
South Sudan, the EAC and East African Monetary Union

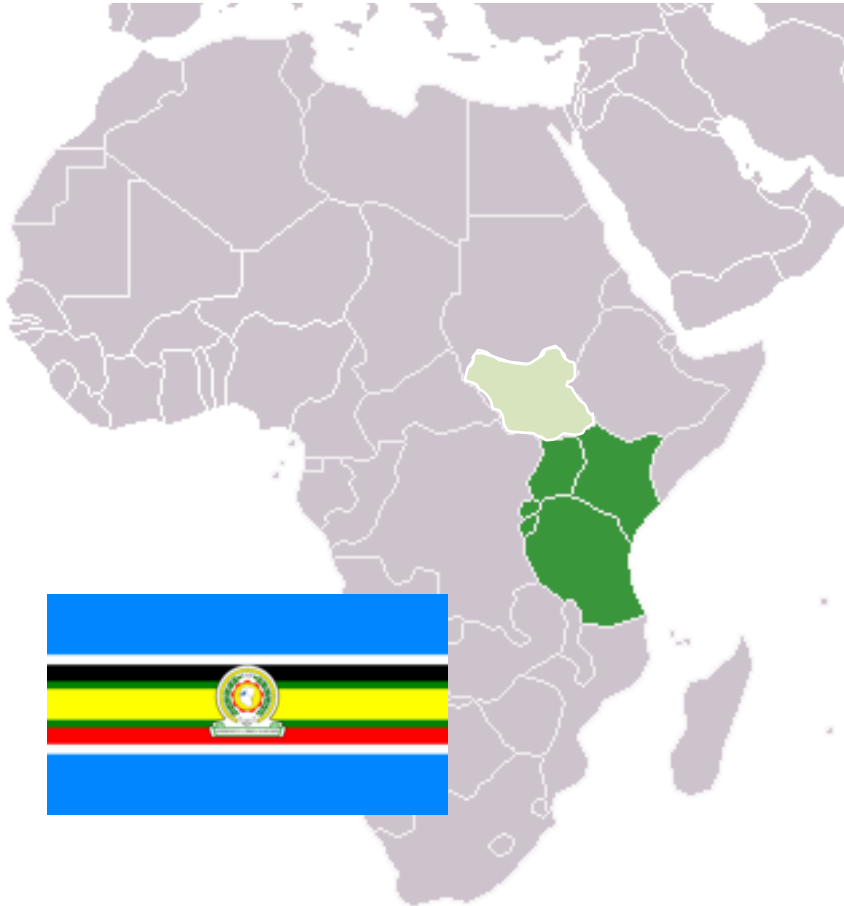
Christopher Adam

IGC-South Sudan Seminar

16 June 2016

- **EAC History**
- **Regional Integration: the EAC Customs Union and the Single Market**
 - Economic Considerations
 - Political Considerations
- **Monetary Union**
 - The Protocol and Real Convergence
 - Exchange Rate Arrangements
 - Fiscal discipline and fiscal flexibility

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East Africa High Commission: 1948-61

