

FEASIBILITY OF THE PROPOSED SADC CURRENCY UNION

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ABSTRACT

In conformity with a goal of the African Union to build a monetary union for the entire continent, one of the goals of the Southern African Development Community (SADC) is the formation of a monetary union with a single central bank. Towards this end certain macroeconomic convergence criteria, which are closely aligned with those used by the European Union (EU), have been set. While empirical research on whether or not SADC would benefit from the formation of a currency union has been focused on the optimum currency area criteria, no reference to these criteria is made in the SADC programme. Doubts regarding the continuing stability of the EU have recently been raised as a result of debt crises in certain member states, implicitly raising questions about the adequacy of the convergence criteria that were adopted. The paper accordingly considers the feasibility of establishing a currency union in the SADC region. The convergence criteria proposed are assessed against the theory of optimum currency areas as well as in terms of their adequacy in the light of recent EU experience.

1 INTRODUCTION

Doubts regarding the continuing stability of the European Monetary Union have recently emerged as a result of fiscal crises in certain member states. This has raised questions about, *inter alia*, the adequacy of the convergence criteria that were adopted and, implicitly, whether some attention should have been directed to the theory of optimum currency areas (OCA). These problems and the related questions are relevant to the proposed SADC monetary union in terms of both the stated convergence criteria and other problems that have become evident in the EU. The paper starts by briefly setting out the benefits and costs that are argued to derive from forming a monetary union. This is followed by a consideration of the OCA theory alongside the convergence criteria, highlighting the differences and similarities. Attention is focused on the problems currently being experienced in the EU and the proximate causes thereof; these are set both against the theory and lessons learned from the experience. The paper concludes with a preliminary discussion of the lessons to be learned from the EU experience and (as a result, the prospects for success of the proposed SADC monetary union.

2 BENEFITS AND COSTS OF A MONETARY UNION

The interest in assessing the feasibility and consequences of monetary integration in Southern Africa stems not only from this ultimate goal of achieving the African Union agenda but from several other factors. Firstly, the favourable experiences of the European monetary union have stimulated further interest in monetary unions in regions beyond Europe (Masson and Pattillo, 2005:35; Jefferis, 2007:83). Secondly, monetary unification is often viewed as the key to a faultless single market especially for countries, such as those of Southern Africa, already belonging to regional trading blocs (Kenen and Meade, 2008:4). Lastly, studies on the potential costs and benefits of currency unionisation suggest that the adoption of a common currency can lead to the improvement of the structural characteristics of concerned economies, increasing trade integration and business-cycle correlation and enhancing the credibility of macroeconomic policies (Rose, 2000).

2.1 *Benefits of forming a monetary union*

Tavlas (2008:12) argues that, in the traditional OCA literature, the main benefits of monetary union derive from the efficiency gains arising from the elimination of the transaction costs of exchanging currencies

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and elimination of exchange-rate volatility and uncertainty. Uncertainty about future exchange rates introduces uncertainty about future revenues, as well as for the prices of goods and services, for firms. In addition to eliminating exchange transaction costs, a single currency could make an important contribution to cutting the costs and delays associated with cross-border bank payments as well as foster increased price transparency (De Grauwe, 2007:68). The associated welfare gains are likely to increase with the degree of openness of an economy (McKinnon, 1963) whereby the elimination of transaction costs will weigh more heavily in countries where firms and consumers buy and sell a large proportion of goods and services in foreign countries and are thus more subject to decision errors because they face large uncertain foreign markets with different currencies. Thus, small and relatively open economies will experience larger welfare gains from the elimination of these risks compared to say large and relatively closed countries. The pooling of national reserves of foreign currencies will also allow for the internalisation of “foreign” trade thus reducing the demand for foreign currency (Jovanovic, 2005: 105); this would, however, depend heavily on how much the countries actually trade with one another.

The adoption of a single currency together with a joint system of central banking will accommodate major simplifications of banks’ treasury management, accounting and reporting to monetary authorities. When flanked by internal market measures to remove the technical barriers that complicate the processing of international bank transfers, these simplifications could act as catalysts for cheaper cross-border payments. This should in turn promote increased trade and long-term investment among the countries of the union and hence increase income and economic growth within the region. According to De Grauwe (20017: 74), the “new” currency adopted by a monetary union is likely to weigh more in international relations than the sum of the individual currencies prior to the union. As such two key benefits are created for the union as a whole. First, an international currency will mean increased exposure to additional revenue sources through increased global transactions with that unit of currency. Second, an international currency will boost activity for domestic financial markets as increased demand for foreign direct investment in financial markets will follow this “new” currency.

