CHAPTER 5: INTEGRATION OF THE FINANCIAL SECTOR IN SOUTHERN AFRICA

5.1 Introduction

Financial market integration has grown rapidly during the late 1980s and 1990s due to the increase in pace of the globalisation of investments seeking higher rates of return and the opportunity of diversifying risk globally. Many developing countries are encouraging capital flows by dismantling financial controls and deregulating their domestic financial markets.

The increase in the degree of integration of global financial markets is accompanied by an increase in the development of economic integration groupings. Integration with neighbouring countries can produce economies of scale when competing with other regions of the world. It can be one way that countries could ensure that the best use is made of the resources, capabilities and abilities within their region (Mboweni, 1999:1).

In the world of increasing interdependence, and with global financial markets, the question of addressing regional financial integration is becoming more urgent. This chapter analyses the nature of financial market integration in southern Africa, looking mainly at the various issues pertaining to the integration of the banking sector in the region.

5.2 Integration of the banking sector in southern Africa

Regional financial integration is principally dependent on the integration of the banking sector since banking is the main source and conduit of finance. The banking sector is primary in the development of other financial markets since it

has the capacity to mobilise savings and investment, which gives promise for financial instruments and market innovation.

Sound bank regulation and supervision enhances the prospects of a healthy financial system which boosts the financial integrity and stability of the region as a whole. The chapter analyses the possibility of integrating the banking sector in southern Africa. It also looks at structural issues, regulatory frameworks and strategies for increasing the pace of bank sector integration in the region.

5.2.1 The size and structure of the banking sector in southern Africa

The southern African region has a less than enviable reputation because acute banking and financial problems confront the regional banking sector. Generally, in most regional member countries the banking sector is severely crippled by extreme financial distresses. This contributes to financial and macro economic instability. The banking sector has failed to play a positive role in financial intermediation and as an agent for the allocation of financial resources in the region.

The structure of the banking sector is characterised mainly by government ownership in some countries, low financial depth, low liquidity, a poor supervisory framework, and a low level of sophistication in terms of the market operation. However, financial and banking development and innovation is growing in the region (SADC, 2007).

The southern African region is characterised by the co-existence of private and state ownership, with the exception of South Africa. The private banking sector is primarily dominated by foreign and South African banks that have made considerable inroads in the region. They have expanded their operations

continentally beyond the SACU and MMA borders. The South African banks are actually accelerating the pace of regional financial market integration.

Table 5.1: International ranking of African banks, 1999

COUNTRY	BANK	RANKING 1999
SA	Stanbic	157
SA	ABSA Group	193
SA	Nedcor	231
SA	First rand Bank	257
SA	NBS Boland Bank	274
SA	Investec Group	352
Morocco	Credit populaire du Merc	413
Morocco	B. Marocainedu Commece Exterieur	543
Nigeria	First Bank of Nigeria	369
Morocco	Bonque Commerciale du Moroc	629
Tunisia	Baque Nationale Agricole	864
Morocco	Wafabank	700
Nigeria	Union Bank of Nigeria	708
Mauritius	Mauritius Commercial Bank	861
Kenya	Kenya Commercial Bank	950

[Source: Bank Survey Africa, 2002]

The regional banking sector is still under-developed when compared to its global banking counterparts, again with the exception of South Africa. The South African banking sector is tapping into the whole continent and is very competitive regionally and internationally.

Table 5.1 illustrates the ranking of the key international banking players in the African context. The table indicates that six southern African banks rank among the top 300 in Africa and internationally. In the regional context, the Mauritius Commercial Bank is also ranked among the top banks in Africa.

The region generally appears to be well capitalised and profitable based on their healthy capital adequacy ratios and returns on assets. The banking market is broadly dominated by lending in the following areas: foreign loans, retail, bills, public sector, mortgage, instalment, equities and corporate banking. The banking sector also overlaps into other financial sectors like insurance, unit trusts, financial services and micro lending.

There is great potential for integration in the banking sector, most importantly with the setting of common regional standards. Regional harmonisation in terms of bank regulation and supervision should be promoted to establish a common regulatory and supervisory framework at the regional level.

5.2.2 The integration costs of the banking sector

Regional financial integration in southern Africa will usher profound benefits for regional economic growth and development. However, there will be significant costs associated with the integration of the banking sector in the region. These costs would put pressure on the banking sector in the region. The severity of the pressure will depend mostly on the integration processes and the intensity across the region might vary because of the strength of the domestic banking sector during the pre-integration phase.

A number of costs have been identified by Cabral et al. (2002:45) for the general bank sector:

i. Increased competition in banking
ii. Reduction in bail outs
iii. Increase in mergers and acquisitions
iv. Pressures in regulators and legislators
v. Increase in operational costs
vi. Sinking profit margins

vii. Technological costs
viii. Skills development and training costs
ix. Increase in legal costs (e.g. validation of conducts).

5.2.3 Supervisory and regulatory framework in the southern Africa region

Taking into account the diverse nature of the banking sector in the region, much more concerted efforts should be made to develop a rigorous framework for bank regulation and supervision. This creates greater scope for the regional integration of the banking sector, where southern Africa can serve as an anchor in the process of harmonising and lifting less developed countries to global banking standards.

Regional initiatives should set rigorous common regional standards. This would allow the regulatory and supervisory authorities to pay special attention to compliance and monitoring policies and procedures that would enhance the development of the banking sector. A sound regional framework will develop and strengthen the southern African financial system. The regional banking sector will be able to handle cross-border problems and lobby regional syndication of larger lending activities. This would reduce high exposure to a few large borrowers.

5.2.4 Regional integration of bank regulation and supervision in southern Africa

Regional integration of bank regulation and supervision in southern Africa has predominantly been carried out under the auspices of the SADC and ESAF umbrella. The initiatives of establishing a common regional set of standards and supervisory practices are urgent in enhancing a sound and prudent regional framework.

The ESAF Annual Report (2000) details some basic projects that had been undertaken to date on regional regulatory and supervisory activities. They are now discussed individually.

i. Compliance with core principles of effective banking supervision

All ESAF member countries which are all SADC countries inclusive of Kenya, which endorsed the Core Principles for effective Bank Supervision and have declared their intention to implement the Core Principles within a reasonable time frame.

ii. Harmonisation of accounting and audit standards

The Eastern, Central and Southern African Federation of Accountants (ECSAFA) was established with the objective of harmonising the accounting and audit standards on a broader basis. Member countries implemented the International Accounting Standard 30 (AIAS 30).

iii. ESAF training programmes

Various training programmes were installed to address the training and skills needs for the region. The courses were facilitated by the IMF, Financial Stability Institute and South African Reserve Bank.

iv. Off-site and on-site surveillance model

The off-site and on-site supervisory model was developed by the World Bank for the implementation in the region of which great progress has been made to date.

v. ESAF Website and standard data collection

ESAF Website was launched on 31 March 2000, which enables the distribution of information and documentation in the region. The website is

interactively used for the publication of statistical information which is collected through the D1 900 forms.

vi. **Harmonisation of provisioning standards**

Harmonisation in this area is of cardinal importance because it is used to identify common standards of provisioning for identically perceived risks in the banking book for banking supervisors of the region.

vii. **Deposit-insurance scheme for the region**

Progress is made in the development of the regional legal framework of deposit insurance scheme.

viii. **Research projects**

Various research projects have been conducted on a continuous basis on various regulatory and supervisory issues.

ix. **Regional harmonisation of business application and technological architecture of banking supervision**

The region is developing business applications and technological architecture for the region, with the intention of harmonising supervisory legislation, regulations, procedures and systems at national and regional level.

x. **Harmonisation of e-banking supervision standards**

The ESAF Secretariat developed a guideline in dealing with e-banking in the region as it is becoming a worldwide issue (ESAF Annual Report, 2000).

5.2.5 The role of South African banks in integrating the banking sector in southern Africa

The South African banking sector is emerging as a force to be reckoned with because of their growth, and extension into Africa and international markets. Most

of the big four banks are making acquisitions and developing branch networks into Africa, especially in the southern African region South African banks dominate in the MMA, SACU and SADC territories.

Globalisation has contributed to encouraging some SA-based banks like Investec to list on the London and New York Stock Exchanges and some foreign based banks to invest in Africa.

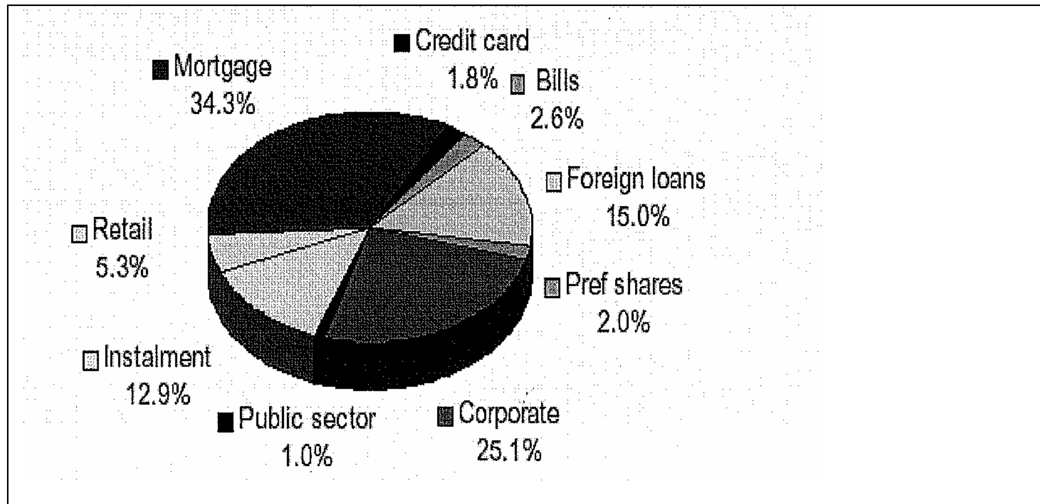
The South African banking system is well developed and largely established according to the Western European model, due to the countries colonial history. The South African banking sector is astute and highly rated. It is considered to have a prudent regulatory and legal infrastructure and well developed accounting standards and disclosure practices.

The industry structure is dominated by four large banks. There are, however, 58 licensed deposit-taking institutions of which 33 are domestically owned, 8 foreign owned, 2 mutual banks and local bank branches of foreign banks.

In addition there are 55 foreign bank representative offices in the South African banking sector, which create linkages with the international markets (SARB, 2002: 79–85).

The banking sector is offering a wide range of comprehensive banking products and services, which include mortgage, credit, retail, foreign loans, instalment sale, public sector and corporate banking services.

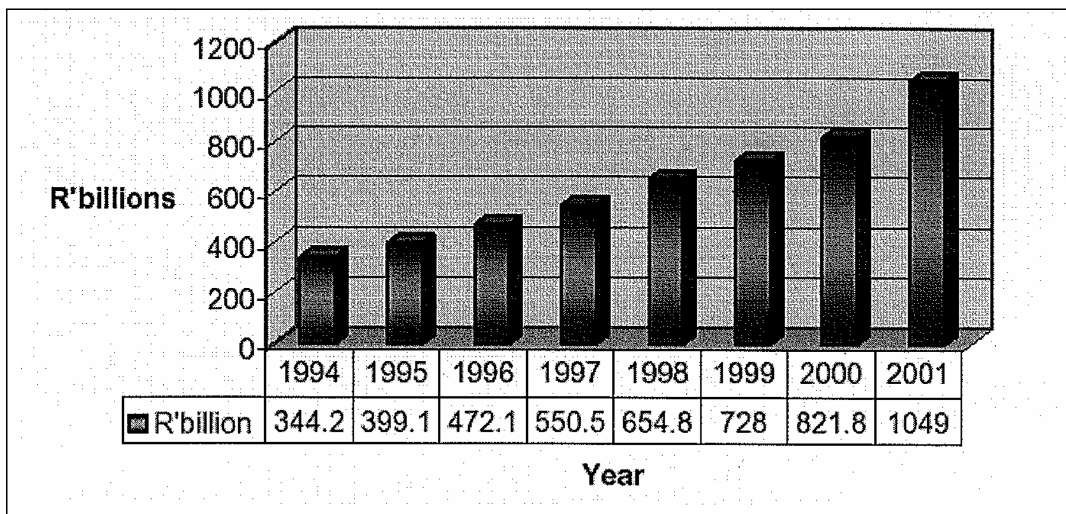
Figure 5.1: SA banks' credit extension by type, 2001



[Source: Bank Survey Africa, 2002]

The banking sector is relatively stable with an increase in general asset growth. The total banking assets base is standing at R1 049, 3 billion as at December 2001.