Kenya, Uganda, Tanganyika

East African Common Services Commission 1961-67

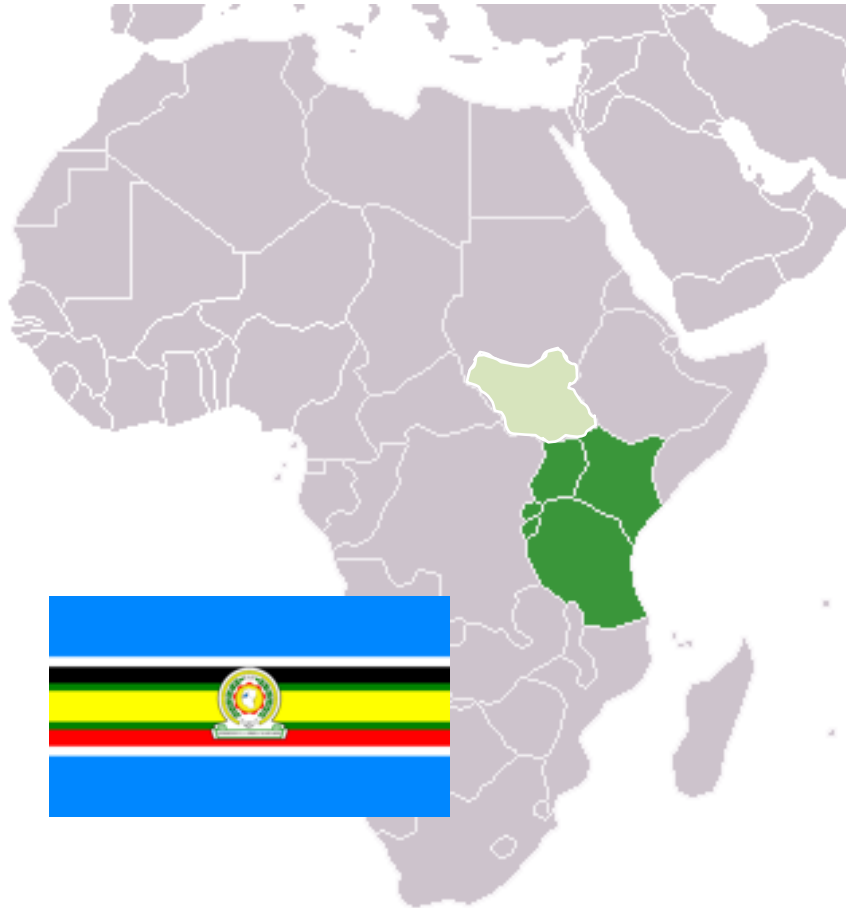
The East African Community I: 1967-1977

- Conflict in Uganda
- Tensions between Kenya and Tanzania

The East African Community II: 2000 -

- Rwanda and Burundi join in 2009
- Preliminary discussions on membership for South Sudan and Somalia in 2013.
- South Sudan joins April 2016

The East African Community Common Market and possible Monetary Union



Customs Union and CET 2005
(full implementation 2010)

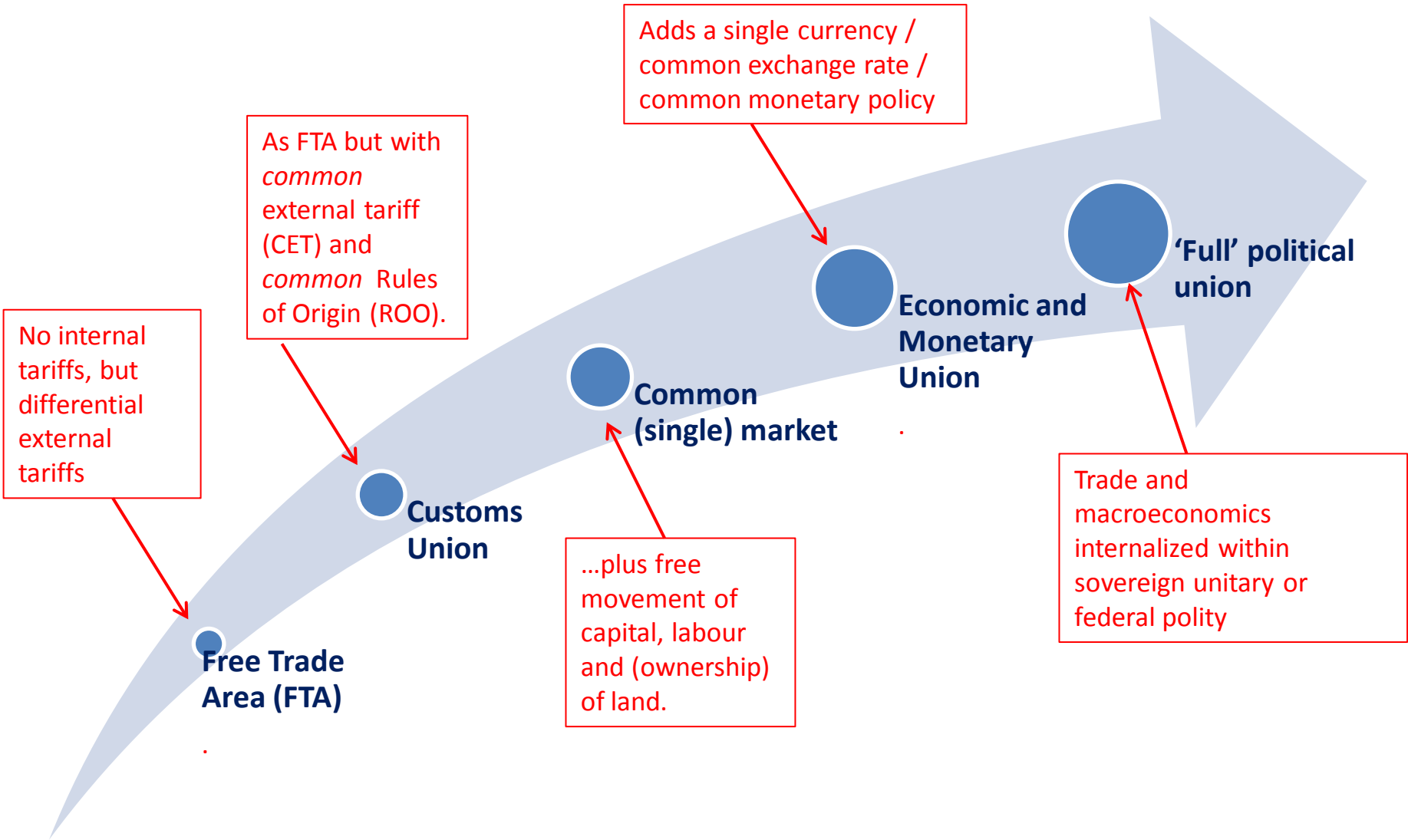
Single Market 2010
(full implementation 2015)