To the extent that low and stable inflation rates reduce anticipated inflation, more stable economic growth rates may result. Union members’ commitment to meeting and maintaining price stability will ultimately result in an improvement in the credibility of previously inflation-prone countries. The associated short-run costs of disinflation will be minimised if there are reliable commitments to stable prices by all union members. As such, there are welfare gains to be accrued from movement towards a monetary union and the reduction in uncertainty about financial and economic conditions following such membership.

2.2 *The costs of forming a monetary union*

Disparate socio-economic conditions among countries make the process of forming a monetary union challenging. Whether or not a country would be willing to relinquish its national currency and simultaneously lose its ability to conduct country-specific monetary policy lies at the heart of the debate. There is no denying that because nations are different in some important aspects that the use of exchange rates as a policy instrument is useful and convenient. Exchange rate adjustments (along with other monetary policies) are critical in maintaining internal balance and effectively managing these differences (De Grauwe, 2007:5). When such power is surrendered countries can neither independently change (and thus manage) their currencies, nor change short-term interest rates. In addition to this, preferences about economic and socio-political issues such as inflation and unemployment are questioned in the face of monetary union membership. Differences in labour market institutions, legal systems, growth rates as well as fiscal systems could result in significant adjustment costs for countries considering joining the union.

While Mundell (1961) and McKinnon (1963) believe that the loss of exchange rate control entails too high a cost, De Grauwe (2007:58) argues that the “exchange rate” argument is unfounded. The ability of exchange rates to absorb asymmetric shocks is a lot weaker than the traditional OCA theory proposes, and exchange rate adjustments have been observed to have only temporary effects on both output and unemployment. Furthermore, countries that independently manage their monetary and exchange rate policies often discover that the movements of the exchange rate become a source of macroeconomic

disturbances as opposed to tools of macroeconomic stabilisation. This volatility in exchange rates may be a significant source of asymmetric shocks for these countries.

Theoretically, a range of costs and benefits associated with the formation of a monetary union exist; a brief outline of the main economic costs and benefits is provided above. Naturally, the nature of these costs and benefits will depend on the structural characteristics of the economies concerned and would need to be investigated and understood in the context of the regions involved.

3 OPTIMUM CURRENCY AREA THEORY AND CONVERGENCE CRITERIA

With the costs and benefits associated with belonging to a monetary union having been briefly set out, and assuming that the countries concerned decide (in principle) to form a union, the matter of whether or not this is practical needs to be addressed. There are two standards against which this can be measured, namely the *optimum currency area* (OCA) criteria and the *convergence criteria* employed in the European unification.

Mundell (1961), regarded as being the pioneer of OCA criteria, describes an OCA as an “optimum” geographic area in which a group of countries either (i) shares a common currency or (ii) maintains separate national currencies with permanently fixed exchange rates and full convertibility. Optimality is then measured on the grounds of each member country’s ability to maintain external and internal equilibrium. The notion of an OCA was initially formulated in the context of the debate over the relative merits of flexible and fixed exchange rates and their ability to respond to external and/or internal shocks and still maintain equilibrium. Friedman (1953), Mundell (1961), Ingram (1962), McKinnon (1963), Kenen (1969) and Fleming (1971) identify the characteristics necessary for the construction of a successful currency union, these being factor mobility (specifically labour and capital) and adjustment to asymmetric shocks, financial integration, degree of openness, similar inflation rates and the level of economic diversification respectively. More recently, issues such as degree of financial development, fiscal balance, political integration and ease of currency substitution have been added to the list (El Hag, 2007).

Although Mundell’s (1961) seminal paper is universally recognised as being the pioneer of OCA theory, the conceptual foundations of Mundell’s work had been introduced long before that time. During the late 1940s and 1950s Lerner (1974), Friedman (1953), Meade (1953) and Scitovsky (1957) had already anticipated the basic doctrine of OCA analysis (Dellas and Tavlas, 2009:2). In analysing the effectiveness of inter-regional adjustment within countries, these authors identified the importance of a system of a central monetary and fiscal authority and the free movement of goods and factors of production among regions in economic adjustment. The classical view was that when countries or regions are subjected to asymmetric shocks the adjustment processes will call for an adjustment of exchange rates (due to countries having different currencies), a reallocation of resources or a combination of both. The abovementioned authors believed that this classical adjustment mechanism could still, even in the absence of exchange-rate adjustments, be effective and thus postulated that a regional single-currency could in fact be optimal.

