Chapter 3

LITERATURE REVIEW

3. LITERATURE REVIEW

This literature makes use of the main strands of economic integration theories - Viner's Customs Union and the Optimal Currency Area – to examine the processes involved in the formation of an economically integrated regional body and its influence on governance. It is a review of the existing literature on economic integration and governance. However, it firstly looks into the various definitions of the terms used in the study as presented by a wide variety of authors. It will then provide a discussion of both Viner's trade theories and the Optimal Currency Area, further examining the current literature on regional economic integration with a particular focus on the African context.

3.1 CONCEPTUAL FRAMEWORK

Robson (1968) argues that the economic integration between sovereign states has become a trend in the mid-twentieth century and the increasing formation of such integrated bodies has led to this era being termed 'the age of integration'[98]. This need for integration is manifested in the establishment of organizations such as the European Economic Community (EEC), the European Free Trade Area (EFTA), the Central American Common Market, and the Arab Common Market across the developed, Latin American and Middle Eastern world respectively[99]. With the formation of institutions such as the Southern African Custom Unions (SACU), African countries have increasingly joined the integration bandwagon and their interest not only comes from the economic benefits of such bodies but is also as a result of the political and social aspects, all of which are closely associated to one another[100]. Although regional integration is not a new concept to Africans, it has increasingly become a

[98] See; Robson 1968: 11, citing Haberler (1964)

[99] Robson, 1968: 11

[100] Robson, 1968: 11

high priority in the political agenda of many African countries and its importance is associated with the need to form strong Regional Economic Integration (REI) mechanisms which would in turn lead to an increase in economic growth through the convergence of macroeconomic and fiscal policies, and an increase in intra-regional trade[101].

Robson (1968) further argues that for Africa to be significantly free of external dependence and overcome the disadvantages of state size, there has to be a certain level of economic integration across the continent and in terms of the political aspects, integration occurs because of *the assumption that for all but a few larger African states, considerations of modernization and genuine independence render some form of international cooperation or interdependence inescapable*.[102] Therefore, given the importance of economic integration, it is vital that this term be closely examined in order to provide a clearer understanding of the concept, theories and processes which are used to explain this term.

3.1.1 Governance

Several definitions have been provided to describe "governance". According to Mgonja, governance and good governance are terms which are often used in International Relations; however, there is no accepted definition of governance and their meanings vary across a wide range of authors and theoretical frameworks[103]. Despite the lack of a single acceptable definition, "governance" rapidly gained significance in many policy agendas at the end of the Cold War as a condition for receiving development aid.

[101] Although there exists other forms of informal integration which are based on technological advancement in the transportation and communication fields, economic integration is the most common form of integration existing across the world despite the fact that it affects the member states differently. The processes involved in the form of integration are driven and regulated by the World Trade Organization (WTO) because smaller states usually only gain from economic integration when there is at least one superpower regulating the policies and enforcing free trade agreements across these countries. See, Baldwin (1970)
[102] Robson, 1968: 11

[103] See: Mgonja, 2006.

Although "governance" is known to be an old term, it still remains a very complex term whose meaning has evolved over the years to cover a wide range of institutions both in the private and public sectors and varies across nations[104]. Firstly, the United Nations Development Programme (UNDP) defines governance as "the exercise of economic, political and administrative authority to manage a country's affairs at all levels. It comprises the mechanisms, processes and institutions, through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences"[105]. Keohane and Nye (2000) further state that governance is the "processes and institutions, both formal and informal that guide and restrain the collective activities of a group."[106]

The World Bank however argues that governance is "the method through which power is exercised in the management of a country's political, economic and social resources for development"[107]. It goes on to state that this method includes (i) *the process by which governments are selected, monitored and replaced; (ii) the capacity of the government to effectively formulate and implement sound policies; and (iii) the respect of citizens and the state for the institutions that govern economic and social communications among them*[108]. It is considered to be the kind of interaction a states has with the society it governs and the various ways in which the government efficiently and effectively carries out its functions[109]. Olowu and Sako (2002) further break down this concept by stating that governance is "a system of values,

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[104] Dethier (2000: 2) argues that in some countries, the term is used to refer to the government.

[105] United Nations Development Programme, Governance for sustainable human development, UNDP policy document, New York, 1997.

[106] For more on this, see Keohane and Nye (2000).

[107] World Bank, *Governance*, Washington, D.C., 1993

[108] See; Policy Research working paper 2196 entitled 'Governance Matters' by Daniel Kaufman, Aart Kraay, Pablo Zoido-Lobaton, The World Bank, 1818 H Street NW, Washington DC, 1999, pg.1. Also cited in; Singh, B. (2008). "The Challenge of Good Governance in India: Need for Innovative Approaches," Cambridge, Massachusetts, USA, (accessed September 15, 2011), [available at: http://www.innovations.harvard.edu/cache/documents/1034/103461.pdf]

[109] World Bank, 1994

policies and institutions by which a society manages its economic, political and social affairs through interaction within and among the state, civil society and private sector”[110].

While Lynn et al (2000) define governance as the judicial and administrative practices that dictate, restrain and allow governments to effectively perform their duties of delivering public goods and services to their citizens[111], Ngware (1999) argues that governance refers to the “exercise of social, political, economic and administrative authority to manage a nation or municipal affairs”[112]. On the other hand, Wohlmuth (1999) states that governance relates to more than just the political structures and the capabilities of a country’s government. He goes on to propose that governance is the arrangement of a social group on the basis of a ruling coalition and the policy direction that arises from the interaction of its political and social elites[113]. In addition to this, Weiss (2000) refers governance to both government and underlying actors, mechanisms and institutions that “transcend the formal government apparatus”[114]. To Brilliantes Jr. (2005), governance represents all the mechanisms, processes and institutions through which citizens and other interest groups exercise their legal rights and make their interests known.

The different styles of governance are often judged as being good or bad. Good governance is considered to be a more challenging term to define because it is hard to determine by whose standards governance is judged and what constitutes good or bad governance. However, Hyden and Braton argue that four main criteria can be used to evaluate a society’s style of governance and these include: the degree of trust in the government, the degree of responsiveness in a government’s relationship with its civil society, the degree of accountability

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[110] Olowu and Sako, 2002: 37

[111] Lynn et al., 2001: 20

[112] Ngware, 1999: 9

[113] Wohlmuth, 1999: 18

[114] The actors mentioned here refer to the citizens and international institutions which all play a great part in influencing a country’s governance structures. See; Weiss, 2000: 800

a government has towards its voters and the type of the authority that a government exerts over its society[115].