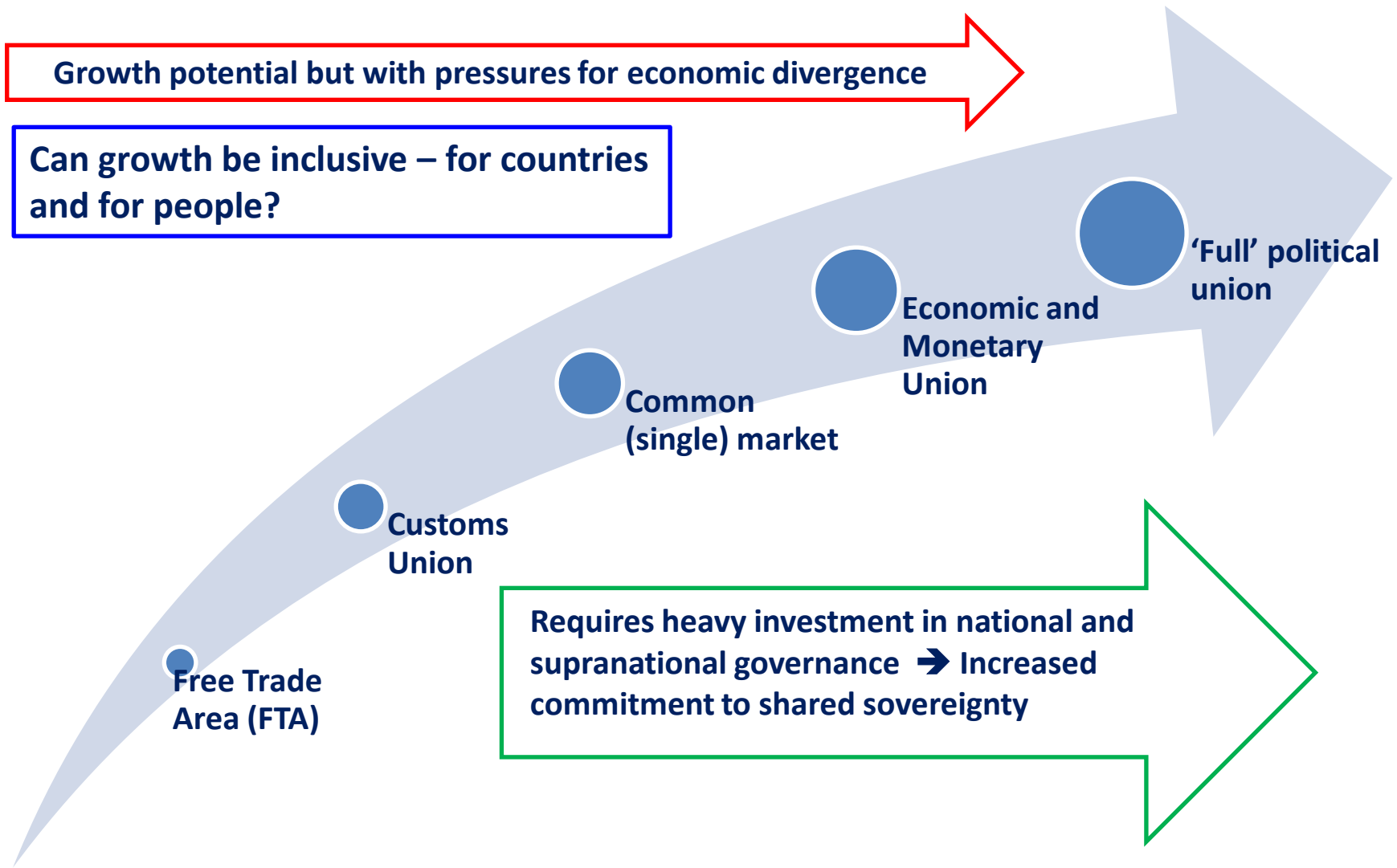
Protocol for Monetary Union 2013
(implementation by 2024...?)

