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Background note on the establishment of the African Union financial institutions and their roles in fostering productive transformation

I. Background

1. In June 1991, the Heads of State and Government of the Member States of the Organization of African Unity (OAU) adopted the Treaty Establishing the African Economic Community (AEC), which entered into force in 1994. This treaty known as the Abuja Treaty aims at developing the continent for current and future generations by utilizing all available human and natural resources. Its main objective is "to *promote economic, social and cultural development and the integration of African economies in order to increase economic self-reliance and promote an endogenous and self-sustained development".*

2. The Abuja Treaty states that the AEC should be established through six (6) stages, the last one being devoted, inter alia, to the implementation of the final step for the setting up of an African Monetary Union, the establishment of a single **African Central Bank (ACB)** and the creation of a single African Currency.

3. In July 2000, the 36th OAU Summit held in Lomé, Togo, adopted the Constitutive Act of the African Union (AU) whereby the Heads of State and Government of the OAU completed the financial architecture of the AEC with the creation of two additional financial institutions: the African Monetary Fund (AMF) and the African Investment Bank (AIB). Article 19 of the Constitutive Act provides the creation of three financial institutions namely the African Central Bank, the African Monetary Fund and the African Investment Bank. Furthermore, in January 2016, in Khartoum, Sudan, the Commission was requested by the Assembly of the African Union (Assembly/AU/Dec.109), to conduct a feasibility study on the creation of a Pan-African Stock Exchange (PASE). The three financial institutions and the PASE are the four African Union Financial Institutions.

II. The role of the African Union financial institutions in facilitating productive transformation

4. With the signing of the African Continental Free Trade Area by the AU Heads of State and Government in March 2018, the continent is set to create a single internal market. Diversifying national economies through industrialization and adding value to the raw materials became an imperative for Africa.

5. African exports remain highly commodity driven, making them vulnerable to price fluctuations. They are not inclusive and thus exacerbating poverty, inequality and fragility. The low level of integration of African economies is another concern. Intra-African Trade is only about 16% compared to 607% in the EU region where economies are more diversified and integrated.

6. African economies have enormous potentialities for diversification to overcome the dependence on commodities and creates sufficient jobs for its bulky young population. This involves, among other measures, (i) developing the private sector and strengthening the productive capacity of the informal sector to ensure a more active contribution to

industrialization and value-addition; (ii) processing and adding value to primary commodities by developing national value chains across sectors; and (iii) moving from low- to high-productivity activities within and across all sectors (agriculture, manufacturing and services) through the use of new technologies and good management practices that increase the productivity. These are a prerequisite for the successful implementation of CFTA.

7. Furthermore, the continent is lacking of hard and soft infrastructure which is undermining progress towards the attainment of structural transformation and CFTA. Structural transformation and industrialization demand appropriate infrastructure to foster economic activity, fuel industrialization, connect producers to markets, enhance intra-Africa trade and foster regional integration. On the continent, the infrastructure services cost is higher than any place in the world. Africa needs well-functioning regional and national infrastructure, including energy facilities to produce and roads, railways and ports, information and communication technology, etc. improve intra-Africa trade.

8. However, to turn Africa’s structural transformative agenda into a reality and bridging infrastructure gap requires substantive financial resources. In the context of decrease of Official development assistance (ODA) and foreign direct investment (FDI) because of the slowdown of the economies of the developed world, African Union Heads of State and Government have set domestic resources mobilization as a priority to finance Africa’s productive transformation by improving tax revenues and tapping into domestic financial markets.

9. The African Union financial institutions project is one of the vehicles that will drive the continent’s financial sector with a view to facilitating its productive transformation and development, as there is a general consensus among academicians and policy makers regarding the positive correlation between finance and productive transformation. Indeed, evidences suggest that efficient financial market plays a prominent role in economic and productivity growth by providing good information on firms and market niches at a lower cost to investors, and channel resources into the more productive investments and fostering growth. Furthermore, financial market improves the use of new technology and new processing methods (Greenwood and Jovanovic (1990) and mechanisms (King and Levine (1993b), that directly influences firms’ performances and boost productivity.