Figure 5.2: SA banks' total assets, 1994-2001

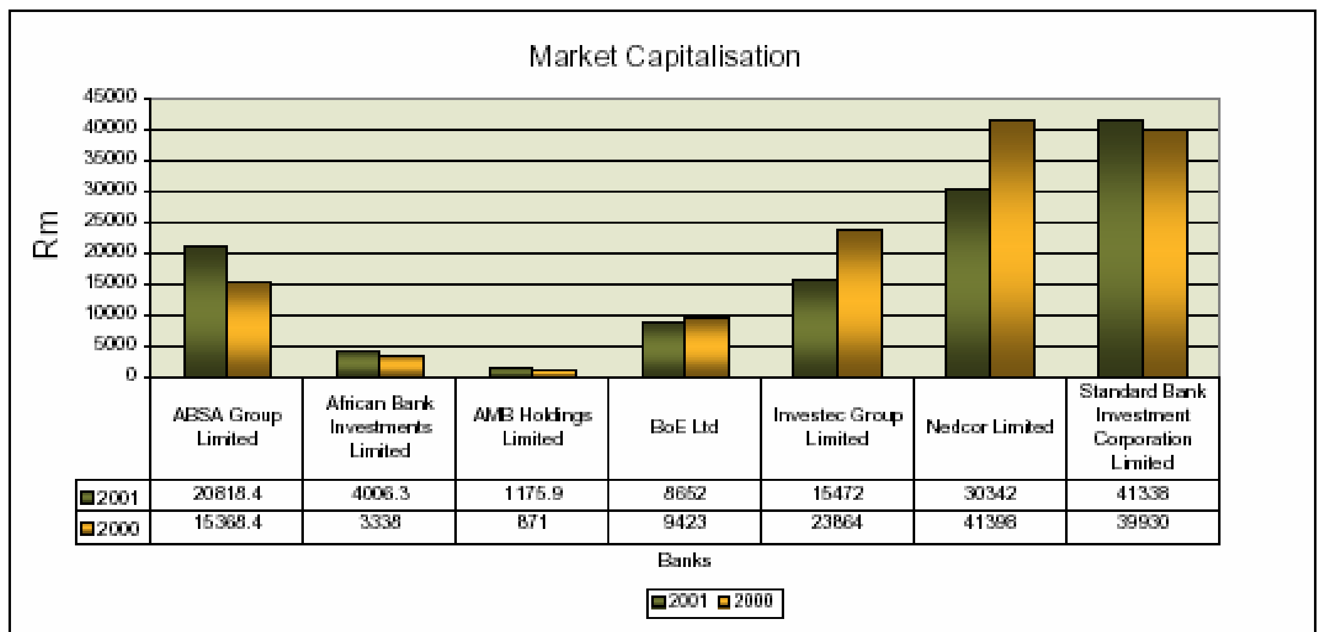


	1994	1995	1996	1997	1998	1999	2000	2001
R'billion	344.2	399.1	472.1	550.5	654.8	728	821.8	1049

[Source: Bank survey Africa, 2002]

Figure 5.2 illustrates the growth pattern in terms of bank assets in South Africa between 1994 and 2001. Total banking asset growth was 70 percent between 1994 and 2001. The bank sector capitalisation steadily improved. This is demonstrated by the performance of the top seven banks in South Africa.

Figure 5.3: SA banks' market capitalisation, 2000/1

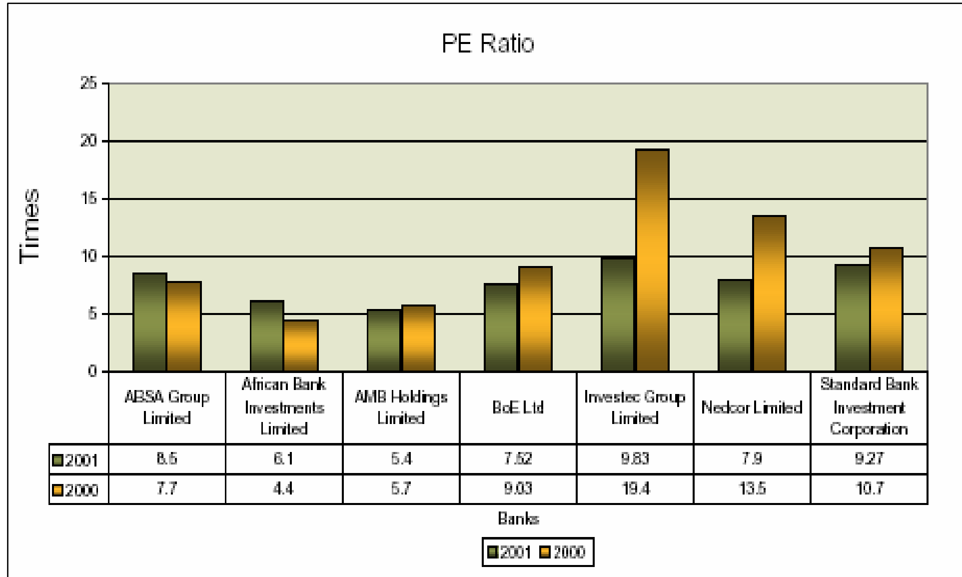


	ABSA Group Limited	African Bank Investments Limited	AMB Holdings Limited	BoE Ltd	Investec Group Limited	Nedcor Limited	Standard Bank Investment Corporation Limited
2001	20818.4	4006.3	1175.9	8652	15472	30342	41338
2000	15368.4	3338	871	9423	23864	41398	39930

[Source: Bank Survey Africa, 2002]

The industry is relatively well in terms of return on investments for the shareholders. This could also be illustrated by looking at the individual PE ratios for the period 2000 to 2001. The average PE ratio was 10 for 2000 and 2001 respectively. This also indicates that BOE, Investec, Nedcor, AMB and Stanbic experienced decline in their respective PE ratios for 2001.

Figure 5.4: SA banks' PE ratio, 2000/1



	ABSA Group Limited	African Bank Investments Limited	AMB Holdings Limited	BoE Ltd	Investec Group Limited	Nedcor Limited	Standard Bank Investment Corporation
2001	8.5	6.1	5.4	7.52	9.83	7.9	9.27
2000	7.7	4.4	5.7	9.03	19.4	13.5	10.7

[Source: Bank Survey Africa, 2002]

The South African banks have shown good profitability although there are lots of challenges which need to be overcome. The banks in South Africa are also receiving accolades in terms of good credit ratings reflected by their current ratings on the national scale of South Africa.

Table 5.2: International ranking of African banks, 2000/1

Bank	Ranking**	
	2001	2000
Standard Bank Investment Corporation	146	159
Nedcor Bank	158	204
ABSA Group	250	203
FirstRand Banking Group	300	316
Investec Bank	331	343
Boe Bank	455	422
Mercantile Lisbon Bank Holding Ltd	n/a	983

[Source: Bank Survey Africa, 2002]

Table 5.2 indicates that the six top banks in South Africa are ranked among the top 1000 banks in the world in 2001. Generally, all top SA banks are ranked among the top 300 in the world. The stability of the South African banks will contribute significantly in the integration of the banking sector and other financial markets in the long term.

Table 5.3: Credit ratings of African banks, 1999

Locally registered banks and other financial institutions	Long-term rating	Short-term rating	Outlook
Absa Bank	ZaAA-	ZaA1+	Stable
African Bank	ZaBBB+	ZaA2	Stable
BOE Bank	ZaA	ZaA1	Positive

FirstRand Bank	ZaAA-	ZaA1+	Stable
Gensec Bank	ZaAA-	ZaA1+	Stable
Imperial Bank	ZaA	ZaA1	Stable
Investec Group	ZaA+	ZaA1	Stable
IOTA Financial Services	ZaBBB-	ZaA3	Stable
Mercantile Bank	ZaBBB-	ZaA3	Stable
Mettle	ZaBBB	ZaA2	Stable
Nedcor Investment Bank	ZaA	ZaA1	Stable
PSG Investment Bank	ZaBBB+	ZaA2	Stable
Safrich Financial Services	ZaBB+	ZaB	Stable
Securities Investment Bank	ZaBBB	ZaA2	Stable

[Source: Bank Survey Africa, 2002]

The South African banking sector is also ranked highly against other international institutions. This is illustrated by their ranking based on the dollar equivalent of the bank's BIS Tier 1 capital.

5.3 Overview of clearance, settlement and payment systems in southern Africa

The clearance, settlement and payment systems are a critical component in the integration of the banking sector and other financial markets. It enhances efficiency and also reduces risks associated with financial markets. Africa is lagging behind the world with regard to financial infrastructure architecture when it comes to the continent's improvement of financial markets.

The African continent, together will the various sub regions should implement synchronised clearance, settlement and payment systems to reduce systemic risk. This would also develop sound links with the various banking sector role players, regionally, continentally and with rest of the world.

The clearance, settlement and payment systems in southern Africa are also characterised by manual systems as compared to electronic and Real Time Gross Settlement (RTGS) systems in the developed world. Only six countries, namely South Africa, Malawi, Mauritius, Namibia, Tanzania and Zimbabwe are on the RTGS system. Tanzania is using both the manual and electronic systems because of its infrastructural deficiency.

Table 5.4: Payment systems in SADC

COUNTRY	MANUAL	ELEC-TRON-IC	RTGS	AGENT	INTERNA-TIONAL
Angola	X			Central Bank	S.W.I.F.T
Botswana	X	X		Central Bank	S.W.I.F.T
Lesotho	X			Central Bank	S.W.I.F.T
Malawi			X	National Payment Council	S.W.I.F.T
Mauritius			X	Central Bank	S.W.I.F.T
Mozambique	X			Central Bank	S.W.I.F.T
Namibia			X	Central Bank	S.W.I.F.T
South Africa			X	Central Bank	S.W.I.F.T
Swaziland		X		Central Bank	S.W.I.F.T
Tanzania		X		Non Central Bank	S.W.I.F.T
Zambia		X		Central Bank	S.W.I.F.T
Zimbabwe		X	X	Central Bank	S.W.I.F.T

NB. Manual – manually operated system RTGS – Real Time Settlement System Electronic.

[Source: Payment Systems in Southern African Development Community, 1999]

Table 5.4 illustrates the structure of the payment systems in the southern African region today, indicating the type of system, the agent overseeing the system and also indicating the usage of S.W.I.F.T., which is the international settlement link.

5.3.1 Barriers to integrating clearance, settlement and payment systems in southern Africa

5.3.1.1 Legal framework

Many southern African member states in the region do not have specific legislation to govern their own payment systems. More efforts should be made in developing domestic legal frameworks. This would be harmonised with other payment system legal frameworks in the region. The process should include all dynamic changes and all payment system participants in the region.

5.3.1.2 Communication and power supply infrastructure

The region is also experiencing an integration barrier arising from the lack of reliable communication infrastructure and power supply in most member states. The regional authorities should encourage development of telecommunications infrastructure and power supply in ensuring that the regional payment system is developed within a safe and efficient framework.

5.3.1.3 Effects on inflation costs

The region's economic situation is characterised by adverse conditions, in terms of inflation, economic growth and financial stability. In an environment of high inflation and unstable exchange rates, the development and modernisation of payment systems is likely to be constrained by increasing costs of software, hardware and labour.

5.3.1.4 Dominance of the banking system by a few large South African banks

The region's banking system is dominated by SA banks, which might pose problems for cooperating in the integration or development of new payment systems. This may be because of the complacency benefits of their current systems, which would indirectly influence the choice and development of the regional payment system.

5.3.1.5 Great disparity in technologies used by banks in the region

The region experiences great disparity in terms of technologies used in its payment systems. This varies from country to country and overlaps in the regional boarders. This creates a barrier to integrating the systems since different technologies are applied and are difficult to interface. The development of integrated payment systems should incorporate all these disparities in their operating technologies.

5.4 Integration initiatives on the clearance, settlement and payment systems in southern Africa

The integration initiatives of the payment systems in the region are mainly undertaken though the PTA Clearing House, MMA and SADC multilateralism arrangements. The PTA Clearing House has been operating since 1984 and provides clearance, settlement and payment facilities for eleven countries in the region. They are Angola, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe (Economic Integration in Southern Africa, 1993:164).

The MMA also makes provision for the clearance, settlement and payments of transactions between South Africa, Lesotho, Namibia and Swaziland. Integration initiatives for the clearance, settlement and payment system in the region would be insufficient without making mention to SADC'S contribution.

Significant progress has been made by the Committee of Central Bank Governors (CCBG) in SADC, in coordinating the regional integration of payment systems. The projects are outlined below:

- The SADC have completed a document, Guide to Developing a Strategic Framework for Payment System Modernisation in 1997 which serves as a guide handbook to assist member countries in reforming their payment systems.

- Vision and Strategic Framework documents, which describe the strategic framework for the modernisation of SADC countries' payment systems.

- Payment Systems in the Southern African Development Community. This is a statistical document on Payment Systems in SADC which was completed in 1999, popularly known as the Green Book.

- Assistance to SADC member countries with the development of clearing and settlement systems. The SADC Payment System Project Team has continuously provided assistance to member countries in various aspects of the development of clearance, settlement and payment systems.

- National Payment System legal framework. The SADC have initiated a project in the drafting of a model National Payment Systems Act that is currently in progress of completion.

5.5 Integration strategy for clearance, settlement and payment systems in southern Africa

In essence, the strategy for the development of the clearance, settlement and payment systems in the region should establish adequate machinery in promoting financial market integration. The system should encourage the use of national currencies in the settlement of transactions between member countries in the region.

