IS THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY (SADC) SUITABLE FOR A MONETARY UNION?

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51 Uporoto Street (Off Ali Hassan Mwinyi Road), Ursino Estate
P.O. Box 31226
Dar es Salaam, Tanzania.
Tel: (+255) 22 2760260, 2760751/52
Mobile: (+255) 754 280133
Fax: (+255) 22 2760062
Email: esrf@esrf.or.tz
Website: www.esrftz.org

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CHAPTER ONE

INTRODUCTION

1.1 Background Information

Developing countries worldwide have adopted different strategies aiming at achieving the goal of economic growth. Among these, priority is accorded to internal development and regional integration strategies. In Africa, most countries consider regional integration as the easiest path in attaining this goal. According to Lee (2003), regional integration is defined as a process, by which a group of nations, voluntarily and in various degrees, have access to each other's markets and establish mechanisms and techniques that minimize conflicts and maximize external and internal economic, political, social and cultural benefits of their interactions. In most cases, these countries are close to one another geographically; and one of the reasons for the integration is to liberalize trade among themselves.

The Southern African Development Community (SADC) consists of countries from the southern part of Africa. Ever since the formation of SADC[1], many questions have been raised about its effectiveness and impact of the organization's institutions, as well as on long-term growth performance of the member countries. The main aim for the formation of SADC was to create a community that will assure regional peace and security within an integrated regional economy. But basing on many scholars who have researched on the SADC bloc, SADC has not been very successful on a number of indicators, such as prevailing on poverty, diseases and food insecurities in the majority of the member countries. In addition to these, there has been slow growth of real GDP and high levels of external debt in most of its the member countries.

This study is initiated as a follow up to the agreement of SADC's 16th Annual Summit which was held in Maseru, Lesotho in 2006. SADC adopted the Regional Indicative Strategic Development Plan (RISDP) in order to provide the design and formulation of SADC programmes, projects and activities so as to achieve development and economic growth, as well as enhance the standard and quality of life of the people of Southern Africa, through

[1]SADC was formed on 17th August, 1992. Before this, the bloc was known as Southern African Development Co-ordination Conference (SADCC).

regional integration. Their final agreement was to establish a common Central Bank by 2015, as well as start a Monetary Union by 2016.

It may now be pertinent to define what a monetary union is. According to a report by Alkholifey A et.al, a quoted definition through the 1970 Werner Report on economic and monetary union in the European Community states: "*A monetary union implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberation of movements of capital"*

This whole idea on forming a monetary union is based on the European Union experience, which emphasizes certain pre-conditions for Macroeconomic Convergence (MEC). In this regard, the following conditions have been identified as indispensable:

(i) markets for products as well as factors of production must be efficient and not distorted;
(ii) there should be free movement of capital and labour;
(iii) domestic costs of adjustment should be affordable with the help of effective financial arrangements, while the costs and benefits of integration are to be equitably shared;
(iv) enabling policies must be in place in order to reduce risks;
(v) requisite human capacities needed in leading sectors must be developed and retained; and
(vi) for greater success, focus must be on forming on smaller sub-groupings (Maruping, 2005).

As per plan, SADC is supposed to be a Free Trade Area[2](FTA) since 2008; a Customs Union[3] by 2012 and a Common Market[4] by 2015 and finally a Monetary Union by 2016. Why the interest in monetary union for the SADC region anyway? Masson and Pattillo (2004) tried to explain this by giving a reason that: it is mostly the desire to counteract perceived economic and political weaknesses. For example, SADC could help its members in negotiating for favorable trading arrangements, both globally (with the World Trade Organization) and bilaterally (with the European Union for example, as well as with other regions like the East African Community -

[2] It is where member countries eliminate tariffs among themselves, but maintains independent external tariffs on non-members

[3] Intra-regional tariffs are eliminated as well, but in addition, member countries maintain a common external tariff (CET) which is agreed among themselves

[4] It takes all the features of a customs union. An addition is on factors of production movements. With a common market, the factors can move freely within the member countries

EAC, COMESA, and others). Another reason might be reduction in transaction costs. This means that SADC countries can reduce currency losses that are incurred during exchange of one currency with another currency, for transaction purposes.

