# CHAPTER 7: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

## 7.1 Summary

In Chapter 1, an introduction to the study is set out, which outlines the importance and motivation for the study. The hypothesis and objectives are clearly specified as well as the research methodology and a brief summary of the structure of the study and outline of chapters.

Chapter 2 provides the theoretical background of economic integration. Economic integration encompasses the formulation and application of common regional trade, exchange and labour markets. Common fiscal and monetary policies at the regional level will lead to the development of a common currency and a single central bank or monetary authority. This would regulate the monetary environment within which national governments could function. Economic integration also allows movement of all factors of production and technology within the region (Rwegasira, 1996:15).

Generally, economic integration is defined as a state or process that derives its importance from the potential for its participants to achieve a variety of common goals more effectively by joint or integrated action as opposed to unilateral effort.

Some economists define it as “a state of affairs or a process involving the combination of separate economies into a larger economic region” (Asante, 1997:19). This could include all measures that aim at abolishing discrimination among the member countries of the unit, with the formation and application of

coordinated and common economic policies to achieve various economic and welfare objectives. In some studies the concept of economic integration is used interchangeably with economic regionalism or economic union. Economic Integration could also be defined as "the design and implementation of a set of preferential policies within a regional grouping of countries aimed at the encouragement of the exchange of goods and factors between members of the group" (Mills & Handley, 1998:2).

Apart from economic integration there is also trade integration, which takes place through the establishment of either a preferential trade area or free trade area. Other forms of economic integration are custom unions, common markets, economic unions and total economic integration. Financial integration is a situation where there are open or competitive capital markets with the elimination of barriers to capital movements and a resultant gain in saving and investment (Van den Bergh & Sahajwala, 1989:15). This could be categorised further into regional financial integration and international financial integration. Monetary integration revolves around the integration of monetary policies, the exchange rate system and a single currency.

Monetary integration or monetary unions require the convertibility of member country's currencies and a central monetary policy, unified financial markets, capital market integration, identical rates of inflation, the harmonisation of fiscal systems, regional development and the coordination of economic policies among member countries (Javanovic, 1997:43).

The chapter also examines various economic integration models around the world; most specifically the European Economic Community integration model. Various forms of economic integration are also studied which is followed by an investigation of the steps of economic integration.

The specific steps of economic integration covered in the chapter are: preferential trade area (PTA) is a form of economic integration, which is described by the existence of lower tariffs and intra-regional trade in goods and services originating in member countries; a free trade area (FTA) is described by the non-existence of tariffs on goods and services from other members leaving open the possibility for each member of structuring and applying its own regime of tariffs to goods or services imported from outside the FTA; a custom union (CU) involves free trade among member countries but applies uniformed external tariffs with members ceding sovereignty to a single unified customs administration or applying their own different tariff regimes alongside a common external tariff; a common market (CM) arises when a customs union abolishes non-tariff barriers to trade to allow free trade among members. This also involves greater harmonisation of trade, exchange rates, fiscal and monetary policies. This requires some form of internal exchange rate stability and full internal currency convertibility; an economic union (EU) is an agreement by member countries on a common currency and a unified monetary policy which conforms to specified convergence criteria and parameters within which national fiscal policy can operate; a political union (PU) represents the ultimate stage or form of integration in which the legislative and judicial processes of member states are either unified or federated under agreed arrangements.

According to Balassa (1961), five main stages are identified and defined as the outcome of policy decisions taken by regional inter governmental forums and/or supranational institutions in order to affect the depth and breath of regional integration.

A political union has many elements, but usually depicts the existence and emergence of a political community based on trust, loyalty and common

principles. It has four elements of integration namely institutional union, policy integration, attitudinal integration and security integration. Total economic integration (TEI) represents an economic union with all the relevant economic policies conducted at the supranational level, possibly in compliance with the principle of subsidiarity. Both supranational authorities and supranational laws need to be in place.

The chapter also explores the various regional economic cooperation agreements which have led to economic integration in Southern Africa. Economic cooperation exists in the region national states with varying degree of rigour and intensity. Numerous bilateral and multilateral treaties on economic issues, varying by sector have been agreed to, between countries of the region in Southern Africa. Economic cooperation has resulted in the formation of the following multilateral organizations of economic integration in southern Africa with different objectives and treaties that is; PTA, SACU, CMA, SADC, ECOWAS and ESAF.

