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The Eurozone Crisis: The Realities, Myths and Lessons for the East African Community Integration Process

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Abstract:
This paper synthesizes and distills some literature regarding the evolution of the EU and the Eurozone crisis in particular, providing insights that could appraise the structure and convergence of the EAC. Interest in regional integration in Africa has accelerated recently, reflecting a renewed political will for a more cohesive continent, or simply the desire to cash in on the benefits of expanded regional markets. On January 1, 1999 eleven European countries decided to denominate their currencies into a single currency, the Euro. 15 years on, the Eurozone is in deep financial crisis and what seemed like a mere aftershock of 2007/08 global financial crisis is turning out to be a systematic exposure of the major weaknesses within the integrative framework of the EU. Key issues raised by analysts include the core objective of unification, antagonistic monetary policy stances and tools, exogenous shocks such as the global financial crisis among other factors. Key lessons have been raised from the EU experience to appraise the EAC integration process and these include establishment of robust institutions, research as well as clarification and unanimous embracing of the core integration objectives and agenda. Whether the events in the Eurozone are related directly or not to the integration process, the role of the structure and the responses to the crisis offer invaluable lessons and insights for posterity. The EAC decision making organs need to take cognizance of these lessons, learn from the mistakes of the failed EAC and establish well informed, unified institutions that will not just give good form to the Union but also confer global competitiveness to the Community in light of the current and future challenges. Success can be planned and pursued and as such, the fate of the Community should not be left in the hands of uncertain, random future events and outcomes.

1. Introduction

1.1. The European Union and the Eurozone Crisis

The European Union is a union of 28 Eurozone countries whose main objective was the establishment of a common market. This was expanded to other objectives which include promotion of peace and the well-being of the Union´s citizens; an area of freedom, security and justice without internal frontiers, sustainable development based on balanced economic growth and social justice; a social market economy highly competitive and aiming at full employment and social progress a free single market. The Eurozone crisis has been moving from one peripheral economy to the next, and more recently, is affecting the core economies in the union. The EU accounts for close to 26 per cent of the world GDP (at market exchange rates) and the Eurozone19.4 per cent (Anand, Gupta and Dash, 2012). The Euro area accounts for about 10 per cent of the global equity markets turnover and the euro accounts for 26 percent of the allocated global holding of reserves. Thus the significance of this crisis is not merely that it comes in the aftermath of the global crisis, but more importantly, it threatens the pace of recovery of the global economy especially because the EU and within that, the Eurozone is a significant market for rest of the world. In its "spillover" report on the effects of Eurozone policies on other major economies, the IMF observed that an intensification of the Euro area debt crisis, especially if stress were to spread to the core economies could have major global consequences. Banks throughout the Eurozone immediately require more and higher quality capital. While capital raising and recapitalizing banks is needed, the report observes that in the short run, this may have a contractionary effect. But the critical question that arises in this context is where the resources for recapitalizing the banks will come from? The Eurozone crisis is part of a much broader economic and financial crisis that has afflicted the global economy since 2008. The global crisis is manifested primarily in slow economic growth and the fragility of financial systems. Global economic growth fell by about two percentage points in the five years since the crisis began in 2008,relative to the preceding five years. Although all regions of the world suffered a slowdown in economic growth as a result of the crisis, the Eurozone is one of the regions hardest hit; its economy has gone back into recession, its banking system is very fragile and countries on the periphery of the Eurozone have unsustainable levels of public debt.

1.2. The East African Community

The East African Community (EAC) is the regional intergovernmental organisation of the Republics of Burundi, Kenya, Rwanda, the United Republic of Tanzania, and the Republic of Uganda, with its headquarters in Arusha, Tanzania. The Vision of EAC is a prosperous, competitive, secure, stable and politically united East Africa; while the Mission is to widen and deepen Economic, Political, Social and Cultural integration in order to improve the quality of life of the people of East Africa through increased competitiveness, value added production, trade and investments. The Treaty for Establishment of the East African Community was signed on 30 November 1999 and entered into force on 7 July 2000 following its ratification by the original three Partner States – Kenya, Tanzania and Uganda. The Republic of Rwanda and the Republic of Burundi acceded to the EAC Treaty on 18 June 2007 and became full Members of the Community with effect from 1 July 2007.

Integration measures in the East African Community (EAC) economic regained momentum in 2005, after some stagnation. Over the years, the members have established closer economic links through a Free Trade Area (2001), a Customs Union (2005), and a Common Market (2010). These efforts have paid off: a deeper regional integration and trade within the EAC than in other African sub-regions have contributed to East Africa's resilience during the global financial crisis (GFC) in 2009 and 2010 and to overall fast growth (Brixiova and Ndikumana 2011; Guerguil 2011; and Winston and Castellanos 2011). The next phase of the integration would see the bloc enter into a Monetary Union and ultimately become a Political Federation of States.

The March 2010 Joint Meeting of the EAC Ministers adopted the road map for this goal, which includes milestones such as the adoption of an Exchange Rate Mechanism (ERM), creation of the regional central bank, and finally the establishment of the EAMU. The regional integration process is at a high pitch at the moment as reflected by the encouraging progress of the East African Customs Union and the establishment in 2010 of the Common Market. The Protocol for the establishment of EAMU signed by the Heads of State in November 2013 and implementation is underway. The process towards an East African Federation is being fast tracked, underscoring the serious determination of the East African leadership and citizens to construct a powerful and sustainable East African economic and political bloc.