- The integration of the clearance, settlement and payment systems should have an impact on the member countries, with some potential gains (Economic Integration in Southern Africa, 1993:166), which may include:

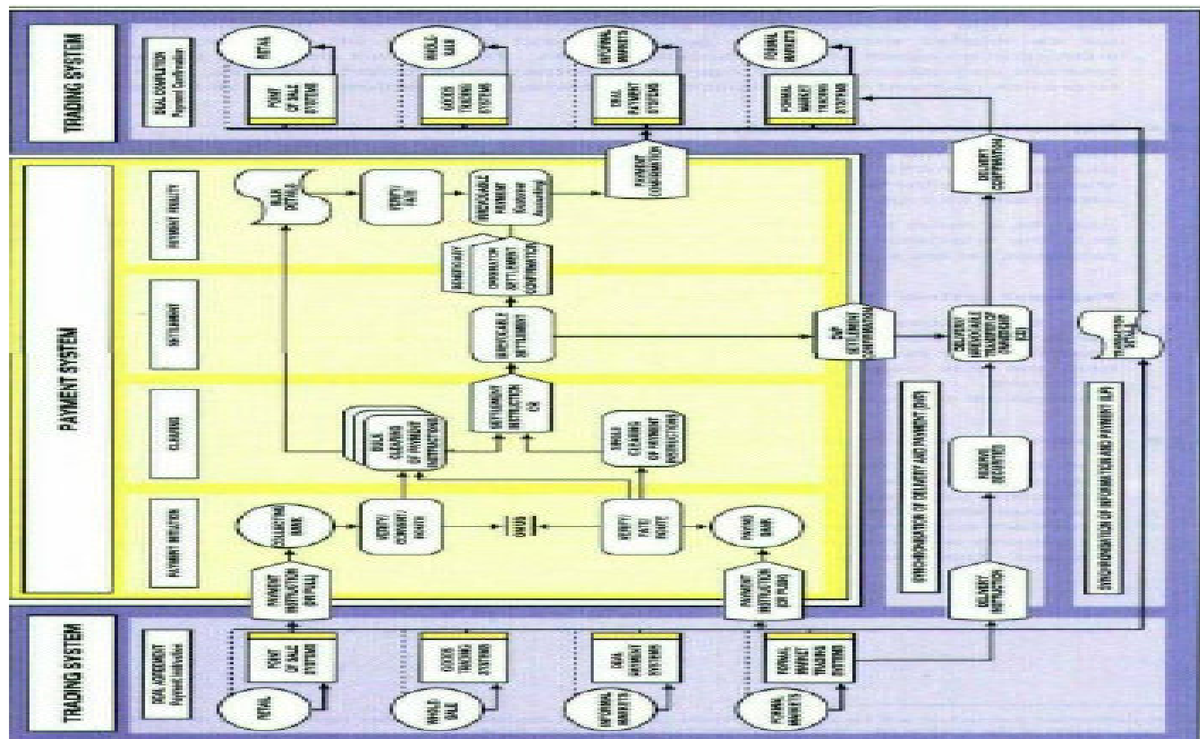
    - Reduction in monetary reserves
    - Reduction in correspondent balances
    - Minimising the transaction costs
    - Speeding up the growth of intra regional payments

The regional payment system should be developed with a view of reducing a range of risks, which could be broken down to credit risks, liquidity risks, legal risks, operational risks and systemic risks. The payment system for the region should be based on the BIS Core principle, which set standards for reliability and security. The BIS Core principles for systemically important systems are outlined by the Committee on Payment and Settlement Systems (2000) as follows:

- The system should have a well-founded legal basis under all relevant jurisdictions.

- The system's rules and procedures should enable participants to have a clear understanding of the system's import on the financial risks they incur through their participation.
- The system should have clearly defined procedures for the management of credit risks and liquidity risks.
- The system should provide prompt final settlements on the day of value preferably during the day and at a minimum at the end of the day.
- A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.
- Assets used for settlement should preferably be a claim on the central bank, where other assets are used; they should carry little or no credit or liquidity risks.
- The system should ensure a high degree of security and operational reliability with contingency arrangements.
- The system should provide a means of making payment, which is practical for its users and efficient for the economy.
- The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
- The system's governance arrangements should be effective, accountable and transparent.

Figure 5.5: Overall payment process in SA



[Source: South African National Payment System, 1995.]

The regional authorities should design a regional payment system that has the capacity to function efficiently.

- ❖ The system process should include the following critical components in sequence (SADC: Guide to Development a Strategic Framework for Payment System Modernisation, 2002:20):
- ❖ Deal agreement
- ❖ Payment initiation
- ❖ Clearing
- ❖ Settlement
- ❖ Payment finality
- ❖ Synchronisation of delivery and payment
- ❖ Synchronisation of information

- Deal completion

5.6 Integration of the equity market in southern Africa

The integration of financial markets would be inadequate without the harmonising and integration of the equity markets in the region. This is fundamental in developing the base of other derivative markets and also channelling capital plans in the southern region of Africa.

Equity markets' development has sound long-term benefit for economies in their development stages because the equity markets can mobilise long-term savings for financing long-tenured investments, provide risk capital (equity) to entrepreneurs, encourage broader ownership of firms and improve the efficiency of resource allocation through competitive pricing mechanisms (Emenuga, 1997: 157).

The integration of equity markets will enhance sound benefits for the whole region in terms of financial market development. This section looks at a general overview of capital markets in the region and the obstacles in integrating equity markets. A discussion is also envisaged on the regulating framework, cooperation, initiatives and finally recommendations on the integration strategy of equity markets in the region.

Most of the stock exchanges in Africa range from the larger South African and Egyptian exchanges that were established in the 1880s to smaller exchanges in Uganda and Mozambique only in the past four years (African Stock Market Handbook, 2003: 1).

The southern African region has much more stock exchanges when compared with the African region. Out of 18 exchanges in Africa, 50 percent are established in the region. Southern African region indices, weighted by country market

capitalisation, have outperformed most development and emerging markets indices. The cumulative returns in the past five years in US dollars for southern Africa have been 43 in comparison to -3.9 percent for the S&P 500 and -15.5 percent for the UK FTSE 100 (African Stock Market Handbook, 2003: 1).

5.6.1 Overview of the equity market in southern Africa

The equity markets in Africa as a whole have a diverse and contrasting nature. The continent has 20 operational stock exchanges out of 53 countries, with small market capitalisation. The equity markets in southern Africa are now discussed at the hand of the African Stock Markets Handbook (2003:20).

Southern African stock markets are gradually developing with the aid of South Africa, which boosts market capitalisation to over 180 billion US $. Out of the 20 stock exchanges, 50 percent are located in the southern region of Africa. These include Botswana, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

Stock Exchanges in southern Africa are still lagging behind in terms of growth and development, but increasing positive developments in the region enhanced by privatisation, macro economic developments and developments in other financial markets like insurance and banking sector.

Southern African stock exchanges also face a number of challenges in entering the growth phase. The most critical impediments include a wider dissemination of information on these markets, lack of sound and robust electronic trading systems, capital restrictions, poor settlement systems and a sound regulatory framework. The other critical obstacle is an unliberalised market structure which discourages market participation by the foreign investor community.

5.6.1.1 Market size

The southern African stock markets have a peculiar feature, in that there are very few companies listed in their markets and none listed in some countries.

The number of listed companies in the region is very small by international standards; with the exception of South Africa which has the biggest and most advanced stock market.

Table 5.5: Number of companies listed on stock exchanges in SADC, 1992-2002

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Botswana	11	11	11	12	12	12	14	15	16	16	19
Malawi	-	-	-	-	1	3	6	6	7	7	8
Mauritius	22	30	35	40	40	40	40	41	40	40	40
Mozambique	-	-	-	-	-	-	-	-	-	-	-
Namibia	3	4	8	10	12	13	15	14	13	13	13
South Africa	683	647	640	640	626	642	668	668	616	542	472
Swaziland	3	4	4	4	6	4	5	7	6	5	5
Tanzania	-	-	-	-	-	-	2	4	4	4	5
Zambia	-	-	-	2	6	7	9	9	9	9	11
Zimbabwe	62	62	64	64	64	64	67	70	69	72	77
Africa total	1771	1785	1811	1875	1784	1818	2078	2279	2273	2233	2213
Southern Africa	773	747	762	772	767	784	826	834	780	708	650

[Source: Liquid Africa, S&P Emerging Market Handbook, 2003]

Most of the listed companies in the southern African region are foreign owned firms and this indicates the lack of financial sovereignty and underdevelopment of financial markets in the region. The phenomenon arises from the fact that the commercial sector is still dominated by the government as well as structural

problems such as entrepreneurial skills, capital resources, technological developments and the liberalisation of financial markets. The growing pace of liberalisation, privatisation and regional integration will nurture the development and growth of the stock markets in the region.

Table 5.6: SADC stock listed on various stock exchanges in SADC and abroad

Market	Index	Weighing	Local currency	Us currency
Botswana	DCI	13%	8.8%	41.4%
Malawi	-	-	-	-
Mauritius	SEMDEX	10%	27.2%	30.8%
Mozambique	-	-	-	-
Namibia	NSX Local	2%	-38.8	-15.8%
South Africa	JSE overall	-	-7.4%	27.9%
Swaziland	-	-	-	-
Tanzania	-	-	-	-
Zambia	LuSE	2%	24.9%	9.9%
Zimbabwe	ZSE	11%	122.1%	-52.2%
UK	FTSE-100	-	-22.5%	-14.2%
US	S&P 500	-	-22.4%	-22.4%

[Source: Liquid Africa, S&P Emerging Markets Handbook, 2003]

5.6.1.2 Market liquidity

The southern African equity market dwarfs the others in terms of market capitalisation, turnover, and new issue volumes. However, it remains illiquid by international standards. Stock market liquidity refers to the ease of buying and selling shares in the market. Liquidity is very important for a number of reasons,

namely economic growth, market development and more financial instrument innovations.

Generally, investors are not interested in illiquid markets because an exit cannot be made at the desirable time. The more liquid the stock market is, the more it commands investor's interest and creates more access to debt, and equity and shares become easily acceptable as collateral for bank lending, which boosts credits and investments (Emenuga, 1997:161).

The quality of liquidity in the regions stock markets lacks which also affects the turnover ratio, which is a measure of the value of shares traded relative to the total market capitalisation.

Table 5.7: Market capitalisation of SADC stock exchanges in US dollars, 1992-2002

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Botswana	295	261	377	398	326	614	724	1052	978	1269	1717
Malawi	-	-	-	-	15	110	148	161	212	152	107
Mauritius	424	842	1578	1562	1693	1754	1849	1643	1335	1061	1324
Mozambique	-	-	-	-	-	-	-	-	-	-	-
Namibia	21	28	201	189	473	689	429	691	311	151	201
South Africa	103537	171942	225718	280526	241571	232069	170252	262478	204952	139750	182616
Swaziland	111	297	338	339	471	129	85	95	73	127	146
Tanzania	-	-	-	-	-	-	236	181	233	398	695
Zambia	-	-	-	19	195	705	301	280	236	217	231
Zimbabwe	628	1433	1828	2038	3635	1969	1310	2514	2452	7972	11689
Southern Africa total											
Africa Total	113423	184845	249334	309471	283317	281251	225772	325419	260777	195202	244672

[Source: African Stock Market Handbook, 2003]

Table 5.8: Value of SADC stock traded in US dollars, 1992-2002

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Botswana	15	20	31	38	31	59	70	38	47	65	62
Malawi	-	-	-	-	-	-	10	6	9	21	3
Mauritius	10	39	86	69	81	142	104	78	74	109	59
Mozambique	-	-	-	-	-	-	-	-	-	-	-
Namibia	-	-	18	3	41	24	13	22	22	8	129
South Africa	7767	13049	15607	17048	27202	44722	58347	72917	77494	69626	76792
Swaziland	-	-	2	-	2	378	-	-	-	10	-
Tanzania	-	-	-	-	-	-	-	7	40	8	19
Zambia	-	-	-	-	3	8	3	12	8	53	2
Zimbabwe	20	53	170	150	255	539	186	227	279	1530	131
Southern Africa total											
Africa total	18140	13910	17928	21189	30966	53353	65677	85677	91171	77228	85825

[Source: Liquid Africa, S&P Emerging Market Handbook, 2002]

5.6.2 The integration obstacles in the equity markets in southern Africa

The stock markets in the region are characterised by relatively small capitalisation and liquidity levels. Southern African stock exchanges confront a number of challenges before they could be integrated regionally and globally. The most critical impediments include a number of issues like slow privatisation, openness and market barriers, financial market development, market infrastructure and regulatory regimes.

5.6.2.1 Slow pace of privatisation

Privatisation of public assets is a cardinal conduct in channelling capital in the private sector and also increasing private sector activities in the development of economies in many developing countries. Privatisation creates opportunities for developing stock markets through the public offering of the privatised shares. The pace of privatisation in the past decade has slowed.

SADC governments have embarked on privatisation programmes for unleashing the economic potential of the region and also attracting new capital investments with transference of technical capacity to safeguard long-term employment in the region.

5.6.2.2 Openness and market barriers

The regional economies are still constrained by the openness to international markets and certain market barriers like exchange controls are also obstacles for some member countries' economies to trade internationally, which also slows the pace of financial development in the region.

5.6.2.3 Regulation and supervision

A sound regulatory and supervisory environment is very important in the development and integration of stock exchanges. The region must harmonise or align their regulatory and supervisory standards required for the efficient operation for stock exchanges and this includes registration of securities, monitoring market activities, licensing and ensuring compliance with approved global practices and conduct.

The existence of sound regulatory and supervisory frameworks enhances the confidence of internal and external investors in the regions' capital markets. The committee of SADC stock exchanges has initiated many projects in promoting quality regulation and supervision of capital markets for the region.

5.6.2.4 Market Infrastructure

The stock exchanges in the region are also experiencing obstacles in terms of developing the systems and regional integration because of inadequate market infrastructure. This includes the under developed trading on un-automated trading systems, telephone lines and insufficient existence of electronic communication. The market infrastructure hinders the harmonisation of trading systems across countries in the region.

5.6.3 The regulatory framework of the stock markets in the region

The stock exchanges in the region operate under diverse market conditions and each stock exchange has its own peculiar set of rules which governs its market operation with the purpose of regulating the securities markets. They also ensure fair play and transparency by all market participants.

The prudence of stock exchange regulation not only enhances market activities but most importantly, it maintains and improves market integrity which will encourage market participation and capital flows in the region.

The primary function of the regulators is threefold, namely:

- Promoting investors' interests and enhancing their confidence in the capital market;
- Ensuring orderly, fair and equitable dealing in securities;

- Promotion of growth and development of capital markets (Emenuga 1997:163).

Table 5.9: Regulatory institutions of stock exchanges in SADC

Country	Stock Exchange	Market Regulatory
Botswana	Botswana Stock Exchange	Botswana stock exchange committee
Malawi	Malawi Stock Exchange	Stock exchange committee
Mauritius	Stock Exchange of Mauritius	Financial Services commission
Namibia	Namibian stock exchange	
South Africa	Johannesburg stock exchange	Financial service board
Swaziland	Swaziland stock market	Capital markets development unit
Tanzania	Dar-es-Salaam stock exchange	Dar-es-Salaam stock exchange
Zambia	Lusaka stock exchange	Securities exchange Commission
Zimbabwe	Zimbabwe stock exchange	Zimbabwe stock exchange committee

[Source: African Stock Market Handbook, 2003]

The region's stock exchanges are all regulated by their own agencies with different sets of rules which need to be harmonised to encourage cross border listings and the development of an integrated supervisory institution for the region.

