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Economic Implications of the Pan-African Payment and Settlement Systems (PAPSS) on Inflation and Financial Stability

Research Article

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Abstract

This article examines the economic implications of the Pan-African Payment and Settlement System (PAPSS) for inflation and financial stability in Cameroon. PAPSS aims to facilitate cross-border payments in local currencies, lowering transaction costs and reducing the risks of external shocks. The system can improve liquidity management, foster financial integration, and support SMEs by streamlining payments and reducing currency risks. Policy recommendations include regulatory harmonization, digital infrastructure investment, and enhanced cybersecurity. PAPSS has the potential to strengthen monetary sovereignty and financial stability, promoting sustainable growth across African economies.

Keywords: Economic implications; Financial stability; Cameroon; Harmonization; Sustainable growth; Bank of central African states

Introduction

African countries are more prone to financial stability risks than other continents due to shortages in foreign exchange reserves. In Central Africa, the Central Bank's foreign exchange reserves are vital for maintaining price and financial stability, covering imports, maintaining competitiveness and ensuring long-term savings. The Bank of Central African States (BEAC) mandate is FX stability, but it nonetheless conducts monetary policy in a manner consistent with financial stability. The Banking Authority – COBAC – regulates banks and financial institutions to ensure financial stability.

Cameroon, like most developing countries borrows from other banks and institutions across the world in dollars. Because 45% of its payments are cleared through the Swift system, the dollar is central to the functioning of the financial system. However, the dollarization of the financial system can increase liquidity risks, dollar-driven financial crisis and inflation. As a result, while the U.S. dollar increases the resilience of countries like Cameroon through their FX reserves, it also increases the vulnerability of the Cameroonian economy to a sudden appreciation in the U.S. dollar. Because a significant portion of trade is cleared in the U.S. dollar, the central bank is forced to keep a significant amount of the U.S. dollar in its reserves. This article presents the Pan African Payment and Settlement System (PAPSS).

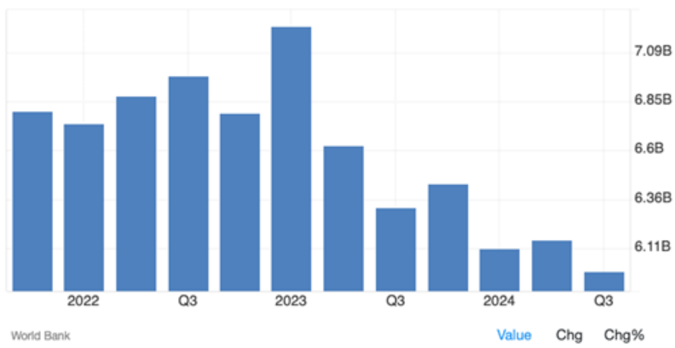

Figure 1. Cameroon - Cross-border Loans from BIS Reporting Banks Tending Down

Source: World Bank

PAPPS Will Reduce the Dollarization of the Financial System: Cameron has a total of 18 banks whose assets are estimated at FCFA 4000 billion. However, financial institutions rely on lending by international financial institutions, with negative consequences for financial sector development and financial efficiency [1, 2] Similarly, Marcellin & Mathur [3] find that private firms benefit from lower interest rates on dollar loans but equally face substantial exchange rate and currency risks due to the mismatch that emerges from their dollar-denominated debt and receivables (dominated by local currencies) [4] (Figure 1).

- Kouam & Ferdeinang, 2024 politiques vertes [5]
- Kouam, 2023 [4]. Crypto
- Mua & Kouam, 2025 [2]

Dollarization is Forcing Banks to Lend More to the Government

When the currency of heavily dollarized economies like Cameroon depreciates, financial assets and liabilities reflect foreign currencies, which adds pressure on the exchange rate. In the case of Central Africa, the central bank then raises interest rates- substantially higher than those of the U.S. economy - to keep the exchange rate stable as it mandates dictates. This partly explains why banks prefer to lend to the government at higher rates than to the private sector, that is dominated by informal actors and SMEs with little financial capacity to handle higher interest rates [5].

The PAPSS Can Improve Financial Stability

The Pan-African Payment and Settlement System (PAPSS) has the potential to boost financial stability and reduce dollarization in the Cameroonian economy. Given that the PAPSS supports the African Continental Free Trade Area (AfCFTA) by facilitating intra-African trade without reliance on foreign currencies like the dollar, it will limit exposure to foreign shocks linked to a stronger dollar on the financial system. This will equally free up bank resources to pay dollar-denominated debt and allow the central bank to reduce its holdings of the U.S. dollar. Although intra-African trade ranges between 16-18%, less than 5% of trade across the continent is conducted in local currencies. However, we must equally not overstate the role of the dollar, as informal trade and unreported cross-border activity is an important component of trade.