1.3. About Financial/Credit Crises

There are three major kinds of crises; global financial crisis, credit crisis or credit crunch and sovereign debt crises. All three kinds of crises are either related or will follow each other, one triggering the others, often in quick succession. A financial crisis is applied broadly to a variety of situations in which some financial assets suddenly lose a large part of their nominal value. A global financial crisis refers to a situation when, for reasons and factors related to the financial system, parties to financial contracts in many nations simultaneously conclude that the contracts they hold are unlikely be honoured by counterparties or that the financial assets that they hold are likely to be worth substantially less than previously thought. A credit crunch (also known as a credit squeeze or credit crisis) is a reduction in the general availability of credit or a sudden tightening of the conditions required to obtain credit. A credit crunch generally involves a reduction in the availability of credit independent of a rise in official interest rates. A country is defined to be in a debt crisis if it is classified as being in default by Standard & Poor's, or if it has access to non-concessional IMF financing in excess of 100 percent of quota (IMF, 2003). Detragiache and Spilimbergo (2001) define a country to be in a debt crisis if the country has arrears on external obligations toward commercial creditors in excess of 5 percent of commercial debt outstanding or has a rescheduling or restructuring agreement with commercial creditors.

1.4. Summary

The pace for the integration of the East African member states into a confederate union has gathered momentum in the recent past. However, macroeconomic convergence in the EAC has been limited. The regional integration of the Eurozone state into a single economic block faces a host of challenges with the Euro economy grappling with major recession and now serious sovereign debtcrises affecting a number of Union members. As the EAC moves towards regional integration, it is essential to learn from the mistakes of the EU so as to avoid the driving the convergence agenda take cognizance of historical lessons that can and should be learnt from the failure of historical collaborative efforts such as the now defunct EAC of 1967-1977. The correlation between the Eurozone crisis and the creation of the giant economic bloc may not be apparent based on current literature; however, we review vulnerabilities in the structure and integration efforts as well as the key lessons that can be learnt from the Union.

2. Key Structural, Demographic, Macroeconomic and Policy Comparative

2.1. Structural

No.	EU	Functional Role	EAC	Functional Role
1	European Parliament	The only directly elected body in the Union represents the EU's citizens. Shares the legislative and budgetary authority of the Union with the Council of the European Union	East African Legislative Assembly	The Legislative Organ of the EAC and liaises with National Assemblies of Partner States. Its functions are representation and oversight, i.e. deliberating and approving the EAC budget and considering annual reports of the activities of the Community
2	European Council	Represents the governments of the individual member countries and define the Union's policy agenda and give impetus to integration	The Summit	Consists of the Heads of the Partner States and gives general direction and thrust to the development and achievement of the objectives of the Community.
3	Council of the European Union	Has legislative and some limited executive powers and is thus the main decision making body of the Union	The Council of Ministers	The Policy Organ of the Community charged with promoting, monitoring and keeping under constant review the implementation of the programmes of the Community and ensures the proper functioning of the regional organisation.
4	European Commission	The executive arm of the Union composed of one appointee from each state, currently twenty-eight. It is responsible for drafting all laws of the European Union and has a near monopoly on proposing new laws (bills). Also deals with the day-to-day running of the Union and has the duty of upholding the law and treaties	The Secretariat	The Executive Organ of the Community charged with arranging meetings with external actors such as those within Civil Society, the market and foreign governments.
5	Court of Justice of the European Union (CJEU)	Upholds the rule of European law	East African Court of Justice	Tasked to ensure adherence to law in the interpretation and application of and compliance with the Treaty
6	European Central Bank (ECB)	Is responsible for European monetary policy	EAMU/EACB/EAMI	To be established in line with the EAMU Protocol
7	European Court of Auditors (ECA)	Checks the financing of the EU's activities		
8	European External Action Service (EEAS)	Assists the High Representative of the Union for Foreign Affairs and Security Policy	The Coordination Committee	Responsible for: implementing decisions of Summit and the Council of Ministers, and the Treaty in general; the determination of its own procedures for convening meetings; and the co-ordination of the activities of the Sectoral Committees.
9	European Economic and Social Committee (EESC)	Represents civil society, employers and employees		
10	Committee of the Regions (CoR)	Represents regional and local authorities	The Sectoral Committees	Created by the Council of Ministers to oversee the sectoral implementation of programmes of the Community and report to the Coordination Committee.
11	European Investment Bank (EIB)	Finances EU investment projects and helps small businesses through the European Investment Fund		
12	European Ombudsman	Investigates complaints about maladministration by EU institutions and bodies		

Table 1: Comparison of the EU and EAC Administrative Structures

2.2. Demographic and Macroeconomic Indicators Comparison

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014
EAC									
No. of countries	3	5	5	5	5	5	5	5	5
Population-million	118.4	121.7	124.6	128.3	132.8	136	139.5	143.5	145.5
GDP-USD Million	42193.3	47411.4	49969.7	46735.3	47536.5	45229.4	48271.4	49515.2	110300
GDP Growth Rate*	6.34	6.72	7.08	4.56	6.26	5.92	5.46	5.16	6
Lending Rates*	16.53	15.77	15.90	15.50	15.00	17.73	16.77	16.40	16.85
Headline Inflation*	6.4	6.96	15.68	11.28	4.48	12.14	12.78	6.24	4.7
Eurozone									
No. of Countries								27	28
Population	496,543,994	498,408,547	500,418,320	502,186,144	503,234,845	504,494,374	504,056,505	505,114,995	506,880,616
GDP-USD Billion	10523.4	11171.9	12865.2	14104.5	12898.2	12635.4	13621.7	12642.8	13186.4
GDP Growth Rate	3.4	3.1	0.5	-4.4	2.1	1.7	-0.5	0.1	1.3
Interest Rates	2%	3.25	4	1.25	1	1	1	0.9	0.75
Inflation	1.58	0.88	1.84	2.48	2.13	2.37	1.95	2.35	2.3

