for the UNDP by R.J. Bhatia.
42 S. Siddique, ASEAN Vol. 1, p 471
43 Address by H.E. Dr. Sathirathai, Deputy Prime Minister of Thailand, to the Asia Society, Bangkok 9 June 2005.
### Table 3-1: Importance of Intraregional Trade, by Region, 1980–2005 (percent of total trade)

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<td>62.5</td>
<td>63</td>
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Note:
- East Asia = Japan and emerging East Asia
- Emerging East Asia = Asian NIEs and ASEAN
- Asian NIEs = newly industrialized economies
- ASEAN = Association of Southeast Asian Nations
- NAFTA = North American Free Trade Agreement

Source: Computed from IMF, Direction of Trade Statistics; CEIC databases (Table 1 in Kawai 2007).

### Table 3-2: Intra-regional Merchandise Exports within Main African Blocs

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Data Source: World Bank

3.4.1.5 The experience in fostering regional cooperation and integration in Asia, as well as the successes in achieving high and sustainable rates of growth that have reduced poverty and created vast internal markets, have encouraged Asian countries to expand their cooperative efforts beyond the sub-regional borders and aim for pan-Asian integration. Interesting examples of such broader arrangements are the ASEAN links with China, India, Japan, and South Korea through the ASEAN+ formula, bilateral FTAs, and full Dialogue Partner agreements.

3.4.1.6 Measures have, therefore, been taken to enhance monetary and financial cooperation within Asia, especially among the ASEAN+3 countries. Thus, within the framework of ASEAN+3 the ASEAN, China, Japan, and South Korea agreed on the Chiang Mai Initiative (CMI) “to
strengthen self-help and support mechanism in East Asia through the ASEAN+3 framework to supplement the existing international [financial] facilities.” CMI has three elements of financial support: (i) original ASEAN Swap Arrangements (ASA), (ii) existing repurchase arrangements, and (iii) new Bilateral Swap Arrangements (BSA).

3.4.1.7 While the above-mentioned bilateral and multilateral arrangements among countries from different sub-regions of Asia provide avenues for wider co-operation, none of them provides a broad enough forum for discussions and development of all-Asia-wide co-operation. It was to fill this missing link that Thailand in 2000 proposed the creation of such a forum. The idea was translated in the establishment, in 2002, of the Asian Cooperation Dialogue (ACD) that brings together Foreign Ministers of Asian member countries to develop and chart the future direction of Asia-wide collaboration. The ACD process is “informal, top-down, evolving and non-institutional”. Its guiding principles may be summarized as “positive thinking, non-institutionalization, respect for diversity, and comfort level”, aiming to build unity among Asian countries and forge a substantive and meaningful platform for the continent by creating an Asia-wide strategic partnership for cooperation. ACD has rapidly developed in two dimensions: the dialogue dimension, and the project dimension. On the dialogue side, ACD Ministers have held various annual retreats, besides meetings on the sidelines of other international gatherings, to discuss ACD developments, issues of regional cooperation, and ways to enhance Asian unity.

3.4.2 Asian Surveillance of Member Policies

3.4.2.1. Surveillance within Asian cooperative arrangements has two unique characteristics as compared to other similar arrangements. First, none of the Asian arrangements prescribe any convergence criteria for members to respect, and second, surveillance has increased in intensity as the degree of cooperation has intensified, though as yet there is no disciplinarian or sanctions mechanism, notwithstanding the establishment of financial transfer mechanisms such as the CMI. Further, the surveillance mechanism and actual implementation, does not single out fiscal developments for surveillance but rather speak of macroeconomic policies. This may be because in general ASEAN countries have had a fairly good record of sound public finance management; financial crises of the 1990s were financial rather than fiscal crises.

3.4.2.2. The surveillance process takes place in various fora (some extinct and superseded by others by now), comprising the Manila Framework Group (1997), the ASEAN Surveillance Process (1998), the ASEAN+3 Economic Review and Policy Dialogue Process (1999) which was extended in 2002 to include a larger number of other Asian countries, Asia-Europe Finance Ministers’ Process, and APEC Finance Ministers’ Process. The AsDB supports these efforts through training of country officials from the central banks and ministries of finance in methods of regional monitoring and surveillance, capacity building support for the activities of the ASEAN Surveillance Coordination Unit in the ASEAN Secretariat, support for the establishment of surveillance units in the ministries of finance of several member countries of the region, participating in and providing monitoring inputs to various high level regional meetings, development of regional early warning systems, etc.

