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## Experts Group Meeting

### Financial Integration and Regional Governance in North Africa

3-4 July, 2012  
Casablanca, Morocco

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## Aide – memoire

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### Background and Rationale

The financial and economic crises of recent years have revealed or confirmed two important features in North Africa. The first is that its poor integration with global financial markets proved to be a protection that has limited direct contagion of its financial system by the toxic products causing the crisis. The second feature of the sub-region is the weakness of its economic integration and a fortiori its financial integration, which did not allow the implementation of coordinated interventions in front of the impacts of the global financial and economic crisis it has generated later.

In 2010, the Association of African Central Banks held that one of the main lessons that Africa should learn from the international financial crisis is that it has become urgent to establish mechanisms for prevention and response coordination. If this is true for Africa as a whole, it is first true for the different sub-regions, which have all endorsed the idea that regional integration provides development and that African integration is ultimately only the culmination of a series of sub-regional processes. The need for coordinated responses of North African countries to external shocks, whether real or monetary sends back to the issue of integration with all that it entails as harmonization of rules and practices and establishment of institutions of regional governance.

In fact, North Africa has embarked since the late 80's in the dynamics of regionalism, namely with the Arab Maghreb Union (UMA) which includes five countries (Algeria, Libya, Morocco, Mauritania and Tunisia). Among other objectives, the Treaty establishing UMA provides in Articles 2 and 3 research for a "...common policy in various fields", "... free movement of persons, services, goods and capital," "... achievement of industrial, agricultural, commercial, social development of Member States and bringing together the means necessary for this purpose, including setting up joint projects and developing global and sectoral programs." Several states in the sub-region are also parties to other regional economic communities that have similar objectives: CEN-SAD (Libya, Morocco, Mauritania, Tunisia) COMESA (Egypt, Libya, Sudan), IGAD (Sudan).

The finding, however, remains the same: Nearly twenty years after entry into force of the Abuja Treaty (May 1994) and five years before the deadline for the establishment of a Customs Union in each of the regional blocs, North Africa finds it hard to realize the establishment of basic integration. The North African market remains one of the least integrated in the continent. Over the period 2006-2010, the overall intra-regional trade varied between 3 and 4% of foreign trade in the area. Two decades after the signing of the Treaty of Marrakech, the Free Trade Area of UMA is still in draft form. Except for CEMAC whose intra-regional trade is below that of UMA, the other RECs reach 9.2% for ECOWAS, 9.8% for SADC and 15.2% for WAEMU. This rate is about 19% for MERCOSUR, 21% for ASEAN, 60% for the European Union.

The CEN-SAD project, which was intended to bridge between North Africa, West Africa and part of Central Africa, lack visibility for the moment, in terms of regional market structure and credible alternative to the weakness of intra-Maghreb trade (ECA-NA, 2011). The optimal strategic positioning of North Africa on the chessboard of economic groupings under construction requires at least a quick upgrade of its integration institutions, compared to other regional areas, West Africa and Southern Africa in particular and against the political and economic weight of European partner. This upgrade should also be conducted in relation to the new agenda set by the Minimum Integration Program of the African Union, and of trends across the continent, especially with the initiative called "Kampala" (CEA -AN, 2011). In March 2012, African Ministers of Planning and Economic Development, while reiterating their support for the Minimum Integration Program, welcomed the tripartite agreement between the East African Community, COMESA and SADC in the implementation of their large free trade area to establish a common market and called for the establishment without delay of a similar initiative between North Africa, West Africa and Central Africa.

In this context where we are far away from achieving successfully the first stages of integration, one might question the relevance of addressing issues of financial integration and related regional governance. In most cases, regional integration follows a classic process: an area of tariff preference and a free trade area, a customs union, a common market, an economic union<sup>1</sup>, a monetary union and finally an accomplished integration with a regional government, a regional parliament and all the institutions of regional governance.

If in some places on the continent, there are RECs that have not respected this classic line in their integration process (at least under construction), due mainly to a colonial monetary legacy that has made these areas monetary unions before even the constitution of their customs union, a good "sequencing" remains important for many analysts to achieve the construction of strong regional blocks and optimal markets. According to McKinnon (1991), liberalization of capital accounts, a crucial step towards financial integration, must be the latest in a long series of liberalization and should take place only after complete trade liberalization. Nevertheless, the theoretical validity of this assertion has not always been confirmed by empirical work dealing with the issue. Thus, Haggard and Maxfield (1993) showed that trade openness is a condition of financial openness while Leblang (1977) found no influence of trade liberalization on financial liberalization. Aizenman and Noy (2004) found a bidirectional relationship between financial openness and trade liberalization, even if they found that financial openness leads to trade liberalization rather than the reverse. Tornell et al. (2004) have shown that financial liberalization has always followed trade liberalization in the last two decades.

