REGIONAL INTEGRATION

and

DEBT IN AFRICA

A Comparative Report of Africa's Regional Groupings

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# Regional Integration and Debt in Africa

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Introduction

Despite the widely documented failures of regional integration schemes in the past, lack of a breakthrough and even the demise of some regional integration arrangements, the unfolding of the 21st century has seen the revival of regional integration in Africa. The ever-increasing challenges of globalization, the birth of the European Union and the African Union among other episodes, should have been very inspirational in reviving regionalism in Africa. Africans and their leaders are becoming more convinced than ever before that integration is one way by which the relevance of a debt and poverty-free continent can be established in an increasingly globalizing world.

The heavy debt burden and continued reliance on countries of the North for hard currency has been a major impediment to accelerated integration within and across regional groupings in Africa. There is growing concern over the amount of borrowing indulged in, the servicing of such foreign debt and the future strain on regional schemes and general sustainable development. Resources transferred abroad for debt servicing reduce what can be devoted to regional schemes and economic development. Not only is potential regional integration foregone, but also in many cases previous development achievements are being eroded. Debt repayments in form of arrears have grown very rapidly giving rise to questions regarding the credit worthiness of a number of countries. On the other hand, conditionalities associated with debt repayments and trade have stood in the way of successful African regional groupings’ intra-trade, monetary and fiscal policies especially payment mechanisms. Some states are left without trade options but to trade with the northern creditor at the cost of intra-regional trade.

In general, regional integration refers to the unification of neighbouring states working within a framework to promote free movement of goods, services and factors of production and to co-ordinate and harmonize their policies. This might involve convergence of trade, fiscal, debt management and monetary policies as a prelude to integration. It can also be defined as a process and a means by which a group of countries strive to increase their levels of welfare- reduction of poverty, indebtedness and economic malaise. It recognizes that partnership between countries can achieve this goal in a more efficient way than unilateral or independent pursuance of policy in each country. In Africa, regional integration was also introduced to promote development among African countries as well as help reduce indebtedness and dependence on western countries. Regional unification in Africa through meaningful co-operation is expected to help arrest the ballooning external debt burden in many countries.

Recent developments in regional integration schemes could spur enhanced progress that might help develop strong monetary ties within the RECs that could help alleviate the burden of debt. Such developments include the implementation of a Free Trade Area in COMESA, the beginning of the implementation of the SADC trade protocol, the fast track monetary harmonization by non-UEMOA members of ECOWAS and the attempts to revive integration efforts in ECCAS.

2. Ibid
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Historical Basis

African leaders have long recognised the significant opportunities presented by a regional approach to development and have supported regional efforts for many years to sustain advances made in economic policy reform and democratic governance. With the current challenges of debt crisis, regional integration in Africa is no longer a subject of academic debate or mere political expression; it is an imperative if the goals of integrated economic development and a debt-free continent are to be realised.

The 1980 Final Act of Lagos was the first continent-wide effort by the African governments towards regional integration through forging of a comprehensive unified approach to economic development. The drive towards regional integration was given a further boost in 1991 with the adoption, by the OAU summit, of the Abuja Treaty establishing the African Economic Community (AEC) that stipulated a stage-by-stage modus operandi that must be put in place to achieve this goal. First, is the strengthening of existing sub-regional economic groupings and establishing the ones where deemed desirable. Second, is the consolidation of tariff and non-tariff barriers as well as the strengthening of sectoral integration at the continental level. And, third, is the promotion of the coordination and harmonisation among the existing and future economic groupings for a gradual establishment of an African Common Market. To this end, it authorized the drafting of the treaty for the establishment of the African Economic Community whose aim is to promote collective and accelerated self-reliant and self-sustaining development cooperation among the states and their integration in the economic, social and cultural fields. That treaty was subsequently signed in Abuja in June 1991.

So far, the AEC has established direct working relations with the Economic Community of West African States (ECOWAS) in the West African region, the Economic Community of Central African States (ECCAS) in the Central region. In the Southern Region the AEC has been dealing with the Southern African Development Community (SADC) and in the East with the East Africa Community (EAC). In North Africa, there is the Arab Maghreb Union (UMA) that has no direct contact with the AEC, so far. In both the East and Southern region, the Common Market for East and Southern Africa (COMESA). Apart from these Regional Economic Communities (RECs), there are other groupings like the Economic and Monetary Union of West Africa (UEMOA) and the Customs and Economic Union of Central Africa (UDEAC), all of which are engaged in the promotion of integration. All these organizations were already in existence and operating when the AEC Treaty was signed in Abuja in June 1991.