1. Reducing Dollarization and Enhancing Monetary Sovereignty

Cameroon, as a member of the Central African Economic and Monetary Community (CEMAC), uses the Central African CFA franc, which is pegged to the euro. However, the economy remains heavily dollarized, because a substantial portion of its trade is invoiced in dollars and banks have a significant amount of dollar-denominated debt. The PAPSS enables payments in local currencies, reducing the need to convert African currencies to the US dollar or euro for intra-African trade. This reduces demand for foreign currencies and keeps liquidity within the African trading system.

Furthermore, its multilateral net settlement framework consolidates cross-border payments and settles only net balances from each country, minimizing currency exchanges and foreign currency reserves needed. This mechanism helps central banks optimize liquidity management and reduces exposure to dollar fluctuations, which have historically caused economic instability in African economies [1].

2. Lowering Transaction Costs and Boosting Trade Efficiency

Currently, African countries lose an estimated $5 billion annually in currency exchange fees as they must convert local currencies into the U.S. dollar before trading across the continent.

Cameroon's trade is largely invoiced in US dollars, reflecting the dominance of the dollar in global commerce, with negative implications for local economies without deep financial markets and diversified economies. This increases transaction costs and creates inefficiencies that disproportionately affect small and medium enterprises (SMEs).

PAPSS allows businesses to invoice and settle trade in African currencies, reducing transaction times and costly conversions. For example, instead of converting CFA francs to dollars and then to another African currency, PAPSS enables direct local currency payments. This simplification will boost intra-African trade, foster SME development and support the informal economy.

3. Mitigating Risks from External Shocks & Volatility Caused by the U.S. Dollar

Cameroon's economy is vulnerable to external shocks linked to dollar fluctuations due to its dollar-denominated debt and trade invoicing. In 2023, Cameroon's trade deficit reached CFA 2.004 trillion, up from CFA 1.428 trillion in 2022, driven by a surge in imports and a decline in exports. Historically, strong dollar episodes have accentuated financial crises in African economies by increasing debt burdens and reducing export competitiveness. During such periods, countries face higher repayment costs, which cause financial stress and potentially lead to defaults. PAPSS's local currency settlement reduces dependence on the dollar, thereby insulating Cameroon from such external shocks and enhancing financial stability.

4. **Strengthening Financial System Stability and Integration**

Cameroon's financial system faces challenges, including inefficiencies in payment systems, delayed settlements, and high non-performing loans in banks. PAPSS introduces a modern, efficient payment infrastructure that guarantees settlement and transparency in cross-border transactions. This can reduce payment delays and enhance liquidity management. Moreover, PAPSS will foster regional financial integration by harmonizing payment systems and regulatory frameworks across African countries. For Cameroon, deeper integration with other CEMAC members and the broader African market through PAPSS can attract investment, facilitate cross-border capital flows, and support economic diversification.

Recommendations

- **Harmonize regulatory frameworks:** Governments should prioritize aligning financial regulations, data privacy laws, and security standards across African countries to facilitate seamless cross-border payments through PAPSS. Regulatory harmonization reduces compliance complexity and fosters trust among participating institutions.
- **Incentivize local currency usage:** Policymakers must introduce financial incentives such as reduced transaction fees, tax breaks, or regulatory exemptions to encourage businesses to settle trade in local currencies via PAPSS. Additionally, developing currency-hedging mechanisms at the policy level will protect businesses from exchange-rate volatility, increasing confidence in local currency transactions.
- **Enhance digital infrastructure investment:** Governments should allocate resources to improve internet penetration, digital literacy, and financial inclusion, especially in underserved areas. Bridging these infrastructure gaps is critical for broad PAPSS adoption and ensuring equitable access across regions.
- **Strengthen cybersecurity and data governance:** Establishing robust cybersecurity protocols and data governance frameworks is vital to protect PAPSS from cyber threats. Governments must collaborate with the private sector to adopt international best practices, thereby building trust and safeguarding the system's integrity.
- **Adopt advanced technology and security measures:** Businesses must implement state-of-the-art digital identity verification, AI-driven fraud detection, multi-factor authentication, and encryption to ensure secure transactions within PAPSS. This will mitigate risks and enhance user confidence.
- **Promote interoperability and integration:** Payment service providers and financial institutions should prioritize integrating their systems with PAPSS and other interoperable platforms, including mobile wallets and telecom providers, to facilitate smooth cross-border payments and improve user experience.

Conclusion

In 2023, Cameroon's trade deficit exceeded CFA2 trillion for the first time, reaching CFA2.004 trillion, up from CFA1.428 trillion in 2022. This increase of CFA576 billion, or 40.3%, highlights a worsening trade imbalance due to a surge in imports and a decline in exports. The import volume jumped by 11.4% year-over-year in Q3 2024, while exports dropped by 4.9% year-over-year, pushing the trade deficit to 11.7% of quarterly GDP. As a result of having to fund its current account deficit in dollars, driven by demand for U.S. dollars for imports and exports, the economy is dollarized. However, the PAPSS will improve the resilience of the Cameroonian economy by reducing the economic effects of sudden swings in the value of the dollar.

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