Good governance is however contrasted with "bad governance". For instance, the World Bank explains bad governance as the increase of corruption within every government structure and its understanding of good governance begins with the rejection of all previous development models, blaming these failures on a misconceived strategy. Good governance is therefore explained as the existence of more transparency and accountability within the private and public structures[116]. Cloete (2000) adds to this point by stating "good governance is conceptualised here as the achievement by a democratic government of the most appropriate developmental policy objectives to sustainably develop its society".

Kjaer (2004) argues that the good governance agenda was introduced by the World Bank as a requirement for development in order to comprehensively understand the underdevelopment of so many states in spite of the implementation of Structural Adjustment Programmes (SAPs)[117]. This good governance discourse however has been challenged by some authors as promoting a Westernized form of liberal democracy and economic liberalisation which is used to carefully conceal their primary interests[118]. Despite these contrasting views, the European Union supports the World Bank's good governance discourse and explains governance as having five underlying principles – participation, openness, accountability, effectiveness and coherence – which are essential for the establishment of a more democratic state[119].

In the same line, the World Bank states that the good governance agenda places an emphasis on the restrictive role of the state and the expansion of its markets to establish a more

[115] Hyden and Braton, 1993: 7

[116] World Bank, 1989: 3

[117] Kjaer, 2004: 138

[118] Refer to Abrahamsen (2000) for more on this debate.

[119] See the EU White Paper.

competitive environment. It also places a great emphasis on the establishment of a democratic state structure and on the role of civil societies in strengthening democracy by building an informal sector and community institutions which supports its citizen's entrepreneurial skills. In order to establish a template by which countries should abide, it provides six indicators of governance as political stability, voice and accountability, rule of law, government effectiveness, regulatory quality and control of corruption[120].

Ngware (1999) considers good governance to be the practices of democratic values, the accountability of both political and administrative structures, the lack of corruption and transparency in all decision-making bodies, respect for the rule of law and non-discriminatory access to the public offices[121]. He goes on to argue that good governance is used as a template to ensure that there is a lack of corruption and the interests of vulnerable citizens are taken into account during decision-making processes.

Rhodes (1997) in his definition of good governance indicates that it refers to inter-organisational and self-organised networks which are characterised by interdependence, rule of law and an effective form of autonomy from the state[122]. Unlike other authors, he does not place a central focus on the state and institutions as the main actors in implementing mechanisms for good governance but goes on to suggest that inter-governmental, inter-organizational and transnational networks also play a vital role in this process. He further argues that good governance pertains to how efficiently a country can manage its resources and affairs in a way that encourages more openness, transparency and equality, while respecting the rule of law and taking the needs of their citizens into consideration. However reiterating Hasnat Abdul Hye, governance is much more than organs or actors and the quality of governance is just as important

[120] See World Bank, 1993. This study however focuses on the Rule of Law, Political Stability and Control of Corruption indicators.

[121] Ngware, 1999: 9.

[122] Rhodes, 1997: 15.

because "just as the dancer cannot be separated from the dance, the organs or actors executing governance in their respective spheres cannot be relegated to the background".[123]

Furthermore, Pierre and Peters (2000) have argued that governance can be understood as both a structure and a process[124]. As a structure, they argue that governance involves the influence of markets, networks, institutions and communities on finding solutions to socio-economic challenges: while the procedural approach to governance refers to the processes and outcomes of governance as opposed to the stereotypical practices of institutional arrangements[125]. Governance as a structure emphasizes on governments to effectively provide their citizens with public goods and services, and these governance systems shape the ways in which governments exercise authority by setting up incentive schemes and mechanisms[126]. However, the lack of adequate incentives and enforcement mechanisms will lead to a failure in governments as a result of institutional weaknesses[127].

All these definitions of good governance, although different in their explanations all suggest that there are certain core values which should be adopted by every government[128]. However, for the purposes of this research, the author uses the World Bank's definition of good governance highly focusing on the political stability, rule of law and control of corruption indicators[129]. Thus, the study will seek to explore the implication of Cameroon's membership of

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[123] Abdul Hye Hasnat, *Governance: South Asian Perspective* (Oxford, 2001), p1

[124] Pierre and Peter, 2000: 15-27

[125] Ibid. pp. 15-27

[126] Deither, 2000: 3

[127] These institutions are established to promote a more efficient environment which would lead to the political and socio-economic development of their country. However, ineffective incentive systems and enforcement processes will lead to the failure of such institutions and the government. Refer to Dethier, 2000: 3-4.

[128] According to these definitions, the government should be owned by its people and must have very effective political and socio-economic structures. See: Mgonja (2006) and Cloete *et al.,* (2003).

[129] Voice and Accountability, Government Effectiveness and Regulatory Quality are not used in this study because of their emphasis on the perceptions of citizens' participation and freedom, public service quality, and the

CEMAC on country's internal political environment, including adherence to the rule of law, and mechanism put in place to reduce corruption.

3.1.2 Economic Integration

Although the concept of integration is commonly being used it is yet to have a clear meaning. The term is often used to signify the bringing together of parts of an object to form a complete whole and Mendes (1987) posits that there are two fundamental ideas which are associated with the integration concept: "the need to abolish discrimination within a spatial unit and the necessity of promoting some sort of policy coordination on issues considered as being of mutual interest"[130]. With this in mind, Balassa (1961) defined "integration as both a process and a state of affairs", while Robson (1984) regarded international economic integration as a means and not an end.

Economic integration does not have a clear cut meaning in economics, however, the term can be used to refer to the combining of several national economies into a much larger territorial unit and although it is a concept which is often considered to be a part of the international economics field, authors have argued that economic integration is broader than Viner's customs union theory[131]. Mutharika (1972) argues that in the economic term, integration would signify the coordination of economic policies by states within a specific region[132] so as to attain a certain level of development[133]. The degree of integration however,

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formulation of policies that promote development of private sectors: all of which deviate from the subject of this research which is more interested in the political and decision-making aspects of governance.