10. The economic benefits of a monetary union are also well-recognized. Monetary unions foster sound macroeconomic stability and create an enabling environment in which financial institutions can operate across the region rather than being restricted to national economies. It also might contribute to the creation of deeper and more liquid financial markets, further reducing borrowing costs and exchange rate volatility risks associated with cross-border trade and investment. All these will lead to the reduction of the costs of borrowing and facilitate a more efficient allocation of capital and improvement of financial market efficiency and competitiveness of the economy, which in turn will improve the productive capacity of the economy. Furthermore, the use of a single currency for the pricing of goods and services in different countries makes cross-border

comparison of prices easier, and therefore improves the efficiency of markets and reduce vulnerability to asymmetric shocks.

11. It is in light with the above that the Commission has decided to accelerate the establishment the AU financial institutions with the following role and responsibilities.

II.1 The African Investment Bank (AIB)

12. **The AIB** will be the long-term financing institution of the Union to support its priority objectives of fostering economic integration and balanced development of the continent. In this regard, the main functions of the AIB are to mobilize resources from local as well as foreign sources and finance viable programmes and projects in African countries. The AIB will finance private sector development within the continent as part of efforts to put the continent on a sound growth path towards its industrialization.

13. There is still a huge deficit of infrastructure on the continent because of the lack of adequate financing. Most financial institutions are operating at national level. The African Investment Bank will finance regional infrastructure projects to benefit several countries. It will also provide the much-needed capital to finance the construction of cross-border highways and the creation of telecommunication links. The AIB will complement the work of the African Development Bank (AfDB), which has been at the forefront of financing national infrastructure projects.

II.2. The African Monetary Fund

14. **The AMF** will promote the development of African financial markets and ensure exchange rate stability among currencies and their mutual convertibility. It will also promote and facilitate trade, the settlement of commercial payments and encourage capital flow between member countries. In addition, it will provide short-term and medium-term credit facilities to sustain balance of payments and provide technical assistance and policy advice to member countries with a view to assisting in financing their overall balance of payments deficits.

II.3. The African Central Bank (ACB), preceded by the African Monetary Institute (AMI)

15. **The ACB's** role will consist on establishing a robust Monetary Union with a single African Currency. It will manage African monetary and exchange rate policy. The ACB will be preceded by the AMI, which will carry out the preparatory technical, policy, statistical, legal and institutional groundwork towards the establishment of the ACB in a gradual step by step approach. The AMI will support the AU organs and the RECs in the implementation of the monetary cooperation programme, working closely with Regional Monetary Institutes and sub-regions to monitor and implement macroeconomic convergence and financial integration. It will also review the design of the Strategic Plan and Roadmap for the establishment of the ACB by 2034, taking into account emerging African realities and undertaking any other initiatives needed to facilitate the integration

process. The AMI will further play the role of a “clearing house” to assist in currency conversion and boosting intra-African trade.

II. 4. The Pan-African Stock Exchange (PASE)

16. **The PASE** will be a virtual continental market in which companies that are incorporated within participating countries receive permission to issue securities to the general public from the regulator in their country of incorporation. This permission allows them to market their securities to the general public in all countries in the market. These companies may then apply to list on any exchange within the group of participant countries and will be accepted, provided they meet that exchange’s listing conditions. It is anticipated that companies will only seek a single listing but this does not prevent a company seeking multiple listings if they wish. This will be done through a gradual process of creating and harmonizing regional securities exchanges.

17. The major advantage of this model is that it is not necessary to completely harmonize laws, regulations, rules, currencies or other ‘soft’ infrastructures within the regional groupings. A measure of harmonization and the setting of basic standards are required but within this framework national priorities and variations can be accommodated. The ‘pooling’ of technology costs can result in very significant savings for the financial market as a whole and thus in the reduction of trading and associated costs for brokers and investors.

III. Approach to the setting up of the Financial Institutions

18. Following the adoption of the African Union Constitutive Act, the Assembly and the Executive Council took additional decisions related to the location of the African Union Financial Institutions and the working arrangements with regard to the preparation of the legal instruments of the Financial Institutions.