Frankel and Rose (1998, 2002) initiated the discussion on the *endogeneity of OCA criteria*. Compared to the static and *ex ante* nature of the earlier model, which sought to identify characteristics that an economy should satisfy before it was considered eligible to join a monetary union, this model focused on changes in economic structure and performance that may result from participating in a monetary union *ex post*. The core propositions of endogenous OCA literature are as follows: Free trade is severely hampered by the existence of borders, which are broadly defined to include separate monies. When two or more countries decide to form or join a monetary union this barrier to trade will be removed, fostering increased trade between the members (McCallum, 1995, Engel and Rogers 2004). The introduction of the single currency will eliminate exchange-rate risk and the cost of hedging, reduce information costs, and raise price transparency all of which will reduce market segmentation and encourage completion. De Grauwe and Mongelli (2005) argue that a common currency promotes what could be attained through pegged rates among separate currencies, common trade, financial and economic integration as well as the

accumulation of knowledge. Furthermore, trade integration will result in more-highly-correlated business cycles because of common demand shocks and greater intra-industry trade, lessening the need of country-specific monetary policies and reducing the cost of giving up a nationally tailored monetary policy. Thus, in contrast to the earlier literature which emphasised the number and severity of asymmetric shocks among countries as a criterion for choosing union membership (*ex ante*), endogenous OCA literature concludes that participation itself will result in a reduction in the incidence of asymmetric shocks among participants. From this perspective it is less important that some of the convergence and optimal currency area criteria are met prior to a monetary union being established, and membership will induce convergence, institutional and structural changes that will assist members of the union to find new methods of adjusting to economic shocks.

A remarkable feature of OCA theory is its silence on the need for the attainment of *prior* convergence of macroeconomic variables such as inflation, interest rates and budgetary policies. According to traditional OCA theory, these convergence criteria are unnecessary because countries with different inflation rates prior to the union may share similarities in other key economic variables. In fact, the transition to a monetary union has traditionally not called for the need for member countries to first slowly meet convergence criteria before forming a union. The Maastricht Treaty employed by the European Union is the first transition strategy that emphasised the need for convergence criteria. For example, a key characteristic of the German monetary union which happened on 1 July 1990 was its speed and absence of any convergence requirements. Germany's decision to implement the monetary union was made at the end of 1989, and a mere six months later the union was a reality. Unlike the Maastricht-type convergence which encompassed a long-term effort to finalising union formation, the German case is proof that monetary union can be established quickly without prior conditions but it does not prove in any way that this is the most desirable way to organise any monetary union.

The question of why OCA theory essentially focused on microeconomic conditions, and the Treaty on macroeconomic convergence, can be addressed at two levels. Firstly, a number of the countries wanting to join the European Union failed to meet all the OCA criteria, presenting the need for alternate approaches towards increased integration. Secondly, there was the fear that a future monetary union would have an inflationary bias. De Grauwe (2003:132) argues that that when candidate member countries are asked to prove their commitment to low inflation levels (by permitting the disinflationary process to fuel a temporary increase in unemployment) they may act in the best interest of the union and commit themselves to conforming to the required levels. The danger lies in the fact, as pointed out by De Grauwe (1996:1094) that they may also act opportunistically to ensure entry but may later falter and re-commit themselves to their own preferences. On the other hand, differences in inflation rates between countries may be a reflection of differences in the institutional features in monetary policy decision making, and in forming a monetary union these institutional differences will disappear making the prior differences in inflation irrelevant.

Similar arguments have been developed for the other convergence criteria (interest rates and budgetary requirements). In the case of budgetary convergence requirements the OCA theory advises that if the monetary union fails to simultaneously involve some degree of centralisation of national budgets the imposition of budgetary convergence requirements is going to make matters worse for the management of the union. When asymmetric shocks occur, the requirements to keep budgetary policies in line with other members will rob countries of the last instrument to absorb these shocks. As a result, the pressure on the union's central bank to change its monetary policy stance will be more pronounced. The argument for debt and deficit reduction prior to entry into a union is made not because countries with high debt and deficits cannot form a monetary union, but because allowing these countries into the union increases the risk of more inflation in the future union. Another more positive argument for deficit and debt reductions as a condition for entry into the union is that the authorities with large debt levels will face a higher default risk and, if allowed into the union, will increase the pressure for a bailout in the event of a default crisis (De Grauwe, 2003:134). In essence, traditional OCA theory views convergence criteria as unnecessary and inadequate. According to Bayoumi and Masson (1994), they could also prove to be dangerous for the smooth functioning of a monetary union.

Nonetheless, there are strong arguments to impose budgetary convergence prior to entry in the union (see De Grauwe, 1996:1096). These conditions, however, also carry great risks in the form of an increased debt burden for the high inflation country. De Grauwe (1996:1097) explains this as follows; *ex ante*, the high inflation, high government debt country will be required to reduce its inflation and debt in line with the low inflation, low debt country. This disinflationary process will raise issues of credibility and could result in a joint reduction in inflation coupled with an increase in the real interest rate i.e. there will not be a decline in expected inflation and the debt burden will be pushed up. Thus the inflation convergence requirement makes debt reduction more difficult, making a credible anti-inflation policy difficult to follow and will create doubts about the possibility of meeting the targets, inducing speculative crises and raising the country's interest rate.