[130] Mendes, 1987: 1

[131] The customs union theory promotes the elimination of intra-trade barriers and the equalization of tariffs on imports from non-member countries. For more on this discussion, see Mendes (1987).

[132] Sometimes, the member states of an economically integrated organisation can be based outside the geographical region as in the case of the Democratic Republic of Congo and the Southern African Development Community (SADC).

will depend on how willing member states are to share or give up a certain level of their sovereignty. Van Langenhove further states that irrespective of this commitment, regional integration programmes must satisfy certain characteristics;

> *"reduce social elision and create a more comprehensive civil society; Strengthen regional trade integration; Create an efficient environment for the development of the private sector; Establishment of development programmes which will encourage growth an integration; Advance the creation of effective public sector organizations and promote good governance; Boost the region's interaction with the rest of the world and contribute to the political and economic stability of the region"*[134].

According to the European Union (EU), economic integration is a term which is often used to refer to the abolishment of the different constraints of trade between countries to include all institutional forms that this international economic cooperation processes may take: Free Trade Areas (FTA), customs unions, common markets and economic unions[135]. The first form starts off with a Preferential Trade Agreement – also known to be the weakest level of economic integration – and later evolves into a FTA[136]. The FTA is an agreement between member states to reduce restrictions on trade and abolish tariffs between the member states while allowing these member states to individually set tariffs against the imports from third party countries[137]. In addition this free trade within an economically integrated region does not only refer to goods and service, but also includes the unlimited movement of capital,

[133] See: Mutharika (1972). In addition, Myrdal argues that *the economy is not integrated unless all avenues are opened to everybody and the remunerations paid for productive services are equal, regardless of cultural and social differences*. See Myrdal, 1956: 11

[134] For more on this discussion, see Van Langenhove, L., and H. van Ginkel, 2003: 1-9

[135] Robson, 1968: 25

[136] Not only can these FTA agreements be restricted to a few economic sectors or cover all areas of international trade, they can also be made up of formal processes aimed at resolving trade disputes. Ibid. p.25

[137] Examples of such Free Trade Areas include the North American Free Trade Area (NAFTA), the European Free Trade Area (EFTA), and the Latin American Association (LAIA). For a more detailed discussion, refer to Robson, 1968: 25.

labour, and the harmonization of macroeconomic policies, institutions, and civil and constitutional laws[138].

Just like the FTA, customs union does not only promote the abolition of tariffs between member states but enables these member states to set up a common customs tariff against non-member states and examples of such institutions include; the Southern African Customs Union (SACU), the Central American Common Market (CACM), the Caribbean Community and Common Market (CARICOM), among others[139]. Although these customs union institutions on their own will not necessarily result in a significant economic growth without the implementation of efficient infrastructures and markets, their main purpose is to enable countries to enjoy the benefits of economies of scale[140]. The Common Market is considered to be a more advanced form of integration which often refers to custom union markets whereby trade tariffs are removed and there exists an unlimited movement of labour and factors of production within the economically integrated region as in the case of the EU[141].

The economic union on the other hand is the much more advanced form of integration and it is considered to be the stage where complete economic integration has occurred because it refers to the complete integration or harmonization of a supra-national organization with an efficiently coordinated common market, unified monetary system, fiscal, and other socio-economic policies[142]. Robson (1968) argues that all of these forms of integration share two fundamental features; *first, they facilitate expanded specialization and exchange between a group of independent countries by means of the elimination or substantial reduction of*

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[138] DeRosa and Gilbert, 2004: 386

[139] DeRosa and Gilbert, 2004: 387

[140] Ibid. p. 387

[141] Robson, 1968: 25

[142] For a more detailed explanation, see Robson (1987).

barriers to trade among them; secondly they entail discrimination against non-members of the group.[143] He further suggests that states are often motivated by the economic benefits of such an integrated process and this integration process occurs over a certain period of time.

3.2 THEORIES OF ECONOMIC INTEGRATION

There has been quite a significant increase in the literature on economic integration and customs over the past decades and several theories have been used to explain economic integration with many associating it with the original contributions presented in the *Customs Union Issue* by Jacob Viner (1950), followed by James Meade (1955) and many others[144]. In order to provide a better understanding of the economic integration concept, this section closely examines some of these fundamental theories.

3.2.1 Viner's Custom Union Theory

Lipsey (1987) argues that in relation to economic integration the customs union theory has always been historically concerned with the welfare gains and losses which succeed the establishment of customs union[145]. These gains and losses could occur because of specialization, the economies of scale, changing the terms of trade, changes in efficiency through an increase in competition and on account of changes in the rate of economic growth. Customs Union defined as the "elimination of intra-trade barriers and the equalization of

[143] Robson, 1968: 25-26

[144] See; inter alia, Lipsey (1970), Lloyd (1982), Robson (1987), and Pomfret (1988).

[145] Lipsey, 1987: 357

tariffs on imports from non-member countries"[146], is often used to examine goods and markets within a region.

In his classical book *The Custom Unions Issue*, Viner makes an important distinction between trade creation and trade diversion, arguing that custom unions were a common characteristic of the international scene in the post-World War II era at a point when the International Monetary Fund (IMF) and the World Bank were being established due to the fact that it was thought to lead to economic gain[147]. Viner states his claims by employing the assumption of static theory of comparative advantage, suggesting *with a situation in which the input factors of production, the technical knowledge, tastes and the forms of economic organization are all treated as constant or as autonomous variables.*[148] This approach relates customs unions to the losses and gains obtained by the formation of a preferential trade agreement.

Using Viner's work as a fundamental framework, traditional economic theory greatly focuses, but is not limited to the concepts of trade creation and trade diversion due to the fact that gains achieved from customs union is significantly influenced by achieving a balance in trade creating and trade diverting[149]. Trade creation is used to explain the "possible expansion of a country's total imports on entering into a bilateral or other preferential trade arrangement, leading to an improvement in economic welfare as high-cost domestic output is replaced by lower-cost output produced abroad"[150]. In essence therefore, trade creation can be said to occur when trade between the customs union members increases.

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[146] For more on this discussion on Customs Union, see Viner, J. (1950). *The Customs Union Issues*, New York: Carnegie Endowment for international Peace.