The development of effective regional securities and exchanges enhances the quality of regulation and supervision of the capital markets and boosts the confidence of internal and external investors in the capital markets in the southern African region.

The regulatory framework should enhance integrity of the regional stock markets by attracting foreign portfolio investment and reducing the potential costs associated with regional financial integration. This objective is only realised when critical regulatory issues are properly managed and this includes ensuring disclosure of all material information, eradicating insider trading and improving corporate governance.

5.6.4 Cooperation on equity markets in the region

There is a growing development of stock exchanges in Africa and southern Africa, which also requires the continent and regional blocks, like southern Africa, to respond to the globalisation challenges and regional integration initiatives of stock exchanges which will increase capital flows and bring long term macro economic benefits.

Some of the benefits of regional cooperation of stock markets in the region are:

- Expansion of investment opportunity of southern African investors and companies;
- Availability of a broader range of stocks to the region and African investors;
- Reduction of risk on investments through diversification of country macro economic risks.

At the continental level coordination and cooperation of stock exchanges have been undertaken by the African Capital Market Forum (ACMF), which was established in July 1996 and the Association of African Securities Markets (Emenuga, 1997:180).

The southern African integration initiatives of stock exchanges have accelerated very rapidly within the SADC framework, with the vision of harmonising the operations of stock exchanges in the region by 2006. The SADC Committee of Stock Exchanges was formed in January 1997 with membership comprising of countries with stock exchange in Southern Africa, Namibia, Botswana, Mauritius, Mozambique, Swaziland, Tanzania, Malawi, Zambia and Zimbabwe (Regional Economic Review: 2000:86).

i. The aims and objectives of the committee intends increasing cooperation and links in operations, communication, regulations, technical skills, development and other areas on SADC stock exchanges to (Regional Economic Review, 2000:86)

ii. Maintain and improve market integrity and promote markets that are fair, efficient and transparent with proper price discovery

iii. Increase the liquidity of trading in equities, bonds, derivatives and other financial instruments

iv. Enforce legislation and rules to protect participants and investors

v. Render SADC securities markets more attractive to local and international investors

vi. Improve the operational capacity of SADC stock exchanges

vii. Advocate and lobby for private sector led marked integration

viii. Building cooperation between the SADC stock exchanges and their regulators;

ix. Establish a forum through which SADC regional policy makers can consult the regions' existing securities markets before planning further development within this field.

By the year 2006, the stock exchanges in the region would have established an integrated real-time network of the regions' national security markets with a seamless clearing and settlement, compatible with international systems across the region.

Much progress has been made to date regarding the integration of SADC stock exchange. The Johannesburg Stock Exchange (JSE) has played a pivotal role in the regional cooperation initiatives by providing some of the stock exchanges because of its expertise and since it acts as a rapporteur to the International Federation of Exchanges (FIBV) sub-committee on emerging markets in the southern African region (Economic Integration in Southern Africa, 1993).

Some of the successful projects undertaken to date by the SADC Committee of Stock Exchanges are:

- ❖ The harmonisation of listing requirements for issuers identical to the JSE requirements almost completed
- ❖ Harmonisation of procedures for clearing and settlement which is at the advanced stage of implementing a central depository system for the region

The JSE offered Namibia its trading system (Jet trading system) at cost to SADC countries of which Namibian Stock Exchange installed the system in 1998. There are also cross listings of shares on different exchanges in the region. Rationalisation of entry level examination for stockbrokers is improving their expertise in the region's financial markets (Regional Economic Review, 2000:87).

In addition, the JSE has offered technical assistance and continues to disseminate important information to other SADC exchanges. Notwithstanding some of the obstacles that hinder development and integration of exchanges, much progress has been achieved to enhance the critical mass necessary for the development of financial markets in Southern Africa. The region has been confronted with problems that obliviated the chance of close cooperation between regional exchanges.

There are some fundamental obstacles, which include:

i. A lack of institutional investors in the region;
ii. Lack of capital to improve the operational capacity of stock exchanges;
iii. Slow pace of implementing the appropriate regulatory framework for effective functioning of financial markets in the region;
iv. Unliberalised financial markets which also operate within severe exchange control exposure.

5.6.5 Integration strategy for equity markets in southern African region

As noted in this chapter, the southern African stock exchanges in general are very small and under-developed in terms of world standards. This requires rigorous efforts in designing and implementing the integration strategy for the region.

The SADC Committee of stock exchanges has made profound progress in the establishment of an integration stock exchange for the region and harmonisation of stock exchanges. However, there are several ways in which the stock exchanges could be harmonised and integrated for the development of regional financial sector.

The integration strategy could be based on the following strategic framework. Firstly, all member countries should liberalise their financial markets and also completely abolish exchange controls to allow cross boarder capital flows and cross listings in the region. This includes the following:

- ❖ harmonisation of listing requirements and operational procedures of the stock
- ❖ increasing technological cooperation and also implementing a uniformed trading system for the region
- ❖ harmonisation of taxes, investment policies and guidelines and transaction costs
- ❖ development of dual or multiple listings of stock in the national stock exchanges.

Creation of international linkages with other global stock exchanges encourages affiliation by regional countries to the International Federation (FIBV), of which currently the JSE is the only member.

Development of cooperation and assistance to regional countries without stock exchanges sharing infrastructural capacity and human capital development through continuous training and skill development would not lead to sound financial integration.

CHAPTER 6: MONETARY POLICY INTEGRATION IN SOUTHERN AFRICA

6.1 Introduction

This chapter begins with a description of the concept of monetary policy integration followed by a discussion of the benefits and costs of monetary policy integration. Thereafter, global experiences of monetary integration, with special reference to the European monetary integration and the West African Monetary Union (UMOA), are discussed. In the final part of the chapter, the southern African monetary integration process is explored and analysed and conclusions are drawn on the monetary policy integration strategy for southern Africa. The chapter analyses southern Africa's macro economic performance against the monetary integration macro economic framework targets and compares southern Africa's performance against the monetary integration targets of the European Union.

6.2 The concept of monetary policy integration

Any financial integration process would be incomplete or disintegrated if monetary integration were not attained. Global experience indicates that in most regions financial integration is mainly achieved with the establishment of regional monetary integration initiatives. The emergence of the EMU has sparked a new wave of interest in monetary integration in Asia, other regions around the world and Africa. Since the inaugural meeting of the OAU in 1963 and the current integration initiatives like NEPAD, there have been many regional financial and monetary integration initiatives on the African continent.

In theory, monetary integration can be defined as a set of legal arrangements that two or more sovereign countries enter into to unite more closely their monetary systems. The degree of integration distinguishes or characterises the nature of the monetary integration formation. The other traditional approach of dealing with monetary integration is through the '"optimal currency area' (OCA) approach.

An optimal currency area is defined as the optimal geographic domain of a single currency, or of several currencies, whose exchange rates are irrevocably pegged and might be unified. The single currency or the pegged currencies can fluctuate only in unison against the rest of the world (Mongelli, 2002:17).

The OCA properties may include mobility of all factors of production, economic openness, and diversification in production, consumption, fiscal- and political integration.

Monetary integration advances an element of sharing among members, especially in terms of costs and benefits. It also fosters internal and external balance and may serve to protect a country from external shocks.

6.2.1 The benefits of monetary policy integration

The theoretical construct of an optimum currency area is based on the concept of a sizeable geographic area with sufficient labour mobility such that the residents can enjoy potential welfare gains by fixing their exchange rate or adopting a common currency (Mundell, 1961).

Such monetary integration makes possible a number of macro economic benefits to the region in the form of speedy adjustments to unemployment and balance of payment imbalances. The other benefit of monetary integration is price stability, because maintenance of price stability is also associated with significant efficiency gain that results in long term benefits to growth for the whole region. Positive

growth prospects are associated with the elimination of separate currencies. Growth could increase because of broader productive investment and a deeper integrated financial sector.

Other benefits may include high labour mobility, which facilitates equalisation of wages, restoration of employment equilibrium in the event of asymmetrical demand shocks in the region.

Intra regional trade intensity and openness of an economy act as shock transmitters, thereby reducing the need for giving up independent monetary policy in the event of a monetary union. The institutional and structural features of the member countries will to a large extent determine the costs and benefits of forming a monetary union.

Monetary integration also benefits the region by lowering transaction costs between member countries. This is demonstrated by the fact that there will be one single currency and no longer a need to exchange currencies, no exchange rate costs and no need to insure against currency fluctuations within region.

Finally, monetary integration creates the opportunity for lower interest rates to exist. The exchange rate stability is assured and this leads to lower interest rates for the whole region because of the non existence of risk premiums.

Greater economic certainty is experienced in a monetary integration region, because prices and revenues are more stable and this improves the quality of production, investment and consumption decisions in the region.

Monetary integration has been adopted and supported because of some long-term benefits arising from the establishment thereof. This has also contributed to the world-wide acceptance and formation of monetary integration structures in the recent past.

The success of monetary integration depends mainly on the openness and size of the economies forming the monetary union, product diversification, similar inflation rates and the depth of economic integration in the region.

6.2.2 The costs of monetary policy integration

The success of monetary integration is determined by how the integration authorities and structures deal with and manage all the cost issues. These are critical challenges which need to be resolved in order for the benefits of monetary integration to be realised.

The most typical costs of monetary integration are the following (Mongelli, 2002:33):

- Loss of national sovereignty

  One of the arguments against the establishment of a monetary union or joining of a monetary union is said to be the loss of monetary sovereignty. This actually entails the capacity and the ability to engage domestic monetary policy to achieve domestic economic objectives. The loss of monetary sovereignty might be a small price to pay as long as monetary integration will yield definite economic and welfare benefits in the form of lower transaction costs, elimination of exchange rate risk and higher productivity.

  Monetary integration leads to a loss of control over monetary policy by member states, which implies that member states will be unable to use monetary policy as a means to control internal or divergent economic difficulties such as high inflation or a high unemployment rate.

- Loss of monetary policy autonomy

The loss of monetary policy autonomy explicitly implies that member countries will be unable to utilise their monetary policy instruments as a measure to control domestic economic difficulties which might result in less control over high inflation and unemployment.

- Constraints on fiscal policies

Monetary integration also constrains member countries in respect of fiscal policy decisions. Monetary union implies that member countries will be limited in the use of deficit financing through sale of debt, and tax revenue and borrowing will be constrained due to crowding out. Domestic government spending certainly will be limited and constraining the domestic economy in its capacity to absorb new issues of short term public debt in the event of a funding crisis.

6.3 Global experiences of monetary integration

There has been a growing trend and a wide range of monetary integration initiatives around the world which have been triggered mainly by globalisation and the eagerness of countries to open their economies to more opportunities beyond their borders. The most familiar monetary integration institution which has demonstrated the success of regional financial and economic sustainability, post monetary integration, is the European Monetary Union. The success of the Euro has given rise to more regional cooperation and integration of economies on a bilateral and multilateral platform. The African continent is following suit as is exhibited by regional integration initiatives in the various sub regions of the continent.

6.3.1 The European monetary integration

The European Union is an unparalleled example in the current and past processes of regional integration. The European Monetary Union was established in 1999 by eleven European countries after the adoption of the Maastricht Treaty which laid out the objectives and principles of this regional integration initiative.

The EMU has quite a long history which profiles the various phases which it has gone through, from economic integration to monetary integration. The intensified existing economic links contributed to better coordination, and the harmonisation and establishment of a monetary union with a denouncement of domestic currencies by a unilateral link. The process involved the transfer of authority over monetary policies to a supranational institution, the European Central Bank (ECB). However, member states kept their political autonomy and maintained responsibility over the remaining macro economic policies.

6.3.2 History of European integration

The European monetary integration was proposed as early as the fourteenth century, but it was not until the period of reconstruction after the Second World War that it was put into practice.

It was only in 1958 when the Treaty of Rome was ratified that monetary issues were of common concern, especially in relation to exchange rate policy.

The most fundamental event was the completion of the Werner report in 1970, which detailed a proposal on a three stage approach towards monetary union, leading eventually to fixed exchange rates and a common monetary policy.

All the major stages towards the European Monetary Union occurred between 1970-2002, until such time as the Euro currency was in circulation and regarded as a legal tender to all member countries.

Table 6.1 below illustrates the chronology of events which led to the establishment of the EMU as from October 1970 to January 2002.

Table 6.1: Chronology of European economic integration

DATE	EVENT
July 1952	European Coal and Steel Community (ECSC) is established
July 1958	European Economic Community (EEC), and European Atomic Energy Community are established
January 1973	Denmark, Ireland and the United kingdom join the three European Communities
January 1981	Greece joins the three European Communities
January1986	Spain and Portugal join the three European Communities
November 1986	The single European Act is adopted
January 1993	The Treaty on European Union which was signed in February 1992, enters into force
January 1995	Austria, Finland and Sweden join the European Union
May 1999	The Treaty of Amsterdam which was signed in June 1997, enters into force
January 2002	Euro banknotes and coins were put into circulation
February 2003	The Treaties are further amended by the Treaty of Nice, which was signed in 2001 to pave the way for an enlarged European Union
May 2004	The Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia join the European Union, bringing the total number of Member

	States to 25.
June 2004	The EU Member States agree on a Treaty establishing a Constitution for Europe

[Source: The EMU, ECB and the Euro, 2007]

Table 6.1 above outlines the chronological events which led to the EMU dating from July 1952 to June 2004. The EMU was created within the framework of the European Community (EC), which itself had increased significantly since its inception in 1952. The EU now has 25 member countries, with the most recent addition of ten central and eastern European and Mediterranean countries. These member countries will join the EURO at a later stage after meeting all the necessary conditions of adopting the Euro.