Table 2: Aggregate Macroeconomic Statistics
**Average*

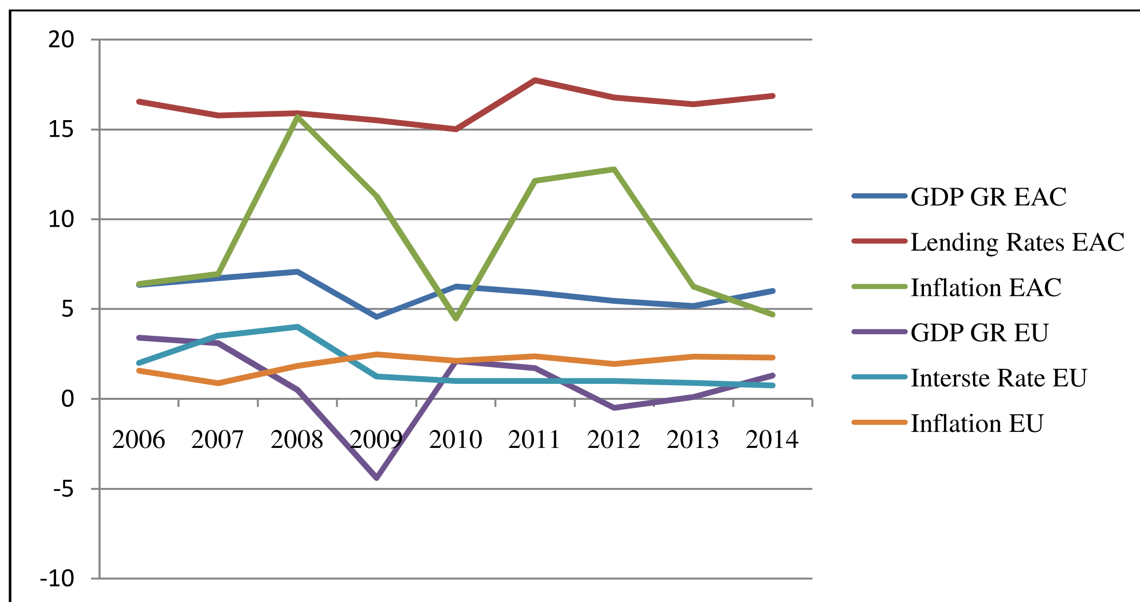

Figure 1: Graph of Selected Macroeconomic Indicators

2.2.1. Comments

i. The EAC lending and GDP growth rates are very high compared to the Eurozone. The trend however mirrors the trend of inflation rates in the East African region underscoring the fact that high inflation and interest rates drive economic growth.
ii. Most Eurozone fundamentals are very weak indicating a clustering of the variables. This clustering is an indicator of the correlation risk inherent between the macroeconomic variables and GDP growth.
iii. These trends should be closely interrogated and considered by EAC organs to derive a correlation risk stress testing model that can be used to predict the impact of the changes in these fundamentals on the Community's well-being.

2.3. Monetary Policy Tools and Monetary Policy Stance

EAC*	EU*
The EAC is grappling with high inflation arising from foreign exchange shocks as well as high cost of production. The 5 economies in the region and indeed most SSA economies are using conventional monetary policy tightening to mop up excess liquidity, discourage private expenditure and avert the risk of imported inflation. The capital structures of the countries are quite different. Kenya is capitalized by foreign investments in government securities while Tanzania for example is capitalized by foreign aid. The primary monetary policy tools in operation in the EAC member states are open market operations (OMO) such ass REPOs, CBR/interest rates, foreign currency intervention aimed at mopping up excess liquidity and achieving the target inflation rates	The Eurozone economies are dealing with close to a decade of near deflation. Inflation Rate in the Euro Area averaged 1.99 percent from 2006 until 2015, reaching a record low of -0.70 percent in July of 2009. Near deflation has negative price effects which disincentivises production but also encourages cash hoarding which negatively impacts financial sector stability by encouraging bank runs. This has negative repercussions on GDP growth as is the case in the Eurozone. As a result, the Eurozone Economies have adopted non-conventional monetary policy stance and tools to stem the near deflation situation. Primarily the Eurozone economies are employing quantitative easing and purchase of asset backed securities to inject liquidity in the system with the aim of stimulating private spending to raise inflation rates.

*Table 3: * As of 2015*

3. Review of Critical Events, Myths and the Outcomes of Integration

3.1. The EAC Facts and History

The countries of the East African Community have a unique relationship arising from culture, history, geography and human contact that dates from time immemorial. The roots of cooperation in East African region date back to the colonial era when the five member countries of the Community came under various German and British administrations as well as United Nations Trusteeship. The German administration of Tanganyika, Rwanda and Burundi and later British administration of Tanganyika including Zanzibar, Kenya and Uganda are cases in point.

Prior to the re-launching of the East African Community in 1999, Kenya, Tanzania and Uganda enjoyed a long history of co-operation under successive regional integration arrangements. These included the Customs Union between Kenya and Uganda in 1917, which Tanganyika later joined in 1927; the East African High Commission (1948-1961), the East African Common Services Organization (1961-1967), and the previous East African Community that lasted from 1967 until its collapse in 1977. The reasons cited for the collapse of the EAC in 1977 include;

i. Ideological differences
ii. Structural problems that impinged upon the management of common services
iii. Limited participation by people in decision-making
iv. Lack of compensatory mechanisms for addressing inequalities in the sharing of costs and benefits of integration.

Kenya's economy is larger than the economies of Tanzania, Rwanda, Burundi and Uganda. However, it is worth noting that the economy of Tanzania has grown significantly, and that in 2002 it was 72 percent of the size of Kenya's economy, compared to 57 percent in 1990. The same growth trend has happened to Uganda's economy in comparison to Kenya's economy. This fact suggests that the Tanzanian and Ugandan economies have been converging towards the Kenya economy. On average, from 1990 to 2002 Tanzania's economy was growing faster than those of Kenya and Uganda. This trend persists to date even though the capital structures of the 5 member countries are significantly different. The regional partners have an almost similar profile presenting the following commonalities;

i. Similar socio-economic way of life and a common culture
ii. Common language, Swahili
iii. Common geographic classification (great lakes region)
iv. Near harmonious political culture
v. Similar ecological challenges and common climatic patterns
vi. Similar macroeconomic indicators and economic growth trends ass exemplified by Tables 4, 5 and 6.

