ROLE OF REGIONAL FINANCIAL INTEGRATION IN PROMOTING GROWTH, DEVELOPMENT AND POVERTY REDUCTION IN AFRICA

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Introduction

Regional financial integration refers to a process, market driven and/or institutionalized, that broaden and deepen financial links within the region. At the very least, this process involves eliminating barriers to cross border investments and differentiated treatment of foreign investors. Further deepening of financial links can take the form of harmonizing national policies, laws, and institutions. Over time, cohesion of regulatory frameworks, operational structures and information systems, and convergence of prices and risk assessment mean that national financial markets within the region effectively function as one. Taking this concept further, a group of countries may set up a regional bond or stock market, distinct from and potentially coexisting with national markets, with the specific intent of pooling resources, risks, and returns. Whatever form they take, Regional Financial Integrations (RFIs) have a certain minimum set of prerequisites: currency convertibility and payment system integration to reduce settlement delays, information and communication infrastructures and removal of legal and regulatory barriers[1].

Most African countries are still at a relatively early stage of development and financial integration is low and global banks have a bigger foot print than regional banks. However, there is a great drive by all major regional integration initiatives in Africa, towards liberalization of inter and intra-regional flow of goods, services and capital which are beneficial for growth. In view of this, many regional organisations in Africa are in the process of being converted to a Common Market with "free movement of goods, services, investment, skilled labour, and freer flow of capital." With the advent of CAFTA there is also scope for further regional trade liberalization, with potentially important benefits for growth, employment and poverty reduction. Typically, enhancing trade integration requires a high degree of financial integration, in order to boost growth, employment, financial inclusion and poverty reduction.

The objective of this paper is to provide requirements for promoting safe RFI in Africa. The paper is organized as follows: Section 1 review benefits of RFI. Section 2, review impediments to and risks from closer financial integration. Section 3 discusses some experiences of financial integration in Africa. Section 4 presents some lessons that could be drawn from successful European experiences in establishing RFI. Section 5 provides generic roadmap for achieving RFI in Africa. Section 6 provides brief conclusion.

1. Benefits of Regional Financial Integration (RFI)

In theory, financial integration can bring important benefits to a country and a region. African countries financial systems remain for the most part bank centered. Quantifying and valuing the benefits specific to RFI can be extremely difficult. However, several existing regional financial integration initiatives around the world provide direct evidence that such integration can help unleash certain "external" macroeconomic benefits, and at the same time also lead to several "internal" or direct micro benefits. The World Bank publication on "The Guidelines for the Successful Regional Integration of Financial Infrastructure" lists the following potential direct and indirect benefits of RFI:[2]

a) Direct benefits include among others the following:

- Lower user-costs for individuals, businesses and public administrations as end users of the RFI arrangement.
- Lower end to end transaction costs for the financial firms participating in RFI arrangement.
- Improved cross border access and reach to all market participants to financial services, with faster, more reliable and simpler transaction services;
- Improved risk management, greater risk reduction and stronger financial stability resulting from wide spread utilization of

1. John Wakeman-Linn and Smita Wah, "Regional Financial Integration: It's Potential Contribution to Financial Sector Growth and Development in Sub-Saharan Africa" Presentation at the Finance for the 21st Century. High level Seminar organized by the IMF Institute in Collaboration with the Joint Africa Institute, Tunis, Tunisia,
2. Guidelines for the Successful Regional Integration of Financial Infrastructure (Draft), World Bank, September

consistent and up-to-date international policy, legal and technical standards, as well as best practice risk management designs and procedures.

- Help the less financially developed economies to catch up with the more developed ones.
- Spur the development of the financial sector and product innovation.

b) The indirect benefits include among others the following:

- Expansion of trade and investment flows among market participants in the region to enable deeper regional economic and financial integration.
- Attraction of external investment capital to the region, which deepens and broadens regional financial and capital markets.
- Deepening and broadening of regional financial and capital markets.
- Impose greater discipline on governments, banks, and non-bank institutions and make the economy more resilient to shocks.

2. Barriers, Risks and Other Challenges that can prevent Successful RFI

Barriers relate to differences or incompatibilities across the various countries that want to participate in the common regional arrangements. These may cause severe delays or otherwise impair or even impede successful RFI in terms of the efficiency, safety and overall effectiveness of regional solutions. The barriers will need to be addressed as prerequisites of the regional financial integration programme. The key barriers include:[3]

(i) Differences in national legal, regulatory and oversight regimes among member countries. This results in competitive distortions and encourage regulatory arbitrage. The differences also go against efficient group approach towards risk management and make the resolution of cross border financial institutions very difficult.

(ii) Inadequate harmonization of national financial integration operating schemes, rules, and technical standards etc.