6.3.2.1 Phases of European monetary integration

The European Monetary union was designed to follow a three pronged sequential stages:

- **Stage 1**
  This phase occurred during the period of 1990 – 1993 and this was characterised mainly by the establishment of a single market which allows for the free movement of factors of production within Europe.

- **Stage 2**
  The second stage occurred during 1994 – 1998 and it was characterised by the establishment of the European Monetary Institute. This stage was dedicated towards technical financial preparation with the intent of establishing a single currency. This included all aspects relating to financial system architecture, which is inclusive of fiscal and monetary policy.

- **Stage 3**

  This phase began on 1 January 1999 with the irrevocable fixing of exchange rates, transfer of monetary policy powers to the European Central Bank (ECB) and the introduction of a single currency.

6.3.2.2 The EMU institutional structures

The EMU was coordinated mainly through a number of fundamental institutions namely (ECB Compendium, 2002:5):

- The European Commission (EC) is the executive body of the European Union (EU). It is also responsible for initiating legislation proposals and give recommendations on all policy issues.
- The European parliament (EP) is composed of representatives of all member countries and has the power to dismiss the EC. It also approves the EU budget and gives opinions on legislative matters.
- The European Court of Justice, which comprises fifteen judges and nine advocates are tasked with ruling on legal matters, hearing applications and ensuring coherence to the European law. There are also a number of internal structures with the ECB and other peripheral institutions and committees that contribute to the coordination and efficient management of the EU.
- The European Central Bank (ECB) is a primary independent economic institution of the EU tasked with the goal of achieving and maintaining price stability. The ECB has two main decision making bodies which govern the EC Council and Executive Board.
- The governing council is responsible for the formulation of guidelines and takes decisions to ensure performance of tasks entrusted to the ECB. It is also responsible for the formulation of monetary policy in the region.
- The Executive Board of the ECB is responsible for the following:

- Preparing meetings of the Governing Council
- Implementing monetary policy and decisions in accordance with the guidelines
- Managing the day to day activities of the ECB
- Assuming certain delegated powers from governing council which may include regulatory powers.

6.4 African experience of monetary integration

In Africa's colonial and past-colonial era monetary cooperation between different countries was widespread, but only few emerged into successful partial monetary integration formations. The failure of these integration attempts could be explained by a number of factors ranging from divergent ideologies, languages, colonial heritage, national interests and country rivalry. Despite all the set-backs, the West African Monetary Union (UMOA) or CFA zone and Multilateral Monetary Agreement (MMA) are testimony to success stories in Africa on monetary integration and have also delivered macro economic stability.

6.4.1 The West African Monetary Union (UMOA)

The UMOA, constituted by the seven West African countries, Benin, Burkino Faso, Ivory Coast, Mali, Niger, Senegal and Togo, came into existence on 10 January 1994 (Medhora, 1997:215).

All seven countries use the CFA franc as a common currency; however, UMOA countries have retained their principal economic stabilisation policies like fiscal, trade and monetary policies. MOA was later transformed into UEMOA to harness greater harmonisation of economic policies in the region.

The UEMOA brought some benefits to the region which includes the use of a fully convertible currency backed by the G-7 countries, risk free investment within the franc zone, economies of scale resulting from the issuance of a common currency and the existence of an independent central bank that can pursue consistent policies without fear and prejudice.

6.4.2 Institutional framework of the UMOA

The UMOA's institutional framework consists of two main structures, the Conference of Head of States and the Council of Ministries, who oversee the Central Bank of UMOA (BCEAO). The Conference of the Head of States comprises of Political Heads of each country and the Council of Ministries is constituted of finance ministries of each member country. The BCEAO is headed by the Council of Ministries who has input in the decision making process of the bank.

6.4.3 UMOA and monetary policy

Monetary policy announcements and decisions are deemed to be in the hands of an independent apolitical technocratic central bank, the BCEAO. The goal of monetary policy has mainly dealt with inflation stabilisation in the region.

6.4.4 The UMOA and seigniorage

Seigniorage is the command over real resources that a central bank captures by issuing "high powered" money. This monetary seigniorage is then used for central bank operating costs, retained, or returned to the public via dividends to the national treasury or via subsidised lending to designated sectors (Medhora, 1997:221).

How seigniorage is distributed depends on the legal provisions of the UMOA statues. The allocation is based on an agreed formula by member countries. In the UMOA the profits are allocated equally amongst members since all members have contributed equally in terms of external reserves.

6.4.5 UMOA and external reserves

The pooling of external reserves is an integral part of monetary integration. The contribution of external reserves by member countries in the UMOA was very equitable. Each member was required to pledge 65 percent of its external reserves to an operations account managed by the BCEAO and it is maintained with the French Treasury in Paris.

6.4.6 UMOA and external convertibility

In the UMOA, the CFA franc was pegged to the French franc at an exchange rate of 50 CFA francs to 1 French franc. The French Treasury guarantees full convertibility of the CFA franc since its stands surety for it, unconditionally.

6.5 Monetary integration developments in southern Africa

The Multilateral Monetary Agreement (MMA) is one of the oldest and most successful integration initiatives in southern Africa. This integration establishment was formed in 1974 by three signatory members, namely South Africa, Swaziland and Lesotho. The MMA was later called the Rand Monetary Area and in 1992 it became known as the Common Monetary Area (CMA), after Namibia became a member.

The objective of the MMA was sustained economic development of the CMA with equitable benefits for all members. All four member countries have their own

central banks and are responsible for their own monetary policy. The Rand is the legal tender in all four member countries but other member currencies are not legal tenders in South Africa. The Rand is pegged at 1:1 to other member countries' currencies. However, there is always mutual consultation on monetary issues and no restriction on the transfer of funds among members.

Table 6.2: Common Monetary Area milestones

Year/Period	Major Events
1961	Informal Monetary Union under British ruling: pound as common currency
1961-1974	Countries become independent (except Namibia) The Rand replaces the pound as common currency still informal arrangement
1974	South Africa, Botswana, Lesotho and Swaziland sign the RMA treaty
1976	Botswana exits RMA and sets its own monetary policy. However it keeps linked to the Rand (60 to 70 per cent) through a currency basket
1986	South Africa, Lesotho and Swaziland sign the trilateral agreement CMA, replacing the RMA. Additional provisions concerning capital account liberalisation, intra-zone fund transfers and seigniorage compensations are made
1992	Namibia, which became independent in 1990, joins the CMA

[Source: Grandes, 2003]

6.5.1 The institutional framework of the MMA

The MMA is mainly managed and coordinated by the central banks of the member countries to facilitate and ensure continued compliance with the MMA and to reconcile different interests in the formulation of monetary and foreign exchange policies of the CMA.

The South African Reserve Bank (SARB) is the key player in terms of the execution of monetary and exchange rate policies through its Monetary Policy Committee (MPC). All other matters arising from the MMA are decided by the CMA commission, which is the executive body established from representatives and advisors of member countries.

6.5.2 The MMA and monetary policy

The MMA has its own unparalleled arrangements when compared to other integration establishments around the world, especially on monetary policy issues. Monetary policy issues in the MMA are distinct from the EMU and other monetary integration models around the world. This is now discussed at the hand of seigniorage, external debt reserves and currency convertibility.

6.5.3 The MMA and seigniorage

Seigniorage is a source of revenue for the Treasury, which can contribute to the country's fiscus. Developing economies rely heavily on income from seigniorage, especially in Africa. The division of income from seigniorage is a contentious issue in the formation of a monetary union in Africa.

In accordance with the objectives of the MMA, Namibia and Lesotho share in the returns from seigniorage to the extent that the Rand is used as a legal tender in their territories. Returns are shared according to an agreed formula. Swaziland is excluded from this arrangement because of a Bilateral Agreement of 1986 by which the Rand ceased to be legal tender in Swaziland. However, in reality, the rand is still accepted as a legal tender for convenience in the retail sector.

6.5.4 MMA and external reserves

The contacting parties to a large extent share a common pool of foreign exchange reserves under the control of the SARB and under the control of the South African authorised dealers in foreign exchange (banks). The central banks and authorised dealers in foreign exchange in the member countries have access to the foreign exchange market in South Africa under the MMA; SARB will on request make the required foreign exchange available.

6.5.5 MMA and currency convertibility

The rand is an anchor currency in MMA and has both a dominant influence in the sub-regional trade, investment flows and inflation rate. The currencies of these countries have been pegged to the South African rand at par since their introduction and their currencies are freely convertible into the rand with the exception of Swaziland (Stuart, 1992:80).

6.6 Macro economic convergence in the European Monetary Union (EMU)

There have been major improvements in the Euro area with regard to macro economic convergence targets, especially towards the end of 1990. The average rate of the Harmonised Index of Consumer Prices (HICP) (inflation) has fallen

from 2.2 to 1.3 percent for most of the member states with the exception of Greece. Long term interest rates have been falling throughout the EU to reach average levels around 5 percent. Exchange rates have in general remained broadly stable. Significant reductions in fiscal deficits were experienced in the region and are currently at an average of 2.45 percent of GDP. The average debt ratio stands at 72 percent of GDP, which is higher than the reference level.

6.6.1 Choice of macro economic convergence targets in the EMU

The EU has selected and adopted some key macro economic convergence targets as outlined in Table 6.3. The criteria were applied in a strict manner with the sole view of committing the member states towards an efficient monetary union.

The rationale for these targets is to ensure that only member states which have economic conditions that are conducive to the maintenance of price stability and the viability of the European currency area should participate. The targets constitute a coherent and integrated strategy and all member countries should be on the same footing before accession to monetary integration is granted. The macro economic convergence targets should be consistent, transparent and simple.

The target on the price and long term interest rates convergence are based on the average of the three best performing countries in terms of inflation, as the price performance of the countries with the lowest rates of inflation. On the fiscal target the reference values and indicators underlying the developments are considered. In respect of debt, the reference value is 60 percent of GDP. Exchange rate targets are based on the principle that member countries should not devalue their currencies against any other member state currency.

Table 6.3: Macro economic convergence targets for the EMU

Description	Target
Inflation (HICP)	Not exceeding 1.5% of the three best performing member states
Long term interest rates	Not exceeding 2% of the performing member states
Fiscal deficits	Not exceeding 3% of GDP
Public debt	60% of GDP
Exchange rate	Not devalue the currency against any currency of the member states

[Source: Grandes, 2003]

6.7 Performance of the European Union (EU) prior to the establishment of the EMU

The performance of the EU prior to the establishment of the EMU, is summarised in Table 6.4 below, and discussed in the proceeding paragraphs.

Table 6.4: Macro economic convergence performance of the EMU, 1997

Country	Inflation (%)	Interest rate (%)	Trade balance (% of GDP)	Public Debt (Billion EURO)
Belgium	1.6	6.7	-3.3	130.6
Denmark	2.2	7.4	-1.4	70.2
Germany	1.3	6.3	-4.0	60.8
Greece	8.4	15.1	-7.9	110.6
Spain	3.8	9.5	-4.4	67.8

France	2.1	6.6	-4.0	56.4
Ireland	2.1	7.5	-1.6	74.7
Italy	4.7	10.3	-6.6	123.4
Luxembourg	1.3	7.0	0.9	7.8
Netherlands	1.2	6.3	-2.6	78.7
Austria	1.7	6.5	-4.3	71.7
Portugal	3.0	9.4	-4.0	71.1
Finland	0.9	7.4	-3.3	61.3
Sweden	1.6	8.5	-3.9	78.1
United Kingdom	3.0	8.0	-4.6	56.3

[Source: Convergence report, 1998]

❖ **Inflation (HCIP)**

In the EU fourteen member countries (Belgium, Demark, Germany, Spain, France, Ireland, Italy, Luxembourg, Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom) had average HICP inflation rates below the reference value. The reference was calculated by using an unweighted arithmetic average of the rate of HICP inflation in the three countries with the lowest inflation rates, plus a 1.5 percentage point. The reference value was 2.7 percent. Greece's HICP inflation was 5.2 percent lower than the average when compared with all the member states before the finalisation of monetary integration. Generally all member states recorded relatively similar inflation rates before the establishment of the Euro.

❖ **Interest rate**

In the Euro area all the member states had average long term interest rates below the reference value. (Reference value is 7.8 percent). Over the periods 1990 to 1997, long term interest rates were broadly similar in a number of countries, namely Belgium, Germany, France, Luxembourg, Netherlands, Austria, Denmark and Ireland. The pace of convergence of interest rates for

Finland and Sweden was lacking behind. Spain, Greece, Italy and Portugal's interest rates were declining steeply below the reference value. A different trend in relation to long term interest rates was experienced in the United Kingdom. The long term interest rates had been declining throughout the EU to reach a low EU average of 5 percent.

- **Trade balance**

Much progress had been achieved in fiscal deficits across the EU, and in a few countries budget surpluses were experienced. The EU-wide fiscal deficit ratio had declined to 2.4 percent of GDP. During the period under review only three countries recorded surpluses, viz. Denmark, Ireland and Luxembourg. Eleven member states achieved or maintained deficits at or below the reference value percentage as specified by the treaty. They were Belgium, Germany, Spain, France, Italy, Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom. Greece was the only state that recorded a deficit of 4 percent, which is above the reference value.

- **Public debt**

The debt to GDP ratio for the EU as a whole was declining before the integration of the EU. However, overall conditions necessary to maintain an environment conducive to non-inflationary growth had improved. The average debt ratio was 72.1 percent of GDP.

- **Exchange Rate**

During the period under review only three currencies remained outside ERM, which are the Greek drachma, Swedish krona and pound sterling. On occasion several currencies traded outside a range close to the central rates with a maximum deviation limited to 3.5 percent. But generally there was a widening trend in terms of interest rates convergence.