[147] Viner (1950)

[148] Robson, 1968: 27

[149] Ibid. p. 27

[150] DeRosa and Gilbert, 2004: 384

On the other hand, trade diversion occurs in cases where high-cost imports from one or several preferential trading partners supersede lower-cost imports from external states which are not part of such economic unions, thereby leading to a decrease in the economic well-being of importing countries[151]. Therefore, trade diversion occurs when imports from producers of a more efficient or cheaper world market are substituted with imports from the customs union member states. DeRosa and Gilbert further argue that *on balance, if trade creation effects outweigh trade diversion effects, then the preferential trade arrangement is said to be trade creating on a net basis and the arrangement* leads to a significant increase the in income of the economically integrated institution's member states[152].

In addition, it has also been argued that the outcomes of forming such custom union structures heavily relies on whether the initial grounds for this formation was for the protection of the markets or the implementation of free trade because if a state joined this structure in a quest to protect their markets, a new trade flow which would occur between the member states of this institution will lead to trade creation[153]. However, if it was on the basis of free trade, it would cause a negative development and a decrease of trade on both production and consumption, thereby diverting trade from world market producers to higher and more efficient partner countries[154].

According to Dalimov (2009), trade creation and trade diversion occur as a result of "economic unification of states changing direction of the goods from one to the other state supplying the goods to a third country"[155]. He further argues that although these two concepts provide better prices and facilitate the cancellation of tariffs, they differ significantly. This

[151] DeRosa and Gilbert, 2004: 384

[152] Ibid. p. 384

[153] Refer to Ruiz, 1999: 4 for more on this.

[154] Ibid. p. 4

[155] Dalimov, 2009: 1

difference is explained in the sense that while *trade creation provides real net improvement of the price, trade diversion comes at the moment when trade from the cheapest supplier state is diverted to the state inside the union which became cheaper as a result of a decrease in tariffs*[156]. Further explaining these theories, economists rely on the assumption that existing variables such as competition in markets, employment of all resources, unrestricted movements within local and across national boundaries and prices which are highly regulated by costs and the prices of supplies from external sources are elastic[157].

Viner therefore reaches a conclusion that although the aim of customs unions is to enhance political and socio-economic development this is not always the achieved outcome because this would only occur when trade creation is promoted through the abolishment of obstructions to free trade between member states. On the contrary if trade flow is diverted from efficient non-member states to less efficient member states in a bid to promote more cooperation between member states, there would be a decrease in welfare and because states are presumed to be in search of ways to maximize returns and increase welfare, more trade creating customs unions should be encouraged[158].

However, while Viner limits his research to customs union formed by small trading states, Meade elaborates on his analyses by including situations arising from the influence of world relative prices caused by the establishment of a customs union whereby one or more of the union members are said to be large trading states and whose trade policies are capable of

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[156] These cheaper prices are actually *more expensive in comparison with the rest of the world*. Refer to Dalimov, 2009: 1, for a further discussion on this.

[157] See, El-Agraa, 1989:13. Robson (1987), further enlists these assumptions as:
- pure competition in commodity and factor markets;
- the reflection of the opportunity costs of production on the prices of commodities;
- restrictions to trade in the form of ad valorem tariffs only;
- unrestricted movement of the components of production within but not between countries;
- no transportation costs;
- a balance in the trading of goods ; and
- a complete usage of resources.

[158] Ruiz, 1999: 4

causing spill over effects on the economic structures of external states through the deviation of trade flows and their causal effects on world relative prices[159].

He further argues that when pre-arranged tariffs for member nations of the customs union are high, the this can lead to an increase in trade diversion and on the other hand, the existing possibility for trade diversion in these regional organizations may experience a significant reduction because implementing a common tariff against third parties will offer less scope for the displacement of imports from external sources with regional production[160]. In addition, the continuous emphasis on markets, goods and factors of production by the customs union theory disregards the importance of the political environment and the supranational institutions in the integration process.

Viner's *Customs Unions Issue* has led to several other theories and is now used as a template on which other economic integration theoretical frameworks are built. However, contrary to Viner's assertion, Cooper and Massell (1965) argue that based on the fact that unilateral trade liberalization institutions are more effective than customs unions in this sense, the main aim for regional economic integration is not solely to achieve the most favourable conditions for promoting welfare but to promote the protection of markets and tariffs[161]. They go on to propose another approach to customs union by arguing that the aim for creating such structure is not to advance trade and welfare but to create conditions which are conducive for supplying public goods and as such, research on customs unions should be focused on ways in which these conditions can be instrumental in promoting strategic policies[162].

[159] DeRosa and Gilbert, 2004: 285

[160] Meade (1955)

[161] Many African leaders and even the Economic Commission for Africa (ECA) have relied on the formation of an economically integrated region as a way of advancing development. For much more analysis on this, see; Cooper and Massell (1965); Nkrumah (1963); and Robson (1983).

[162] Examples of such policies include; industrialisation, economies of scale and stabilisation in regions which are smaller than the world but larger than states. See Cooper and Massell (1965), often cited in Ruiz (1999).

Johnson (1965) correlates with this adding that promoting the formation of customs unions is driven by a states' desire to encourage the flow of "public goods". He further distinguishes between public and private consumption arguing that existing competition between in-state political parties can result to governments implementing policies which maximizes the consumption of both private and public goods.[163] Baldwin (1997) further states that apart from Viner's trade theory, two other concepts can also be used to explain the formation of economically integrated institutions: the allocation effect and the accumulation (or growth) effect[164].

Based on the economic theory, the allocation effect occurs in a competitive economy when the "the demand for a good directs productive resources to the production of that good" and because tariffs are known to interfere with this process, getting rid of such barriers in trade during an economic integration will therefore lead to an increase the effectiveness of resource allocation[165]. Baldwin (1997) goes on to argue that expanding the markets in the context of regional economic integration will not only enable small industries to grow but it would also weed out inefficient industries through the reallocation of resources and supply consumers with a wide variety of goods and services[166].

In terms of the accumulation or growth effect, it is argued that an expansion of the markets through economic integration causes more attraction to these markets and an

[163] Johnson argues that custom unions are a means of capturing economies of scale, inducing investments and advancing competition in the industrial field. To Johnson, these customs union structures serve as a platform for states to reach other collective goals such as ameliorating their term of trade in comparison to the rest of the world or amend their bargaining power in comparison to their larger counterparts. See; Johnson (1965); Ruiz (1999) and Brada and Mendez, 1993: 187.