1.2 Statement of the Problem

Mundell's theory of Optimal Currency Area (OCA) (Mundell, 1961), highlights three main conditions that must be satisfied for a group of countries to adopt a veritable common currency (which is the symbol of a monetary union), namely:

(i) In case of economic and financial shocks, their impact should not be asymmetric among the group of countries aspiring for membership in a monetary union; in other words, one country should not be substantially worse off while the other countries are faring well;

(ii) There should be a high degree of labor mobility or wage flexibility within the group of countries; and

(iii) There should be a centralized fiscal policy in place that would facilitate transfer of money or other resources from countries that are doing well to those that are doing poorly.

Macroeconomic stability as a condition for capacity-creation as well as cross border investment is important when looking at the concept of monetary union formation. A strategy for macroeconomic convergence, that is a package of policies aimed at the convergence of stability indicators in a regional integration arrangement, is not always the best course of action. In a region such as SADC, which is exposed to asymmetrical external shocks, convergence can in fact be counterproductive. In the case of Monetary Union, MEC is necessary, but this is a stage in the progression of regional integration for which SADC is not ready. The MEC programme requires a clear perception of the appropriate target variables. In this context, reference is made to the EU which adopted five convergence variables, namely: inflation, interest rates, budget deficits, national debt and exchange rates. The SADC committee of ministers of finance and investment identified the following benchmarks to be monitored to assess effective implementation of the monetary union process:

- **Inflation:** to be below 5 percent by 2012 for an effective establishment of a common currency;

- **Budget Deficit:** to be 5 percent or less of Gross Domestic Product by 2008 and 3 percent or less by 2012;

- **Public Debt:** to be below 60 percent of GDP by 2008; and

- **External Account:** reserves to be equal to three months of import cover by 2008 and six months by 2012.

Are the SADC member countries able to meet these conditions within the identified time frame?

The goal of a Monetary Union for SADC is considered to be a pillar and a symbol of strength for the development of the member countries. This is so since, with a Monetary Union, assumptions are that there will be clear movement to price stability; and to increases in Foreign Direct Investment (FDI), more trade flows, and reduction in transaction costs together with elimination of exchange rate risks, thus lowering the costs of capital; and there would be robust macroeconomic discipline.

The challenge to achieve a Monetary Union in SADC has been compounded by overlapping membership of countries in different regional groupings. According to a study carried out by the Harvard Institute for International Development, the number of regional integration blocs in Africa outstrips that of any other continent. This situation is unsustainable. Overlapping membership results into overlapping commitments in different blocs which in turn can result into duplication of effort and occasionally inconsistent aims in the regional blocs. This case is as well playing a major role in hindering decision making in the SADC bloc on many sensitive and important matters, including the issue of a Monetary Union. The economies of these countries cannot operate with different currencies within the same bloc.

1.3 Objectives of the Study

This study applies the theory of an Optimal Currency Area (OCA) to examine the suitability for the existence of an effective Monetary Union in SADC, for which the Macroeconomic

Convergence criteria had been set for the member countries to implement within the time frame between 2008 and 2018.

In the above context, the specific objectives of the study are:

(i) to determine the suitability of SADC to form a Monetary Union (under the concept of the OCA theory);

(ii) to assess the status of major Macroeconomic Convergence variables, basing on the criteria set by SADC; and

(iii) to analyze the existing issue of overlapping membership of SADC members in other regional blocs and its implication for a Monetary Union formation.

1.4 Significance of the Study

Although many papers have discussed regional integration issues in Africa, in general, only few studies discuss monetary integration issues in SADC. Notable exceptions include Bayoumi and Ostry (1998), Guillaume and Stasavage (2000) and Sparks (2002). The most current studies are those by Burgess (2009) and the USAID Agency (2012). Therefore, there is a need for more studies to evaluate the suitability of a Monetary Union in SADC, and in particular to cover more recent developments after 2008, in order to analyze the behavior of the crucial macroeconomic variables that are to be satisfied in the remaining period (up to 2016). One of these developments is in the area of globalization which has evolved into economic and trade relations that impinge enormously on the welfare of SADC countries and does not support healthy cross-country relations, and especially integration initiatives in regions such as SADC.