The preceding paragraphs have focused on outlining the nature and arguments for and against OCA theory and Maastricht-type convergence criteria. There is a great divide in academic writing regarding which approach is most suited to forming a monetary union. Some advocate OCA theory on the grounds of its emphasis on real convergence requirements to facilitate integration. Others argue that it is the Maastricht-type convergence criteria's nominal macroeconomic concerns that are most practical and applicable. It is necessary to distinguish between the two set of criteria as they tell us different conditions about a country's economy. In doing so it is important to note one key difference between the two; unlike OCA criteria, Maastricht criteria have reference values which makes detailed comparisons of the two rather difficult (Jygert, 2008: 33).

The Maastricht criteria display the scope within which a monetary union can reach a state of economic stability (nominal convergence) whereas the OCA criteria reveal the suitability of an economy to act in a currency area (real convergence) and places less emphasis on economic stability (Lein-Rupprecht *et al.*, 2007:9). Real convergence is described as a planned approach towards the economic level of another more developed country/group of countries within an integration group. It implies a process of structural transformation that might lead, through increased specialisation and productivity expansion, to a higher degree of trade openness, as firms are likely to become more export intensive and with a higher level of import penetration (Lein-Rupprecht *et al.*, 2007:12).

Conversely, the theoretical foundation of real/absolute convergence lies in the neoclassical growth theory, which assumes convergence towards a steady-state equilibrium is influenced by an array of country-specific characteristics and parameters such as population growth, savings rates and the degree of depreciation of the capital assets used. Nonetheless, this theoretical paradigm lacked sufficient explanation of the reality of alternate results when less developed countries attempt to catch up with more developed countries (Lein-Rupprecht *et al.*, 2007:10). The process of real convergence (OCA criteria) has diverse consequences for catching-up countries and has been observed to be a driver of nominal convergence (convergence criteria) making the two more closely linked than has previously been argued.

The process of real convergence, and the asymmetric shocks associated with this process, may entail higher returns on capital as well as a substantial appreciation of the real exchange rate for some time for counties moving towards meeting convergence criteria. Within a monetary union, such an appreciation may take place through higher inflation rates which may fuel an inflationary spiral. In this context, the continued process of real convergence (through increased factor mobility and openness) will be inconsistent with nominal convergence (higher inflation rates and hence higher nominal interest rates). The emphasis on flexibility governing the OCA criteria could be the key to solving this dilemma. The process of real convergence requires significant shifts in the real exchange rate and, since in a monetary union the nominal exchange rate cannot be used as an adjustment tool, it is vital that prices can move speedily in the required direction. A key factor is thus wage formation whereby real wages will need to adjust swiftly (and in the opposite direction) to changes in the real exchange rate in order to safeguard the counties' competitive positions. The OCA requirement for increased financial integration coupled with globalisation will lead to demand shocks in different sectors of the economy, calling for factor mobility and flexibility to allow the needed factor shift from one sector to another (Smaghi, 2008:186). In essence, although OCA and convergence criteria differ in a number features, they are both centred on issues of monetary, economic and financial integration and each is influenced, or influenced, by the success of the

other. The two concepts are a lot more closely linked than the existing literature seems to suggest, as they work in unison in promoting an economic and social environment that fosters conditions for monetary union formation.

4 RECENT EUROPEAN UNION EXPERIENCE

There are a number of important lessons to be learnt from the steps employed in forming monetary unions like the EMU. Further, although there is consensus amongst the signatories of the SADC Treaty that underdevelopment and backwardness in Southern Africa will best be overcome through economic cooperation and integration, recent issues of debt and debt management in the Eurozone must be considered.

The debt crisis that started in the spring of 2010 in Greece culminated into a crisis of the Eurozone as a whole by the end of that year. Since then, much commentary on the causes and drivers of the crisis has been presented, most of which give rise to three key explanatory themes. These can be summarised as follows: First is the issue of Greece and the mismanagement and deception by its authorities about the sizes of its fiscal and current account deficits, coupled with an overall lack of fiscal discipline in the EMU (Wihlborg *et al.*, 2010:52; De Grauwe, 2010:1; Maurer, 2010:3). It is this deception that fuelled the substantial revision of these statistics and projections, triggering an immediate sense of panic within the Eurozone. Secondly, the destabilising role of financial markets together with their inability to perform as efficiently as the models of efficient markets predicted and the central role of ratings agencies in amplifying the destabilising movements in financial markets. According to Wihlborg *et al.*, (2010:55) the biggest failure of financial markets was a failure to register the early warning signs of the underlying deterioration of a number of the euro countries' financial positions. Coupled with added pressure by rating agencies for governments to reduce their own and private sector debt levels lead to a self-defeating dynamic in which neither the private nor public sector could effectively reduce their debt.