Post independence Africa witnessed two major macroeconomic regimes: the pre and post Structural Adjustment periods. The pre-Structural Adjustment period notwithstanding the political importance of pan-Africanism was informed by import substitution strategy. This strategy was not pro-open trade policy and to that degree has adversely affected regional integration efforts. The adoption of Structural Adjustment Programs (SAPs) starting in mid 1980s in almost all African countries has led to openly adopting a liberalization (open economy) policy. The identical nature of policy instruments prescribed by International Financial Institutions (IFIs) across countries in the continent implies a defacto macro policy harmonization, at least at the level of intent. Although the SAPs followed across the continent have resulted in relatively better fiscal posture and some degree of success in managing major macro variables, evidence from studies on debt and regional integration indicate that both the macro environment and the current fiscal posture (including indebtedness) leaves much to be desired.
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Though trade liberalization is linked with the quest for regional integration, trade liberalization is also associated with increased debt levels\(^3\). In SADC for instance, trade liberalization was followed by devaluation of local currencies that meant that debtor firms or governments had to search for more local currency to pay off foreign debts. Trade liberalization exposed local industries to intense foreign competition that caused company failure and inability by firms to meet their debts either local or foreign. Liberalization allowed firms to borrow directly offshore, sometimes without approval by government, leading to huge debt built up.

Although regional integration in Africa is attainable and can secure more development by pulling the region out of its debt trap, of all its regional economic communities (RECs) none of them have specific constitutional reference to the debt problem despite its being the biggest obstacle to regional integration. Most RECs are into conventional regionalism (an initial stage of regional integration) where the regional integration is not effectively mainstreamed in member country structural operations. Conventional regionalism as opposed to monetary regionalism is based on trade and does not increase the monetary and financial linkages between participating economies until they reach a high level of integration\(^4\).

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Intra-REC Trade and Debt

Despite various initiatives such as the PTA, COMESA, EAC, ECOWAS, UDEAC, UMA, ECCAS, UEMOA, and SADC inter-African trade remains a small proportion of total African trade as African economies maintain traditional roles of exporters of primary goods to industrialized countries. Although progress have been made in trade liberalization, Intra-REC trade is still low at 10.5% and could be higher if informal trade is considered. High levels of indebtedness and lack of foreign exchange has made it difficult for neighboring states to trade equally within a regional bloc. It has intensified the demand for foreign currency to enable countries to import from outside Africa. The obsession with foreign currency has been extended to African countries their fellow REC members to pay in foreign currency, forcing most of the to trade with the North and consequently African countries Debt burden has increased as a result of arrears.

Regional integration has been marred by governments pre-occupying themselves with negotiating preferential agreements and compensation arrangements, unwillingness to buy high priced goods from their partners when lower-priced goods are available elsewhere. African Regional integration usually has to battle with unequally strong partners, different levels of commitment to the integration process, with divergent economic, political and/or environmental interest both at government and at private sector levels and with uneven integration speeds. The function of policy making itself, has been surrendered to external agencies- the World Bank and International Monetary Fund. Trade, financial and economic policies are not erected on local resource constraints, endowments and opportunities; instead they serve purposes in conflict with local development priorities and human development.

Existing trade patterns reflect strong vertical linkages (developed - developing country) and weak horizontal linkages (between developing countries), which are symptomatic of an unequal global balance of economic power and debt problems. ECCAS and CEMAC of Central Africa are among the RECs with the lowest levels of exports and imports among themselves, having 1.3 percent and 1.1 percent respectively. In the East Africa Community, Kenya is the dominant player, exporting some US$ 435 million (most of it to Uganda) and importing US$ 39 million. Uganda and Tanzania have imports many times in excess of their exports. Kenya enjoys a favourable intra-EAC balance of trade. Tanzania a moderate deficit and Uganda a considerable deficit. Yet, intra-EAC trade is a low proportion of the member countries total trade. For example, most of Uganda’s trade is with the European Union, Kenya being the destination for only 4.6 percent of Uganda’s exports and origin of only 12.4 percent of imports. Similarly, Tanzania’s exports to Kenya account for less than 3 percent and Tanzania takes about 10.2 percent of her total imports from Kenya.