State	2005	2006	2007	2008	2009	2010	2011	2012	2013
Burundi, 2005=100	0.9	5.4	3.5	4.9	3.8	5.1	4.2	4.2	4.8
Tanzania, 2001=100	7.4	6.7	7.1	7.4	6.0	7.0	6.4	6.9	7.0
Uganda, 2002=100	10.0	7.0	8.1	10.4	4.1	6.2	6.4	3.6	4.7
Kenya, 2001=100	5.7	6.1	7.0	1.5	2.7	5.8	4.4	4.6	4.7
Rwanda, 2011=100	7.2	6.5	7.9	11.2	6.2	7.2	8.2	8.0	4.6

Table 4: Real GDP Growth Rates

State	2005	2006	2007	2008	2009	2010	2011	2012	2013
Burundi	1,117.1	1,237.8	1,218.2	1,165.6	1,166.3	1,225.6	1,246.7	1,135.7	1,103.0
Tanzania	10,749.2	10,289.3	11,195.6	12,395.2	11,907.4	11,941.1	11,396.3	12,149.3	12,825.0
Uganda	8,319.6	8,659.1	9,943.5	11,000.1	9,705.5	9,611.2	8,830.3	9,210.3	9,338.1
Kenya	15,514.2	17,259.8	19,842.0	19,613.6	18,026.5	18,619.8	17,346.1	19,054.6	19,578.4
Rwanda	1,669.1	4,747.3	5,212.1	5,795.2	5,929.6	6,138.9	6,410.0	6,721.5	6,670.8
EAST AFRICA	**37,369.1**	**42,193.3**	**47,411.4**	**49,969.7**	**46,735.3**	**47,536.5**	**45,229.4**	**48,271.4**	**49,515.2**

Table 5: Real GDP US Million Dollars

Partner State	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Burundi, 1991=100	8.3	13.2	2.7	8.3	24.5	10.5	6.5	9.6	18.2	7.9
Tanzania, Sept. 2010=100	4.2	4.4	7.3	7.0	10.3	12.1	5.5	12.7	16.0	7.9
Uganda, 005/06=100	3.7	8.6	7.2	6.1	12.0	13.0	4.0	18.7	14.0	5.5
Kenya, 2009=100	11.6	10.8	6.0	4.3	16.2	10.5	4.1	14.0	9.4	5.7
Rwanda, Feb 2014=100	11.9	9.1	8.8	9.1	15.4	10.3	2.3	5.7	6.3	4.2

Table 6: Annual Headline Inflation

3.2. The Eurozone Facts and Process

The slowing down of the Eurozone economy for the prolonged period coupled with the sovereign debt crisis affecting a number of Eurozone countries has drawn sharp criticism from a various quarters. According to Klaus (2012) the driving force behind the European monetary unification has always been solely politics, not economics. The political ambition has always been dominant. The Euro was regarded as a useful tool for creating a political union. When the single European currency was born in 1999, the expectations were high and the Euro was expected to boost economic growth, employment and overall prosperity. In the beginning, it seemed that the future full of prosperity and social security was becoming a reality. Fifteen years on and the dream of a stable and healthy economic union is still not realized. The Euro did not provide stability, on the contrary, it has become a source of instability (Jones, 2009).

According to Anand, Gupta and Dash (2012) the overarching justification for the Euro was not merely economic, but political. A single currency was perceived as a symbol of political and social integration in the post WW II Europe and a catalyst for further integration in other spheres. At the micro level, the use of a common currency was expected to increase cross border competition, integration and efficiency in the markets for goods, services and capital. These developments were expected to reduce transactions costs (Hämäläinen, 1999). The underlying logic for economies to integrate and adopt a single currency was based largely on the Theory of Optimum Currency Areas (OCA), pioneered in the seminal work of Mundell (1961).

At the macroeconomic level, a single monetary policy in the Euro area was expected to be geared to price stability. According to the ECB, the monetary policy in the Euro system has been guided by two pillars. First, an inflation target broadly based on an assessment of future price developments and the risks to price stability in the euro area measured by the Harmonized Index of Consumer Prices (HICP) and second, a reference value not a specific monetary target for the growth of a broad monetary aggregate. The Euro system's commitment to price stability was expected to contribute to the long-term stability and credibility of the euro and promote its attractiveness as a trading and investment currency (Anand, Gupta and Dash, 2012).

In the long run, the development and integration of the Euro area financial markets was expected to enhance the attractiveness of the euro. The Euro was also expected to become an important currency in the foreign exchange markets. Since the euro came into existence in 1999, and later in the physical form in 2002, there remained some skepticism on its future as some members had failed to stay within the norms under the growth and stability pact. Nevertheless, the euro area money and financial markets saw rapid changes with the introduction of a new currency. Bond markets that were segmented got integrated in short period. From 1999 to 2002, and then on, there was convergence in the yields on government bonds. Interest rate dispersion between the rates offered by different banks also declined. The dispersion of country short term rates measured also reduced.

Increased competition, the establishment of common benchmarks and lower transaction costs led to narrowing of yield and spreads and market liquidity across borders. These changes were facilitated by the TARGET system that linked large-value national payments in the EU. Thus similar instruments traded in the different national markets came to be perceived as close substitutes. The convergence in interest rates meant a fall in nominal rates in the peripheral economies towards the lower German levels. Credibility of the monetary policy on price stability and the accompanying economic growth were seen as positive outcomes of a single market and a seemingly stable common currency. Credit growth surged as currency risk premium diminished and competition spurred financial innovations as financial institutions could borrow easily abroad. The growth in credit was concentrated in the housing sector. Construction and financial services grew rapidly thereby increasing macroeconomic vulnerability. While property prices boomed, the credit growth got translated into a buildup in debt.

Faster growth hid the weakness in the fiscal system that got revealed with the worsening in the fiscal deficit and public debt. Growth was also accompanied by a rise in demand for imports and, in turn, a larger current account deficit from 2003. The rise in the twin deficits were financed largely through debt, especially, in the case of Greece. So long as growth was strong, it was hard to make out whether there had been an improvement in the fundamentals, or it was a bubble. Till 2005, the general growth momentum was in

place, perhaps waiting for a trigger. The global financial crisis in 2007–08 acted as the trigger that set the snow ball of debt rolling across Europe and in the Eurozone as growth declined sharply.