Thirdly, and most relevant here, are issues related to the Eurozone's faulty design, its authorities, its inability to develop adequate internal adjustment mechanisms as well as its incomplete monetary and fiscal policy framework (De Grauwe, 2010:2; Wihlborg *et al.*, 2010:54; Maurer, 2010:3; Gianviti *et al.*, 2010: 1). Hesitation on the part of, and ambiguities created by, the Eurozone governments and the European Central Bank allowed the crisis to unfold and was further aggravated by disagreements concerning how to best respond to the Greek crisis. As is argued further below, one of the most important criteria for forming a monetary union is that, in the absence of the ability to change national exchange rates, the joining members must have considerable flexibility in terms of factor mobility and price/wage flexibility in order to allow economic adjustments without provoking recessions (Mundell, 1961). It could, on the other hand, be argued that the formation and efficient operation of a monetary union would foster the needed increase in flexibility within and among the countries involved (endogenous criteria); it is thus not necessary for all member countries to meet the criteria (this was the case for the EMU) *ex ante*. It was, however, observed that, once the euro was in operation, many countries failed to sustain efforts towards reform and there was a tendency for stronger responses to the competitive discipline of the common currency in surplus countries like Germany than in deficit countries like Greece, thus adding to the already existing internal imbalances (Wihlborg *et al.*, 2010:54). Furthermore, the Growth and Stability Pact failed to limit severe fiscal imbalances with the EMU and it became increasingly clear that a union without political union, or at least a fiscal union, is bound to fail.

Verdun (2010) reviews a selection of five prominent political and five prominent economic claims that were publicised in the 1990s about the potential faults in the structure of the EMU. Based on an assessment of the first ten years of the EMU, almost none of the claims turned out to be a problem. However, since the onset of the recent financial crisis and EMU debt crises, a number of these faults have begun to show. In fact, six of the ten claims are believed to have played some role in triggering and fuelling the EMU debt situation. The ten issues can be summarised as follows: to begin, the EMU (1) was formed and will only endure if it remains in the interest of large member states; (2) needs an economic government (or political union) or it will be prone to instability; (3) is illegitimate and requires more democracy, accountability and transparency; (4) needs a common identity to be stable; (5) will lead

to welfare state retrenchment and also to (6) war; (7) participating countries need to form an OCA in order for EMU to work; (8) ECB will be too weak; (9) Growth and Stability Pact will stifle growth and finally (10) Currency will be too weak/strong (depending on views).

It is evident that the recent challenges faced by the EMU go beyond Greece's lack of fiscal discipline and lie at the core of the union's foundations. Two main issues related to the feasibility of a SADC monetary union immediately come to the fore: First is the question of whether SADC can learn from the mistakes of the EMU in its efforts toward forming its monetary union. Secondly, Southern Africa already seems to be going through a situation much like the PIIGS crisis in Europe. The recent fiscal crises in Lesotho and Swaziland stem from large reductions in SACU transfers due to the negative trade effects of the financial crisis, and have proven just how challenging it is to manage even the smallest of monetary union-type communities. The Southern African Customs Union (SACU) made up of Lesotho, Namibia, Botswana, South Africa and Swaziland, is but a small step towards increasing regional integration within SADC; the fact that debt crises are already evident in this region (before monetary union implementation) is worrying. Unlike the EMU, which has a number of core economies, Southern Africa has only one (South Africa); this *may* make political decisions easier here than in the EU. The complex nature of political decisions such as these cannot, however, be stressed enough and whether countries on the outside will support aggressive fiscal policies to manage such debt will depend on a number of regional and international factors. What is even more relevant about sovereign debt and default in this context, is that it more significant an issue in a regime of monetary union than in one where member states have full control over monetary policy tools.