6.8 Macro economic convergence development in southern Africa

There are a number of motivations behind the commitment to macro economic convergence. One such motivation is recognition that economic instability in one or more countries in the region, as has been the case historically, had negative effects both on the countries themselves and the region more generally, through spill over effects. Hence the most basic component of macro economic convergence is to achieve macro economic stability across the region, thereby avoiding instability in terms of high inflation, unstable currencies, and other forms of macro economic imbalance.

6.8.1 Performance of member countries on the targets

The SADC countries' macro economic performance has improved markedly in recent years, such that throughout most of the SADC region macro economic stability has been achieved with the exception of Zimbabwe, the DRC and Madagascar. The general outlook in the region is one of reduced inflation, reduced fiscal deficits, a reduced debt burden and improved debt sustainability, and more sustainable balance of payments.

Economic growth performance has also improved. A number of factors underlie this improved macro economic performance. These include much improved policy formulation and implementation, the impact of ongoing structural and institutional reforms, greater trade openness and improved trade performance, as well as debt relief and the end of civil conflict.

6.8.2 Choice of macro economic convergence targets in southern Africa

The selection of macro economic convergence criteria are key in ensuring that member countries' economies commit to the establishment of a monetary union with the eventual achievement of price stability in the region. The targets have to be realistic, transparent and easy to measure. Non compliance precludes member states from accession into the union. However, a balance should be struck between the target period of achieving the goals and the stringency of the targets as this will enhance the credibility of the region.

- **Inflation**

In principle, inflation is the key indicator of macro economic convergence, and is arguably the most important of the four chosen indicators. Low inflation cannot be achieved on a consistent basis in the absence of stability-oriented macro economic policies, and the achievement of low inflation therefore indicates that other policies are being implemented in a manner that is supportive of macro economic stability. More generally, high inflation is an indication of macro economic imbalances in an economy. Inflation is also relatively easy to measure, and in most countries data is readily available, at high frequency (monthly).

Core inflation measures are not readily available in SADC countries (only SA has a publicly available measure). There are also different ways of measuring core inflation (exclusion of specific items, trimming etc.), and no general agreement on which method is the most appropriate. There is also a more general problem of inconsistent inflation measures across countries. This was resolved in Europe by the adoption of the Harmonised Index of Consumer Prices (HICP), which is used for monetary policy purposes, but which co-exists with other, country-specific inflation measures.

There is also the more general problem of inconsistent inflation measures across countries. The 2008 target of single digit inflation is not especially onerous, and should be achievable by all SADC members except for Zimbabwe. The 2012 target of 5 percent is tough but achievable, and indeed some countries have already achieved inflation at this level. The 2018 target of 3 percent would require a shift to a different level of macro economic performance – this level of inflation has not been achieved by any African country to date.

- **Fiscal balance**

Fiscal balance (the budget deficit/surplus) is an important contributor to macro economic stability. While the quality of measurement of the fiscal balance is improving, due in part to improved government accounting systems and reduced usage of quasi-fiscal (off budget) expenditure, there are nevertheless a number of problems that make monitoring of performance difficult. It is important to have consistency across countries over the treatment of key items, such as privatisation receipts, other asset sales, and government lending, and improvements in this area, as well as improved forecasting, are important.

In many SADC member states, grants form an integral part of overall revenues, and without grants, many projects would not proceed and expenditure would be lower; hence a fiscal balance calculated without grants would not be meaningful.

The 2008 target of a deficit of less than 5 percent of GDP is reasonable, but the 2012/2016 target of 3 percent of GDP may be too tight. The figure appears to have been borrowed from the European Union's Maastricht Treaty, but it is not clear that this makes it relevant to SADC (and many have argued that it is inappropriate to the EU).

- **Public debt target**

In principle, the level of public debt is an important determinant of and contributor to macro economic, fiscal, and balance of payments stability in SADC. In sub-Saharan Africa, debt is not homogeneous, as it varies by currency (domestic or foreign), source (commercial or concessional), and duration (short or long term). The macro economic impact of debt works through several channels, and depends on the type of debt. For instance, domestic debt does not have a direct balance of payments impact, but may have a crowding out impact in domestic financial markets, and *vice versa* for foreign debt.

In Europe (Maastricht Treaty), a single indicator was adopted for public debt, and was arguably more appropriate as public debt was homogeneous, i.e. generally denominated in domestic currency and issued in commercial terms, hence the debt service burden was closely related to the total outstanding debt. The benchmark of 60 percent of GDP that was chosen in Europe may have represented a suitable benchmark for debt sustainability. Hence the focus on debt levels alone in the SADC macro economic convergence criteria may be misleading. Debt of 60 percent of GDP could be sustainable if, for instance, most of this debt is concessional and exports are strong.

- **Current account deficit**

The current account deficit (CAD) is one of the most commonly used indicators of external stability and sustainability. However, while the CAD is important, it is difficult to define what a sustainable level is. For instance, a country with low savings and high investment will have a relatively high CAD, which may be good if it is due to a high level of productive investment based on long-term foreign financing. Whether a given level of the CAD is sustainable depends on various factors.

- **Exchange rate target**

One of the stated objectives of the SADC macro economic convergence programme is to provide the foundation for the eventual adoption of a single currency. The attainment of monetary integration is mainly based on the pursuance of exchange rate convergence for the region because of the critical nature as a prerequisite for a monetary union. There are very wide divergences between economies in SADC in terms exchange rates in the region.

The other challenge in southern Africa is that exchange rate convergence is difficult to measure, but one approach is to consider the level of volatility in regional exchange rates and the extent to which they move together considering the divergent economic conditions of the region, which are mainly characterised by growing trends of volatility.

6.8.3 The criteria for selection of macro economic convergence targets

Main macro economic targets

The SADC focuses on four main macro economic variables: inflation, fiscal balance, public debt, and the current account of the balance of payments. The specific targets to be achieved in terms of these four variables are progressively stricter over the period from 2008 to 2018, and are set out in Table 6.5 below.

Table 6.5: SADC macro economic convergence targets

Year / Indicators	2008	2012	2018
Inflation annual rate	<9.5%	<5%	<3%
Fiscal Deficit/GDP	<5%	<3%	<1%

Public Debt/GDP	<60%	<60%	<60%
Current Account/GDP	<9%	<9%	<3%

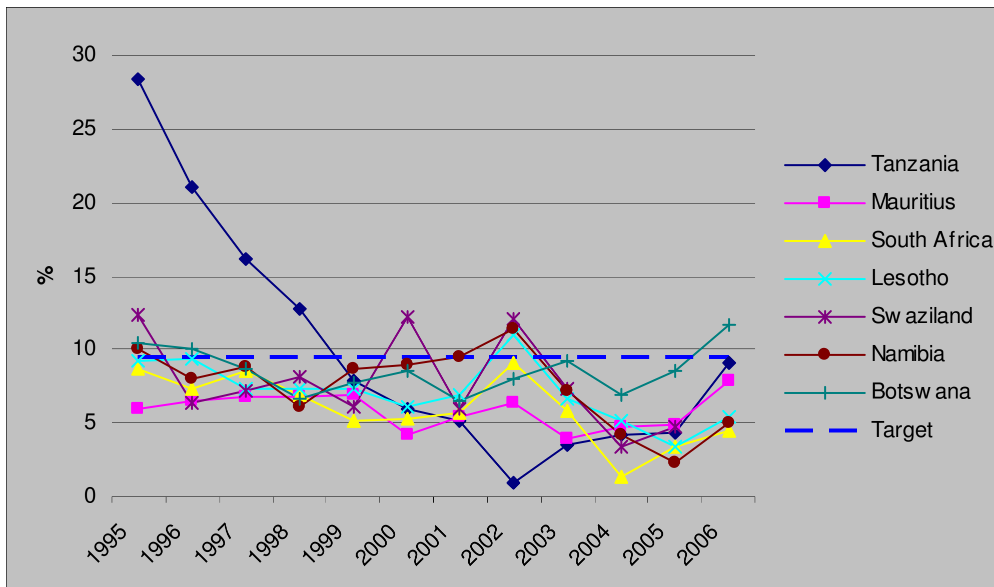
[Source: SADC, 2007]

6.8.4 Performance of SADC countries in terms of macro economic convergence targets

❖ **Inflation rate**

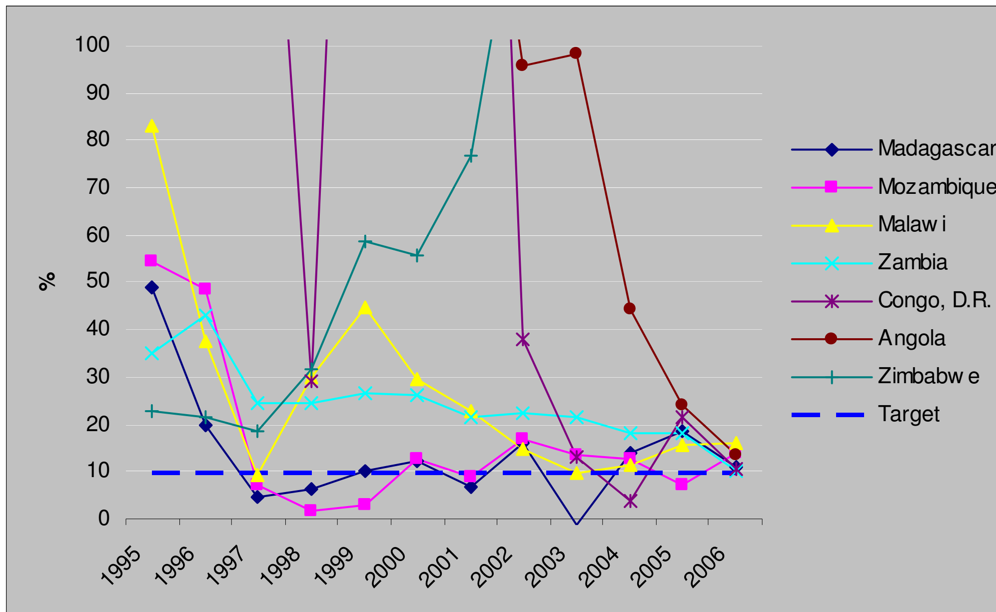
All of the countries in this group have had very high inflation (over 50 percent) at some point in the past. Nevertheless, even Angola and the DRC have managed to bring down inflation from very high levels quickly, and by 2006 almost all countries in this group had inflation below or close to the SADC target. The exception is Zimbabwe, who has had high and rising inflation in recent years, with no sign of stabilisation on the horizon. Figures 6.1 and 6.2 illustrate inflation performance by member countries in the SADC region in terms of high and low inflation performers respectively.

Figure 6.1: SADC low inflation countries



[Source: SADC, 2007]

Figure 6.2: SADC high inflation countries

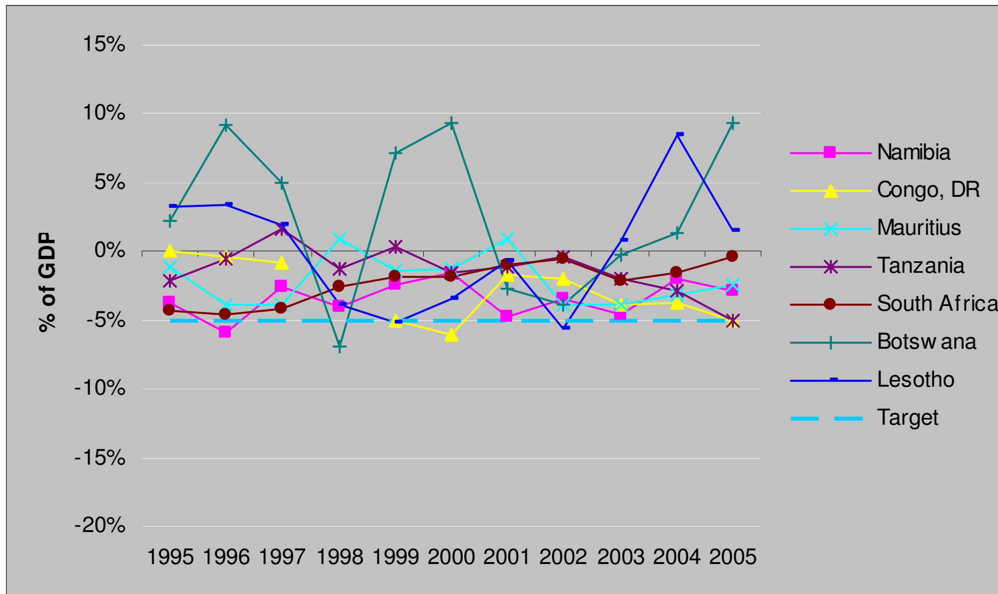


[Source: SADC, 2007]

- **Fiscal deficit**

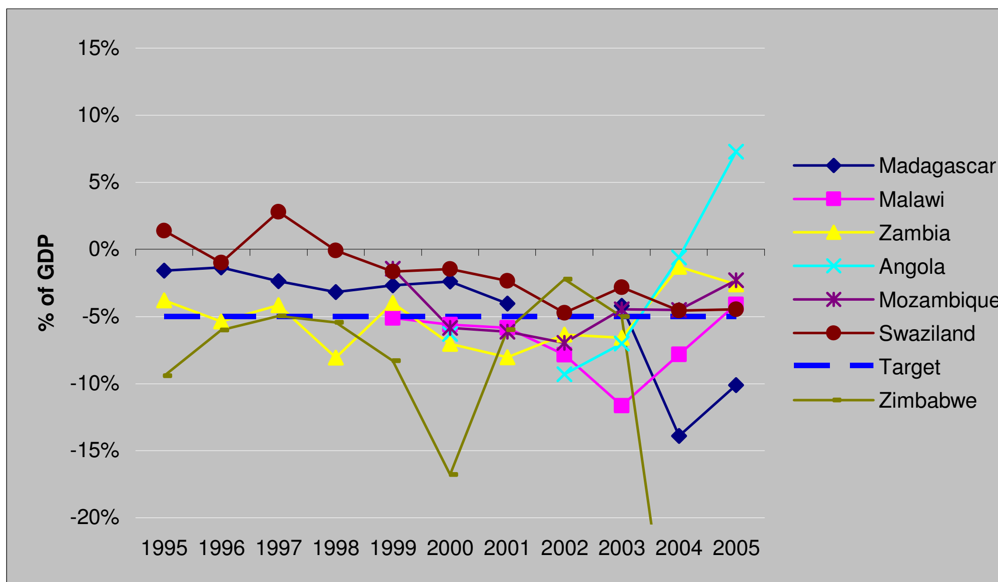
In regard to fiscal deficits from 1995 to 2005, SADC member countries may be divided into Low and High performers, relative to the 2008 SADC budget deficit target of less than 5 percent of GDP. The Low performance group shows some volatility in budget balance, especially Botswana and Lesotho, but generally fiscal deficits are consistently below the SADC target and fall into the range of 0-5 percent of GDP, with some budget surpluses. The composition of the Low group is similar to that of the Low Inflation group, with the exception of Swaziland (out) and DRC (in).

