Do African Monetary Arrangements Make Sense? Evidence Based on Business Cycles Symmetry

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Just as the launch of the European Monetary Union sparked interest in the creation of monetary zones and in the expansion of existing ones across the world, the current debt crisis in Europe is a reminder of the cost associated with common currency. Nonetheless, the idea of creating a single African currency area, merging existing and futures monetary zones, is currently advanced. Effective economic integration did not precede the creation of the existing monetary arrangements, making their path different from that followed by Europeans. The slow progression of economic integration in Africa, suggests that creating a single currency, will likely precede economic integration at the level of the continent. It is however, possible to consider benefits of monetary zones to be endogenous, which would make benefits to appear after unions are created. If benefits are endogenous, existing monetary unions offer a laboratory for testing the validity of this idea.

This study investigates the benefits of existing African monetary zones by analysing the transmission of business cycles between countries in a three-step process. First we test business cycles for symmetry, using a sample of 60 countries with no a priori on the connection between those countries. Second, we analyse the transmission of business cycles among mix of countries using a vector autoregressive model. Finally, we check the strength of the bond among countries by looking at the link between pairs of series of cyclical component of real GDP. Our results provide an insight on the transmission of macroeconomic shocks and on the strength of the links among countries in African monetary unions. We find that business cycles of countries in a monetary union are not homogenous, and that the bond among members of existing unions in Africa is weaker than that between these individual countries and their major trade partners. We conclude that stronger bonds among studied countries should precede successful monetary integration.