The challenges currently facing the EMU have led economists to think about the governance of a monetary union in a different light. The fundamental idea is that the absence of a political union is an important flaw in its governance. Dating back to the 2010 where the lack of political union had the unfortunate effect of putting the entire burden of macroeconomic management in the Eurozone on the shoulders of the ECB, which was not, and possibly still is not, ready or willing to carry such a burden (De Grauwe, 2006:728). This is in contrast with the case in the US where both the central bank and the federal government have used their respective instruments to stabilize the business cycle. While the EMU has undeniably defied a number of sceptics' predictions about its potential to succeed, it remains a fragile body due to flaws in its governance and the absence of a sufficient degree of political union. A politically and fiscally unified government is imperative to promote the macroeconomic management of the Eurozone, currently entrusted solely to the ECB. Additionally, the absence of a minimal degree of budgetary integration that forms the basis of an insurance (transfer of funds) mechanism is another flaw in the design of the EMU. Keeping member countries motivated (through efficient supervisory efforts) to fulfilling their commitments to integration requirements could greatly facilitate addressing the issues faced by EMU.

5 PROSPECTS FOR THE SADC MONETARY UNION

The Southern African Development Community (SADC) vision is one of a common future founded on common values and principles within a regional community that will ensure economic welfare, improvement in standards of living and quality of life, social justice, freedom, peace and security (SADC, 2009: 52). In pursuit of this agenda, SADC adopted a Regional Indicative Strategic Development Plan (RISDP) in 2003 which sets milestones to facilitate its attainment, explicitly the SADC Free Trade Area by 2008, a Customs Union (CU) by 2010, the Common Market (CM) by 2015, Monetary Union (MU) by 2016 and the Single Currency by 2018 (SADC, 2009: 52). The SADC countries' central bank governors laid down a strategy for monetary union similar to the approach adopted by the European Monetary Union. This approach is based on two core principles (De Grauwe, 2007:143): Firstly, the road towards monetary union should be gradual, extending over a number of carefully planned years. Secondly, the satisfaction of convergence criteria should be a prerequisite for monetary union membership.

SADC's targets and convergence criteria can be summed up as follows: Ensuring the administrative completion of negotiations by 2015; Promoting the diversification of industrial structures and exports; Macroeconomic convergence of inflation rates (single digits by 2008, 5% by 2012 and 3% by 2018 for all

members by 2018); Ratio of budget deficit to GDP not exceeding 5% by 2008 and ensuring the nominal value of public and publicly guaranteed debt is less than 60% of GDP by 2008 and maintained throughout the planning period (SADC, 2003). Table 1 below outlines these convergence criteria and goals for SADC together with other important financial indicators.

Table 1: Macroeconomic Convergence Criteria and goals for SADC

Criterion	2008	2012	2015	2018
Inflation rate	Single digit	5%	5%	3%
Budget deficit	5% or less of GDP	3% or less of GDP as anchor, with 1% range	3% or less of GDP as anchor, with 1% range	3% or less of GDP as anchor, with 1% range
Govt foreign and domestic debt & debt guaranteed by govt	Less than 60% of GDP	Less than 60% of GDP	Less than 60% of GDP	Less than 60% of GDP
Current account balance % of GDP	Less than 9% of GDP	Less than 9% of GDP	Less than 9% of GDP	Less than 3% of GDP
Foreign reserves	3 months' import cover	More than 6 months' cover	More than 6 months' cover	More than 6 months' cover
Central Bank credit to govt	Less than 10% of previous years' tax income	Less than 10% of previous years' tax income	Less than 5% of previous years' tax income	Less than 5% of previous years' tax income
Level of savings	At least 5% of GDP	Up to 30%		
Domestic investment levels	At least 30% of GDP			

Source: Adapted from (Rossouw, 2006) and (SADC, 2010)

Progress towards achieving these convergence criteria has been tracked by a number of authors over the years (see, for example, Rossouw, 2006, Jeffries, 2007, Zyuulu, 2010 and Kumo, 2011). Numerous other studies have investigated the rate of SADC convergence and most of the earlier studies (dating from around 2005 – 2008) came to similar conclusions, the essence of which can be summed up as follows: SADC countries had made considerable progress towards the achievement of the goals set for 2008. In addition, the degree of compliance with the criteria was predicted to increase even further between 2008 and 2012, indicating that the region was initially on track to achieving its goal of a single currency and regional central bank by 2016. Despite these early signs of convergence, however, the process has been observed to be unequal whereby a said 'convergence group' comprising only a few countries was identified. Lastly, and most importantly, a SADC union was perceived as impractical in the near future for two key reasons: Firstly, deeper and more equal convergence is still required and secondly, the exclusion of the regions' political dimensions in previous analyses meant that a number of complexities which could override progress in convergence were not considered. Table 2 overleaf provides a more recent look at the SADC convergence situation. 2008 values for the SADC convergence targets and goals (excluding Central Bank credit to government due to data issues) are shown. 2010 figures are also shown in an attempt to shed some light on the feasibility of the countries meeting their 2012 targets.