With regard to North Africa, Beji (2010)<sup>2</sup>, from a sample of countries south of the Mediterranean including Algeria, Morocco, Egypt, Tunisia and Libya showed that trade openness is a necessary condition for the successful opening of capital account and hence financial integration. The fact, however, is that with the potential benefits of financial integration, even in the absence of trade integration, it may be useful to reconsider the issue. Indeed, financial integration follows its own purposes but can make a positive contribution to the establishment of a regional bloc.

Theoretically, financial integration is manifested by an increased mobility of capital within the region to form only one integrated market in the last stage. The volume of this regional market being higher, it should result in lower interest rates with a positive effect on regional growth. The second benefit of financial integration is to facilitate the diversification of risks, by distributing the investment portfolio between stocks and bonds of the different member countries. Macroeconomic shocks should be theoretically better absorbed.

The question according to some economists is whether or not these benefits can (or should or should not) occur in the context of a process of monetary integration. From an empirical point of view, some benefits of financial integration have been demonstrated through its link with economic growth. Thus, Mensi et al (2010)<sup>3</sup> show that the direct relationship between financial integration and economic growth is positive and stable. Moreover, they show the existence of a weak relationship between economic growth and financial instability, which leads us to assume that countries in their sample are not financially destabilized and that, on the other hand, financial instability does not affect the positive effects of financial integration on economic growth.

Beyond these theoretical contrasts and empirical contradictions, we should recognize with Turunc (1999)<sup>4</sup>, that an efficient financial system activates economic development while guiding it. It ensures the functioning of an efficient and evolutionary payment system able to mobilize savings and improve its allocation to investment. This is true both in country and in a wider area incorporating several countries. In fact, all countries of North Africa undertook a review of their financial sector under the FSAP program led by the IMF and World Bank (ECA-NA, 2008)<sup>5</sup>. These countries are thus engaged in the implementation of the recommendations of the FSAP<sup>6</sup>. It remains true, however, that there are significant disparities in terms of development of the financial sector and of the banking supervision framework between North African countries. Morocco, Tunisia and Egypt are at a relatively advanced and similar development stage of their financial sector. These three countries have, in this respect, the most developed stock markets in the region. We can therefore consider initiatives between these countries that seek to adapt the technical infrastructure (interconnection), double quotation (cross-listing). One can even consider initiatives beyond this group.

It is in this spirit that the ECA Office for North Africa organized in 2008 a meeting on capital mobility in North Africa. Analyses presented and the discussions of the experts found that the capital intra-regional mobility in North Africa was modest and represented only about 6% of total investment in the region. Morocco and Egypt, supported by dynamic stock exchanges, were the main contributors with 45% and 36% of intra-regional investments, respectively.

Host countries of these investments were mostly Algeria, Mauritania and Tunisia in sectors such as energy, banking, telecommunications, construction and tourism. The meeting also indicated that an increased mobility of capital can be good for economic growth of countries in the region under certain conditions. Thus, capital flows are determining for regional integration, which itself

is a source of growth, when only minimum levels of intra-regional trade and harmonization of the laws is reached. The issue of harmonization of legislations obviously refers to that of regional governance, a prerequisite for successful financial integration.

Therefore, what options are available for successful financial integration in North Africa while many countries are reluctant to the idea of opening the capital account? What configuration is to be chosen for regional governance that facilitates country financial development while minimizing the risks to which their capital balances may be exposed? What sequencing process can we learn in light of the experiences of other regions in the continent? Can we move towards a successful financial integration without developing even a common currency in the absence of a single currency? What are the implications of exchange rate regimes of countries in the sub region? What would be the banking reforms to be implemented according to the level of integration envisaged? Should we go gradually from a UMA integrated area even by expanding it to the other two North African countries which also belong to other integration movements?

As many questions as the meeting of experts will address in order to reach concrete proposals for improvement of North African financial integration.

## **Objectives of the expert meeting**

The meeting aims at proposing ways of achieving financial integration in North Africa. It should lead to concrete proposals for governance arrangements to better coordinate the movement of capital in North Africa in support of the regional integration process.

## **Participants**

The meeting will bring together experts from North Africa countries. They will come from Central Banks of the seven member countries and from Ministries in charge of financial regulation in the country. Representatives of Real state Stock Exchange will also be involved in the moderation of discussions just like representatives of national institutions and regional organizations, research centers, representatives of the UN system and development partners. Representatives of other RECs will eventually present their experiences to facilitate exchange of experience.

## **Running the Meeting**

The meeting will be held over two days and will focus on four areas of discussion. For each theme, the main outcome of the study will be presented and presentations related to the topic will enrich the discussions.