19. **On the host countries of the AU Financial Institutions:** The Assembly decided in January 2005, in Abuja, Nigeria, decision No Assembly/AU/Dec.64 (IV), that the African Central Bank should be located in the Western Region, the African Investment Bank in the Northern Region, and the African Monetary Fund in the Central Region. Following this decision, the Northern Region decided that the African Investment Bank should be located in the Great Socialist People’s Libyan Arab Jamahiriya (now Libya), the Central Region designated Cameroon as the host country of the African Monetary Fund while the Western Region designated the Federal Republic of Nigeria as the host country of the African Central Bank. Subsequently, the Commission and the Government of the Republic of Cameroon signed a Headquarters Host Agreement in April 2018.

20. **Establishment of the Steering Committees and preparation of the legal instruments**: In line with the Executive council decision, the Commission signed a Memorandum of Understanding (MoU) with each of the host countries. The MoUs were signed in January 2008 with the Government of the Great Socialist People’s Libyan Arab

Jamahiriya, in April 2008 with the Government of the Republic of Cameroon, and in April 2009 with the Government of the Federal Republic of Nigeria.

21. The technical steering committees were tasked to work closely with the African Development Bank (AfDB), the Association of African Central Banks (AACB), Regional Development Banks and Regional Economic Communities (RECs) to ensure synergies and complementarity in the preparation of the legal instruments of the PAFIs, the Protocols and Statutes.

22. The steering committees for the establishment of the AIB and the AMF have finalized their work on the preparation of the legal instruments of these financial institutions in 2008 and 2011 respectively.

23. Regarding the African Central Bank, the African Union Commission and the Association of African Central Banks agreed to carry out a Joint Study from which a Joint Strategy would be derived for the establishment of the Bank. The Legal instruments would be then prepared after the adoption of the recommendations of the Study and the Joint Strategy. The Study as well as the Joint Strategy were successfully carried out by a Joint Study Group made up of Experts of the Steering Committee and Experts designated by the AACB.

24. **Adoption of the legal instruments of the AIB:** The Protocol of the African Investment Bank was adopted in February 2009 during the twelfth Ordinary Session of the Assembly of the African Union held in Addis Ababa, Ethiopia, (Assembly/AU/Dec.212 (XII)) while its Statute was adopted later on in February 2010 during the fourteenth Ordinary Session of the Assembly of the African Union held in Addis Ababa, Ethiopia (Assembly/AU/Dec.286 (XIV)).

25. **Adoption of the legal instruments of the AMF:** The Protocol and the Statute of the African Monetary Fund were adopted in June 2014 during the 23rd Ordinary Session of the Assembly of the African Union held in Malabo, Equatorial Guinea (Assembly/AU/Dec.517 (XXIII)).

26. **Adoption of the Study and the Joint Strategy for the establishment of the ACB:** The Study Report and the AUC-AACB Joint Strategy for the establishment of the ACB were validated by the AUC and AACB Joint Technical Committee at their meeting held in February 2013 in Dakar, Senegal. The documents were adopted by the Assembly of Governors of the AACB during its 38th Ordinary Meeting held in Malabo, Equatorial Guinea, on 14 August, 2015, with reservations noted from the Southern Africa sub-region. The Assembly of Governors requested the Commission to move the process forward and consequently, the documents were submitted to the STC on Finance, Monetary Affairs, Economic Planning, and Integration in March 2016 which recommended the documents for submission to the AU organs for adoption.

27. **Adoption of the recommendations of the Study on the feasibility of a PASE:** The Technical Study on the feasibility of establishing a Pan-African Stock exchange was

successfully carried out by an independent group of consultants. The main findings of the study were to take a gradual approach comprising of the establishment of regional virtual stock exchanges and the deepening of cooperation between regional entities. The AU Extraordinary Conference of Ministers of Economy and Finance held in March 2014, in Abuja, Nigeria, recommended that the study report be submitted to Member States for further review.

IV. Challenges

28. The main challenges towards the establishment of the Pan-African Financial Institutions are as follows:

IV.1. African Investment Bank

29. The slow signature and ratification process: As of today, twenty-two signatures of the legal instruments of the AIB had been registered: Angola, Benin, Burkina Faso, Chad, Cote d'Ivoire, Comoros, Congo, Democratic Republic of Congo, Gabon, Gambia, Ghana, Guinea-Bissau, Guinea, Libya, Liberia, Madagascar, Niger, Senegal, Sierra Leone and Sao Tome & Principe, Togo, and Zambia. Among them, only **six** have ratified these instruments: Benin, Burkina Faso, Chad, Congo, Libya, and Togo.