Full Political (con-) Federation 20??
(*Wako Committee, 2004*)

Levels of regional integration

The baseline: single country with “most favoured nation” reciprocity





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The Economics of Regional Integration ...potential gains but with important implications for governance.



Scale and competition

- Market enlargement and erosion of local monopoly
- Easier to absorb 'lumpy' infrastructure (→ more attractive to FDI)

Trade Creation, Trade Diversion and Trade Location

- Reduction in internal tariff encourages consumers to switch demand towards 'regional supply' and away from imports and domestic production and imports.

- Gains for consumers (trade creation)
- Losses to domestic producers
- Revenue losses for government (made up from elsewhere)

Net trade diversion effect could be positive or negative

South Sudan?

Convergence and Divergence?

- Production may move towards lower-wage locations → 'convergence'
- But...integration may accentuate agglomeration and clustering → advantages accrue to 'first movers' → **Role of Structural and Regional Funds / Institutions**

Normally countries enjoy a *fall* in tariffs when they enter a regional trade arrangement....

- Lower costs for consumers
- Lower tariff protection for domestic producers...
- Lower revenue (switch to consumption of lower-tariff goods)

Here, South Sudan tariffs are *generally lower* than EAC CET (especially for 'Sensitive Items' list)...which means these 'static' effects are potentially reversed.

- Impact on domestic consumers?
- Domestic producers?
- Government revenue?

Means transitional arrangements important and consideration of dynamic growth effects.

- Economic integration can support a security agenda
 - Cross-border: Interlocking economies *can* make conflict more expensive → **Post-WWII Europe**
 - Regional obligations may lock in domestic policy commitments – a form of external ‘agency of constraint’ → **Stabilizing fledgling democracies in Europe (e.g. Spain, Portugal, Greece and Central European accession countries).**
 - Solidarity: regular political contact builds trust and reduces the cost of cooperation (in the economic and other spheres)
 - But... these gains can be threatened if the aggregate gains from economic integration are perceived to be mal-distributed → **American Civil War 1860s ; collapse of EAC I in the 1970s**
- Economic Integration can leverage power in global markets
 - Small countries get voice.....and may get better terms
 - ...and enjoy scale in accessing resources.....may get more *extra-regional* security.

How does EAC stack up on these considerations?