[164] Baldwin, 1997

[165] UNCTAD, 2009: 14

[166] To Baldwin (1997) this is known as the "scale and variety effect". These effects results to a significant increase in market competition, providing consumers and other firms with lower prices. UNCTAD (2009: 14) states that giving a firm the opportunity to choose from several production factors enables them to utilize the best inputs and increase their productivity.

opportunity for industries to specialize[167]. This further results to a reduction in the production costs, increase in productivity, increase in investments, higher efficiency and an accumulation of the factors of production such as, inter alia, human resources, knowledge, and technology. Therefore, given the fact that market competition is largely based on higher efficiency and the increase in accumulation, the establishment of more regionally integrated bodies will serve as a springboard for advancing Africa's economy.

3.2.2 Optimal Currency Area Theory

The Optimal Currency Area (OCA) is used to refer to "an area in which exchange rates are immutably fixed or in which a common currency exists"[168]. This theory which was originally presented by Robert Mundell (1961)[169] cautions against the use of a floating exchange rate system and is aimed at answering the question of the adoption of a single currency by two currencies as opposed to separate currencies. It further provides an in-depth understanding of monetary integration and the approximate costs and benefits of implementing a common currency. The OCA approach analyzes the conditions "an independent currency and an independent monetary policy are potentially useful stabilization tools, especially when other stabilization instruments are lacking or inadequate"[170]. The OCA is aimed at finding ways in which minimum costs can be used to obtain both internal and external balances without compromising monetary and fiscal policies.

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[167] Also considered to be "the second major effect of regionalism", see UNCTAD (2009: 15).

[168] In this case, the common currency can only fluctuate in unison against the global economic system. See, Mattli (1999) for more on the discussion on the OCA theory.

[169] Other contributors include Kenen (1969); and McKinnon, R. (1963). "Optimum Currency Areas," *American Economic Review*, 53: 717 – 25

[170] For an overview of possible sources on the optimal currency area theory, see, Goldberg, L. (1999). "Is Optimum Currency Area Theory Irrelevant for Economies in Transition?" in Sweeney, R., C. Wihlborg, and T. Willett (eds.) *Exchange Rate Policies for Emerging Market Economies* Westview Press

This theory which is organised in four main phases[171] has two main arguments which are presented by its advocates as the best way to obtain both internal and external balance[172]. While the first set of advocates argue for the implementation of "flexible exchange rates to maintain both internal and external balance"[173] as this would give member states the freedom to follow up on national macroeconomic policy objectives, the second set of OCA theory advocates argue that this internal / external equilibrium can only be achieved through the implementation of fixed exchange rates as this will in turn reduce the volatility of the currency.

Mundell (1961) however states that none of the arguments presented by the two groups (either fixed or flexible exchange rates) will neither guarantee the fulfilment of the OCA theory benefits such as full employment and low inflation, or lead to the successful implementation of a single currency in a given area as this is highly dependent on a number of factors[174]. Other benefits include the stability of the macro-economy[175], and an increase in trade[176] and savings on regional exchange reserves[177]. Furthermore, in order for a group of

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[171] The four main phases include: the *"pioneering phase"* which first presented the OCA theory and its properties, the second is the *"reconciliation phase"* during which its diverse facets were combined, the third is the *"reassessment phase"* which resulted in the "new OCA theory," and the last phase is the *"empirical phase"* during which empirical methods were used to scrutinize the theory. See Paolo, F. (2002). "'New' views on the Optimum Currency Area Theory: What is the EMU telling us?" *European Central Bank*, Working Paper No. 138: 1-54. (accessed on October 29, 2011), [available at: http://www.ecb.int/pub/pdf/scpwps/ecbwp138.pdf]

[172] These two main arguments are the adoption of a fixed or flexible exchange rate.

[173] Friedmann, 1953: 157-202. These advocates further argue that if a fixed exchange rate is adopted, unemployment, inflation, price instability and external imbalance will skyrocket which can only be terminated through inducing changes in trade and real wages. Also see, Kawai, 1992: 78

[174] Such as the *high mobility of factors of production within the region*, see Mundell, R. (1961). "A Theory of Optimum Currency Areas," *American Economic Review*, 51: 657-65

[175] Entering into a monetary union with countries with low inflation rates will force other countries to revise their own inflation policies.

[176] From increase transparency and openness

[177] Countries will therefore become more dependent on intra-regional trade and less reliant on international reserves.

countries to fully benefit from the implementation of a single currency, three conditions need to be met: firstly, the region should not experience an asymmetric shock whereby one country's economy is significantly worse off in comparison to the rest of the region; secondly, there must be a high level of mobility of factors of productions (labour and / or wages); and lastly, the region's fiscal and monetary policies must be harmonized[178].

The economies of countries seeking a macroeconomic convergence also need to be more open, diversified, and have a fiscal integration as this reduces shocks on the economy related to specific industries, and allows for the possibility of its impacts to be absorbed through the transfer of finances from one country to another[179]. In addition, the small size of many economies added to their inability to influence the international economic system and failure to fully liberalize and harmonize their economic and fiscal policies also negatively impacts on the formation of a single currency area, as seen in the case of the Central African sub-region. Some authors further argue that the OCA theory only exists because "no single currency regime is right for all countries or at all times" and the benefits of monetary integration is highly dependent on the certainty of exchange rates and convergence of macroeconomic policies[180].

3.3 ECONOMIC INTEGRATION AND THE AFRICAN CONTEXT

3.3.1 Effects Of Economic Integration On Member States

Economic integration has increasingly been at the forefront of many political agendas and several works on economic integration have concluded that the outcomes of

[178] Also see, McKinnon (1963: 717-725) for more on the conditions necessary for a successful currency union.

[179] See McKinnon (1963) and Kenen (1969) for more details.

[180] For more on these arguments on the OCA, refer to Gandolfo (2002); Frankel (1999); Bofinger (1994); De Grauwe (2003); Ishiyama (1975); Krugman (1992), Masson and Taylor (1992); Mongelli (2002); Tavlas (1993a, 1993b, 1994); Tower and Willet (1976); and Wyplosz (1997). For a more skeptic view, see Buiter (1995).

economically integrated institutions affect the participating countries differently. Bretschger and Steger (2004) argue that "on the one hand, there are effects on the static allocation and hence direct effects on the income level" and "on the other hand, it is important to understand the dynamic implications of economic integration"[181].