30. The commitment of the Libyan government to the project of the African Investment Bank has not been expressed since the new political leaders have taken over from the previous government. The Commission should engage the Libyan authorities to discuss how to move the process forward.

IV.2. African Monetary Fund

31. The agreement on the Statute of the AMF for which discussions have started in 2011 and ended in March 2014. he legal instruments of the AMF were then reviewed in May 2014 by the STC on Justice and adopted by the Assembly in June 2014. As of today, ten signatures have been registered: Benin, Cameroon, Chad, Comoros, Congo, Ghana, Guinea-Bissau, Mauritania, Sao Tome and Principe and Zambia. Only o**ne instrument of ratification has been deposited by Chad**.

IV.3. African Central Bank

32. Approval of the AACB for the AUC/AACB Joint Strategy on the ACB was granted at their Assembly Meeting in Malabo, Equatorial Guinea, in August 2015 after delays in engaging all the sub regions. Engaging all the sub regions is crucial in moving the project forward and implementing the Strategy as there are still reservations from the Southern African region related to the current timeline and the prerequisites for the establishment of the ACB. There was also delays in submitting the Joint Strategy for approval by the AU Summit.

IV.4. Pan-African Stock Exchange

33. Responses from Member States have not been forthcoming since the Joint Conference of Ministers in Abuja in 2014. The slow response from Member States has resulted in a delay in moving the project forward.

V. Conclusions and Recommendations

34. The African Union financial institutions are at the heart of the implementation of Agenda 2063, “the Africa We Want” and its flagship programmes such as but not limited to Africa’s structural transformative agenda, CFTA, and PIDA.

35. Diversifying African economies and enhancing their productive capacity are the first step the continent should take for the successful implementation of the CFTA. To achieve this, mobilizing domestic resources through the creation of an enabling environment and the establishment of the AU financial institutions is central.

36. Africa-wide free trade area will constitute the world largest free trade area in terms of participating countries. It will cover a market of 1.2 billion consumers and weight $2.5 trillion in terms of Gross domestic product.

37. The elimination of tariffs between countries will increase intra-African trade, boost Africa’s economic growth, and support the African Union in achieving its vision of an integrated, prosperous and peaceful Africa, driven by its own citizens, representing a dynamic force in the international arena, as set out in Agenda 2063.

38. Several challenges are hampering the creation of the AU Financial institutions. The pace of the signing and the ratification is very low. After more than five years, none of the institutions has got enough ratifications to enter into force. In order to speed up the process, the Commission should undertake the following actions:

1) Send notes verbales as a reminder to Member States each time a Member State signs or ratifies a Protocol;

2) Carry out a comprehensive study to establish the challenges and reasons Member States are taking long to sign and ratify the legal instruments of the AIB and the AMF. Once the study is finalized, the report should be submitted to the next coordination meeting in June/July 2019 in Niger for consideration and way forward.

3) Sensitize Member States on the importance and benefits of the African Union financial institutions, particularly in supporting the establishment of the African Continental Free Trade Area, and provide them with much more detailed technical explanation on the modalities of the subscription of the State party to the shares of the authorized capital based on its capital subscription allocation and the payment of paid-up capital initially subscribed by a State Party

4) Publish the status of signing and ratification of the legal instruments of the AU financial institutions on the AU Website, with regular updates.

5) Designate a champion to undertake advocacy campaign to sensitize all government officials and parliamentarians and advocate the importance of the signing and the ratification of the legal institutions of the AU financial institutions.

6) Work together with the Cameroonian authorities to develop a strategy to ensure that the AMF is established by the 2023 timeline set in the First Ten Year Implementation Plan of Agenda 2063.

7) Engage the Libyan authorities on moving forward the process of the establishment of the African Investment Bank;

8) Take all the necessary measures to ensure that the AUC/AACB Joint Strategy on the establishment of the African Central Bank is submitted for approval to the AU Summit to ensure the timely implementation of the recommendations contained therein including the setting up of the African Monetary Institute and the implementation of the convergence criteria towards to the establishment of the ACB; and

9) Engage with the African Securities Exchanges Association (ASEA) on moving the Pan-African Stock Exchange project forward.