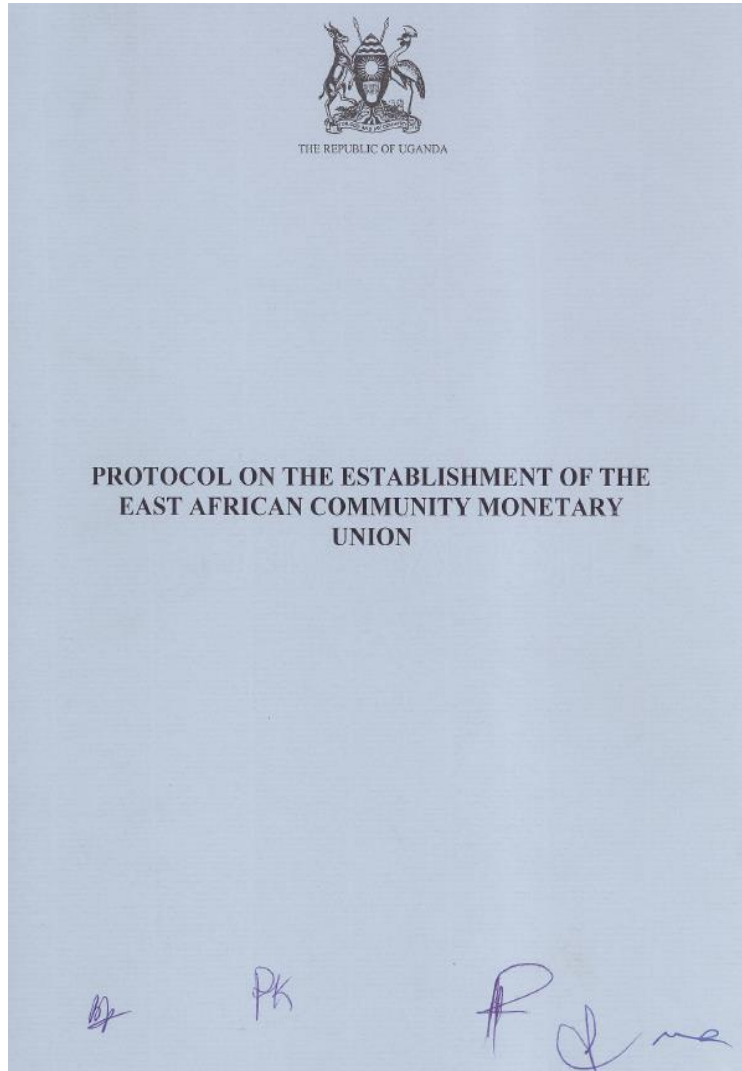
Very much a work in progress...



- **Progress on market enlargement?**
 - Some useful gains on tariff and non-tariff barriers (but latter still proliferate)
 - Single market still quite incomplete
- **Gains from cooperation in infrastructure may exceed gains from cooperation in trade**
 - Can the supranational agency of EAC offer more credibility to foreign investors?
 - Railways, pipelines and ports
 - Regional power generation and distribution
 - Financial services

But politics of infrastructure placement are fierce; necessary to have a seat at the table?
- **A relatively weak (and under-funded) governance structure at the centre**
 - If an IMF program cannot enforce fiscal discipline, will regional peer pressure?
 - Investment in governance institutions essential to success

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East African Monetary Institute (to be established 2015)...

...becomes East African Central Bank by 2024...

