Erkki Liikanen: Regional economic integration and monetary cooperation

Chairman's remarks by Mr Erkki Liikanen, Governor of the Bank of Finland, at a Eurosystem seminar with the central banks of West and Central Africa, jointly organised by the Bank of France and the European Central Bank, Paris, 1 February 2007.

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Opening remarks

Before we begin the discussion, I would like to thank our hosts and the ECB for organizing this important seminar that gives us a unique forum to exchange views on important issues of common interest.

It is a great honor and privilege for me to be chairing this first working session. The topic of the session – Regional economic integration and monetary cooperation – is an interesting one and highly relevant to all of us. The Banque Nationale de Belgique has prepared an excellent issues note which sets the stage for our discussion by reviewing the economic and monetary cooperation in the EU and in Africa, and by identifying some of the key challenges that these two regions face in their quest for deeper integration.

We have an hour and a half for this session and I hope that this will allow us time for some general discussion following our speakers' presentations. Our lead speaker today is Mr. Guy Quaden. Our first discussant is Mr. Damo Justin Baro, Acting Governor of the Central Bank of West African States (BCEAO) and the second discussant Mr. James D. Rogers, Governor of the Bank of Sierra Leone.

General discussion

I want to thank the speaker and the discussants for their most interesting and very insightful presentations. Now the floor is open for general discussion.

Concluding remarks

Let me try to recap shortly some of the key findings of our discussion.

In general, it is obvious that Africa's situation in many important respects differs from that of the EU. Therefore, we have to be very cautious in drawing lessons from the EU's experience for Africa. Nevertheless, there are also some important underlying issues that are common to both regions.

First, as regards the origins and triggering factors of integrations processes in the two regions, there are clear differences:

- In Europe, the traumatic experiences of the Great Depression and the Second World War gave an impetus for the integration process and the experience of the German hyperinflation had far-reaching impact on the nature of integration in the area of monetary policy.
- In Africa, the first steps in economic integration were taken shortly after the bulk of the countries gained their independence. Some limited advances were made in subsequent decades within regional blocs, but the integration process was largely put on hold for over a quarter of a century owing to conflicts, which in part were driven by divisive forces of the Cold War. Only after the collapse of the communism was the integration process in Africa revitalized.

As regards the three long-term key structural factors that were identified behind the success of EMU, it was noted that some of them seem to be present in Africa, while some are lacking:

- **Growing consensus on macroeconomic policy objectives** was an important factor in the European integration process, and it seems that similar phenomenon is taking shape in Africa. Indeed, in addition to favorable external environments, more prudent macroeconomic policies are clearly one of the key factors behind impressive growth performance of Africa in recent years.

- As in Europe, there also seems to be **an increasing underlying policy will** to drive the integration process forward. In Europe, this policy will was personified in certain visionary strong leaders who salvaged and/or reinvigorated the integration process at some critical junctures. Africa has also its share of strong leaders but owing to a larger number of countries participating in the process keeping up a momentum toward integration is even a greater challenge than it was in the case of Europe.
- The key weakness of the African integration process when compared with the European experience, is the lack of "natural", market-driven **increase in economic integration**. In Europe, trade interdependence increased rapidly following the Second World War and this trend has remained intact. However, in case of Africa, the level of intraregional trade remains low, even when taking into account the informal trade flows.

The role of monetary integration has been of decisive importance in the European context. It has yielded significant benefits for the region and is an area in which integration has become most securely entrenched. The launch of the euro triggered many changes in the financial markets and we are still far away from realizing the full benefits of financial sector integration. The ECB continues to have a central role in facilitator or further financial integration within Europe, thus contributing to the improved growth potential of the euro area.

Also in Africa, monetary integration has been a positive factor, as evidenced e.g., by the Franc Zone's contribution to relatively better price stability. Moreover, monetary cooperation and integration will have an important role to play also going forward. At the same time, it was emphasized that the role of monetary integration should not be overstated because the main impediments to integration in the Western and Central African region, and in Africa more broadly, are non-monetary by nature.

- As was pointed out by several speakers, the key challenge in African economic integration is to boost cross-border trade within the continent, i.e., within and across various regional integration structures. In this regard, lowering of relatively high tariff rates was mentioned as a priority.
- Also a number of other well-known measures to boost trade and economic growth were discussed: remove red tape, harmonize rules and practices, improving transportation and energy infrastructure, improve business climate, invest in labor force skills, etc.

Also in Europe, there remains more to do on most of these areas, we need to continue to address similar issue in order to boost the growth potential.

Our discussion has highlighted the crucial role of institution building for successful integration, both in Europe and Africa.

The underlying logic behind any economic integration process is to pool sovereignty or to give up some flexibility in decision-making in order to realize something that is mutually beneficial. This requires clear "rules of game" and mutual trust in the decision-making structures and at each participant's national as well as at the supranational level. The more heterogeneous the participants are, the more essential it is to have in place clear decision-making structures.

The EU was built gradually around a nucleus of countries that were relatively homogenous in terms of culture and the level of economic development. Each new entrant to the "club" had to accept the common rules of the game and had to adjust its own institutions to comply with the community standards. Over time, as the number and heterogeneity of members has increased, it has become evident that EU needs to update and strengthen its decision-making structures.

To achieve this, the European countries need to come to a better understanding on an allocation of policy responsibilities to their most appropriate levels. While the subsidiary principle has served EU well owing to its flexibility, it alone cannot provide sufficient clarity on the durable allocation of responsibilities. Clearer rules of game and more efficient decision making mechanisms would facilitate deeper economic integration within Europe, the draft EU "Constitution" would constitute, despite its shortcomings, is an important improvement in this respect.

When talking about challenges brought about heterogeneity, it was noted that heterogeneity has not posed significant problems for the Eurosystem's monetary policy. Indeed, it was emphasized that some growth dispersion within monetary union is inevitable and even desirable. Related to this, I am personally fully convinced that individual euro area countries can cope with asymmetric shocks that are inevitable fact of life in a monetary union. Indeed, before Finland joined EMU, there was much skepticism about its suitability for a country whose economy, in particular its export structure, was very different from the rest of the euro area. After more than eight years in the monetary union, many of the feared asymmetric shocks have been realized (e.g., volatile swings in the telecom sector and significant weakening of the U.S. dollar) but the Finnish economy has performed well, both in terms of growth and price stability.

Turning back to the case of Africa, it seems that the combination of heterogeneity (both cultural and economical), the larger number of initial participants and the proliferation of overlapping integration initiatives implies special challenges for devising clear and credible decision-making structures to support integration process. At the same time, these initial conditions imply that such structures are indispensable for successful broadening and deepening of economic integration. Against this background, the importance of strengthening domestic and supranational institutions by clarifying their decision-making and by making them more transparent and accountable was regarded as essential.

Conclusion

Finally, I would like to thank all the participants, especially our speaker and discussants. I think that we had a frank and meaningful discussion of the challenges facing both EU and Africa. I think that we all benefited and learned from this discussion that has offered many different perspectives to issues of common interest.

It seems to me that, notwithstanding formidable challenges and many potential pitfalls, the outlook for greater integration in the both regions is fundamentally positive. With these remarks, I like to conclude and wish my African colleagues success in their challenging road toward further economic integration in Africa.