Chapter 3 reviews economic integration around the world; much focus is placed on the economic integration in Africa. The economic ranking of many African countries is appalling because of various political and socio economic hurdles. Many African country economies are dilapidated in terms of growth and development. The economic status could be pictured by an adverse outlook in terms of declining growth, double-digit inflation, dependence on aid, poverty, no savings, low investment, high levels of unemployment, high deficits and under utilisation of production resources.

Tremendous efforts have been taken to address some of these problems after the colonial era, to emancipate their economies through economic cooperation and economic integration.

Various initiatives were taken, but mainly in trade and sectoral cooperation and much fewer efforts were made in the financial sector. There is some evidence of monetary and financial cooperation in the western African region and also other regions in the form of currency boards.

The inception of the EMU has sparked a new wave of interest in economic and financial integration in Africa. The formation of an African Economic Community may provide some foundation to empower the African continent in developing technical, technological, political, economic and financial infrastructure to address numerous problems on the continent.

Throughout the continent of Africa vigorous efforts had been made to promote economic development and regional integration, but much needs to be done to address financial issues which will enhance much monetary, fiscal and financial harmonisation with the eventuality of realising an African Monetary Union.

In light of the above, this chapter discusses the concept of financial integration and all issues of financial integration such as the development of various financial markets, instruments, and risks and benefits pertaining to this subject.

These economic integration initiatives can be analysed and classified in the following sub regions that is West, East, North, Central and the southern African Sub region. The benefits of economic integration are also studied which are followed by impediments towards economic integration.

The chapter closes with various ways of measuring economic integration starting with the theoretical approaches of measurement. The methods of measurement which are covered in this study are the Optimum Currency Area and the African integration index methods.

Chapter 3 continues with an investigation of the concept of financial integration and, more specifically, regional financial integration in southern Africa. A further analysis ensues on the theoretical approaches to and the benefits and risks of financial integration. Regional macro economic indicators are analysed, followed by an investigation of financial integration progress in southern Africa. Capital flows in the region, structural changes in the international financial markets and regional changes in financial market developments in southern Africa are covered in this chapter. Evidence of substantial misalignment of macroeconomic indicators among the different economic regions in Africa, and between major trading partners in the EU exists and was uncovered in the analysis of this chapter.

The most important finding made in Chapter 3 is that the EU economies, possesses much more depth (volume of production and trade) than Africa and its regions. In this regard, and although Africa's regions are generally doing far better in regard to fiscal and financial management, they lack the financial resources to manage external debt more effectively and efficiently.

In Chapter 4 it is found that the effect of globalisation on the world financial system is evident and poses a challenge to most emerging African economies and regions. Globalisation has been a key underlying factor for the upsurge and increase in integration of financial markets at regional and international level.

Many developing countries around the world are also positioning themselves by dismantling restrictions, deregulating their markets and improving the macro economic and political environments by increasing the degree of financial integration.

The potential for achieving the substantial benefits of regional financial integration is unlikely to be realised if all the barriers for integration in southern Africa are not reduced. This chapter will focus on the constraints, costs and benefits associated with financial integration in southern Africa. It looks at all domestic and international constraints, costs and benefits for the region and finally the degree or measurement of regional financial integration is also discussed (Mongelli, 2002:33).

The recent surge and pace of regional financial integration in southern Africa has been curtailed by a number of factors. The constraints are the underlying factors for poor financial market development, capital flows and most importantly for poor regional financial integration. These barriers have been classified into two main categories by nature, which are domestic or regional and international constraints.

These factors together had made it difficult for the region to develop progressively in terms of financial integration, with the exception of South Africa, Botswana and Mauritius.

The main factors constraining financial integration in the region are the political and macro economic environment which could be simplified into political instability, lack of market openness, regulation and liberalisation of markets, infrastructure, economies of scale, low economic growth, slow privatisation, low reserves, low investments, capital flows and poor macro economic performance in terms of inflation, public deficits, public debt, balance of payments and exchange rates.

