African Continental Free Trade Area : What Implications for African Central Banks?

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African Continental Free Trade Area : What Implications for African Central Banks?

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Economic analysis summary note (EASN) is a framework for reflection in a few pages (maximum 5 pages) which analyzes fundamental questions related to economics, mainly in macroeconomics, financial system and economic policy.

"No nation has ever been ruined by trade"

Benjamin Franklin

"We must view free trade as an ethical principle, not just a doctrine of economic advantage"

John Keynes

"Free trade is not the main cause of economic difficulties ... The slowdown in growth is almost entirely due to internal causes"

Paul Krugman

"we must not make any assumptions about trade that are not based on facts…Trading between pairs of people, whether it's between two people who happen to live in the same household, the same village, the same country, or the same planet, is the basic source of economic development. It's the reason that we no longer live like cavemen"

David Donaldson

The Eighteenth Ordinary Session of the Conference of Heads of State and Government of the African Union concluded with the adoption of a strategy aimed at creating a **continental free trade area**, which aims to deepen the economic integration of Africa; intensify intra-African trade; improve competitiveness; contribute to the movement of capital and people; promote sustainable and inclusive socio-economic development; transform the structural structure of African economies and promote industrialization.

The creation of a continental free trade area is advantageous and constitutes a cornerstone of the African integration process insofar as it facilitates access to finance ; promotes opportunities to add value to natural resources ; supports economic growth ; creates jobs through the development of trade and investment; provides the state with more resources through competition and the establishment of new businesses; accelerates the accumulation of human capital and develops the research and development sector; stimulates technology; diversifies consumer choice and allows Africa to finance its own development.

However, a free trade area incurs some risks, in particular, the unequal distribution of costs and benefits between countries ; exposure to competition from small and medium-sized enterprises ; development of proactive trade policies, pushing countries to take vigorous actions for national companies ; long process of convergence and harmonization of regional and continental regulations and finally loss of government revenue for the least competitive economies.

Certainly, the continental free trade area would be risky an adventure. Yet this loss aversion[2] to a free trade area does not significantly affect many economists and politicians. It is appropriate to think that it would be an opportunity to be seized to widen further the curve of the output possibilities of the African economy, as Goethe said, "*bold ideas are like the pieces that are moved on a chessboard: we risk losing them but they can also be the beginning of a winning strategy*." To this order we analyze the implications of African central banks and their strategic roles in the process of the continental free trade area. We note that much of the analysis of the continental free trade area in Africa has turned to the implications for government revenue, tariff and non-tariff barriers, welfare, uneven distribution, etc. This note examines the implications of central banks in the continental free trade area.

What implications for central banks?

Central banks should get started and reflect on the implications of the continental free trade area in their two main functions, which are to define monetary policy and maintain financial stability.

Monetary policy and the continental free trade area

The question of the impact of free trade on inflation is both important and much debated. Economic theory has many channels through which trade and financial opening can influence the price level. This effect puts pressure, in particular, on the slightest increase in the cost of labor, particularly unskilled labor. More generally, it tends to significantly alter the balance between capital and labor at the continental level.

[2] Loss aversion is a concept of behavioral economics which states that losses tend to do more harm than gains of equivalent value do good (see Thaler, 2018).

In addition, the Amazon effect also exerts pressure favorable to price stability, as a result of this stabilization of inflation, this results in lower volatility of macroeconomic variables. But it would be absurd to conclude that this correlation between trade openness and low inflation demonstrates a cause and effect relationship. Indeed, several other independent factors of openness or integration can be identified as contributing to explain that, in this case, the progress of science, in particular information and communication technologies, entails significant productivity gains which coincide with integration and which, moreover, are one of the underlying causes; the implementation of structural reforms may gradually intensify. These structural reforms would help increase the growth potential of African economies and thereby facilitate price stability.

Particular emphasis should be placed on the fact that, whatever the influences exerted in the context of the continental free trade area, the fundamental principle which allows the anchoring of monetary policy remains: in the long term, inflation is a phenomenon monetary. As a result, the free trade area does not affect the central role and primary responsibility of central banks to maintain price stability; in the short term, central banks should continue to anchor their inflation expectations and / or target monetary aggregates at a level consistent with their definition of price stability.

Financial stability and continental free trade area

The widespread interconnection of financial institutions and markets would create a continental financial system that would be a real and important one at continental and global level. This would affect the assessment of financial stability carried out by central banks in several ways: the first would be to change the methods of analysis of financial stability which would focus on the continental sphere. For example, for the Congolese economy, a complete and exhaustive view of the main sources of risk and vulnerability of the financial system cannot be formed without taking into account the major continental imbalances or concerns relating to the excess of continental liquidity. The second would involve enhanced cross-border cooperation and an exchange of information between central banks. This should provide a full picture of the risks and identify appropriate and effective strategic mitigation actions.

The free trade area also affects the role of central banks in the design of the financial infrastructure (regulation, financial supervision, payment system, etc.). This role is played by central banks because they have direct or indirect supervisory responsibilities. In general, the connection calls for an intensification of the cross-border efforts of regulators in order to set up coherent standards in terms of regulation, supervision and payments. The aim is to promote a level playing field and reduce regulatory arbitrage. To strengthen financial systems and improve intra-African trade, African central banks should consider linking their payment systems first at the regional level (SADC, COMESA and EAC) and then in the very long term at the continental level. This would strengthen intra-regional trade, simplify payments between regions and remove some of the costs associated with settling payments.

What support policy for central banks?

African central banks should support their economies with policies focused on financing and accompanying structural reforms to prepare economies for the development of the continental free trade area in order to intensify intra-African trade. It should be recalled that African countries face obstacles linked to the low levels of credits to the private sector. This could qualify as a dysfunction of the financial system and could aggravate structural weaknesses. Central banks should strengthen the resilience and robustness of their financial systems to contribute to structural change.

It is important to stress that in meeting these challenges, the role of monetary policy will be to accompany structural reforms and not to replace them. One of the things to look at would be to readjust interest rates, to further finance savings due to responding to a high level of investment in prospect. Promoting investment banks is essential to finance development and improve infrastructure. With that, central banks should influence regulations, business climates and above all preserve macroeconomic and financial stability.

Significant fiscal flexibility is needed to implement far-reaching structural reforms. For example, to increase investment in public infrastructure, education and learning in Africa. In particular, African countries should reduce their dependence on commodities and move up the value chain. Policies to encourage structural transformation could include training programs for workers to ensure a smooth reallocation of labor and capital to sectors more likely to develop, such as manufacturing (Abrego et al, 2019). "*Only in this way can Africa use the continental free trade area as a mechanism to claim its place in the global value chain*".

Références

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