In the 1960s and 1970s, theories used in explaining economic integration were considered to be particularly significant in the third world[182] and because of the realisation that Viner's trade creation and trade diversion arguments were not very relevant to the customs unions which were formed by developing countries. It has been argued that economic integration in these regions was more likely to result in trade diversion as opposed to trade creation[183]. Axline (1977) further argues that one of the most striking outcomes of integration in the developing world is their decreasing dependence on external producers and the aim of integration is to restrict foreign investment, limit the transfer of technology with external sources and expand the regional markets while cutting back the region's trade reliance on non-member states[184].

In addition, the most anticipated effect of economic integration is its boost in economic growth and development which is based on the assumption that an increase in trade will result in an increase in the returns of some factors of production[185]. However, due to the fact that many African countries lack their own capital, Foreign Direct Investment (FDI) becomes a very important tool for stimulating local investment, and providing these states

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[181] Such as gains from trade, low inflation rates, increase in economic transparency, political stability, increase in foreign investments and a diversification of the economy. For more, see Bretschger and Steger, 2004: 1-2

[182] This is commonly referred to as the South-South integration.

[183] Ruiz, 1999: 6

[184] Axline, 1977: 86

[185] However, this would only occur in the case where capital costs remain constant thereby yielding to an increase in return rates / capital stock and subsequently accelerating growth rates, capital accumulation. All things being equal, this trade liberalization process will reduce uncertainty, enhance the credibility of the state and stimulate investment. See, Brada and Mendez (1988); and Baldwin (1992)

with both the technological and managerial knowledge. Furthermore, although creating an integrated monetary union helps to promote both the value and exchange rates of domestic currencies and advance the goal of achieving full economic integration, this can also lead to a loss of autonomy[186].

Additionally, other authors have argued that the implementation of a free trade system within regional trade blocs can limit as opposed to encouraging global trade expansion based on the fact that a common tariff against third parties will result to a reduction in the flow of trade with these third parties[187]. Given the kind of integration being promoted by the ECA[188] there is also the issue of overlapping membership by states who belong to more than one REC because of strategic or political reason. UNECA (2004) argues that the multiplicity of RECs further impedes growth and causes a fragmentation in the continent as opposed to the integration it sets out to achieve[189].

3.3.2 The African Context

There is a growing interest on African development and the integration of African countries, however, the main arguments presented in many economic integration studies

[186] Omotunde, 1991: 5

[187] Therefore these member states can instead be faced with a reduction in production, inefficient allocation of resources and a decrease in welfare. See, Schiff (1977); World Bank (2000); and UNCTAD (2009)

[188] A monetary union and the common market are the two main kinds of integration which are at the centre of African economic integration and the ECA is quite focused on encouraging states to form a common market while maintaining their political independence. This kind of integration calls for a common external tariff, unrestricted movement of goods and factors of production, harmonization of macro-economic policies in order to ascertain an integrated fiscal, monetary, and exchange-rate policies of the member-states. Refer to, ECOWAS (1975); Browne and Cummings (1984); and Omotunde (1991).

[189] Although the aim of RECs in Africa is to advance political and economic growth, the large numbers of RECs in the continent creates several hindrances such as:

- breaking up economic integration and causes the inability for RECs to follow up on efficient integration programmes.
- increasing the membership costs on member states
- creating unnecessary competition by member states for external funds and donors

failed to recognize that not all African countries are the same and have solely been focused on the integration of specific regions in the continent[190]. Adom *et al*., (2010) argue that in 2007 the continent achieved an uneven growth rate of 5.7% and the inflation reached a very low level of 7.5% in 2006 despite the increase in oil prices[191]. They further argue that the continent is constantly faced with "humanitarian crises, high level of corruption, and the presence of social and political tensions" which continue to impede development and as such, forming regional economic integrations will enhance economic performance[192].

Historically, the importance of forming a unified and harmonized continent through regional economic integration as a way of boosting political and socio-economic development has always been acknowledged by African leaders and nationalists.[193] With this in mind, the Organization for African Unity (OAU) was then created in 1963 to achieve this development, solve African conflicts and harmonize their economies[194]. The formation of the OAU subsequently led to the creation of several African sub-regional institutions which were aimed to: *(a) expand the growth of intraregional trade by removing tariffs and non tariffs barriers; (b) strengthen regional development, through the promotion of economic sectors, regional infrastructures and the establishment of large scale manufacturing projects; (c) remove barriers to the free movement of production factors; and (d) promote monetary cooperation.*[195]

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[190] Carmignani (2004) investigated economic integration in Eastern and Southern Africa, and Debrun et al. (2002) explored the perspectives for the creation of a monetary union in West Africa, but so little has been done on the Central part of the African continent which is the main focus of this research.

[191] Adom *et al.*, 2010: 246

[192] Ibid. p. 246

[193] UNCTAD, 2009: 10

[194] Ibid. p. 10

[195] Quote taken from UNCTAD, 2009: 17

Additionally, given their sizes, nature of their primary products[196] and deteriorating economic situation of many African states, the Lagos Plan of Action was then adopted in April 1980 at an OAU extraordinary session primarily focusing on promoting African development through the creation of more regional unions[197]. According to Omotunde (1991), this plan paved the way for the 1991 Abuja Treaty and systematically led to the vision of establishing a continental African Economic Community (AEC) by 2027. Over the years, this need for African integration has increasingly intensified leading to the formation of many institutions with the aim of achieving the common market by 2027 as stipulated by the Abuja Treaty[198]. The creation of such a market is considered to be a springboard for Africa to economically integrate with the rest of the world by enhancing its economic and industrial credibility, and heightening its comparative advantages[199].

Additionally, a harmonized African market would lead to a re-establishment of policies which encourage greater access to regional trade institutions and the full exploitation of human resources. This process is also expected to influence these African countries into

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[196] Prices of most primary products in the African continent tend to fall when compared to those of the industrial products thereby making it difficult to institute and maintain international commodity agreements. Therefore, this plan was adopted with the notion that an increase in the size of domestic markets will lead to an exploitation of the technological economies of scale, an expansion of infant industries and a generation of profits from direct foreign investments. For more on this, refer to Omotunde (1991).