With many Asian and Latin American countries growing rapidly and moving far ahead of most African countries in terms of putting in place the financial infrastructure needed to enhance regional financial integration, most African

regions and most importantly the southern African region, will have to undertake speedy financial sector policy and structural reforms to foster sound regional financial integration.

In regard to the benefits of financial integration it was found that the possible benefits of regional financial integration are twofold, firstly in the form of real economic growth and secondly in the diversification of capital and asset markets, which would reduce the risks and costs of investment. Apart from boosting growth with increased opportunities for risk diversification, financial integration could bring gains in the form of investment, which would increase growth and more capital flow that will afford the southern African region more economic muscle to compete in the global financial markets.

In regard to the risks of regional financial integration, Chapter 4 finds evidence that financial markets and private capital flows are becoming intra regionally concentrated, particularly in Europe, East Asia and more recently, increasingly in Latin America. Furthermore, as Africa is still in its infancy in financial integration, much attention has to be paid to dealing efficiently with macro economic and financial issues in order to prevent or contain currency and capital market crises in the region.

Sound and stable financial integration is needed to avoid any contagion effects, and the real economic and financial costs that might have negative spill over effects on the southern African region. The degree of risk associated with regional financial integration would depend mainly on the strength of macro economic policies, the soundness of the banking sector and the strength of institutional arrangements in the region.

The main, profound risks of regional financial integration, according to Coleman (1999:9) could be in the form of serious adverse private capital flow reversals which could be attributed to international investors becoming more discerning about the region and by the authorities' attempts to restrict capital flight by exerting more controls leading to the loss of investor confidence.

The other important risk (Mills, 1998:25) is the greater volatility which could be experienced by the national economy emanating from the other regional member countries. Financial integration could therefore magnify shock or the costs of policy mistakes and lead to greater instability in the region.

Proper planning and coordination by means of a regional institutional policy framework is unavoidable, because most of the member countries of the southern African region lack a strong macro economic banking sector, and institutional underpinnings to contain vulnerability or potential instability and reversals of private capital flows.

The constraints (barriers) that need to be overcome in regional financial integration attempts in Africa, are mainly macro economic instability, a poor political environment, closed market structures, poor agricultural development, over regulation of markets, slow privatisation pace, high country risk rating for member countries, dependence on donor funds as a source of capital flow, lack of financial innovation, technological development, exchange rate risk and non-convertibility of currencies.

On the international front, the main barriers to regional financial integration are (from an international perspective towards Africa), financial crises, liberalisation of financial markets and capital accounts, international political instability, investors'

perception about Africa and the region, poor risk profile, financial innovation, capital flows, and less international financial integration.

Insofar as financial (and regional economic integration) have progressed, evidence is found of marginal, but healthy improvements in inter-regional trade and international trade, which served to strengthen financial flows to and from Africa. Substantial gains still ought to be made, but evidence suggests that the gains from trade could be extremely helpful in the development of Africa's regional economic and financial integration.

Chapter 5 investigates the financial integration attempts in southern Africa and the progress and performance is evaluated. 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.

This Chapter included integration in various markets for financial services, i.e. the banking sector, clearance settlement and payment systems, the bond market and integration of the equity markets. The chapter also makes a study of barriers to financial integration and finally focuses on the regulatory framework required for sound financial integration.

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.

South Africa has a well developed financial and banking sector and is set to lead the financial integration process insofar as the regulatory and supervision tasks are concerned. 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).

Whatever one's take is on South Africa's role in the financial integration process, it is clear that the process of regional financial integration starts with cooperation in different areas of setting up uniform payments and clearance systems, risk management systems etc. To this extent, much progress has been made on the technical front. However, financial prudence of the regional financial systems would ultimately depend on the vigour of policing and substantial training.

Chapter 6 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.

*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.

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.

*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.

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.

*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 loss of national sovereignty, loss of monetary policy autonomy, and constraints to fiscal policies.

*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.

*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.

*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.

*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.

*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.

*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.

*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.

*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.

*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.

*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.

*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 illustrated inflation performance by member countries in the SADC region in terms of high and low inflation performers respectively.

***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).

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 were illustrated in Figures 6.5 and 6.6 respectively.

***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.

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.

*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 was shown in Table 6.6, 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.

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.