### **Area 1: Financial Integration in North Africa: Where are we?**

The discussions here will help develop comprehensive progress of financial liberalization in North Africa. This includes bilateral agreements between states on the one hand and between some states and third countries (outside North Africa), on the other. It is also proposed to consider at this level the action plan adopted for financial integration by experts from the monetary and supervisory authorities of the Maghreb countries under the IMF's initiative for regional integration. This plan, having been developed after extensive discussions between officials of the Maghreb, may constitute a minimum platform for action in the North African region.

## **Area 2: Lessons from experiences of other regional communities**

Whether in Africa or elsewhere, various experiments were made in terms of financial integration. What are these experiences and what preliminary lessons can be drawn for North Africa?

Instead of pursuing the project of a finance regional market in the sense of a single market as understood by the European Union, should we instead develop domestic financial markets on the basis of common principles to make them more open to the others and to better integrate them in the global market?

On the other hand, it seems that in practice it is difficult to go very far in financial integration without monetary integration. The shared desire, when it exists, to achieve a common or even single currency, appears as the driving force that could mobilize energies and justify the establishment of a finance single market at the regional level.

The weakening of the project of creating an Asian financial market as a collective institution established on common rules can be explained primarily by the limits of monetary integration (Jetin, 2008)<sup>7</sup>. The latter has never progressed beyond the establishment of a monetary safety net in case of currency crisis.

## **Area 3: Financial integration and monetary integration: What scenario to accommodate the current configuration of North African countries belonging to different RECs**

In this context, different scenarios will be considered in light of the developments envisaged in the current situation of the sub-region. Although one can multiply scenarios to infinity, one may consider an acceleration of the integration process in UMA, which will result in a two-speed integration area, UMA on one side and North African third countries not members of UMA on one side. In this case what scenario is to be envisaged for a greater financial integration?

One can also imagine a return to a CENSAD reinforced with a UMA which continues to work at its current speed, or merging UMA with ECOWAS and CEMAC or ECCAS in response to the tripartite initiative launched in June 2011 by COMESA, EAC and SADC etc ... The options to be discussed will depend on the lines proposed by the consultant's report.

## **Area 4: Financial governance in North Africa: Which institutions for which rules?**

The absence and need for strong political will materialized by the creation of effective regional institution is at the heart of the debate on economic integration, which is often characterized as market-driven. How far can economic integration go without political significant will? Regarding economic integration defined as the integration through trade and regional investment, some have an optimistic view. For CR Henning (2004), economic integration can proceed even in the absence of strong regional institutions and can achieve a high level even without monetary and financial integration. A political integration project can undoubtedly enhance economic integration, but is not that essential.

If the desire for peace is obviously essential, a minimum political agreement without aspiration for political unity may be sufficient. Instead, the monetary and financial integration calls for a strong political agreement leading to future strong regional institutions. This is for example the position taken by T. Bayoumi and B. Eichengreen (1999) in the case of Asir when they consider that coordination of macroeconomic policies necessary for the establishment of a coordinated floating

Asian currencies, let alone an Asian monetary system and a fortiori a single currency requires a renunciation of the sovereignty of national monetary policy, creates winners and losers, implying that governments bear the political cost, make compromises, and establish the necessary compensations. B. Cohen (2003) goes further by emphasizing the role of the political dimension of monetary unions and points out that no monetary union has emerged from the only recognition of assumed economic benefits. From this perspective, the creation of the euro can be explained more by the desire to continue the political integration of the European Union than the only economic largely controversial arguments.

## **Products**

As the result of the meeting, two products will be available:

1. A meeting report outlining its progress and the recommendations derived there from.
2. A list of proposals for improving the report submitted by the consultant. Both products will support the improvement of the report on financial integration in North Africa. The report as amended by the Consultant will then be the basis for the publication of the Bureau on financial integration in North Africa. This product will be widely disseminated.

## **Documentation and working languages**

The working paper (summary of the study) and the program of the meeting will be communicated to participants in a timely manner. The meeting will be held in French and English with simultaneous interpretation in both languages.

## **Dates and venue**

The meeting will take place in Casablanca, Morocco on 3 and 4 July, 2012.

## **Contact persons**

### **Director of the office**

Ms Karima Bounemra Ben Soltane

kbounemra@uneca.org

Tel : +212537715613 ou +212537717829

### **Coordination**

M. Ochozias A. K. Gbaguidi

Economiste

Tel : +212537715613 ou +212537717829

gochozias@uneca.org







**United Nations  
Economic Commission for Africa  
Office for North Africa**

P.O. Box 2062 Rabat Ryad, Rabat, Morocco

Tel : +212 537 715 613 or +212 537 717 829

Fax : +212 537 712 702

E-mail : [srdc-na@uneca.org](mailto:srdc-na@uneca.org)

[www.uneca-an.org](http://www.uneca-an.org) / [www.uneca.org](http://www.uneca.org)