Figure 6.3: SADC low deficit countries



[Source: SADC, 2007]

Figure 6.4: SADC high deficit countries



[Source: SADC, 2007]

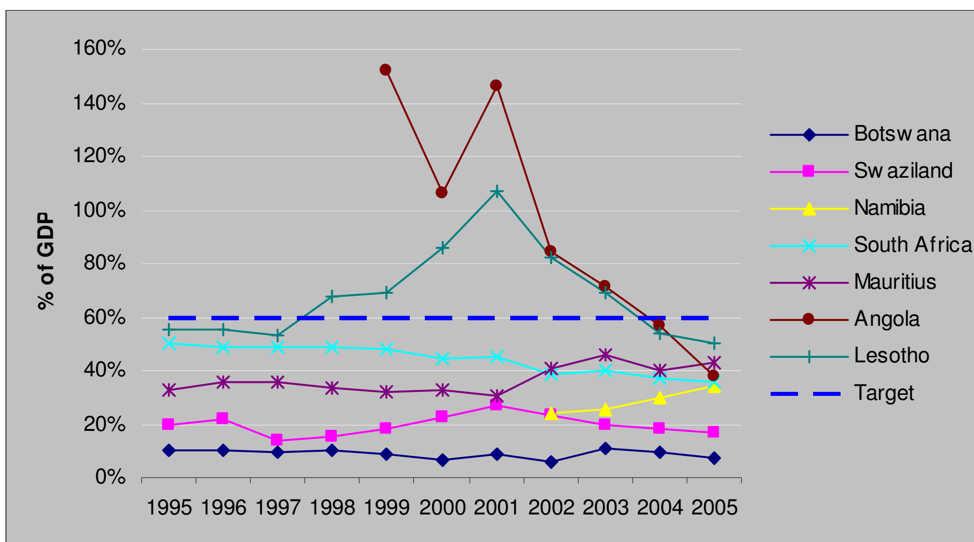
The High Deficit group in general demonstrates a period of worsening deficits, at least until recently, falling within the range of 0-15 percent of GDP.

Notwithstanding the general improvement in fiscal positions, many countries remain highly dependent upon donor grants to fund public spending, especially development (investment) spending (notably Madagascar, DRC, Tanzania, Mozambique, Zambia and Malawi). Hence fiscal sustainability in these countries is, in the short-to-medium term at least, dependent upon continued access to donor funds, the availability of which is in some respects beyond the control of the recipient countries.

❖ **Public debt**

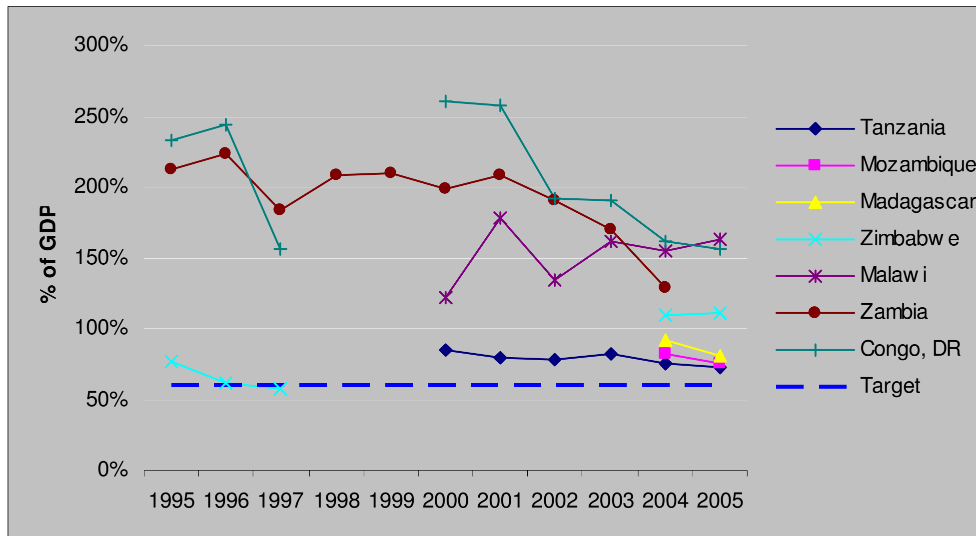
In regard to public debt, performance of SADC member states (1995 to 2005), may be divided into Low and High performers, relative to the 2008 SADC public debt target of less than 60 percent of GDP. Low and High public debt performers are illustrated in Figures 6.5 and 6.6 respectively.

Figure 6.5: SADC low public debt countries



[Source: SADC, 2007]

Figure 6.6: SADC high public debt countries

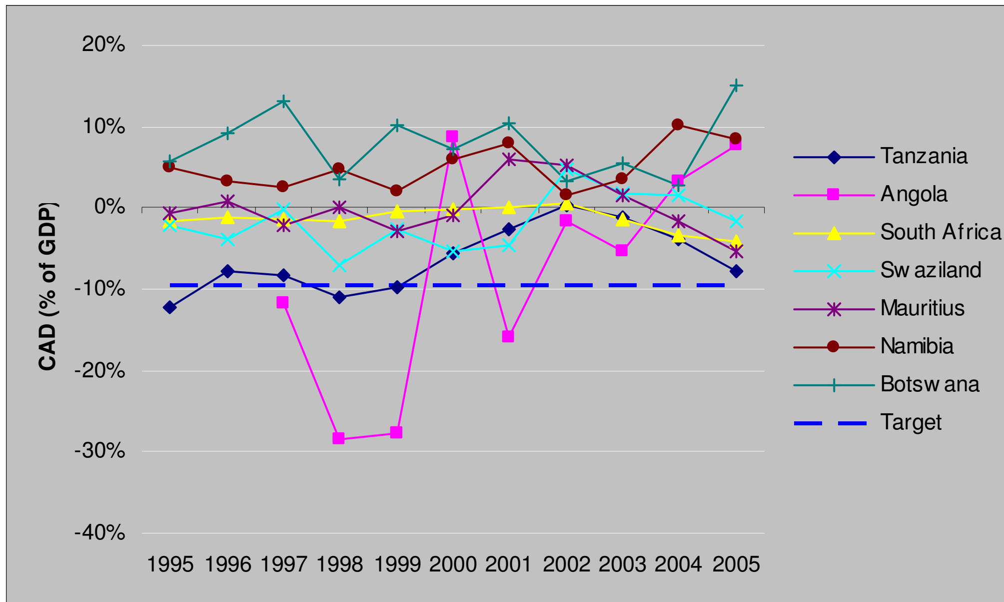


[Source: SADC, 2007]

❖ **Current account**

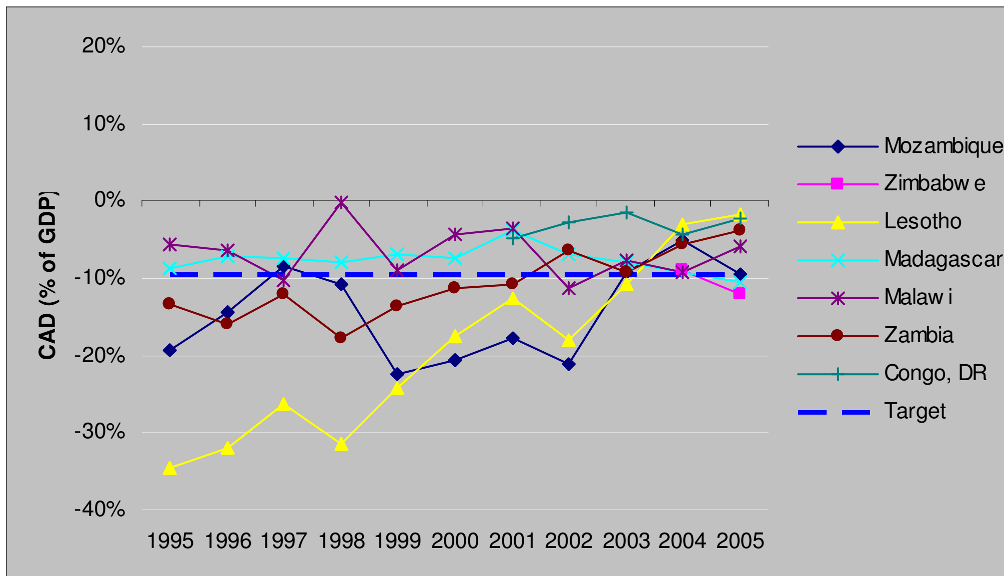
The Low current account deficits (CAD) group includes SACU (excluding Lesotho) plus Mauritius and Angola. Most of these countries have consistently had low deficits, or surpluses in the case of Botswana and Namibia. The exception is Angola which has had a volatile record, recently benefiting from high oil prices.

Figure 6.7: SADC low current account deficit countries



[Source: SADC, 2007]

Figure 6.8: SADC high current account deficit countries



[Source: SADC, 2007]

The High CAD group shows a more volatile and less consistent record. In some countries, the CAD has been improving (Zambia, Mozambique and Lesotho) while in others it has been relatively stable.

6.8.5 Performance of CMA countries against the SADC targets

The EU experience of monetary integration reflects the critical role of macro economic convergence as a prerequisite for the establishment of a fully fledged monetary union. The macro economic requirements for membership into the EMU commit member countries to strict macro economic targets.

Taking cognisance of the CMA's regional political and economic conditions, and given the diversity in the structure of the economies, it may be difficult for these economies to converge with respect to specific indicators, mainly, external balances and budget deficits.

The EU's rather difficult experience with the maintenance of budgetary discipline amongst all member states serves as an important reminder of the challenges that are to be confronted particularly during periods of economic slowdown. With respect to budget deficits, the EU's stability and growth impact on its near-automatic penalties against countries that have excessive budget deficits is difficult to maintain.

❖ **Inflation**

As shown in the accompanying Table 6.6 below, the inflation rates of the four RMA countries have converged to a considerable extent. For example, over the period from 2001 to 2007 the difference between the highest and lowest average inflation rate recorded in the region was only 3 percentage points per annum.

Table 6.6: Consumer prices (annual percent change) in CMA, 1997-2007

Table 6.6: Consumer prices (annual percent change) in CMA, 1997-2007							
COUNTRY	**1997-2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Botswana	2.9	6.3	0.6	0.3	2.0	5.3	1.5
Lesotho	7.2	12.5	5.0	5.0	3.4	6.1	6.0
Namibia	8.4	11.3	7.2	4.1	2.3	5.1	5.9
South Africa	6.4	9.2	5.8	1.4	3.4	4.7	5.5
Swaziland	7.2	11.7	7.4	3.4	4.8	5.1	5.8

[Source: IMF, 2007]

This is not surprising, given the fixed exchange rate between the participating countries and the extent of trade between them. The average inflation rate in the RMA countries ranges between 3 and 12 percent between the period 2001–2003 and much of an improvement was experienced between 2004–2007 with inflation rates averaging from 3 to and 6 percent. The CMA member countries are within the target range prescribed in terms of the SADC macro economic convergence targeting.

❖ **Budget deficit**

The CMA states group shows some volatility in budget balance, especially Botswana and Lesotho, but generally fiscal deficits are consistently below the

SADC target and fall into the range of 0-5 percent of GDP, with some budget surpluses. Deficits have been reduced significantly due to control on fiscal and capital expenditure, tax reforms and privatisation of state owned enterprises.

Table 6.7: Budget deficits in CMA, 1997-2004

Country	1997-2001	2002	2003	2004
Botswana	9.8	9.8	9.3	5.6
Lesotho	62.4	65.5	44.0	35.1
Namibia	3.3	5.6	3.0	4.8
South Africa	3.4	4.2	3.0	2.4
Swaziland	14.5	13.3	18	14.6

[Source: IMF, 2007]

- **Public debt**

It is important to note that CMA member states' public debt, notably for Botswana, Mauritius, Namibia and South Africa, remained stable at relatively low levels in relation to GDP. This is illustrated in Table 6.8 below. Lesotho is the exception when it comes to evaluating public debt in relation to GDP of 66 percent in 2007. Swaziland, also a small economy, managed to contain its debt in relation to GDP and brought it down to 14 per cent of GDP by 2007.