***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. 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.

***Long term interest rates***

Interest rates in the CMA member states vary below 20 percent. 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.

*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.

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.

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 percent 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.

*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 provided an illustrative summary of all SADC countries and distinguished between qualifying and non-qualifying benchmark figures for all SADC member countries.

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.

*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.

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.

## 7.2 Conclusions

*Current state of southern African financial integration*

The Southern African Development Community (SADC) has a variety of policies in place to promote regional economic integration amongst member states. The motivation and outline of these policies is set out in the Regional Indicative Strategic Development Plan (RISDP), approved in 2003, while specific commitments are set out in the various protocols. The SADC Trade Protocol, for instance, sets out legally binding commitments to member states in respect of a Free Trade Area, to which they have to conform by 2008.

The programme outlines key targets for regional economic integration which are stipulated as follows: The programme has seven targets with a time line of achieving these targets over a stipulated timeframe, and which will lead to the adoption of a regional currency in 2018. The attainment of an FTA is to be achieved in 2008, followed by the completion of an SADC Custom Union completed by 2010. By 2015 the SADC Common Market should be completed, which will be followed by the achievement of macro economic targets and the convergence of other financial policy indicators, including external reserves/import cover; central bank credit to government ratios; savings; investment; payments systems interconnection; currency convertibility; dual and cross listing of regional stock exchanges and liberalisation of exchange controls between member states.

Overall, it can be concluded that considerable progress has been made with regard to macro economic stabilisation, and hence convergence in the SADC region in recent years. The SADC macro economic convergence targets are increasingly being integrated into the macro economic frameworks of member states. Nevertheless, several very real challenges remain that will require

concerted efforts to address if the process is to make further progress and completed successfully.

*Remaining obstacles to financial integration in southern Africa*

The potential of achieving substantial benefit from economic integration in the southern African region exists. This study has found that a myriad of economic benefits have already been derived from various forms of economic integration. The next step toward integration is financial and monetary integration. On the road to economic integration, macro economic convergence is a necessary precondition.

The performance against the 2008 macro economic convergence targets as at 2005 were 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 have been with respect to 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 one 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.

## 7.3 Recommendations

This section provides a number of recommendations flowing from both the results of the analysis and comparative study of Chapter 6 and the literature study. The recommendations therefore combine those recommendations found in literature and that the researcher supports, as well as those flowing from the results of the analysis preformed in this thesis.

### 7.3.1 Recommendations following from the literature study

- *Achieving financial integration in southern Africa*

The following are recommended to remedy and improve SADC monetary integration:

Macro economic policy integration

- Improvement in macro economic policy coordination and harmonisation is required to foster healthy economic growth and development in the region. Healthy economic growth and development requires sound debt to GDP ratios and low core inflation.
- The southern African region should also encourage and improve linkages with other trading blocks and optimise on economic partnership agreements and strategic alliances within the World Trade Organisation.
- Other SADC member countries should subscribe to SACU to develop a broader uniform custom market that will yield an improved international trade environment, and food security for the region.

Banking sector integration

- A broader banking sector should be developed that would capacitate liquidity in the banking sector. Robust financial systems should be developed for the region with more programmes that will reduce financial risks and encourage more capital flows and FDI.

Development of a clearance, settlement and payment system

- The payment clearance settlement systems must be harmonised and integrated on real time basis.
- This should also be integrated with other financial centres around the world in various financial sectors.

Financial and capital market integration

- The region must fast track the development of capital markets in the region by improving liquidity of trade in equities, bonds, and other financial instruments. Liberalisation of financial markets is key to attract local and international investors.
- Regional financial regulatory and legal frameworks should be standardised.

Enlargement of the RAND Zone

- The Rand could be considered as the anchor currency for other southern African (SADC) regional member states in order to build confidence in the exchange rate of the region. Reforms of the Rand Zone agreement should be encouraged with fair and stricter measures for the benefit of all member countries and ensuring the region can contain exogenous economic shocks with resilience.

### 7.3.2 Recommendations from the analysis and results

- *Achieving macro economic convergence targets for southern Africa*

The criteria for the choice of macro economic convergence targets

The macro economic convergence targets were selected based on the number of factors capable of expediting the realisation if monetary integration in the region. These criteria were the following:

- Economic development
- Financial structure of the region
- Macro economic diversity
- Political and economic stability
- Trade links
- Regional competitiveness
- Timeframe for the targets
- Level of readiness by member countries for financial and monetary integration.