(iii) The need to have a clear grasp of the potential contagion and spill over risks brought on by integrated financial markets for example which result from macro-financial linkages. The flipside of financial integration is the risk of negative spillovers and spillbacks, which if left unaddressed, could result systemic risks.

3. Some experiences of Financial Integration in Africa

Pan-African Banks (PABs) are undoubtedly the most defining features of regional financial integration over the past decade in Africa. There has been a rapid expansion of PABs in recent years, with seven major PABs having a presence in at least ten African countries. Three of these are headquartered in Morocco, two in Togo, and each in Nigeria and South Africa. Additional banks primarily from Kenya, Nigeria and South Africa have a regional presence with operations in at least five countries. PABs have a systemic presence in around 36 countries. These banks have been particularly active in syndicated loans, especially in the financing of infrastructure and supporting local markets. Some of the PABs have gone beyond traditional banking activities to embrace operations in capital markets, insurance, pensions, money transfers, and microfinancing.[4]

The growth of PABS, offers a number of opportunities and benefits. The expansion of these banks reflects the increase in economic integration within Africa more generally and is contributing to improve competition, support financial inclusion, and give rise to greater economies of scale. In addition, they have been filling the recent gap left by European banks and are becoming the lead arrangers of syndicated loans.[5]

Apart from the success of PABs, there are several interesting success stories. Kenya has been a world pioneer in mobile banking. Many African countries have also started to use technology to leapfrog traditional paths to financial deepening. The Agence UMOA-Titres (AUT) has played an interesting role in developing the regional sovereign bond market in the WAEMU region. Its role is to assist the member states in their financing operations on the financial market by coordinating securities issuance. It is also responsible for the conduct of auctions, oversight of market conduct, publication of market data, and investor relations. As a result, it has provided governments in the region with a wider market for their securities, and undoubtedly led to the extension of maturities as well as lowering of yields, compared to national issuance.[6]

3. Ibid p.13
4. Charles Enoch, Paul Mathieu and Mauro Mecagni "Pan-African Banking: Opportunities and Challenges for Cross-Border oversight, IMF, 2015 p.1.
5. IMF, "The Financing of Infrastructure in Sub-Saharan Africa: A changing Landscape", in Regional Economic Outlook; Sub-Saharan Africa, Washington DC. October 2014

In WAEMU, since 1998, the Bourse Regionale des Valeurs Mobilieres (BVRM) has served as a regional exchange for trade on stocks and bonds. In WAEMU progress are also made on other fronts of market integration largely through supra-national regulatory laws and bodies. Another important development is the rapid growth of the regional market in local currency debt, especially public debt.[7]

4. Some Lessons from the Experience European Union

EU provides most advanced example of RFI. However, given the stark difference between European and African economies, great care must be taken in trying to apply lessons from EU to Africa. The EU model of RFI has evolved and adopted over decades, and functions in an institutional and economic environment that is in many aspects quite different from that found in most African countries.

The following are some of the lessons that could be drawn for successful experience of European Union in achieving RFI[8]

i) Achieving RFI requires strong political commitment.
ii) It is important to have a clear grasp of the potential contagion and spillover risks brought on by integrated financial markets, as well as transition and operational risks. Once these risks are identified, strong policy frameworks at national and regional levels would need to be put in place to properly manage these risks
iii) RFI would need to be supported by sound institutional legislative frameworks, which include among others the following:
   - The minimum regulatory requirement for entry.
   - Permissible banking activities which are consistent with current stage of member countries development and growth objectives.
   - Regional arrangements for effective cross border banking supervision and regulation.
   - Regional institutions to set standards and rules and to enforce national compliance of regional rules.
iv) To have a regional approach to ensure financial stability;
v) The need for regional macro-financial surveillance mechanisms.

5. Generic Roadmap for Achieving Regional Financial Integration

According to AfDB publication on Financial Sector Integration in three regions of Africa, Roadmap for RFI have the following five stages:[9]

(a) Stage I-Preparatory stage: In this stage countries need to fulfil certain preconditions relating to establishing macroeconomic stability and financial system soundness. In this stage, the main responsibility falls on domestic policy makers to modernize domestic financial system, especially the payment system. At the same time Free Trade Area agreement between member countries should be implemented. Substantial exchange of information and other forms of interaction between the countries would be needed to make them aware of the reforms being undertaken in partner countries.
(b) Stage II- Harmonisation Stage: At this stage, modernization of the financial sector in individual countries would be further extended by the introduction of and compliance with various international standards and practices in the financial sector to ensure regional harmonization. Intraregional exchange controls would need to be abolished. Member countries which already have stock exchanges need to strengthen them Those which does not have need to introduce them. Free Trade arrangements should be effective to enable private financial sector to expand their activities cross border.
(c) Stage III- Cooperation stage. The achievement of harmonization in areas of financial institutions; rules and regulations would lay the foundation for this stage of integration. At this point, countries would cooperate in implementing agreed convergence criteria, to be monitored and evaluated by a regional ministerial council. They would also complete the full harmonization process relating to regulatory, supervisory, and accounting procedures began under stage II, and would cooperate in cross border regulation and supervision activities. Arrangements would also be made to link domestic securities