Africa’s continual dependence on external markets for its primary commodities hinders prospects for intra-trade within their RECs. Inevitably, the net result of unequal exchange between African countries and the north generate debt rather than surpluses for the former. Thus, existing trade patterns serve as a vehicle for the systematic transfer of resources, value and wealth from the periphery to the centers, a situation which drives most African countries further into debt as they try to supply the economic needs of their expanding population from a dwindling resource base. The debt crisis in Africa is rooted within the context of unequal relations that underpin and typify capitalist relations of production.


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One would expect that the debt crisis (debt service as a proportion of exports) would be negatively related to the degree of integration. With respect to the EAC, this is true in the case of Tanzania, where the degree of integration is relatively high and the debt service ratio is relatively low (15.5 percent). It also holds true for Uganda where the degree of integration is low and the debt service ratio is high (23.7 percent). This is in spite of Uganda’s HIPC status, suggesting that HIPC mechanisms are having minimal impact on debt relief. Total debt has declined in the case of Kenya since the coming of the Community, but has risen in the cases of Tanzania and Uganda, giving a one third impact. Concessional debt ratio, i.e. loans with an original grant element of 25 percent or more has increased in all three countries, indicating winning at the borrowing stakes. So, all in all, the terms of external borrowing seem to have improved after the coming of regional integration, having a positive impact on debt.

The formalization of regional integration in East Africa saw a marked decline in debt stress, but there are no significant corollary changes in the observed human development trends. Although direct effects on debt can be achieved by regional collective bargaining with donors, the effects of greater integration on socio-economic phenomena and the debt are likely to be indirect. While more productive, efficient and competitive economies earn more foreign exchange to ease the burden of debt servicing, it is prosperity arising from a larger market that will ensure countries have more resources to allocate to social sectors like education and health.

Among the most often cited constraints to greater intra-African trade is the inhospitable macro-economic environment associated with overvalued exchange rates and non-convertible currencies. Currency instability in Africa, as recently witnessed in the Southern African region (Malawi, Zambia and Zimbabwe, for instance) remains a stumbling block to the creation of meaningful and fully operational regional blocs and keeps the continent confined to a vicious cycle of indebtedness and underdevelopment.

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Table 1 Intra-Regional Integration Arrangement (RIA) Trade, 1999 (in percentages)

<table>
<thead>
<tr>
<th>Regional Integration Arrangement</th>
<th>Export (to)</th>
<th>Import (from)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECOWAS</td>
<td>12.1</td>
<td>11.3</td>
</tr>
<tr>
<td>COMESA</td>
<td>7.6</td>
<td>4.3</td>
</tr>
<tr>
<td>ECCAS</td>
<td>1.3</td>
<td>2.6</td>
</tr>
<tr>
<td>AMU</td>
<td>3.0</td>
<td>3.3</td>
</tr>
</tbody>
</table>


Africa’s RECs have little interaction and regionalism is not effectively mainstreamed in member country structural operations. The continent has a problem of overlapping REC membership. Africa has 14 RECs of varying design, 7 of which are considered building blocs. Many members are unable to neither manage effectively nor fund adequately the many RECs that they belong to. The RECs normally have different approaches of development. Take for instance\textsuperscript{10}, there are SADC members affiliated to COMESA and EAC that have conflicting rules or competing obligations and strategies to those of SADC. This results in conflicts within and between member states of each of the RECs.

Some countries get indebted to different RECs as they fail to meet their membership dues and obligations. Over concentration on the choice of institutions needed for integration rather than actually building of the commodity has tended to weaken the effectiveness of RECs and their relevance. A regional grouping like SADC for instance was able to source loans for the construction\textsuperscript{11} of Beira and Maputo corridors in Mozambique, but the repayment of the death incurred through these loans remains Mozambique’s responsibility. SADC acted as a broker to source the funds but the agreement for funding is bilateral. Such a scenario does not help hasten integration or lessen the debt burden.