*The choice of targets*

The strategy towards the achievement of the macro economic convergence in the region is based on the choice of realistic targets and a within a reasonable time frame considering the economic conditions in the southern African region. A two-pronged target approach, i.e. primary and secondary targets, is recommended.

*Primary macro economic convergence targets*

**Table 7.1: Recommended main macro economic convergence targets**

| Indicators | 2010 | 2015 | 2020 |
|---|---|---|---|
| Inflation Rate | 6% | 4% | 4% |
| Fiscal Deficit | 6% | 5% | 3% |
| Public Debt | 70% | 65% | 60% |
| Current Account | 10% | 10% | 5% |

[Source: SADC, 2007 (as adapted)]

Theoretically, inflation is the core underlying 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.

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). The recommended target for inflation for southern Africa should be pitched at lower levels in order to accelerate financial and monetary integration. This will reduce laxity in committing to the attainment of other macro economic convergence targets.

It is firstly recommended that the EMU approach in regard to inflation targeting be adopted. This means that the approach to be followed is firstly aligned with that of SADC's main trading partner – a requirement for external stability. Secondly, that SADC adopts the approach that members conform to a target of not less than a 1.5 per cent deviation from the weighted average of the top three performing members. The suggested targets for the top three members are average inflation rates of per cent for 2010, 4 per cent for 2015 and thereafter. In relation to the 6 per cent target for 2010, other members would therefore have to achieve at least a 7.5 per cent rate of inflation to come within the range to conform to the convergence criteria.

What makes the adoption of fixed inflation targets particular challenging, is the global supply shocks in relation to oil and food price inflation, together with the hyperinflation in Zimbabwe. It is therefore further recommended that these fixed targets should be reviewed annually and brought in line with some external international set of indicators in order to adapt to world economic conditions. The EMU macro economic indicators might serve as a best practice benchmark against which to review a southern African monetary union convergence targets.

Debt in SADC, and sub-Saharan Africa more generally, 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 payment impact, but may have a crowding out impact in domestic financial markets, and *vice versa* for foreign debt.

The economic burden of debt servicing depends on the currency denomination, the interest rate and term structure of debt. More generally, domestic and foreign

debts have different risk profiles. A single debt indicator therefore needs to be carefully interpreted and supplemented by other data to capture these channels.

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 on commercial terms, and hence the debt service burden was closely related to total of debt outstanding.

The benchmark of 60 per cent of GDP that was chosen in Europe may have represented a suitable benchmark for debt sustainability there. In Africa, however, the most advanced analysis of debt sustainability stemmed from the HIPC programme, which focused on debt sustainability (particularly in balance of payments terms), and not debt levels. The recommended debt benchmark from 70 per cent in 2010, 65 per cent in 2015 and 60 per cent in 2020 is recommended for the southern African region.

Fiscal balance (the budget deficit) 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. Deficit targets should range from 6 per cent of GDP in 2010, 5 per cent 2015 and 3 per cent in 2020. Africa has been successful in negotiating debt relief of historic debt, supplemented by international transfers. If Africa can successfully rid itself of corruption and adopt prudent fiscal management, it should not be too difficult to achieve the adopted targets of reducing the debt burden as percentage of GDP. At present, southern Africa collectively wastes too many valuable financial resources on servicing foreign debt. South Africa serves as a perfect example of how foreign debt as a

percentage had been successfully reduced as percentage of GDP and how it had freed scarce financial resources available for use elsewhere in the economy.

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. The CAD is integrally linked to savings, investment and capital flows, through the national account identity. For instance, a country with low savings and high investment will have relatively high CAD, which may be good if it is due to a high level of productive investment based on long-term foreign financing. The benchmark of 10 per cent in 2010, 2015 and a target of 5 per cent for 2020 are recommended for the southern African region.