The financial crisis led to disruption in financial intermediation. The credit boom from 2003 lasting till early 2007 was supported by falling interest rates. But from 2006, interest rates across the Eurozone started to diverge, marking out the weak from the strong economies. Excessive lending had left banks with bad debts and governments with large fiscal deficit and public debt in the peripheral economies (albeit of varying magnitudes).In order to meet liquidity problem arising from the financial crisis, on 11 October 2008, the EU held an extraordinary summit in Paris to define a joint action for the Eurozone and agreed to a bank rescue plan to boost their finances and guarantee interbank lending. Coordination against the crisis was considered vital to prevent the actions of one country harming another and exacerbating bank solvency and credit shortage.

The various emergency measures announced to counter the financial crisis during 2008- 2009, appeared to have been successful in averting the financial crisis and supporting short-term domestic demand. However, they aggravated fiscal deficit and debt. In late 2009, Greece admitted that its fiscal deficit was understated (12.7 % of GDP, as against 3.7 % stated earlier). Ratings agencies downgraded Greek bank and government debt. In late 2009, its public debt was over 113 % of GDP, far more that the Eurozone limit of 60 %. A crisis of confidence due to high fiscal deficit and debt was marked by widening bond yields and risk insurance on credit default swaps. By early 2010, a sovereign debt crisis in the Eurozone was clearly on hand with Greece in the eye of the storm. The problems of Ireland, Portugal and Spain were also out in the open.

Even though, the configuration of fiscal deficit, public debt, private debt and bank lending across these economies was considerably different, the financial markets passed a similar judgment through a rise in the CDS premiums, albeit differentiated. The global financial crisis sunk home a vital lesson, that on the extreme, all private debt could potentially be public debt. On 2 May 2010, to reassure investors confidence, the EU and IMF put together a €110bn bailout package for Greece conditional on implementation of austerity measures. This was followed on 9 May 2010 by a decision by 27 member states of the European Union to create the European Financial Stability Facility (EFSF), a special purpose vehicle, in order to help preserve financial stability in Europe by providing financial assistance to Eurozone states in difficulty. The EFSF was empowered to sell bonds and use the money to make loans up to a maximum of € 440 billion to Eurozone nations. The bonds were to be backed by guarantees given by the European Commission representing the whole EU, the Eurozone member states, and the IMF.

3.3. The Myths

3.3.1. Myth #1

The Eurozone crisis is due to fiscal profligacy and is a sovereign debt crisis right from the start. Wolfgang Schäuble (2011), Germany's influential Finance Minister, wrote in the Financial Times that “excessive state spending has led to unsustainable levels of debt and deficits that now threaten our economic welfare.” Mr. Jean-Claude Trichet (2010), former President of the ECB, agrees: “I want to be candid with you today. The roots of the sovereign debt tensions we face today lie in the neglect of the rules for fiscal discipline that the founding fathers of Economic and Monetary Union laid out in the Maastricht Treaty. The difficulty with the “fiscal profligacy” argument is that the data don’t support it. Eurostat data for the 8 years prior to the crisis (2000-2007) showed that government debt (per cent of GDP) in the Eurozone declined, on average, by 6 percentage points, which contradicts the claim of fiscal irresponsibility (Storm & Naastepad, 2015). Schäuble (2011) argued that western democracies and other countries faced with high levels of debt and deficits need to cut expenditures, increase revenues and remove the structural hindrances in their economies, however politically painful.

By far the largest of such fiscal consolidations has taken place in Greece, 9% of GDP on the basis of the change in the structural balance over 2011-13. In its World Economic Outlook of October 2012, the IMF presents research to show that deficit reduction harms growth: consistently, it was found that growth came in worse than expected, the more so in economies which were implementing aggressive fiscal consolidation plans than in countries that were not (Guajardo, Leigh and Pescaroti, 2011). Austerity may not have been the right solution

3.3.2. Myth #2

The Eurozone crisis is crisis of (unit labour) cost competitiveness in combination with fiscal irresponsibility. This second myth focuses on the divergence in cost competitiveness (under fixed exchange rates) between the Eurozone core and periphery. It is summarized well by Mr. Lorenzo BiniSmaghi (2013) who argues that “countries which lost competitiveness prior to the crisis experienced the lowest growth after the crisis.” Competitiveness must here be read as meaning cost competitiveness, specifically unit labour cost (ULC) competitiveness. The increase in ULC in the southern Eurozone meant real wages were growing faster than labour productivity, a trend argued to be caused by their “rigid” inflexible labour markets, strong unions, and strong employment protection (Sinn, 2014). However, the truth is that there is no statistically significant correlation between pre-crisis increases in unit labour costs (ULC) and post-crisis growth performance for Europe and the Eurozone (Storm and Naastepad, 2015).

The problem is a much deeper one as it concerns a leap of logic, a misleading use of the term “competitiveness” which philosophers would label equivocation, by which the broad concept of “competitiveness” is reduced, with remarkable sleight of hand, to competitiveness in terms of only relative unit-labour costs (or RULC) (Storm and Naastepad, 2015). Their research for the Eurozone countries (Storm and Naastepad,2015a) showed that the RUL Celasticities of export and import demand of Germany, Greece, Italy, Portugal and Spain (and the Eurozone as a whole) are mostly not statistically significantly different from zero and tiny. Research

shows that most goods & services imported into the Eurozone are "non-competing" imports used as intermediate inputs in manufacturing or for consumption—hence imports depend almost completely on domestic income (Bussière et al., 2011).
Export performance by Eurozone members is overwhelmingly determined by world income growth (European Commission, 2010; Schröder 2015). Countries (such as Germany) exporting to fast-growing markets (such as China) experienced rapid export growth, whereas countries (such as Greece, Italy and Portugal) catering to slowly-growing markets had much lower export growth (ECB, 2009). Cutting wages (internal devaluation) and deregulating labour markets undermines a country's competitiveness and stall export growth; combined with fiscal austerity this policy cocktail is lethal given than it directly supports contractionary fiscal policy limiting economic recovery by struggling economies.