3.4.2.3. The Terms of Understanding establishing the ASP noted particularly that the review process be kept informal, simple and based on a peer review. The ASEAN Surveillance Process (ASP) comprises of two components: monitoring of macroeconomic and financial developments of the member countries and a peer review process. The monitoring process is jointly conducted by the ASEAN Secretariat Surveillance Coordinating Unit (ASCU) and the Surveillance Contact Persons from each member country. The Surveillance Contact Person is required to submit the necessary data and country report to the ASCU, in accordance with the template that has been provided. The ASCU then compiles the submissions from each member country and prepares a consolidated report. ASCU also prepares regional and global economic reports. This, together with the consolidated country report, will be evaluated in the peer review process.

3.4.2.4 Peer review is a setup for reviewing reports prepared by the ASEAN Secretariat and the Surveillance Contact Persons as well as reports from IMF, AsDB, World Bank, and other related institutions. Peer review is carried out in two stages. The first stage of the review process is undertaken at the Deputy or Senior Official Level (including Central Banks official from member countries), whereby
a thorough review process is conducted. Ideally, most of the technical aspects should have been settled at this stage but this is not always the case. Deputies tend to focus on their own countries’ reports in order to weed out mistakes and/or “sensitive” issues. The second stage of the review is at the Minister level (Minister of Finance) where policy issues become the focus of the agenda.

3.4.2.5 Some critics⁴⁵ have argued that the ASP is ineffective as it fails to bridge the gap between the existing global surveillance process and national surveillance process, and that the ASP would be ineffective to prevent a crisis, due to its lack of transparency and the presence of political obstacles confronting implementation of the required policy adjustment endorsed by the peer review process. The ASCU, which is the backbone of the ASP, is not supported by adequate human resources. In addition, some member countries have limited resources to carry out their own national surveillance. Different stages of development between the member countries reflect differences in institutional capacities, which have resulted in uneven quality, availability and timeliness of the data. Some member countries can only provide key indicators of certain sectors on an annual basis and sometimes with considerable delay. Consequently, it becomes difficult for the ASCU to conduct cross-country analyses to closely monitor their developments.

3.4.2.6 However, these critics also recognize the potential strengths attributed uniquely to the ASP, one that is absent from the existing global surveillance system. Firstly, the ASP has a regional surveillance network, which comprises of a group of regional experts and the ASCU staffs who are familiar with the issues involved and follow developments in the region on a daily basis. Secondly, ASP has a peer review process, which is considered to be effective in encouraging member countries to adopt internationally agreed standards and codes. To strengthen the related institutions, as mentioned earlier, the ASEAN+3 finance ministers introduced the ASEAN+3 Economic Review and Policy Dialogue (ERPD) process to apply to a larger set of East Asian countries in May 2002. The purposes of the ERPD process include (i) assessing global, regional, and national economic conditions; (ii) monitoring regional capital flows and currency markets; and (iii) analyzing macroeconomic and financial risks.

3.4.2.7 Steps have been taken to strengthen cooperation, including the establishment of expert groups. ASEAN finance ministries and central banks deputies hold an ERPD session twice a year to exchange views. The deputies present the assessment of their own economies, though they refrain from assessing the economic developments and policies of other countries, and recommending policy adjustments (Kawai and Houser, 2007). The recent decision by the ASEAN+3 finance ministers to establish an independent surveillance unit within East Asia reflects the leaders’ recognition that existing processes needed to be strengthened further, especially in view of the prospective needs of the CMIM.

3.5 Latin American Experiences

3.5.1 Eastern Caribbean Currency Union (ECCU)

3.5.1.1 The Eastern Caribbean Currency Union (ECCU) comprises six members: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines; and two territories of the United Kingdom: Anguilla and Montserrat. In the East Caribbean region, economic integration is behind monetary integration. Like CEMAC and WAEMU, ECCU is a custom union-based. All of the ECCB members are also a part of the Organization of Eastern Caribbean States (OECS). OECS, created in 1981, is an inter-governmental organization dedicated to economic harmonization and integration, protection of human and legal rights, and the encouragement of good governance between countries and dependencies in the Eastern Caribbean region.

3.5.1.2 To catch up with monetary integration and better coordinate fiscal trade and monetary policies, OECs countries revised the OECs Treaty for an Economic Union in 2009. The Treaty puts the administration of the organization in three institutions and five organs. The three institutions are the East Caribbean Supreme Court, the East Caribbean Central Bank and the East Caribbean Aviation Authority; and the five organs, the Authority of Heads of Government, the Council of Ministers, OECS Assembly, the Economic Affairs Council and the OECS Commission. Recognizing that a common currency already exists among the member states, the revised treaty does not pay detailed attention to the existing ECCU.