This study takes cognizance of the already existing stock of knowledge and information, while trying to make a useful contribution on the issues of economic convergence and more specifically on the prospects for forming a strong and beneficial monetary union for the benefits of the SADC member countries.

The study has as expected pointed out major challenges that are being faced by African blocs generally as well as the lessons that can be learnt in strengthening the SADC bloc.

1.5 Format of the Study

This report is organized as follows:

- The preceding sections have explained the background as well as the objective of the study;

- The next chapter provides an overview of the SADC member countries (the background of their economies);

- *Chapter Three* reviews theoretical issues in a monetary union and makes references to relevant literature;

- *Chapter Four* explains the methodology used in testing for the suitability of a single currency within SADC;

- *Chapter Five* explains the analysis on the major indicators considered in testing for the optimality of SADC as a currency area, the prevailing levels of macroeconomic indicators and the issue of overlapping membership within SADC; and

- The last chapter, *Chapter Six*, summarizes the report and in so doing answers research questions implied in the study objectives; also draws some conclusion and recommendations in attaining the main goals for the SADC region.

CHAPTER TWO

OVERVIEW OF SADC

This chapter presents general background information on the economies of the fourteen SADC member countries. It discusses the major characteristics in these economies.

Characteristics of SADC Economies:

The southern African region is characterized by a number of regional blocs: SADC, the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Customs Union (SACU) or The Rand Zone, which was officially formed in 1974. The members of SACU[5] formed their own Common Monetary Area (CMA), pegging their currencies to the South African Rand[6]. Among the SADC members, Tanzania alone is a member of the East African Community (EAC). This study focuses more on the SADC region even though the other blocs cannot be ignored.

SADC has immense diversities in terms of economic size, per capita income, degree of urbanization and cultural background. Members of SADC represent a combination of least developed economies, developing economies as well as relatively more developed economies. Table1 represents the economic indicators for the fourteen member countries with an approximated total area of 9,067,959 km^2 and population of approximately 277 million people, where 39 percent of the people lives in urban areas.

[5] Botswana, Lesotho, Namibia, South Africa and Swaziland

[6] Botswana decided to pursue independent monetary and exchange rate policies as from 1976

Table 1: SADC Economic Indicators, 2012

	2008	2009	2010	2011	2012
Real GDP (% Growth)	4.1	1.5	5.5	4.7	5.1
Inflation (%)	13.1	10.0	8.4	8.3	7.9
Government Revenues (% of GDP)	30.2	29.3	29.7	29.2	29.7
Government Expenditures (% of GDP)	30	33.4	32.8	33.5	32.7
Overall Fiscal Balance (% of GDP)	2.4	-4.3	-3.2	-4.8	-3.6
General Public Debt (% of GDP)	42.9	45.8	39.1	39.2	39.5
Total Investment (% of GDP)	23.5	21.6	22.2	21.3	20.9
National Savings (% of GDP)	16.4	13.1	15.5	14.9	16.6
Per Capita GDP based on PPP (% Growth)	4.1	-8.1	18.9	10.3	4.2
Volume of Exports (% Growth)	6.7	-1.7	5.7	4.8	8.5
Volume of Imports (% Growth)	12.1	-2.2	6.1	2.3	4.6
Current Account Deficit (% of Growth)	-10.1	-11.0	-8.8	-8.3	-6.6