3.4. The Pitfalls in the Eurozone Model
By 2011, the Eurozone crisis turned predominantly into a sovereign debt crisis intricately woven with bank debt and claims across borders within and outside the monetary union. In that respect, the Eurozone problem is somewhat unique (Anand, Gupta and Dash, 2015).

3.4.1. A Monetary Union without a Fiscal Union
The creation of the Eurozone had an inherent contradiction of being a monetary union but not a fiscal union. The introduction of the Euro in 1999 explicitly prevented the ECB or any national central bank from financing government deficits. As a consequence the central bank has no power to monetize deficits. The above arrangement put a premium on each country to follow a similar fiscal path, but, without a common treasury to enforce it. The spending authorities remained national and subject to their own political compulsions. So long as growth across the region was strong, the fiscal capacity was not a source of worry. In such an arrangement the possibility of fiscal free riding is present as seen from the current episode for Greece. Given the differences in the structure and competitiveness of the peripheral economies, it is not surprising that their compliance to the growth and stability pact was often in breach.
This weakness became further exposed in the aftermath of the global crisis due to the operation of fiscal stabilizers, a rise in the unemployment compensation and a fall in tax revenues. The option of improving the competiveness of the economy through exchange rate depreciation was not available from the very inception of the monetary union. The EU budget is only 1 % of the EU GDP and not an effective instrument for fiscal stabilization. Had there been a fiscal union, with a system of horizontal transfer and controls, the deficit and debt ratio of the peripheral economies may have been contained (Anand, Gupta and Dash, 2015).
A fiscal crisis in the periphery automatically translated into zonal monetary and financial crisis with the central monetary authority not empowered to act as the lender of last resort. This brings home an important lesson that setting up pacts and codes of conduct by themselves is not enough, unless, the underlying incentives to adhere to them is also reasonably well aligned. They failed to see that other structural problems were far more dangerous to economic stability of the Eurozone that included the lack of control and regulation over national financial institutions (Pavoncello, 2011).

3.4.2. Varying Productivity and Structural Differences
Within the euro zone, there is substantial variation in terms of productivity. The peripheral economies have lower labour productivity compared to Germany (taken as a bench mark of 100) which clearly stands out in terms of unit labour costs. Only France and Ireland are comparable to Germany on this count. The Global competitiveness index for the Eurozone countries also shows vast differences in terms of the ranking and score. On account of differences in the labour market conditions the unemployment rates are also vast divergent. Compared to the peripheral economies, Germany has the lowest rate of unemployment due to its short-time working scheme and flexible time arrangements in the manufacturing sector (Anand, Gupta and Dash, 2015).
The above differences in a currency union could get sharply exaggerated, as they did, when countries are subject to asymmetric shocks, or to put it the other way around, when their capacity to weather a similar shock is vastly different. Member countries cannot use the exchange rate adjustment to improve their competitiveness. Large fiscal deficit and public debt with interconnected and weak banking systems can then make matters worse if debt is held across borders. In the peripheral economies of the Eurozone all these problems seem to have occurred in quick succession (Anand, Gupta and Dash, 2015).

3.4.3. Cross Border Lending
The modest success of the euro had all along been crucially dependent on the ability of the constituent economies to maintain, or appear to maintain, fiscal discipline and the ability of the private sector and the financial services industry to retain the trust of the markets. Ironically, it is the integration in the financial and money markets, that in part, was due to a common currency, which makes the Eurozone crisis harder to untangle. This foregoing integration is seen in terms of the large share of public debt held across borders with European banks (German, French, British and others) having cross border exposure. Data from the Bank of International Settlements gives an indication of the magnitude of exposure for major economies in the euro zone. Germany and France non euro economies like UK and US have substantial exposure to bank debt of the peripheral economies. The interlocking and conflicting interests of the holders of the liabilities of the peripheral Eurozone economies thorough cross border holding of debt makes the resolution of the crisis furthermore difficult (Anand, Gupta and Dash, 2015).

3.4.4. Decision Making System in the Euro Zone

Even at the national level where there are sub national entities, decision making is always problematic. In the case of the Eurozone decisions on financial assistance requires unanimity among representatives of member states. In a monetary union, political decisions taken in one country affect the economies of other countries. Except for the ECB there are few organisations that have a Eurozone wide view. But the ECB is a central bank with a limited focus on the macroeconomy. But economic policies remain controlled by national governments with fiscal consequences (Anand, Gupta and Dash, 2015).

3.5. Increased Systemic Risks

The changing nature of banking systems and interconnectedness of the global economies discussed above has meant that the banking system is now quite prone to having high levels of systemic risk (Kapoor, undated). Some of the reasons behind this are:

i. An increasing number of banks now have similar business models and similar portfolios of assets, are subject to similar regulations and use similar risk management systems so diversity in the system has been reduced.
ii. The financial system has a tendency to make increasingly complex products. The increasing practice of syndicating i.e. sharing out loans amongst several banks reduced the risks faced by each bank but exposed all banks to similar risks.
iii. Banks have large and increasing degrees of interconnections and cross exposures to each other, especially through the interbank market for funds so the failure of one may inflict large losses on other banks.
iv. As information has become cheaper and technology more sophisticated a greater number of banks rely on standardized measures of risk such as credit scores for individuals and credit ratings for corporations.
v. The banking system has become increasingly market oriented where banks no longer just make loans to hold them to maturity, but increasingly trade in market instruments and securities and hold active trading books in, for example, securitized loans.
vi. Increased system risk due to procyclical markets and the herding behaviour of market players