3.5.1.3 The single monetary policy is managed by ECCB. Guided by the ECCB Agreement Act 1983, ECCB orients...
its single monetary policy to four strategic objectives: regulating money and credit supply; maintaining monetary stability; promoting credit and exchange conditions and a sound financial structure for balanced growth and development; and promoting economic development of the territories of the Participating Governments. Consistent with the strategic objectives, ECCB has placed emphasis on four priority areas, namely (1) financial stability; (2) Monetary Policy in a Currency Union with a Quasi-Currency Board Arrangement; (3) Financial and Real Sector Development; and (4) Fiscal and Debt Sustainability. In line with the priorities, ECCB has several policy responsibilities.

3.5.1.4 To support single monetary policy operations, ECCB maintains the U.S. dollar peg through a quasi-currency board arrangement. It has pegged Eastern Caribbean dollar to U.S. dollar at EC$2.70=US$1 since 1976. The ECCB Act places a floor on external reserves at 60% of the demand liabilities of the ECCB, resulting in an implicit ceiling on domestic assets of 40% of reserve money. The ECCB has maintained a reserve cover of 95%. Policy instruments at the disposal of the ECCB comprise discount and rediscount rates, reserve requirements, differential rates and ceilings for various types of transactions, and credit to members in accordance with specific rules.

3.5.1.5 To support single monetary policy operations, ECCB coordinates with national authorities in effecting supervision over financial sectors. The responsibility for regulating and supervising banks and systemic nonbank financial institutions in the ECCU is shared between the ECCB and the Ministry of Finance of each member country. The 1983 ECCB Agreement Act and the 1993 Uniform Banking Act established the ECCB’s regulatory and supervisory jurisdiction over commercial banks and other licensed financial institutions, including offshore banks affiliated with local banks.

3.5.1.6 Regional monetary and financial policy coordination is effected through ECCB regular surveillance and independent policy advice; and other support as is deemed necessary to member states. The related support activities, among others, include: (1) help prepare quarterly, semi-annual and annual economic and financial reviews as well as the Annual Report; (2) participate in IMF staff visits and Article IV Consultation missions in ECCB member countries; (3) participate in assessment missions of Poverty Reduction and Growth Facility arrangements in the member states and prepare policy briefs on current issues of critical regional importance.

3.5.1.7 Structural and fiscal policy issues are attracting an increasing attention in ECCB economic surveillance over member states. In 1998, the Monetary Council of the ECCB adopted a set of fiscal benchmarks to support the quasi-currency board arrangement, to be achieved by 2007: (i) a surplus on the government current balance of 4-6% of GDP; (ii) an overall government budget deficit of no more than 3% of GDP; (iii) a total central government debt outstanding of no more than 60% of GDP; and (iv) debt service payments of no more than 15% of current revenue.

3.5.1.8 A recent event on structural issues is the coordination and hosting of the ECCU Boot Camp to facilitate Economic and Financial Adjustment in 2009. The boot camp focused on assessing the macroeconomic state of the economies given the member governments current policy stance and developing adjustment measures where necessary, to stabilize and correct any fiscal imbalances as well as place the debt on a downward trajectory. Coming to fiscal issues, ECCB outsourced a Canada-Eastern Caribbean Debt Management Advisory Service (DMAS) to improve the capacities of ECCU governments to effectively manage their debt portfolios to sustainable levels in line with the fiscal targets established by the ECCB Monetary Council. This advisory service will remain in effect until October 2014.

3.6 IMF Surveillance and Policy Dialogue

3.6.1. The IMF is mandated to oversee the international monetary system and monitor the economic and financial policies of its member countries. This activity is known as surveillance. During this process, which takes place both at the global level and in individual countries, the IMF highlights possible risks to domestic and external stability and advises on needed policy adjustments. In this way it helps the international monetary system serve its essential purpose of facilitating the exchange of goods, services, and capital among countries, thereby sustaining

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sound economic growth. This surveillance takes place at the country level, regional level, and global level.

3.6.2. The country surveillance is formally conducted under the Fund’s Article IV of the Articles of Agreement. IMF economists visit member countries regularly, usually annually, to exchange views with national authorities. The focus of the discussions is domestic and external stability of the country and whether there are risks to that stability that merit adjustment in economic and financial policies. The staff report of the country mission is submitted to the Executive Directors of the Fund for discussions, and the Board’s views are subsequently transmitted to the national authorities. In view of the recent financial crisis, and the demonstrable linkages between real economy and the financial sector, issues relating to the financial sector are now receiving greater attention in these discussions. In their advice to individual countries, the IMF staff benefits from its cross-country experiences, drawing on the organization’s unique experience as a global financial institution. Increasingly, spillovers of a member country’s policies on other member countries are receiving particular attention in staff analysis.