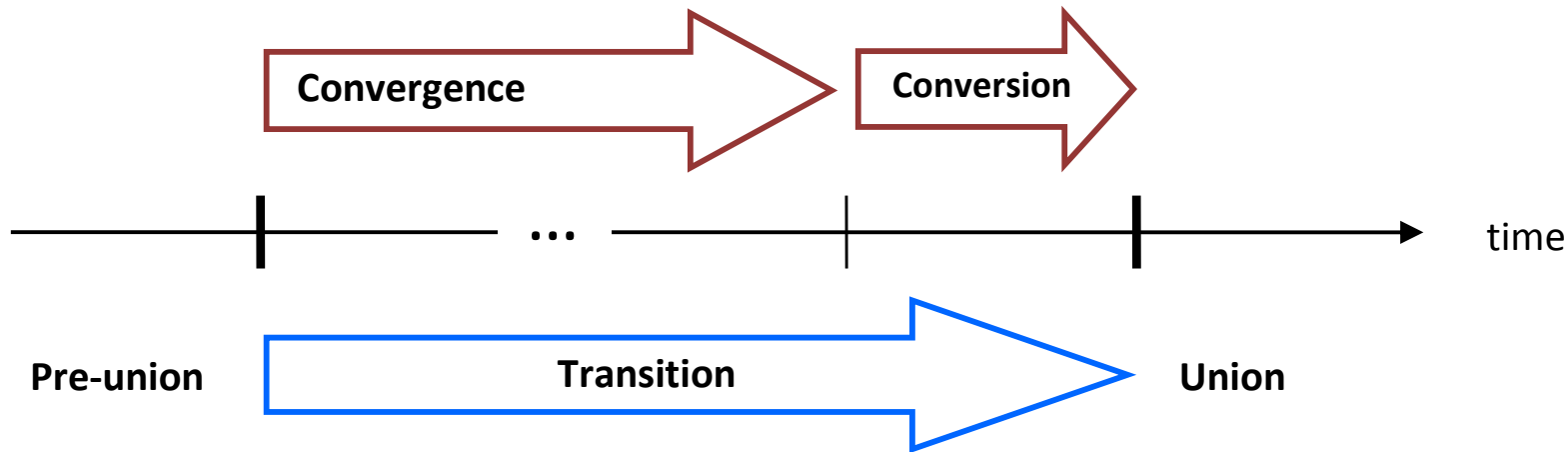
With single East African Shilling and common monetary and exchange rate policy.

Common payments system and financial sector regulatory regime.

Tough convergence criteria established

Principle of 'variable geometry' enshrined.

Variable geometry is helpful for monetary union but not for customs union and single market



Convergence on a potentially long glide-path:

The primary focus must be on **real economic** convergence

➔ Real exchange rate alignment...then fiscal...

...only then nominal exchange rates



The East African

PROJECTING SEA POWER

China and India's profile rises in the Indian Ocean as Western influence declines **Pages 23-25**

JANUARY 10-16, 2011

theeastafrikan.co.ke

IMPACT INVESTING!

Projects aimed at 'uplifting the poor' will earn \$667 billion in profits in the coming decade **Page 31**