3.6. Comparative SWOT Analysis

EU-Strengths Large economic block accounting for 26% of the world GDP Robust administrative structures Megaeconomies providing financial and technical assistance Strong heritage of manufacturing and export Rich cultural heritage supporting tourism Developed economic block **EAC-Strengths** High growth rate of over 4.5% Similar socio-economic way of life/common culture Common language, Swahili Common geographic classification (great lakes region) Near harmonious political culture Similar macroeconomic indicators and economic growth trends	**EU-Weaknesses** Very low inflation/deflation impeding growth Very slow economic growth Antagonistic fiscal and monetary policies Shrinking active workforce Increasing unemployment High cost of production **EAC** Vested political interest Reliance on Agriculture and susceptibility to climate change Very high inflation Dependence on exports Weak domestic production Lack of regional economic powerhouses to provide financial and technical assistance Weak EAC structure High cost of production and High unemployment and illiteracy
EU-Opportunities Enhanced regional trade Technology advancement **EAC-Opportunities** Expanded regional markets Opportunity to cross-sale tourism products Opportunity for strong manufacturing countries like Kenya to export finished goods and import food for food security Intellectual exchange	**EU-Threats** Susceptibility to global economic crises Emerging competitive economies with much lower cost of production **EAC-Threats** Similar ecological patterns Exposure to imported inflation Climate change/aridity Susceptibility to global economic crises

Table 7

4. Distillation of Facts and Decantation of Lessons

As noted above, systemic risks are on the rise due to more complex, higher risk and less correlation understood financial instruments. This coupled with the increasing physical, policy and electronic integration of global financial markets is increasing volatility and susceptibility of Sub-Saharan Africa economies to far reaching economic challenges. The recent declaration by the Zambian Central Bank to cease its support of the local currency, the Kwacha; the failure of the foreign exchange intervention by the Ugandan government to take exchange rate volatility are current challenges and realities that are likely to greet regionalisation. To thrive in a much more difficult global economic environment, EAC economies will have to prioritise measures to promote stronger export growth and to diversify their export markets away from the traditional markets in advanced economies which face a prolonged period of slow growth. Based on the macro-factor comparison, trend analyses and detailed literature review, the following key lessons and conclusions are presented;

4.1. Legal and Structural Issues

A comparison of the EU/EAC administrative structures reveals a more robust, task and business oriented Eurozone structure compared to the EAC structure that seems a bit administrative and national political. For example, the EAC structure lacks high level audit and data analytics/statistical units. Given the increasing importance of information and the independent oversight of audit and risk functions in such sovereign institutions, it would be worthwhile to review the overall EAC structure. There is no empirical evidence linking the structural outlay of conglomerate economies to the success of the unions, neither is there any evidence linking structural issues to failure or vulnerability.

The crisis in the Eurozone economies has been associated more with a policy mismatch such as the contractionary fiscal policy stance among other factors. It is not clear whether it's a structural issue, the myth of one apple gone bad spoiling the whole bunch, size susceptibility or disharmonious political ambitions haunting the success of the Union. The review of literature does not raise any legal challenges in the drafting, interpretation, execution or substance of the various treaties, statutes and pacts that are at the core of the establishment of Eurozone Economic block to which the current crisis can be attributed.

The crisisis attributable to a number issues, from the overarching structure, the quality of fiscal and monetary policy interventions, systemic shocks adduced by banking sector contagions among other factors. We make the following recommendations with respect to the EAC;

i. The structure of the EAC should be reviewed, revised and tailored to the peculiar circumstances of the bloc while benchmarking against best practice from other regional economic blocs
ii. A robust independent statistical and data analytics core unit should be established within the primary administrative structure
iii. A high level audit function embedded within the core structure of the EAC

The EAC structure provided on the EAC website is rather confusing in comparison to their structural write-up. The following concerns are noted;

i. The structure is too long, and as noted above, more administrative than economic
ii. The sectoral committees seem not to have a clear reporting place in the structure
iii. There is no place for EAMU/EACB/EAMI within the entire structure
iv. Some key functions such as internal audit, whose inclusion in the structure seems peripheral, report through the Secretary General. This may restrict independence and encourage unnecessary red tape and bureaucracy.
v. The hierarchy of a large number of institutions reporting directly to the Secretary General is not clear neither are the powers and roles of the Secretary General

4.2. Convergence and Inclusion Criteria

Whereas the European Union has strict membership fiscal and economic structure criteria, the EAC seems to be a regional political federation with no specific economic indicators and targets to be met to gain membership. According to Article 3 of the EAC Treaty, expansion of country membership of the EAC to include any foreign country at the level of full membership or association is based on the following criteria;

i. Acceptance of the Community as set out in the Treaty
ii. Adherence to Universally acceptable principles of good governance, democracy, the rule of law, observance of human rights and social justice
iii. Potential contribution to the strengthening of integration within the East African region
iv. Geographic proximity to and inter-dependence between the foreign country and the EAC partner states
v. Establishment and maintenance of a market driven economy
vi. Social and economic policies being compatible with those of the Community

Though Sudan's application was rejected while South Sudan's and Somalia's applications are pending approval on the basis of these criteria, they are hardly economic. The criteria set out by the EU executive councils was aimed at inculcating economic discipline among member states to safeguard the Union from the challenges it is currently facing. It may be that serious economic misgivings in the troubled economies may have persisted for a long time and the criteria selected overlooked such serious economic vulnerabilities prior to admission into the Union.

Alternatively, the criteria may have been easy to meet on paper but unsustainable in the long-run exposing the Union to serious economic crisis. The EAC must set in place strict but attainable economic performance targets like;

i. Benchmark national debt to GDP ratio

ii. Target inflation
iii. Yardstick GDP and DP growth
iv. Interest rates and exchange rates regimes
v. BOP targets among other sustainable economic targets for membership.

Such a move would not just be a yardstick for admission into the Community but also a monitoring tool for continued economic and fiscal discipline going into the future. It would include enforceable measures for reigning in on rogue members who expose the entire Community to serious crisis through aggressive monetary policy stances like the liquidity management policies recently enforced by the Bank of Uganda and the decision of the Central Bank in Zambia not to support the national currency, the Kwacha.