Table 2: Achievement by 2010 of SADC Macroeconomic Convergence targets and goals

Country	Inflation (end of period % change)		Budget Deficit (% of GDP)*		Govt debt (% of GDP)		Current Account Balance (% of GDP)		Foreign exchange reserves (months of imports)		Gross Net Savings (% of GDP)		Domestic Investment (% of GDP)	
	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010
Angola	13.2	15.3	8.9	7.9	29.5	31.4	8.6	-1.8	5.1	4.7	24.8	8.6	16.2	10.4
Botswana	13.7	7.4	-5.8	-11.3	6.2	13.7	7.5	-2.5	21.6	15.6	39.9	24.9	32.4	27.4
Congo, DRC	27.6	9.8	-5.9	-11.7	136.3	29.5	-17.5	-6.8	0.7	1.7	4.9	20.2	22.4	27
Lesotho	10.6	3.1	2.8	-16.5	53.4	37.8	7.9	-16.2	6.4	4.1	37.4	21.3	29.5	37.5
Madagascar	10.1	9.2	-5.4	-1.7	30.4	35	-20.6	-13.4	3	3.2	20.4	12.4	40.9	25.8
Malawi	9.9	6.3	-17.1	-11.5	42.6	40.3	-10.2	-1.3	1.5	1.5	16.1	28.8	26.3	30.1
Mauritius	6.8	6.1	-3.4	-3.9	44	50.5	-10.1	-9.5	4.1	4.2	18.3	16.2	27.3	25.1
Mozambique	6.2	16.6	-11.9	-12.5	34.4	32	-11.9	-12.7	4.2	4.4	5.7	9.3	17.6	21.9
Namibia	10.9	3.1	2.5	-7.5	17.6	19	2.7	-1.1	3.1	4.3	31.6	26.6	28.9	27.6
Seychelles	63.3	0.4	2.1	-1.3	135.4	83	-48.9	-50.7	0.7	2.3	-8.8	3.3	40.1	54
South Africa	10.1	3.5	-0.5	-5.8	27.3	36.3	-7.1	-2.8	4.6	4	15.4	20	22.5	21.7
Swaziland	12.9	4.5	0.5	-12.7	16.9	18.9	-11.1	-20.6	3.8	3.3	5.7	-5.3	13.9	12.5
Tanzania	9.3	7.2	-6.9	-11.6	40.1	43.8	-11.1	-8.6	4.4	4.8	17.3	19.7	29.7	28.8
Zambia	16.6	7.9	-5.2	-4.9	26.9	26.9	-7.2	3.8	3.2	3.4	13.8	27.6	20.9	23.8
Zimbabwe ¹	--	3.2	-2.8	-2.3	90.8	56.3	-23.2	-18.3	0	0.4	--	--	--	--

Adapted from: International Monetary Fund (2011: 78-104)

* Following Rossouw (2006), budget deficits including grants are used.

¹ The Zimbabwe dollar ceased circulating in early 2009. Data are based on IMF staff estimates of price and exchange rate developments in U.S. dollars. Staff estimates of U.S. dollar values may differ from authorities' estimates.

Inflation targets. The 2008 single digit inflation target was only achieved by 4 of the 15 SADC countries namely Malawi, Mauritius, Mozambique and Tanzania; with Mozambique having the lowest rate of 6.2%. Surprisingly enough by 2010 the numbers had taken a more positive turn for all the countries with the exception of Angola (whose inflation rose by 2.1%) and Mozambique (whose inflation climbed 10.4% from its 2008 figure). This seems to suggest that the SADC countries are making impressive progress towards monetary policy convergence however, given the Mozambique situation this progress is exposed to shock and is thus unpredictable and could be indication of how these economies are struggling to recover from the financial and economic crisis.

Budget deficit targets. Regarding the fiscal policy indicator, 3 member states (Mauritius, South Africa and Zimbabwe) attained a budget deficit of less than 5%. According to Kumo (2010:22), 4 additional member states, (Swaziland, DRC, Madagascar and Seychelles) attained budget deficits of less than 4% in 2009 (Zimbabwe excluded). However, in both years (2008 and 2010) more than 50% of the member states showed divergence in fiscal policies as they failed to achieve the convergence goal set for 2008 and seem to be lagging behind in achieving the 2012 goal.

Government Debt. Lack of consistent data on domestic and external government and government guaranteed debt in SADC states makes the evaluation of the progress with regard to this convergence criterion difficult to ascertain. The existing information does, however, indicate that debt levels in most member states have showed a tendency of borrowing policy convergence. Direct interpretation of the numbers is flawed, however, due to measurement discrepancies across the region (Kumo, 2010:23).