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Macroeconomic Conditions and Debt

The longest-lived example of a monetary union is Africa's fourteen members CFA franc zone, which has used a common currency pegged to the French franc since 1948. The zone helped to support Africa's most successful market integration. Countries in conventional integration project do not enjoy additional protection against financial crises (especially debt crises/insolvency); neither with regard to the stabilisation of the exchange rate of their currencies nor with regard to the stabilization of capital flows do conventional integration schemes strengthen the economies of their member states.12

Regional integration in Africa will not be able to lessen the external debt burden, as macro variables remain unsustainable and characterized by wide fluctuations. There is a wide fluctuation across members of COMESA in terms of Real GDP growth. The debt to GDP ratio in the majority of the member states is above 100 percent. In a couple of countries it is about 50% and is insignificant only in Eritrea. There are countries where inflation is the worst (above 15%) such as Angola, Burundi, Madagascar, Malawi and Zimbabwe and good performers where it is contained below 10% (e.g. Comoros, Djibouti, Ethiopia, Uganda, Egypt, Mauritius). Low saving and investment rate also characterize COMESA members, which are invariably below 20% of the GDP. It seems logical to conclude that fiscal policy harmonization in the existing macro environment in COMESA is a daunting task.13

GDP growth in ECOWAS countries is quite impressive, above 3.5 percent and fairly stable. Inflation however is a problem across the REC. The inflation rate is very high reaching as high as 70 percent in some countries.14 The level of monetization of the economy in ECOWAS is very low except in Cape Verde. In all countries the export to GDP ratio is about 10 percentage points above the import to GDP ratio. In some of them it actually is twice the size of imports. This internal and external balance problem seems to show itself not only through high level of inflation but also through the very high debt to GDP ratio - which invariably is above 50 percent and for most countries above 80 percent. This is reflected on the huge debt burden of the member countries.

The pattern of growth across SADC members is not uniform. In about six countries it is erratic, in two of them very bad and in another three it is very good. In the rest of the members (including South Africa which has a strong impact on the SADC members) there is a declining trend. Similar variation is also observed on the score of inflation. In majority of the countries it is below 10 percent. However, there are worst performers such as Angola, Malawi, Mozambique, Zimbabwe and Zambia where the inflation rate has reached above 100 percent.15

The SADC region is also characterized by very low level of monetization. The most notable form of monetary harmonisation in Southern Africa is the Trilateral Monetary Agreement between South Africa, Lesotho and Swaziland known as the Common Monetary Area (CMA), in which each country’s currency trades at par with the South African Rand. The Reserve Bank of South Africa implements monetary policy after consultation with the central banks of the other countries. Although the foreign exchange regulations and monetary policy reflect the insurance and dominance of the South African Reserve Bank, the monetary union has produced significant benefits, namely a high level of intra-CMA trade, investment creation and low intragroup indebtedness.

Saving and investment in SADC have distinct pattern, which reflects the level of development of member states. There are a few countries where the import and export shares are equal (again Botswana is an exception where its exports are larger than its imports). Each member country has distinct debt profile. The majority of the members (except Botswana and South Africa) have a huge debt burden. Although the Common Monetary Area between South Africa, Lesotho and Swaziland, and the use of the UAPTA in the Preferential Trade Area are promising signs, the levels of convergence in the region are very low. Far greater convergence would be needed for the successful implementation of a broader regional monetary union.

From the above case examples it can be concluded that, in most if not all, of Africa’s RECs the macroeconomic environment does not seem to be stable enough to handle external debt problems. The instability comes not only from domestic policy problems but also, and perhaps more importantly, from external shocks. Successful fiscal policy harmonization requires creating stable macro environment. This may be handled well by policy coordination at regional level that might result in a concerted effort to tackle external shocks including external debt. Internal and external balance problems that besieged African countries have left them heavily indebted to the Northern countries and their financial institutions to the extent of marring their regional efforts.

The convertibility of regional currencies or introduction of a common currency already achieved in some RECs (e.g. EAC and ECOWAS) has been found to encourage trade between member states because it obviates the need for the use of hard currencies. This can be expected to be further enhanced by the proposed introduction of a common continental currency by 2020. Such moves help alleviate foreign debt that comes through borrowing to address national budgets deficits. However, to optimise the benefits of a common currency, it will be necessary to increase actual levels of intraregional trade that are currently very low as a percentage of the total trade of the member countries. Monetary integration will remain a dream in the region until all RECs have a currency that all members identify with. Improvement of services such as intrastate banking would facilitate this process.