*Secondary macro economic convergence targets*

To accelerate the pace of integration and foster more regional economic stability the following secondary macro economic convergence targets are recommended for attaining efficient regional integration in southern Africa. The secondary macro economic convergence targets are outlined on Table 7.2 below which comprises of economic growth, external reserves, central bank credit, domestic savings and domestic investment.

| Table 7.2: Recommended macroeconomic convergence targets for SADC | | | |
|---|---|---|---|
| **Indicators** | **2010** | **2015** | **2020** |
| Economic Growth | 8% | 7% | 8% |
| External Reserves | 4% | 6% | 6% |
| Central Bank Credit | 10% | 7% | 5% |
| Domestic Savings | 25% | 25% | 30% |
| Domestic Investment | 35% | 30% | 30% |

[Source: SADC, 2007 (as adapted)]

➢ ***Recommended monetary policy strategy for southern Africa***

A number of monetary policy strategies are or have been pursued by central banks around the world and the choice of a particular monetary policy strategy depends on a wide array of factors.

The choice of strategy should meet a number of criteria namely:

- Effectiveness – ability to meet the objective of monetary policy
- Transparency
- Accountability
- Medium term focus
- Consistency with independence on monetary authority

However, other factors like financial architecture, economic development and structural outlook also need to be considered before making a choice on a particular strategy. The strategy options for pursuing monetary policy are interest

rate targeting, nominal income targeting, exchange rate targeting, targeting monetary aggregates and inflation targeting.

Most countries in southern Africa opted for monetary targeting strategies with the exception of South Africa, Namibia, Swaziland and Botswana. South Africa applied monetary targeting in the 1990s. The choice of nominal interest rate targeting, exchange rate targeting and nominal income targeting would not be ideal for the region because of a number of structural factors like lack of capital, undeveloped financial systems, small open economies, low exports and undeveloped financial infrastructure.

A strategy capable of delivering the monetary policy goal in the region would either be monetary targeting or inflation targeting. A hybrid strategy could fall somewhere along the spectrum of inflation or monetary targeting.

South Africa is the only country pursuing price stability through an inflation targeting strategy and this might be difficult for some regional members to adopt because of numerous structural factors which preclude other member countries to adopt inflation targeting. Secondly, inflation targeting can only be pursued if most member countries are successful in containing inflation to a single digit level. The southern African region's monetary policy strategy should be a combination of monetary targeting and inflation targeting which will accommodate the structural divergences of the member countries.

<u>The primary goal of monetary policy for southern Africa</u>

The ultimate objective of monetary policy in the region is price stability. This is based on the number of arguments and most importantly the economic developments attained in most countries globally though maintaining price stability.

Fundamental arguments in favour of price stability:

- It allows changes in relative prices to be more easily observed and measurable
- It assist investors in making sound investment decisions, for example, because if they know the price stability will be maintained in the future they will not demand an "inflation risk premium" to compensate them for the risks associated with holding assets over the longer term
- Price stability reduces the likelihood of unnecessary hedging activities against inflation
- Price stability also eliminates the real costs entailed when inflation exacerbates the distortion impact of tax and social security systems
- Finally price stability prevents the considerable and arbitrary redistribution of wealth and income that arises in inflationary as well as deflationary environments.

In countries all over the world, developed or developing economies are mostly pursuing price stability as the main objective of monetary policy. The ECB treaty defines their primary objective of monetary policy as price stability and this is also applicable for the UMOA and other regional monetary integration arrangements around the globe.

It might be appropriate for the southern African region to adopt price stability as the primary objective of monetary policy and besides that, taking into account the benefits of this goal most countries in the region are pursuing price stability.

In conclusion, the pursuance and maintenance of price stability makes an enormous contribution to the broader economic goals, such as a higher standard of living, high level of economic activity and better employment rate.

This could be supported by economic evidence in most economies, economic theories and historical facts that demonstrate that lower inflation enhances economic growth in real terms in the long run.

Operational framework for monetary policy

The design of the operational framework for the conduct of monetary policy in southern Africa will be determined mainly by the monetary policy strategy chosen for the region. The framework should provide the regional central bank with the means through which the ultimate objective of monetary policy could be achieved.

The framework would have to outline how the operating target, intermediary target, monetary policy instruments, procedures in which the structural position of the banking system and liquidity could be influenced. This will enhance better pursuance and effective execution of monetary policy.