KENYA SH60 TANZANIA SH1000 RWANDA RWF650 UGANDA SH1500

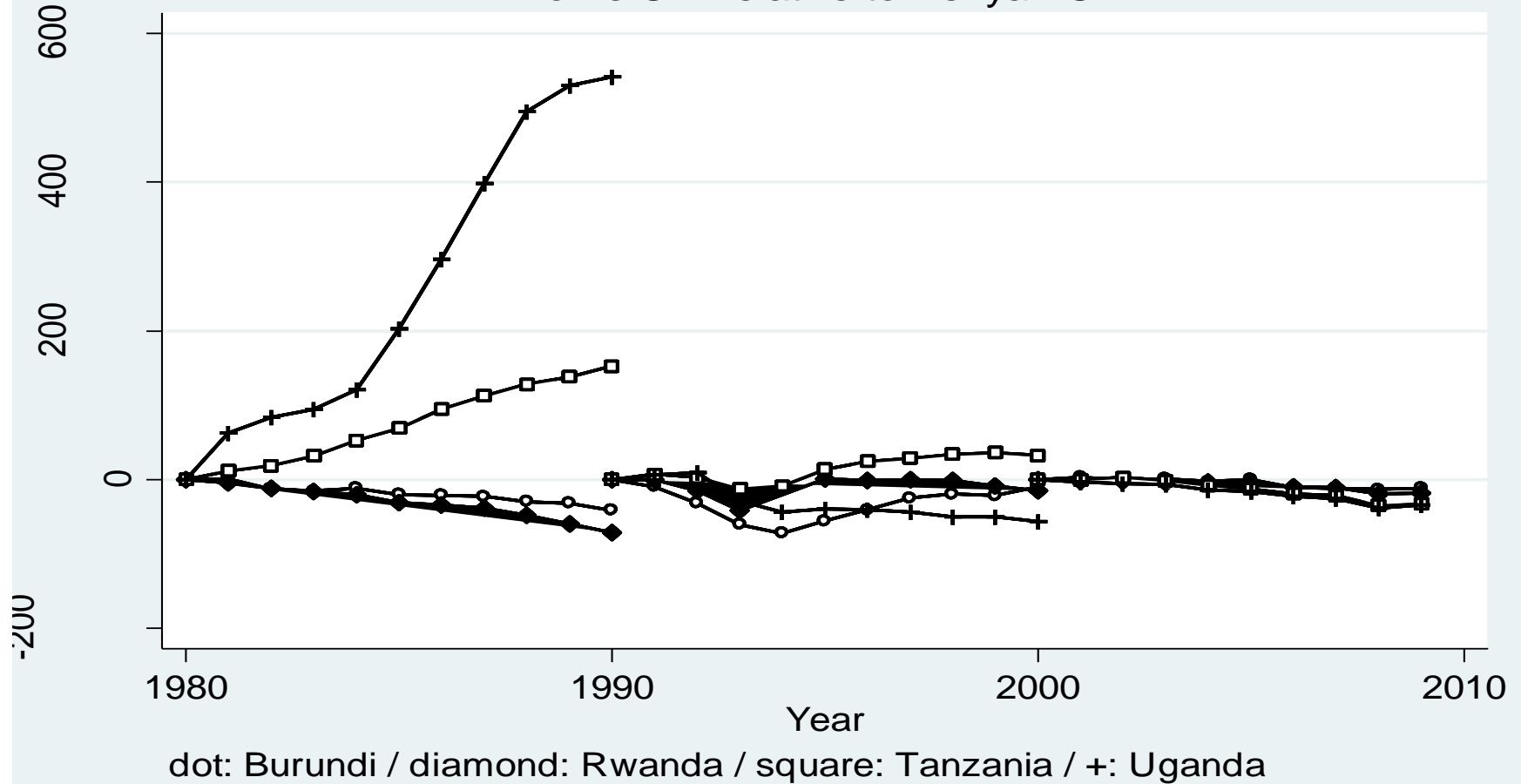
Towards progressive land policies in Africa