Current Account Balance. South Africa and Zambia were able to meet the 9% less than GDP target by 2008 and Namibia, Botswana, Angola and Lesotho all had favourable balances in the same year. Kumo (2010: 23) and the 2010 figures shown in Table 2 show more promising results. A total of 10 (almost 67%) of the member states had reached the 2012 target by 2010, although the current account positions of several member states was worsened following a sharp drop in foreign demand for commodities during the build

up to the crisis. Global economic recovery and revival in commodity prices since mid-2009 conveniently improved the export performance (and thus the balance on current account) of most member states. The two worst performers in current account balance in 2010 were the Seychelles and Swaziland with a deficit of 50.7 % and 20.6% of GDP respectively. The two best performers by 2010 were Zambia and Namibia with a positive balance of 3.3% being held by Zambia and Namibia with a 1.1% deficit.

Foreign Reserves. Of the SADC member states, 73% had achieved the foreign exchange reserve level equivalent to 3 months or greater of import cover in 2008. This dropped to only 40% of the member states meeting the 2012 target of 6 months' cover in 2009. Conversely, the DRC, Malawi, Seychelles and Zimbabwe were the only countries failing to meet the 2008 target. Even more disappointing are the 2010 figures with only Botswana continuing to hold a foreign exchange reserve level equivalent to 6 months or greater. A number of the member states including the DRC, Malawi, the Seychelles and Zimbabwe experienced severe foreign exchange shortages in 2009 which had serious implications on the stability of their exchange rates. In addition, Zimbabwe's adoption of the US dollar had added destabilising effects on that economy.

Savings and Domestic Investment. Regarding the savings requirements, by 2008 all the countries except 2 (DRC and Seychelles) had met the 5% or more of GDP goal. Seychelles was the only member to be characterised by dissavings with a -8.8% of GDP savings value. By 2010 Seychelles had still failed to meet the 2008 target, but had shown a significant advancement to 3.3%. A significant reversal may be noted in Swaziland's savings, dropping a total of 11% from 2008 to 2010. This could have been a warning sign of the recent developments in the Swazi economy. Nonetheless, most countries including Botswana, Malawi, Namibia and Zambia seem well on their way to attaining the 2012 target of saving up to 30% of GDP. It would be interesting to observe what happens to the savings levels of SACU member states Botswana and Namibia in the wake of debt crises in its fellow union members Lesotho and Swaziland.

With regard to the goal of investment levels being at least 30% of GDP by 2008, it is clear that a number of countries were well within reach of the target with a number of them fluctuating within the mid and high 20% range. The same is true for the 2010 values, again suggesting favourable performances in this regard and satisfactory efforts to maintaining these levels.

Prima facie, it would appear that the SADC community is in fact moving towards achieving a state of increased macroeconomic convergence. As mentioned above, this progress continues to be asymmetrical as well as unstable and unpredictable. The presence of a number of other issues that are not immediately apparent in the data does, however, mean that the picture may not be as favourable as it first appears to be.

Firstly, the lack of focus on intra-regional trade flows in tracking such convergence could give biased and unreliable results. The crux of the convergence debate should be how the growth and diversification of intra-SADC trade will be facilitated and promoted. Burgess (2009) observes that intra-regional trade flows in SACU account for about 20% of total trade, but only 5% if South Africa is excluded. The case for SADC is similar, providing a clear indication of the union's dependence on South Africa which, if not addressed, could cause obstacles against promoting a political union within the region.

Secondly, with respect to the convergence targets relating to the current account and the fiscal balance, it must be remembered that many of the SADC countries are primary commodity producers and exporters. Progress with regard to the achievement of these convergence targets may thus be argued to be the result of fortuitous movements in commodity prices rather than being the outcome of policy action undertaken. Divergence from the targeted levels in the future is thus plausible, or even probable, in the event of a failure to achieve adequate diversification. The structure of the proposed member economies also means that shocks to the union members will be *symmetrical* and adjustment accordingly made more difficult.

Finally, recent experience with Swaziland would seem to indicate that the challenge of forming the necessary 'political union' may be a lot more complex than envisaged, even supposing that a sense of

'regional identity' can be created and fostered. As recent EU experience has shown, this is not an insignificant issue.

6 CONCLUSION

With the benefit of some 'hindsight' into the EU experience, it is apparent that the potential problems facing proposed monetary unions in general, and that of the SADC in particular, are more severe than the theory suggests. The macroeconomic structure of the proposed member countries suggests that the union members would be subject to symmetrical shocks and, given this, the necessary stabilisation policy would be difficult to implement. It is tentatively concluded that, if the idea of forming a monetary union is adhered to, that the programme needs to be revised and attention given to some important areas such as diversification of production in the member countries. Realistically, other means of achieving the stated socio-economic goals should be considered; it is clear that a monetary union is not a panacea.

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