Robert Triffin International

Monetary Aspects of the African Continental Free Trade Area *

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The long road to African unity has perhaps taken a major step forward with the decision – adopted on 21 March 2018 and entered into force on 30 May 2019 – by 49 countries to create the AfCFTA, African Continental Free Trade Area, along with the Free Movement Protocol, signed by 32 countries. The AfCFTA is one of the flagship projects of the African Union's Agenda 2063 that also provides for the introduction of a common passport and a single currency.

Established in 1963 as the Organization of African Unity and renamed The African Union in 2002, this organization includes all the countries on the continent and is headquartered in Addis Ababa. So far, the security sector has been its main scope of action with the creation of its "blue helmets", which have intervened on a number of occasions to help stabilize a number of countries troubled by inextricable tribal crises.

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

Reflecting on the African unity issue, the most significant experiences to consider are probably China and India.

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

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

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

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1. The Free Trade Agreement

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

The economic system of many African states is built on the export of energy resources and raw materials, as well as on the import of consumer goods. Dependence on the prices of raw materials – subject to sharp fluctuations in relation to the evolution of the world economy – and on indebtedness in "hard currencies", explain the recurrent financial crises which have plagued many African countries, forcing them to request IMF support (with the application of the related, conditional, monetary and financial policies) and, in the most dramatic cases, debt restructuring and even cancellation.

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

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

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

2. The Monetary Problem in Africa

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

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

The process, despite being the subject of continued political meetings and academic debates, will be long (see also the *Annex* for some possible *parallelisms with the development of* the US Federal Reserve System), but at least it is necessary to identify its direction.

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

- The implementation, at least between groups of countries with stronger economic and proximity ties that are not part of regional monetary unions, of "payments union" agreements similar to those implemented in Europe after World War II;

- The choice of a “unit of account” as was the case for the European Payments Union, when Robert Triffin created the first “European unit of account” that, albeit equal to the gold content of one dollar (the famous 35 dollars per ounce) was, after a long journey, to become the euro;
- The choice of a borrowing currency to finance necessary infrastructure capacity that does not undermine African countries’ monetary stability due to the monetary policies of the issuing countries.

3. The Special Drawing Rights (SDR) unit as a Standard for Africa

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

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

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

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

The ACB could indeed perform the significant task – for those countries wishing to participate – of organizing an African Payments Union (APU), in cooperation with the African Export-Import Bank – which is already working on a Pan-African Payment and Settlement Platform. The ACB could, as was the case in Europe, conclude a technical assistance agreement for the functioning of the APU with the Bank for International Settlements (BIS) in Basel. The ACB could also participate in the BIS – as is already the case at present for European countries with the European Central Bank – thus strengthening Africa’s role in international monetary cooperation.

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

4. The Role of the Mediterranean Countries

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

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

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

5. The Banking System's Contribution

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

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

Annex

The historical example of the US Federal Reserve System

The Unites States could rely on a Central Bank, albeit intermittently, in the Union's early years. In 1791, the National Bank (namely the "First Bank of the United States") was established, championed by the first Secretary of the Treasury, Alexander Hamilton. It had a 20-year charter which was not renewed by the Congress on its expiration in 1811.

The "Second Bank of the United States" was established in 1816, again with a 20-year charter, which expired – and was not renewed – in 1836. In 1841, the third attempt to establish a national bank failed due to President Tyler's veto.

The monetary unification process could only start again many years later, in 1913, with the enactment of the Federal Reserve Act, following the banking crisis that erupted in California. However, it should be stressed that the aim of the Federal Act was the establishment of several Federal Reserve Banks – no less than 8, no more than 12, again granted a 20-year charter – covering different areas of the country, whereas the Federal Reserve would only act as supervisor: banknotes were to be issued by the Reserve Banks, who were also entitled to set the interest rate of open market operations.

With the Great Depression, the renewal of the 20-year charter was facilitated, while the Federal Reserve powers grew stronger.

It was of utmost importance, however, that from the outset the US could rely on an account unit, the dollar, linked to gold – and to silver as well, in the early stages, according to the principle of "bimetallism".

The introduction of the Afro linked to the SDR is therefore the first necessary step towards the African monetary unification. The second step will be the development of regional central banks, anchored to a common account unit and coordinated by the African Central Bank, as provided by Constitutive Act approved in Lomé in the year 2000.