3.6.3. The IMF also reviews global and regional financial and economic trends. Global surveillance is undertaken in the context of three semi-annual publications: World Economic Outlook (WEO), Global Financial and Stability Report (GFSR) and Fiscal Monitor. The WEO provides detailed analysis of the state of the world economy, addressing issues of pressing interest, while the GFSR provides an up to date assessment of global financial markets and prospects, and highlights imbalances and vulnerabilities that pose risks to financial market stability. Regional Economic Outlook Reports, including one on the African region, provide more detailed analysis for the five major regions of the world. The Fiscal Monitor reports on fiscal developments across countries, and addresses specific fiscal issues of the moment. For example, the January 2011 Fiscal Monitor Update reports on the pace of fiscal consolidation in the US, Japan, advanced economies in Europe, and emerging markets, and concludes that sovereign risks remain elevated, underlying the need for more robust and specific consolidation plans.

3.6.4. The practice of surveillance has evolved considerably since the 1970s. In September 2009, the IMF’s Executive Board adopted a Statement of Surveillance Priorities to help the institution to fulfill its mandate. For example, this statement emphasized the orderly unwinding of the (present) crisis-related policy interventions and policy requirements for sustaining world growth.

3.6.5. The Fund also exercises effective surveillance over the members of currency unions entailing discussions at the regional level. This requirement derives from the fact that currency union members have devolved responsibility for policy areas that are central to Fund surveillance, notably monetary and exchange rate policies, to regional institutions. Discussions have been held for some time with regional institutions in the euro area, the Central African Economic and Monetary Union (CEMAC), the Eastern Caribbean Currency Union (ECOU), and the West African Economic and Monetary Union (WAEMU). These discussions are formalized as constituting an integral part of the Fund’s surveillance on the individual members of the currency union. In the case of Africa, since 1998 and 1999, respectively, discussions with WAEMU and CEMAC regional institutions have taken place once a year, and the staff report is discussed in a formal Board meeting and a summing up is prepared47.

3.6.6. Following the G-20 Pittsburg Summit meeting in September 2009, the IMF was asked, and the Fund agreed, to assist the G-20 in their Mutual Assessment Program (G-20 MAP). At that summit, the G-20 leaders had pledged to adopt policies needed for a durable recovery that would achieve strong, sustainable, and balanced global growth. To this end, they launched a “framework for strong, sustainable, and balanced growth.” They committed to develop a process to set out objectives, develop policies to achieve these objectives, and together assess progress (mutual assessment). The Fund – with input from other international institutions – was asked to assist this process. Specifically, the Fund was asked to provide “analysis of how the G-20’s respective national and regional policy frameworks fit together” and “… develop a forward-looking analysis of whether policies pursued by individual G-20 countries are collectively consistent with more sustainable and balanced trajectories for the global economy.” G-20 members also agreed on the template for setting out policy frameworks and plans. They have agreed to share their medium-term

47 Formalization, as part of Article IV consultation discussions, was made only since 2004.
policy frameworks, plans, and projections in the agreed template (in as much detail as they can) with each other and the Fund.

3.6.7. The Fund staff’s analysis would involve: (i) identifying the inconsistencies and incoherence of national assumptions in G-20 submissions; (ii) analyzing the multilateral compatibility of country submissions; (iii) analyzing the aggregate impact of national policies on global economic prospects; and (iv) identifying what additional policy commitments might be needed to reach the G-20 members’ objectives. Fund staff will assess the coherence, consistency, and mutual compatibility of policy frameworks, and their effectiveness in securing strong, sustainable, and balanced global economic growth. This assessment will include assessment of individual G-20 country submissions, assessment of their multilateral consistency, and policy recommendations. The Fund’s report will be considered through a three-step hierarchy; deputy Ministers, Ministers of Finance and Governors of central banks, and finally Heads of State and Governors who will act on recommendations and endorse policy actions by G-20 countries. This process is as yet in a formative stage, but it is a valid expectation that it will ultimately get integrated in the Fund’s overall surveillance mechanism.