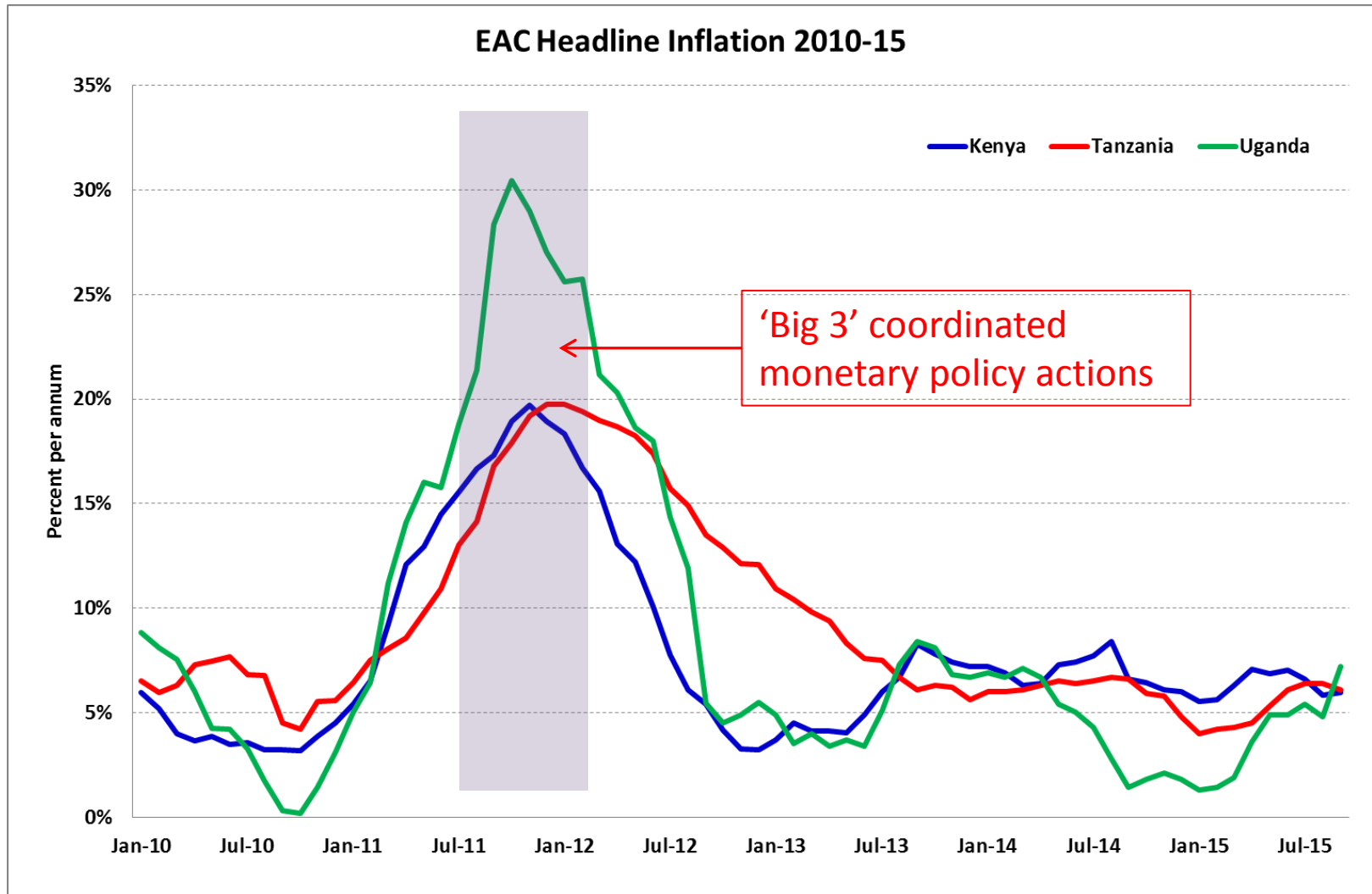
SPECIAL ISSUE: THE NEW SUDAN

Birth of a nation

Inflation convergence in the EAC Home CPI relative to Kenyan CPI



And through recent external shocks we have seen much greater policy coordination...



Fiscal Requirements for Monetary Union: The conventional view stresses fiscal flexibility



Fiscal policy needs to be *flexible* enough – at the union-wide or national level – to offset the loss of national monetary policies (shock management) and lean against tendencies for divergence.

- Not clear how serious this ‘loss’ is : not clear how effective is monetary policy at playing an output stabilization role in EAC ?
- Scope for developing counter-cyclical fiscal structures [in an environment where fiscal policy has been resolutely and strongly pro-cyclical]?

But concerns about the **free-rider problem** argues in favour of **fiscal rules**.

Fiscal fault lines in monetary union: supra-national agencies need to guard against the free-rider problem



- National governments choose whether to adhere to or violate EAC fiscal rules (e.g. convergence criteria on the deficit).
- They will violate rules if they believe that either the hegemon (dominant player) or the collective will provide bailout.
- If denying bailout is difficult – because it is the local population that will suffer – the incentive to ‘free ride’ is baked into the structure.
- ➔ This is a classic moral hazard problem – countries choose policies from which it benefits but for which it bears only a fraction of the cost.
- Requires close surveillance and credible enforcement of clear fiscal rules by supranational agencies (which in turn requires partner states to put more of their resources at risk)

Fiscal free-rider problem symptomatic of deeper challenges with regional integration → underlying centrifugal forces.

Investment in capacity, credibility and governance (at national and supranational levels).

Investment in effective surveillance and enforcement is critical

Distinguish between **structural instruments** (to address deep core-periphery issues) and **stabilization instruments** (to ensure efficient adjustment to shocks)

→ Adequate funding and staffing of supranational institutions

Failure risks break up and/or stabilization obligation falls back on external agency – with consequences for democratic deficit.

Thank you!



International
Growth Centre

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IGC Research Themes



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