[197] The Economic Community of West African States (ECOWAS) is an example of such an institution which was formed at the time. See, UNCTAD (2009)

[198] This common market will allow for the establishment of a common currency, an unrestricted movement of the factors of production, and free movement of goods and services among African countries. In addition, 2001 was a very significant year in the intra-African process because of the creation of two major institutions aimed at promoting and overseeing this integration: the African Union (AU) and the New Partnership for African Development (NEPAD). see, UNCTAD (2009: 18).

[199] Chapter XIX of the Abuja Treaty emphasises the need for creating the African Economic Community “through the coordination, harmonization, and progressive integration of the activities of regional economic communities.” It further calls on African member states “to promote the coordination and harmonization of the integration activities of regional economic communities of which they are members with the activities of the Community.” Additionally, Article 3 of the Constitutive Act of the African Union also underlines the importance of African states “to coordinate and harmonize the policies between the existing and future Regional Economic Communities for the gradual attainment of the objectives of the Union.” see, Clapham (2001); and UNCTAD (2009) for more on this.

collectively enforcing stricter and more efficient trade policies which would not have been otherwise implemented at an individual level such as the reduction of tariffs[200].

There exists 14 RECs which are currently recognized by the AU (see Table 3.1 below), some of which are considered to be co-operation mechanisms which have been put in place to advance the formation of future economically integrated institutions[201]. Of these 14 RECs, only seven of the 54 African countries are said to belong to a single REC while one other country belongs to four of such REC institutions[202].

Table 3.1: Major Regional Economic Communities

Major REC	Type	Areas of co-operation and integration	Start Date	Member States	Specified Objective
Arab Maghreb Union (UMA)	Free Trade	Goods, services, investment, migration	17 Feb. 1989	Algeria, Libyan Arab Jamahiriya, Mauritania, Morocco, Tunisia	Full economic union
Common Market for Eastern and Southern Africa (COMESA)	Free Trade	Goods, services, investment, migration	8 Dec. 1994	Angola, Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, Zimbabwe	Common market
Community of Sahel-Saharan States (CENSAD)	Free Trade Area	Goods, services, investment, migration	4 Feb. 1998	Benin, Burkina Faso, Central African Republic, Chad, Côte d'Ivoire, Djibouti, Egypt, Eritrea, Gambia, Libya, Mali, Morocco, Niger, Nigeria, Senegal, Somalia, Sudan, Togo, Tunisia	Free trade area and integration in some sectors
Economic Community of Central African States (ECCAS)	Free Trade Area	Goods, services, investment, migration	1 July 2007	Angola, Burundi, Cameroon, Central African Republic, Chad, Congo, Democratic Republic of the Congo, Equatorial Guinea, Gabon, Sao Tome and Principe, Rwanda	Full economic union
Economic Community of West African States (ECOWAS)	Free Trade Area	Goods, services, investment, migration	24 July 1993	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo	Full economic union
Inter- Governmental Authority on Development (IGAD)	Free Trade Area	Goods, services, investment, migration	25 Nov. 1996	Djibouti, Eritrea, Ethiopia, Kenya, Somalia, Sudan, Uganda	Full economic union

[200] see, UNCTAD (2009)

[201] Economic Commission for Africa - ECA, 2005: 5. Also refer to Table 3.1 to better understand this overlapping memberships and the extent to which these African RECs vary in their degrees of integration.

[202] Ibid. p. 5

Major REC	Type	Areas of co-operation and integration	Start Date	Member States	Specified Objective
Southern African Development Community (SADC)	Free Trade Area	Goods, services, investment, migration	1 Sep. 2000	Angola, Botswana, Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia, Zimbabwe	Full economic union
Economic and Monetary Community of Central Africa (CEMAC)	Customs Union	Goods, services, investment, migration	24 June 1999	Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon	Full economic union
East African Community (EAC)	Customs Union	Goods, services, investment, migration	7 July 2000	Kenya, United Republic of Tanzania, Uganda, Rwanda, Burundi	Full economic union
Southern African Customs Union (SACU)	Customs Union	Goods, services, investment, migration	15 July 2004	Botswana. Lesotho, Namibia, South Africa, Swaziland	Custom union
West African Economic and Monetary Union (UEMOA)	Customs union	Business law harmonized. Macroeconomic policy convergence in place	10 Jan. 1994	Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, Togo	Full economic union

Source: UNCTAD secretariat, see UNCTAD (2009: 19)

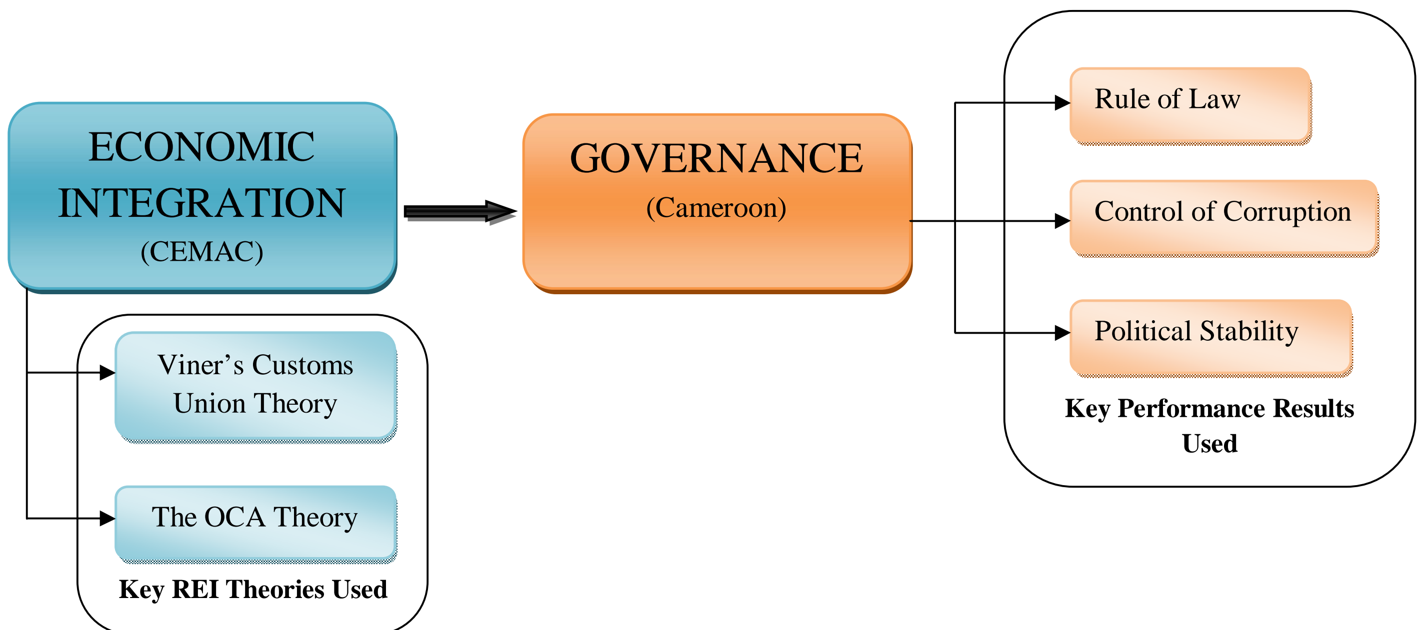
3.3.3 Impact of Economic Integration on Governance