3.7 Conclusions and Implications for East and Southern African RECs:

3.7.1. Taken together, the experiences of EU, WAEMU, CEMAC, Asia and Latin America provide valuable pointers as to some of the essential elements that must be included in devising a multilateral surveillance framework for African RECs in their run-up to monetary unions, and the intermediate steps that need to be taken to ensure its effectiveness. These may be summarized as follows:

- Almost all regional arrangements recognize the central importance of fiscal policies in fostering convergence, and hence the need for enshrining fiscal convergence criteria and their formal multilateral surveillance in agreements/treaties establishing monetary unions.
- The experience of EMU, as well as of WAMZ, demonstrates that monetary union is a long process needing substantial policy and structural reforms, and evolving through various stages of cooperation and integration before a sustainable monetary union can be established. The WAEMU and CEMAC experiences show that establishing a monetary union at the beginning of the integration process necessarily compels member countries to go back to the drawing board and establish the necessary preconditions and pre-stages for the monetary union. The African experiences also show that over-ambitious targets lead inevitably to the postponement of those targets and erosion of credibility in those ambitions. The EMU experience in admitting new members also has cautious pointers for countries wishing to join a monetary union, such as “hasten slowly”.
- The proposition that a monetary union is a combination of real-sector and financial-sector integration is supported by how the EMU has evolved. Indeed, lack of trade integration in various African RECs, by minimizing intra-regional interdependence, may explain the slow progress towards monetary integration in those regions, just as the rapid trade integration in ASEAN may equally account for the greater momentum towards monetary integration in Southeast Asia. Thus, one important and inescapable conclusion is that trade integration must be embedded in an overall strategy for monetary union.
- Fiscal projections should be made on realistic, rather than too optimistic, assumptions, and a corrective period to restore budgetary balance should not be a prolonged one;
- Fiscal policies also cannot be assessed in isolation and their compatibility with the monetary and structural policies should be emphasized in prescribing and assessing convergence criteria performance.
- While the EU has relied on few convergence criteria for entry into the EMU, and even fewer for member countries of EMU, African RECs have a multiplicity of criteria they require of potential member countries to fulfill. There is evidence that, at best, this may have eroded the focus of country authorities on criteria essential for convergence or, at worst, led to ignoring them at the country level. This is where a conceptual distinction between fiscal rules and fiscal convergence criteria in the regional monetary union context is useful. Fiscal convergence criteria at the
union level should be few, as indeed is the case in EMU, and a guide for the member countries to set fiscal rules to fulfill those criteria and other fiscal and developmental objectives of national authorities.

The African experience highlights the need to keep fiscal convergence criteria few, simple, and easily monitored. They should also be realistic, subject to the sustainability constraint, in terms of the ability of member countries to realize them without undue strain on their economic and social fabric.

Peer pressure works when only one or two member countries stray out of the union discipline, but when a larger number happens to be in that position, compromises and collusion inevitably lead to the “softening” (euphemistically called “reform”) of the surveillance process. Thus a careful thought needs to be given as to the relative weight of rules and discretion in the surveillance process.

The Asian experience in particular, fostered by technical assistance from the AsDB, has emphasized the need for strengthening PFM at the national level as the bedrock on which to base regional convergence. WAEMU and CEMAC are following this course and strengthening and harmonizing their PFM (policies and institutions) with technical assistance from the IMF. The Latin American countries, although not generally engaged in establishing monetary unions, have realized the importance of PFM improvement and are pursuing that goal in the context of devising medium-term macroeconomic, fiscal, budget, and expenditure frameworks.

All formal cooperative arrangements have introduced their own multilateral surveillance mechanisms, varying in the degree of intensity and the format. Generally all of them have relied on “peer pressure” as the enforcing element. The EMU framework has formal preventive and corrective arms as essential elements of the multilateral surveillance, but the recent events have shown various gaps in that armor, especially as it concerns monitoring of compliance with convergence criteria, and management of crisis. The existing surveillance mechanisms of African RECs and monetary unions are weaker, and possibly ineffective, in varying degrees in different organizations.

ASEAN countries have paid special attention to the needs of relatively less developed member countries to confront the costs of adjustment and to “catch up” with the more developed member countries. The latter have devised regional and their national assistance programs to that end. This has provided appropriate incentives for the former to adhere to their obligations as members of the cooperative organizations.

The Asian surveillance mechanisms have avoided formal setting up of convergence criteria and enforceable procedures despite the establishment of various intraregional financial facilities. The signs are that these countries may be moving towards a more formal system of monitoring and surveillance would point out the need for retaining formal, and biting, fiscal surveillance frameworks.

The need for providing technical assistance to member countries to bolster their PFM systems is almost universally justified by our survey of experiences of various regional arrangements.