Financial integration is, without a doubt, the most advanced form of integration in the CEMAC zone. The major aspects of this have been the creation of the Commission Bancaire de l’Afrique Centrale (COBAC) to control the management of banks. COBAC oversaw the rehabilitation of banks in each country through the mobilisation of credit portfolios, rearrangement of the exportation account and recapitalisation, and the harmonisation of bank deregulation. This has rekindled confidence among savers and led to harmonisation of savings. In the process, external debt problems have been minimised in CEMAC.  

With the creation of CEMAC, the Banque des Etats de l’Afrique Centrale (BEAC) shifted from only handling the monetary policy of the zone to also overseeing the economic policy of member countries. At the level of monetary policy, the effect of harmonisation was to install a monetary zone, within which identical nominal interest rates were established.

In line with the convergence criteria (agreed levels of budget deficit, inflation etc), CEMAC aims to put in place a common indebtedness policy based on debt indicators. Better performing countries of the zone will serve as a reference. It will be a policy that permits debt control through debt terms
that are easy, as they were in the 1970s. Countries of the zone should only borrow to foster
expansionist policies, and within the limits of their capacity to repay. Thus, signals will be issued
each time the indicators go above a certain threshold\textsuperscript{17}. The application of this criterion should limit
the type of external borrowing that aggravated the debt burden and will ensure the payback of
projects financed with borrowed funds.

In East Africa, the EAC treaty enjoins partner states to work towards closer macroeconomic
convergence. To operationalize this, the 2001-2005 EAC Development Strategy has urged member
states to maintain market determined exchange rates and pursue policies that will achieve monetary
stability and growth in order to lay the foundation for introducing a single currency. The current
convertibility of the three currencies enhances their acceptability in each of the countries, obviating
the use of scarce foreign exchange and releasing foreign exchange resources that could be utilized
for debt liquidation.

\textsuperscript{17} Ibid
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Problems of Regional Integration Associated with Indebtedness

The lack of political will to establish effective and dynamic supra-national institutions and to implement agreed treaties and protocols remains Africa’s handicap to meaningful integration that carries the potential to fight external indebtedness as debtor cartels or regional blocs.

Monetary unions, and particularly payment mechanisms, play an important role in reducing debt. Terms of payment, especially credit terms, are the primary source of commercial debts and bad debts within RECs. By adopting, a single currency or a common unit of account to settle commercial debts, regional integration could directly and positively affect the debt situation of member countries.

The absence of a clearinghouse or payment mechanism has made trade difficult for most RECs and their members. The problem of financing transactions has partially been solved by the creation of a Clearing House in Central Africa (CCAC) and a Payment Union in North Africa. In Central Africa the impossibility of clearinghouses paying back creditors has resulted in informal trade using a parallel rate between the currencies of the region and foreign currencies, causing depreciation of local currencies. This depreciation contributes to increases in the price of importation vis-a-vis national currency and consequently escalating foreign debt. The transaction systems have been far from proper functioning. A significant portion of the little available foreign currency has been devoted to debt servicing. In SADC, Countries such as Lesotho and Mauritius have continued to rely on taxes on international trade for foreign exchange earnings and find it very difficult to cut customs duties in the name of regional integration.

Regional bodies in Africa have strong policy positions that their programmes should be funded primarily from member states’ own resources, with particular emphasis on involvement of the private sector. Shockingly though, most if not all have continued to rely heavily on donor funding, which is unhealthy in light of the prevailing debt situation in these regions. In 1996/97 in SADC only 25 to 30 percent of funding for its Programme of Action was sourced locally, implying about 70 to 75 percent was sourced from external sources (IGD 2001). This had risen to about 80 percent by 1998/99. Foreign funding creates debts that, if not managed well, turn into a debt trap.

Most RECs, jointly and severally, lack an explicit regional debt management system and debt management is generally viewed more as a national issue than a regional one, and even then in the very narrow sense of debt recording. In most of the African countries, the database for policy making on debt issues is inadequate because the chief financial agencies of governments do not communicate effectively with each other. Different functions of debt management are performed by different government agencies that sometimes overlap each other or perform the same functions for different ministries.