The treaty should draft the mechanisms, including early warning signs for serious economic misgivings and indicators for deteriorating conditions and create structures for mitigating such challenges. In the extreme case of noncompliance or unresponsive economic conditions, the criteria should spell out isolating or exclusion mechanisms aimed at protecting the economic integrity of the rest of the Community members. The single currency did not meet the expectations even in the area of mutual convergence of the participating economies as concerns the growth and inflation rates. Some of the Eurozone countries stopped complying with the criteria for stability of public finance that were sanctified in the Stability and Growth Pact. Today, a number of the Eurozone countries do not even meet the Maastricht criterion for inflation. Conversely, the candidates are strictly required to meet the inflation criterion (Coenen, Straub, Trabant, 2012). This non-compliance with the Maastricht criteria may have aggravated the problem or maybe it's just a case of correlation risk and the elimination of inter-country risk isolation mechanisms. Integration in itself may not bring with it direct exposure to crisis.

Assuming that economic systems are the mechanism through and by which financial shocks are transmitted, the less the inter-country, isolating mechanisms, the more effective are the channels of transmission of these shocks. It is thus vital, as noted above, to review the correlation risks as well as the increased exposure that may result from harmonisation of cross border trading and monetary policy stances and instruments upon integration. The overall effects of size vulnerability and intra-country management of externally adduced shocks must be considered.

4.3. Common, Shared, Noble Course

Some of the critics of the EU have raised the argument that the EU was conceived as a political rather than economic confederation, a vision that may not have been embraced and espoused by all member states. Such a dysfunctional, disunited purpose is largely blamed for some of the woes currently bedeviling the Union. The EAC is largely seen to be following blindly in the footsteps of the EU, pushing for a political rather than economic confederation and even with this there have been undertones of reluctance.

The EAC Summit, Legislative Assembly and Council of Ministers must deliberately argue and iron out this fundamental aspect of the unification process and proceed under a common vision and quest pursued with equal vigor and energy by all who join the band wagon to avoid future problems. The EAC has a history of strained relationships which led to the collapse of the first Community in the late 70s and the protracted separation process that followed thereafter. The lessons from the past MUST not be ignored and swept under the carpet only to resurface at the wrong point in the life of the EAC.

4.4. The Role of Supereconomies

The Eurozone economies have some member states with huge and stable economies like Germany and France who have massive bailout powers. East Africa does not have any one such member yet the smaller economies are likely to manifest sovereign susceptibility like some of the smaller Eurozone countries. Consequently, the secretariat driving the integration process should consider establishing within the framework of the EACB, a bailout consolidated kitty/fund to which all member states will have to contribute on an ongoing basis. The kitty can and shall only be appropriated subject to strict bailout criteria. This seemingly light issue should be at the core of integrative efforts. While we hope for the best, we better prepare for the worst.

4.5. Avoid the Allure of a Contractionary Fiscal Policy and Expansionary Monetary Policy

The member states must harmonize their monetary policy stance and monetary policy tools. There must be a way of enforcing compliance with the harmonized monetary policy stance and tools. The stance and tools must be internally harmonized so that fiscal and monetary policy are consistent and not at cross purposes. Secondly, the policy and stance must be externally consistent to ensure that all member states act in a manner to ensure common purpose, common strategies geared at a common monetary and fiscal policy stance. The key players should deliberately anticipate future likely scenarios and come up with tentative solutions to encourage proactive rather than reactive solutions once trouble strikes.

4.6. Financial Markets Complexity and Transparency

The complexity of products such as Collateralized Debt Obligations (CDOs), the opaque nature of derivative securities, the risky nature of the shadow banking system and a host of other problems have been offered as the proximate causes for the global financial crisis. The EAC member states must put in place laws and mechanisms that ensure discipline and transparency of financial markets, particularly with respect to derivative trading and the integrity of the banking systems. Robust Anti-Money Laundering (AML), complex financial instruments and financial trading transparency laws, structures, mechanisms and institutions must be embedded into the current framework of establishment of the Community to avoid confusion and fire fighting in future because these are actual realities that are awaiting the federation in the immediate future.

5. Conclusion

For over 5 years, the Eurozone has been in a near recession with extremely low inflation adversely affecting commodity prices, disincentivising production and sustaining the vicious cycle of a sluggish economy. Eurozone recovery is widely expected to be slow. According to the IMF World Economic Outlook (2015), Eurozone growth will be 1.2% in 2015 and 1.4% in 2016, while a more optimistic European Commission (2015) expects the Euro Area to grow by 1.3% in2015 and 1.9% in 2016. Internal structural as well as exogenous economic shocks triggered and may continue to influence the slow economic growth and spiraling unsustainable sovereign debt in a couple of the member states. Whereas economic regional integration is seen as a tool foster regional economic stability, the paradox of the Eurozone economies seems to tell a different tale.

As momentum gathers in East Africa for the formation of a regional economic block, the EAC, fundamental concerns and questions abound on the structural and technical components of the proposed 5 member Community. Furthermore, with the overall goal of an economic Union, the focus right now should be on fiscal policy and macroeconomic fundamentals and their potential impact on the success of the Community. To this effect, the EAC would have to consider the challenges arising from the review of relevant literature in this document. The first is that the functional and administrative structure of the Community should be seriously interrogated, revised and harmonized to ensure an effective technical structure that will safeguard economic interest first then political interests.

Secondly, it would be of immense value to develop fiscal and macroeconomic indicators to act not just as a benchmark, but continuous economic health self-assessment tool for the Community. Whereas cognizance of the advanced level of progress on the formation of the Community is taken, the future of the Community's sustainability is paramount. It would not be too late in the day for the key issues raised here to be brought to the attention of the decision organ within the Community, the Summit with a view to making requisite amendments and adjustments to streamline the objectives, structure, policy and institutions of the East African Community to ensure a smooth integration process as well as effective processes in future. The EAC should pay attention to the critical issues identified here since there is evidence of correlation between the issues and the current state of the Eurozone.

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