Source: SADC Secretariat, 2012

South Africa is the biggest country economic-wise in SADC with over 70 percent share of the real GDP of the region. In the 1990s, most of the countries experienced positive average growth, with an exception of Democratic Republic of Congo (-1.8 percent). About half of the countries experienced growth of 1 to 2 percent with others registering growth of above 2 percent. From 2000 to 2003, economic growth rates were impressive in many member countries: Botswana and Mozambique registered very high rates of 10 percent and 14 percent respectively; Mauritius, Tanzania and Zambia also maintained impressive economic growth rates averaging between 5 percent and 5.4 percent. This was not the case for countries such as Zimbabwe, DRC and Seychelles, which registered negative growth rates at 8.6 percent, 4.0 percent and 1.9 percent respectively. Due to the poor performance of some countries, SADC's average GDP growth rate dropped to around 1.8 percent in 2003 from 2.1 percent in 2000, with only Botswana and Namibia being able to sustain surpluses in their savings and investment balances (Committee of Central Bank Governors in SADC -CCBG- 2004). According to the SADC secretariat, the region's performance as of 2008 has shown moderate improvement, whereby the growth of the region reached the rate of 5.5 percent in 2010 and is currently at 5.1 percent, heading towards the agreeable level of 7 percent since 2008.

The economies of SADC countries have expanded due to exploitation of available opportunities for the growth of the region. Among the SADC countries, Mauritius, South Africa, Namibia and Botswana are the richest countries. Economically, South Africa dominates (it accounts for 70 percent of SADC's GDP level and 22 percent of its population). South Africa, and to a certain

extent Zimbabwe and Zambia, are countries with relatively larger endowments of skilled and semi-skilled labour.

In 2004, SADC's aggregate growth performance hovered around 3.5 percent, which in effect was a decline as compared to the previous year 2003 with 3.6 percent. Factors that played a major role in this decline included, amongst others, low FDI, slowdown in manufacturing output and unfavorable weather conditions that affected the agricultural sector. In 2005, many countries recorded notable growth of per capita GDP. South Africa, Mauritius and Botswana registered higher per capita GDP, contributing to an average per capita GDP for the whole bloc of US$ 4,171. The economies of Botswana, DRC, Malawi, Mauritius and Zambia registered considerable growth in 2005. On the other extreme Zimbabwe, Swaziland and Lesotho lagged behind in this respect. The factors that led to the picking up of growth in the countries mentioned above include recovery in the agricultural sector, notable growth of the manufacturing, construction, tourism and mining sectors. By the year 2009 the highest per capita GDP was recorded in Mauritius with US$ 6,735, while the DRC registered the lowest level at US$ 160. This was mainly attributed to political instability prevailing in the DRC that have been affecting the country for a long while.

CHAPTER THREE

LITERATURE REVIEW

3.1 Introduction

This chapter explains the theoretical issues in a monetary union. In this regard, the traditional Optimum Currency Area (OCA) theory has been of great assistance. The chapter also highlights on the existing integration arrangements in Africa.

3.2 Theoretical Issues in Monetary Union

A paper by Mundell (1961) on the theory of Optimum Currency Area (OCA) has been used in the analysis of monetary union issues. According to Mundell the traditional theory of OCA originates from recognition that foreign trade imposes special trading costs (such as transport and monetary trade costs) that are not encountered in domestic trading. In addition, the theory compares and balances the costs[7] and benefits[8] of forming a monetary union for any regional bloc.

The theory of OCA also identifies major factors in assessing the suitability of forming a monetary union. These are: degree of factor mobility, degree of openness, degree of product diversification (Mundell, 1961; McKinnon, 1963; Kenen, 1969) and degree of financial integration.

Degree of Factor Mobility:

In the formation of an enduring monetary union, this is an essential element (Mundell, 1961). Mundell postulated that if there is a high degree of factor mobility within a region or a bloc, the cost of forming a monetary union will be minimized, because the region will be able to deal with asymmetric shocks through migration, lessening the need for adjustment of exchange rates.