The role of external forces in Africa’s regional groupings has tended to be negative to the whole concept of regionalism. A case in point is the recent growth in the partnership between South Africa and the European Union that is likely to disadvantage regional economic integration in SADC. It has been linked to the uneven pace of development between South Africa and the rest of the region that is expected to present problems in terms of distributing the costs and benefits of integration. Zimbabwe for instance, due to its foreign exchange problems, is heavily indebted to South Africa’s Eskom for electricity supplied.

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Key Action Areas

Given this background, strong economic integration could present some opportunities for alleviating the debt problem. Increased trade among the RECs in Africa and would allow foreign currency, which would otherwise have been used to pay for out-of-zone imports, to be saved. Foreign currency is also saved because of the incorporation of a common currency factor. This would be much more pronounced if a supranational organ for debt management were put in place for the implementation of certain disciplinary rules. A harmonised debt policy, within the framework of economic integration and in relation to global economic policy, is necessary for all the regional member states. This would need to deal with issues such as export diversification, industrialisation geared towards encouraging manufactured products, and fighting against capital flight. For all these to succeed, the different states must respect the terms of integration that they have signed.

There have always been disparities between the countries of each REC. Apart from the common purpose that unites them; they have never looked for a collective solution to their problems especially the external debt burden. Meanwhile, the problem of debt is similar in all countries. United these countries would constitute a very strong force. The problem of debt would be dealt with by debtor cartels. Countries of the region would be able, as a bloc, to negotiate with bilateral donors to cancel unpayable, odious and illegitimate debts. Regional integration creates the platform for collective bargaining by debtor countries with the north and in international fora that is generally lacking but is very important for reducing debts and relaxing their terms and conditionalities.

A common currency would make foreign investment more attractive in the region of any REC, particularly when it became convertible; and the examples of other experiences in Francophone Africa and Europe are positive. Some of the conditions appropriate to the introduction of a common currency are balanced economic structures (GDP deficit, external account, rate of debt, or inflation etc.) across the zone, a more diversified regional economy, disposal of a minimum quantity of international currencies by the central bank of the zone to enable it to protect the future common currency in the exchange market and a decision on whether the future currency will be linked to another international currency in the short run or be independent and flexible.

Regional economic communities need to promote sustainable development and debt reduction by taking advantage of the numerous opportunities to integrate their subregion’s markets for goods, services and capital to other sectors of the economy, to promote closer cooperation in all other sectors both economic and social, to coordinate monetary, fiscal and exchange rate policies of member states and to promote monetary intervention, among other things.

Existence of a regional monetary authority, or a common development bank is needed to finance regional and national projects in each REC, to assist in the integration process and to reduce economic disparities between the member countries. The problem of each REC member state clamouring to get a regional project could be solved by introduction of such a development bank.

Regional integration affects the savings of member countries that have a direct bearing on the debt levels. Cooperation in banking, insurance and social insurance can reinforce financial mobilisation. More importantly, the process warrants the harmonisation of interest rates that increases the savings rate and lowers indebtedness. Given the mobility of capital from one country to another, the savings rate can even be increased in a poor country. Within this framework, investment risks are reduced and opportunities created for large-scale injection of capital into a region.
African integration process has always been government-led, but it does not need to be monopolized by governments. Where Africa has been regrettably lacking is the failure to bring the people on board, and motivate and mobilized them. Informal trade in which the majority of Africa’s people are involved in has a role in regionalism and debt amelioration.
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Conclusion

Though external debt has not formally featured as a regional integration policy issue, the latter has been found to be a means of achieving development, fighting indebtedness and enhancing the standard of life. The potential positive contribution of regional integration towards the amelioration of the debt crisis in Africa is evident. Integration can increase and rationalise production, encourage domestic savings and act as a magnet for investment by both internal and external players. Regional cooperation and integration in Africa could well be the appropriate platform from which to participate more meaningfully in the global economy in the fight against external indebtedness.

The benefits of integrating exceed the benefits of not doing so and the benefit-cost ratio is positive. The emphasis needs to be, not in cutting costs/inputs (reductionist approach), but on generating more wealth/revenue/income (incrementalist approach) that results in reducing the huge external debt in most countries. The bottom line of successful regional integration is in "providing equal opportunities, however unequal the initial endowment" and hence achieving together more than any one party could achieve alone, with the benefits outweighing the costs, even for the less advantaged members.
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