Table 6.8: Public debt (percent of GDP) in CMA, 1997-2007

COUNTRY	1997-2001	2002	2003	2004	2005	2006	2007
Botswana	10.2	7.5	5.3	4.5	4.0	3.7	3.3
Lesotho	60.8	75.5	170.6	188.9	71.2	57.8	66.3
Namibia	2.8	4.5	5.4	5.4	5.6	6.0	6.0
South Africa	3.4	4.5	3.0	2.3	2.1	2.0	1.9
Swaziland	17.4	24.7	18.5	21.5	15.7	14.8	14.3

[Source: IMF, 2007]

- **Long term interest rates**

Interest rates in the CMA member states vary below 20 pe rcent. This is due to a tight monetary policy aimed at reducing inflation and is anchored by South Africa's inflation targeting framework. Target range rates vary between 5 and 15 per cent on average. This is far better than most of the SADC countries and shows some convergence by CMA member states in relation to interest rates.

6.8.6 Performance of SADC countries against the EU targets

Measuring SADC's performance in terms of the EU macro economic convergence targets makes for an interesting comparison. It should be noted that SADC's main trading partner is the EU, and that SADC stands to gain from striving toward the macro economic convergence targets of the EU. Having similar macro economic

convergence parameters would mean less volatility in the exchange rates between SADC and the EU, would foster improved planning of production activities and place trade and investment between SADC and the EU on a sound footing.

The EU countries have been aligned economically in terms of their macro economic convergence targets, and the accession partners are following suit. On first inspection of SADC's performance in terms of the EU convergence targets, it is clear that SADC, ten years after the EU convergence targets had been set, still are not close to meeting those benchmark targets set ten years ago for EU convergence.

Although the SADC has set its own macro economic convergence targets which might be considered to be softer due to the state of economic developments in the region, this might prolong and make it difficult for the SADC to achieve their monetary integration objectives.

Table 6.9 below illustrates a very a simple comparative performance analyses of the two regions in terms of macro economic convergence benchmark.

Based on the comparative analysis of benchmark convergence figures in Table 6.9, between EU and SADC countries, EU members maintained an average rate of inflation of 2.59 per cent (1997) and SADC members an average of 53.37 per cent (2007). The SADC average is nowhere close to its convergence target of below 9.5 per cent for 2008. On an individual country analysis, Botswana, Lesotho, Mauritius, Mozambique, Namibia, South Africa, Swaziland and Tanzania conform to the inflation target for 2007. This represents eight out of a total of 14 SADC countries. When the EU benchmark for inflation convergence is applied, i.e. not exceeding 1.5 per cent of the three best performing members, only four SADC countries out of a total of 14 conform to this inflation benchmark. In regard to the 2008 current account deficit benchmark for SADC, countries performed much better, in that 12 of the 14 SADC members have current account deficits below 9 per cent of their respective GDPs.

Table 6.9: Comparison on macro economic convergence between SADC and EU

European Union Macro economic Convergence Performance in 10 years (1997)					SADC Macro economic Convergence Performance 10 years later (2007)				
Country	**Inflation**	**Interest rate**	**Trade balance**	**Public Debt**	**Country**	**Inflation**	**Interest rate**	**Trade balance**	**Public Debt**
Belgium	1.6	6.7	-3.3	130.6	Angola	23.0		7.3	37.6
Denmark	2.2	7.4	-1.4	70.2	Botswana	8.6		3.2	7.3
Germany	1.3	6.3	-4.0	60.8	Congo DRC	21.3		-5.0	156
Greece	8.4	15.1	-7.9	110.6	Lesotho	3.4		1.5	50.5
Spain	3.8	9.5	-4.4	67.8	Madagascar	48.5		-10.1	80.2
France	2.1	6.6	-4.0	56.4	Malawi	15.4		-4.1	164
Ireland	2.1	7.5	-1.6	74.7	Mauritius	4.9		-2.4	42.8
Italy	4.7	10.3	-6.6	123.4	Mozambique	6.4		-2.3	75.6
Luxembourg	1.3	7.0	0.9	7.8	Namibia	2.3		-2.9	33.8
Netherlands	1.2	6.3	-2.6	78.7	South Africa	3.4		-0.4	35.8
Austria	1.7	6.5	-4.3	71.7	Swaziland	4.8		-4.5	16.7
Portugal	3.0	9.4	-4.0	71.1	Tanzania	4.4		-5.0	72.1
Finland	0.9	7.4	-3.3	61.3	Zambia	15.9		-2.6	129
Sweden	1.6	8.5	-3.9	78.1	Zimbabwe	585		-65	111
United Kingdom	3.0	8.0	-4.6	56.3					

Source: Convergence report, 1998

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In terms of public debt, the EU and SADC may be compared far easier as the benchmark for convergence in both cases is below 60 pe rcent of GDP. Of the 15 EU members, only 3 of a total of 15 (20 per cent) conformed to the public debt benchmark. In SADC, in 2007, 7 out of a total of 14 (50 per cent) of members conformed to the public debt requirement of 60 per cent of GDP.

6.8.7 Prospects of achieving the SADC targets

On the basis of recent macro economic performance and trends, as well as on country forecasts, it is possible to make an assessment of the likely achievement of the 2008 SADC targets by SADC member countries. Looking at 2005 data (the most recent year for which a comprehensive dataset is available), it is possible to identify problem areas insofar as reaching the SADC benchmark convergence figures. Table 6.10 provides an illustrative summary of all SADC countries and distinguishes between qualifying and non-qualifying benchmark figures for all SADC member countries.

Table 6.10: SADC performance against macro economic convergence targets, 2005/2007

Country	Inflation	Fiscal Deficit	Public Debt	Current Account	Growth
Convergence Targets	*<9%*	*<5% of GDP*	*<60% of GDP*	*<9% of GDP*	
Angola	23.0	7.3	37.6	22.9	18.2
Botswana	8.6	3.2	7.3	15.1	8.4
Congo DR	21.3	-5.0	156	-2.2	6.5
Lesotho	3.4	1.5	50.5	-1.8	1.2
Madagascar	18.5	-10.1	80.2	-10.4	4.7
Malawi	15.4	-4.1	164	-5.9	2.1
Mauritius	4.9	-2.4	42.8	-5.4	2.6
Mozambique	6.4	-2.3	75.6	-9.4	6.2
Namibia	2.3	-2.9	33.8	8.4	3.2
South Africa	3.4	-0.4	35.8	-4.2	4.9
Swaziland	4.8	-4.5	16.7	-1.6	1.8
Tanzania	4.4	-5.0	72.1	-7.9	6.9
Zambia	15.9	-2.6	129	-3.8	4.3
Zimbabwe	585	-65	111	-12.0	-4.3
Key:	***Meets 2008 target***		***Does not meet 2008 target***		

[Source: Jefferis, 2007 – as adapted]

The performance against the 2008 macro economic convergence targets as at 2005 was as follows:

- 8 out of 14 countries (57 per cent) met the inflation target
- 12 out of 14 countries (85 per cent) met the fiscal target

- 7 out of 14 countries (50 per cent) met the public debt target; 12 out of 14 countries (85 per cent) met the current account deficit target.

The macro economic performance of most SADC countries has improved remarkably in recent years, such that most of the SADC region demonstrated exceptional fiscal discipline, as is evident from the stable macro economic data. The general picture is one of reduced inflation, reduced fiscal deficits, reduced debt burdens and improved debt sustainability, and more sustainable balance of payments.

Growth performance has also improved. A number of factors underlie this improved macro economic performance. These include much improved policy formulation and implementation, the impact of ongoing structural and institutional reforms, greater trade openness and improved trade performance, as well as debt relief and the ending of civil conflict in many of the SADC countries.

Member countries in SADC are still heavily donor dependent for the financing of public sector investment projects, budgetary supplements and balance of payments stability. Considerable reforms are still needed to improve domestic revenue generation capacity and thereby reduce donor dependence and vulnerability to changes in aid flows and short term capital flows.

The main achievements by SADC countries has been with respect to the convergence of macro economic outcomes; however, if the process is to be continued and deepened there will need to be greater convergence of policies. While some countries have been following similar policies, this has not been by design (in terms of policy coordination), but the result of similar conditionality

being imposed by multinational institutions, or independent choices of 'best practice' policies.

The more deliberate choices of common policies across countries has stemmed from a programme of trade integration rather than macro economic convergence. However, the adoption of common monetary and exchange rate policies, which would be the central component of policy convergence, needs to be carefully assessed prior to implementation.

Performance on growth in many countries has improved, but there is still a long way to go to achieve the level of growth that would lead to a rapid reduction in poverty in the region. Further progress in removing the impediments to growth and boosting the rate of investment is probably the most important economic imperative facing the SADC region at present.

Finally, the well reported on instability and economic chaos in Zimbabwe is evident from the performance of the Zimbabwean economy over recent years. It is probably the only country that is creating a huge vacuum in the SADC monetary armour. It is also doubtful that meaningful progress toward monetary macro economic stabilisation or convergence and integration should be continued without Zimbabwe, mainly because of the high level of economic integration between Zimbabwe and South Africa in particular.

Unless there is drastic and meaningful political and economic reform, Zimbabwe will continue to undermine the region's prospects of achieving higher growth and investment, and would continue to negatively affect other SADC members through spill over effects. Amongst other things, the Zimbabwe problem illustrates the

difficulties associated with agreeing to a programme of macro economic convergence without the accompanying mechanisms for dealing with member states that do not adhere to the accompanying commitments. South Africa, as a key player in SADC, has also recently displayed signs of political instability insofar as political announcements, xenophobic violence and its silent diplomacy on the Zimbabwean political and economic crises are concerned.

6.9 Monetary integration challenges for southern Africa

The main challenges for southern Africa are to intensify the pace of integration and harmonisation. The southern African region has to implement sound macro economic and prudent fiscal and monetary policies that would facilitate the reduction of inflation and interest rates, deficits, debt and free capital flows through the liberalisation of exchange controls.

Monetary integration challenges in southern Africa can be summarised under three main categories which are macro economic, fiscal and exogenous challenges.

6.9.1 Macro economic policy challenges

- Economic growth

The overall economic growth in the region is very low because of factors like high levels of inflation, lack of intensive foreign direct investment, low levels of productivity, dominance of unskilled labour, loss of competitiveness and reliance on few dominant countries such as Botswana, South Africa and Mauritius for wealth creation, which results into financial instability.

❖ Foreign direct investment

The region's risky overall economic environment imposes a challenge to the inflow of foreign direct investment and long run investment levels. FDI inflows to the region are low when compared to other developing regions around the world, mainly due to high political and economic uncertainty, with the exception of a few member states. Investment needs are large due to the level of economic development required by the region.

❖ Exchange rate

The slow progress with structural reform in many of these economies increases the risk associated with exchange rates volatility. Regional competitiveness may also be eroded by weaker exchange rates in the region. The South African rand plays an informal role of an anchor currency for the region, which makes it vulnerable to external shocks.

Because of consistently high inflation differentials between SADC and EU countries (SADC's main trading partner), the real effective exchange rate is expected to continue to experience extreme volatility. In terms of the balance of payments model, consistent trade deficits also lower foreign exchange reserves that depreciate the currency. Managing the future SADC exchange rate of a SADC monetary union thus poses particular challenges.

6.9.2 Fiscal policy challenges

❖ **Tax system**

The southern African region has a diverse tax structure with a low tax base which constrains growth in the region. Tax collection in the region is also difficult for most of the member countries. Effective tax collection and a strong tax base are

among the requirements for fiscal sustainability and socio-economic stability in the SADC region. This would be required for fuelling growth and economic development. Very few countries like South Africa, Botswana and Mauritius, have sound revenue administration and collection measures. However, there still needs to be some harmonisation of tax systems in the southern African region. Divergent tax systems and rates give rise to tax shifting, whereby firms could well manipulate their financial flows, utilising tax arbitrage opportunities to shift their tax obligation toward lower tax base countries in the region.

- **Public spending**

The region requires substantial public expenditure to meet spending pressure to support growth and alleviate poverty. Most of the member states face a problem of rigid expenditure structures that limits potential growth spending, especially investment spending in infrastructure.

- **Public debt**

The member states in the region have relatively large deficits that are accompanied by high levels of public debt, which increase the region's vulnerability to external shocks. Many member states have high inflation rates, well above the convergence target rate, which increases further macro economic vulnerability.

- **Government revenue**

The region has low levels of revenue to GDP ratios, which makes it difficult to provide basic services to the citizens of the region. This might lead to some social and political instability. Generally most member countries rely heavily on grants and donations.

6.9.3 Other challenges for monetary integration in southern Africa

❖ **Political instability**

The southern African region has a history of political instability, which contributes negatively to macro economic and fiscal performance. The political uncertainty in Zimbabwe and undemocratic conditions in other countries like Swaziland pose a serious challenge for capital flows in the region and for the region's economic credibility.

Because of the way in which countries in the SADC region are interdependent and integrated economically, any form of political instability, violence, crime, xenophobia, civil unrest, etc., creates immediate ripple effects throughout the region, usually, starting with large short term capital withdrawal, adverse exchange rate movements and adverse policy responses, e.g. high interest rates. Experience has shown that SADC members generally have limited capacity to counter such adverse exogenous shocks that steer SADC countries off course insofar as the achievement of convergence targets is concerned.

❖ **International developments**

The region is susceptible and vulnerable to any exogenous shocks due to lack of resilient macro economic and fiscal policies. International developments such as the credit crunch in the US, increasing oil prices and inflationary pressures from other trading blocks always have an adverse impact on the region. When drawing a comparison internationally, some countries have shown some resilience to the world-wide supply shocks from oil and food price inflation. Other countries have been shown to exhibit a high propensity to absorb the international oil and food price inflation, while some have shown a much lower propensity to absorb these price shocks in internal inflation figures.

6.10 Summary

This chapter analysed SADC's performance both in terms of the southern African macro economic integration benchmark and against that of southern Africa's main trading partner, the EU. Southern Africa, and SADC in particular, still face many challenges in respect of reaching these monetary integration objectives. Chief among the challenges are political instability in the southern African region, a reliance on foreign donor money to maintain stability, heterogeneous economic structures, and poor integrated monetary systems infrastructure and policy cohesion among SADC member countries.