The monetary policy framework will encompass the monetary policy instruments, operation target, monetary policy strategy, intermediate targets and price stability as the chosen ultimate goal. However, the actual specific numerical targets would have to be agreed on by member countries taking into account the prevailing conditions.

Institutional framework

The institutional framework of monetary policy will be established by the legal provisions outlined and agreed upon by member countries. The institutional

framework would have to have similar structures like the European Monetary System but with different formations or outlook.

The institutional framework of monetary policy would comprise of the Southern African Central Bank and the National Central Banks (NCBS) of all the southern African member states. The regional central bank will be independent from political influence in pursuing the primary objective of price stability and the national central banks will serve as its supporting agents and would be represented on Board of the Southern African Central Bank.

Monetary policy integration in the southern Africa is already at an advanced stage especially within the pegged exchange rate regime of the CMA with South Africa assuming anchor responsibility in the formulation and implementation of monetary policy.

As a way of enhancing a wider participation in the whole region, more member countries, especially in SADC, should align their monetary policy framework with that of South Africa or should adopt an inflation targeting framework gradually as monetary policy framework. They will also facilitate and pave the way for the establishment of a monetary union which implies the establishment of a supranational central bank for the region.

Exchange rate policy convergence

Macro economic convergence more generally also requires policy convergence, in the sense that countries should follow similar, and consistent, macro economic policies. To a certain extent that has been achieved, with most countries in the region pursuing fiscal restraint, debt reduction, and monetary policy focused on low inflation.

However, there still remains wide divergence in monetary and exchange rate policies. Countries with fixed exchange rates, pursuing monetary integration are Lesotho, Namibia and Swaziland whereas South Africa, Tanzania, Malawi, Mozambique, DRC, Mauritius, Madagascar and Zambia follow a managed floating system.

A complete macro economic convergence would require common policies based on the other financial targets in the region, especially on exchange rates, passive monetary policy at a national level by member countries and an active monetary policy by a supra national monetary policy authority for the region.

<u>The exchange rate and balance of payments</u>

The existence of a single external value for the southern African region has some implications and consequences to all the member countries' national fiscal policies because there will also be common external trade and current account balances.

This is as a result of the regional supra national central bank taking responsibility of the monetary policy on behalf of the national economies in pursuing and maintaining price stability and other related objectives such as current account and exchange rate policy stability.

Monetary integration theory observes and recognises that a monetary union's current account and exchange rates are key as long as their levels do not depart from normal accepted limits. Any errors by supra national fiscal policy authority should be corrected by making adjustments to the deficit and surpluses for the region.

➢ *Final remarks*

With the exception of South Africa, Botswana and Mauritius the other SADC member countries still need much more aggressive pursuit of financial development supported by strong macro economic policies. SADC has to commit all the member countries to improve their macro economic policies, which would assist in overcoming some of the major barriers for financial and monetary integration.

The regional institutional framework should be developed with the eventuality of taking responsibility in the coordination of macro economic policies for the region. Realistic targets and timelines should be honoured in order to realise the ultimate goal of a financially integrated southern Africa. Macro economic convergence targets should be stricter for the realisation of low levels of inflation and growth in the southern African region.

This should also be supplemented by wider policy convergence on exchange rate and fiscal policy issues. The political instability in the region has a damaging effect on the credibility of the region, which impacts on the economic development of the region in terms of trade, employment, business cycles, foreign direct investment and capital flows. The current situation in Zimbabwe has a negative effect on regional stability and regional economic growth. The overdependence of the region on South Africa should be reduced in order to commit other member states to develop their own economies for the benefit of the whole SADC region.

One conclusion that can be drawn from the European experience is that full monetary integration is the final result of a long process of previous economic cooperation, harmonisation and coordination in many areas including exchange rate coordination itself: the customs union, the single market for goods, services

and production factors, etc. In particular, nominal, sustainable and durable macro economic convergence is a precondition for monetary integration. Unless southern Africa gets its act together in terms of stabilising its political-economic environment, it would be tainted with an unstable macro environment, even in the years to come. It would also digress even further from the macro economic aggregates attained by its major trading partner, the EU and stand the real risk of experiencing regression in terms of its ability to create wealth for its nation.