6. Monfort Mlachila " Regional Financial Integration in Sub-Saharan Africa: Key Note Presentation at the XXVII, Lisbon Meeting of the Central Banks of Portugues Speaking Countries, 9 October 2017, p.8.
7. John Wakeman-Linn and Smita Wah, "Regional Financial Integration: It's Potential Contribution to Financial Sector Growth and Development in Sub-Saharan Africa" Presentation at the Finance for the 21st Century. High level Seminar organized by the IMF Institute in Collaboration with the Joint Africa Institute, Tunis, Tunisia, p11.
8. GeertAlmekinders, Salashi Fukunda, Alex Mourmourus, Jiaping Zho &Yong Sarah Zhou" ASEAN Financial Integration" IMF Working Paper WP/15/34, pp17-18
9. AfDB, Financial Sector Integration in Three Regions of Africa: How Regional Financial Integration Can Support Growth, Development, and Poverty Reduction. 2010, pp14-14-17

markets. Building on the effectiveness of FTA, countries would enter into an agreement to establish a customs union. Legal systems would be reformed to enable cross-border enforceability of contracts. This stage would also see enhanced cooperation in the areas of monetary and exchange rates policies.

(d) Stage IV-Integration Stage: This shifts the focus of action to the regional level. This stage would be characterized by an operational customs union, the effective integration of various financial institutions, and the exercise of regulatory and supervisory functions, including single bank licensing, a single regulatory agency, and increased cross border presence of financial institutions originating in member countries. The core measure in this stage would be a partial pooling of external reserves to meet balance of payment difficulties of member countries, the establishment of regional bond markets, and possibly a unified regional stock exchange. Following the strengthening and linking of national capital markets, new regional financial products, such as regional bonds, would also emerge to tap local savings.

(e) Stage V- Unification/ Monetary Union Stage: this final stage would see the introduction of a common currency and a common central bank on the financial side, and possibly the launching of an economic community on the real side. The operationalization of this stage, especially if accompanied by the creation of an economic community, entails the establishment of concrete institutional arrangements to facilitate the transition from national currencies, exchange rates, and central banks to the unified monetary system. It would involve detailed attention to the supporting institutional set up. Achievement of this stage is not easy-it demands strong political will at the highest levels, a dedicated civil service that believes in regionalism.

The roadmap sketched above involves a number of detailed measures to be implemented at various stages of the integration process. However, each stage also implies one or two core measures that must be undertaken. Thus in stage I, the emphasis is on developing national payment systems. In stage two it is the modernization of the financial system by adopting international banking and other standards, abolition of intraregional exchange controls, liberalizing foreign investment flows, combined with strengthening stock exchanges. Core measures in stage III would include effective implementation (monitoring and evaluation) of convergence criteria, cross-border regulatory and supervisory mechanisms, and linking of national stock exchanges. In stage IV the emphasis would be on unifying stock exchanges, and development of regional financial products such as regional bonds.

6. Conclusions

This paper highlights that increased RFI could boost trade, FDI flows, portfolio investment and cross border banking, and become an important source of growth, employment and more inclusive development, poverty reduction, as well as resilience to shocks for African economies. In fact, financial integration is an important component of ongoing initiatives to create a single market for goods and services in most regional integration arrangements. These indeed calls for regulatory harmonization and strengthening of policy coordination among member states. While this is appropriate, the recent experience in EU underscores that it is equally important to take a regional approach to financial stability. European experience also suggests the need for regional macro-financial surveillance mechanisms.

Contributor's Profile:

Mr. Ibrahim Abdullahi Zeidy is the current Director of the COMESA Monetary Institute. He coordinated the setting up of the COMESA Monetary Institute. Previously, he worked as a Senior Monetary Economist at the COMESA Secretariat, in Lusaka, Zambia for 11 years and as a Director of Research in National Bank of Ethiopia which is the country's Central Bank for 6 years. In both institutions, he worked as a researcher and coordinated research activities. As a Director of COMESA Monetary Institute he also organised many knowledge sharing workshops on monetary and financial integration issues.

In his current role, Mr. Zeidy is responsible for the implementation of the COMESA Monetary Cooperation programme which is aimed at ultimately achieving the COMESA Monetary Union.Mr. Zeidy has M. Phil Degree in Monetary Economics from Glasgow University, with about 30 years of experience on macroeconomic policy and financial sector issues. He participated in many international and regional conference and workshops.