The sovereignty of a nation is known to impose restrictions on the economic integration of a region. However despite the fact that both economic integration and good governance are aimed at, inter alia, promoting economic growth and the living standards of its citizens, little has been done to understand the interplay between these two concepts. The ways in which economic integration in turn affects the governance of member states signed up in such an agreement is therefore the main focus of this study.

Given the literature provided above, it can be concluded that many scholars believe regional economic integration has a significant impact on its member states through the convergence of state institutions and policies. Nonetheless, the economical effect of economic integration has been the main focus of many of these studies, therefore, this research employs a theoretical and case study approach to analyse the interplay between

economic integration and its effect on the governance of these member states. The continuous emphasis on good governance by institutions such as the IMF, the World Bank, and developed countries clearly highlights the need by many developing countries to add this to their political agendas. Also, with the increasing focus on regional economic integration in Africa as a way of forming a united African continent and improving the living standards of its citizens, it will be important to understand the ways in which this broader economic integration concept influences the governance discourse in the African context.

Figure 3.1: A Framework of the Relationship between Economic Integration and Governance



3.3.3.1 CHALLENGES FACING AFRICAN RECs

However, there is a general consensus that the success of these African RECs in achieving their objectives has proven to be very unsatisfactory and regional economic processes in Africa suffer from a wide range of problems[203]. Some of these challenges

[203] See Johnson, O. (1995) "Regional Integration in Sub-Saharan Africa,"*Journal of European Integration*, 18/2–3: 201–34; and Lyakurwa, W., A. McKay, N. Ng'eno and W. Kennes (1997) "Regional Integration in Sub-Saharan Africa: A Review of Experiences and Issues," in Oyejide, A., I. Elbadawi and P. Collier (eds), *Regional*

include: unrealistic goals which are set by using the EU framework as a point of reference, unfulfilled commitments, and overlapping memberships[204]. The ECA (2005) report stresses on the challenges posed by overlapping memberships, stating that problems will arise when setting a Common External Tariff (CET) for the FTA as a whole in the sense that if one of the member countries simultaneously belongs to another FTA, it would be impossible to implement the CET against these FTA members[205].

Clapham (2001) argues that in order for African states to successfully set up such economically integrated structures at a regional level, it is vital that they adopt a "good governance" agenda which is considered to be a precondition for economic growth. To Clapham, these states also need to share the same ideology and a "common idea of the state" failure of which could amount to conflicts[206]; however, many post-colonial African states are faced with governance challenges stemming from their lack of democracy, authoritarian regimes and single party governments[207].

Notwithstanding, Chabal and Daloz (1999) posit that for this "good governance" agenda to work in an African context, the nature of politics in Africa needs to be fully understood in its own right without being influenced by a Western framework. They argue that failing to understand the African context has resulted to "historically unrealistic expectations … in terms of the development potential of a modern independent Africa"[208]. As

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Integration and Trade Liberalization in Sub-Saharan Africa, Volume I: Framework, Issues and Methodological Perspectives, London: Macmillan

[204] Dinka and Kennes (2007); Draper *et al*., (2007); and UNECA (2006) and (2008) analyze these challenges.

[205] Economic Commission for Africa – ECA, 2005: 5

[206] Clapham (2001: 66) however suggests that this is considered to be an EU paradigm and such "liberal peace" ideologies may be more challenging to implement within the African society.

[207] Mkandawire (2001) and Abrahamsen (2000) argue that these liberal and good governance agendas in African have been clouded by the forceful implementation of Structural Adjustment Programmes by Western institutions in a bid to secretly promote their own national interests.

[208] They hold the notion that while African states are advancing technologically, they are still "obdurately traditional", patriarchal and determined to achieve short-term micro objectives as opposed to long-term macro

such, while it has been constantly suggested that regional integration will promote more efficient institutions and foster intra-regional cooperation, there are still many challenges which need to be addressed in order to achieve these political and socio-economic goals[209].

3.4 CONCLUSION

The ongoing focus on good governance is a clear indication that the structure of domestic institutions matters in a broader political and socio-economic context, and it is believed that economic integration significantly increases the diffusion of good governance, efficiency and overall welfare[210]. Like stated above, several arguments and theories have been used to explain governance and more specifically good governance on the one hand, and economic integration on the other. However, most of these arguments fail to address the interactional effect between economic integration and the political and economic dynamics within countries. In addition, the formation of regional integration blocs has led to a wide range of economic literature which is mostly in the area of trade theory, the effect of regional integration on trade and resource allocation and the effect of economic integration on economic growth. Therefore by focusing on Cameroon and CEMAC, the study sets out to examine the ways in which economic integration influences governance within an African context by taking into account the political and economic institutional dynamics of the country.

benefits. As such, African leaders are more focused on advancing their own interests mostly to the detriment of national development. See, Chabal and Daloz, 1999: 142-162.

[209] UNCTAD, 2009: 1

[210] Overall welfare in this case refers to the welfare of the state and its citizens.