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[7] Loss of national sovereignty, costs due to differences in the economic cycles within countries and the issue of language also plays a major role, especially on the aspect of factor mobility among member countries

[8] Reduction in transaction costs, elimination of the degree of uncertainty associated with exchange rate movements and furthermore, promotion of investments, market integration and stability in price levels

Degree of Openness:

According to McKinnon (1963), a high degree of openness among nations prior to establishment of a monetary union is likely to be helpful as most prices are already being determined in the market. It minimizes the divergences of different national currencies in the union. Increased openness, relating the proportion of non-tradables to tradables in the economy, increases the variation of the domestic prices under flexible exchange rates, reducing liquidity and the possibility for money illusion.[9]

Degree of Product Diversification:

According to Kenen (1969), a more diversified economy is less likely to suffer from a country-specific shock and the country's economy will have less need to resort to exchange rate fluctuations to maintain internal stability. Thus, surrendering (to the union) the exchange rate policy will not affect that particular economy. However, a less diversified economy will imply that, if one sector (especially the dominant one) suffers, then the whole economy will suffer.

Degree of Financial Integration:

With a high degree of financial integration, there is no need to rely on exchange rate changes to restore external equilibrium since slight changes in interest rates will attract sufficient equilibrating capital flows. Hence it is possible to maintain fixed exchange rates within a currency area.

Similarities in the Industrial Structure:

This criterion can be viewed in the same way as the criterion of product diversification, for economies with similar industrial structure will imply similar effect of shocks and hence effects in one economy will reflect effects of the rest of the economies.

Similarity in Inflation Rates:

Similarity in the inflation rates is important in considering formation of a single currency for a number of economies. This is because it reflects similarity in ways that these economies have been conducting and carrying out their economic policies, especially their monetary policies.

9A false belief that money (a currency) represents a constant value, thus disregarding the effect of inflation.

3.3 Review of Literature on Various Aspects of Macro-Economic Convergence

The long experience of European countries in forming the European Union (EU) provides potent leads to factors that might help or hinder the road to successful development of the SADC monetary union and specifically in achieving monetary convergence (Ogunkola - 2005). Special analyses and studies by experts like Bofinger (1994), von Hagen and Hammond (1995), Artis and Zhang (1997), Bauyomi and Prasad (1995) Erkel-Rousse and Melitz (1995) among others, have examined the relevant issues such as those on measurement of the potential effects of forming a Monetary Union. However, they concentrated on the essence and effects of asymmetric shocks and exchange rate variability and dealt less withanalyzing the issues of the extent of openness, factor mobility, product diversification or possible reduction of transaction costs within those countries aspiring to form a Monetary Union.

The theory of OCA was tested by Grandes (2003) who analyzed the functioning of the Common Monetary Area (CMA) in Southern Africa. He also identified the costs and benefits from macroeconomic convergence to member countries.

An elaboration by Melitz's (1995) shed light on a suitable approach to the theory of OCA by examining the role played by asymmetric shocks to see how crucial they are amongst candidate members in forging a common currency area. Ishiyama (1975) tried to test for optimality for a single currency *vis-a-vis* the degree of financial integration, while Kenen (1969) focused on the levels of product differentiation in explaining the hardships that developing countries encounter in forming a monetary union. This study tries to join the various angles of the views of these experts in order to make an analysis for the SADC region, pertaining to its goal of formulating a Monetary Union by 2016.

Later studies found little support for the creation of large currency union in SADC. This is the case for instance with Bayoumi and Ostry (1998) who applied the general methodology based on analyzing both the size of an economy and its correlation with real disturbances across countries caused by shocks and the level of intra-regional trade. In another study, Guillaume and Stasavage (2000)[10] investigated the experience of countries that have participated in formal

[10]Terence D. Agbeyegbe *of* Department of Economics Hunter College and the Graduate Center, CUNY "On the Feasibility of a Monetary Union in the Southern Africa Development Community - September, 2003

regional arrangements in Africa with respect to monetary policy such as those of the erstwhile East Africa Currency Board, the CFA zone, and the current Rand Monetary Area. That study concluded that the involved countries generally lacked the sincerity and commitment to achieving financial stability due to inability to create or sustain requisite political institutions. In view of this, their ultimate argument is that full-fledged Monetary Unions can in fact engender commitment to sound macroeconomic policies.

T.D Agbeyegbe (2003) argues that "Traditionally, the study of monetary integration suggests that members of regional associations should do an economic cost-benefit analysis of the proposed action and favor forming a monetary union when the economic benefits outweigh the economic costs". His point is that, as already noted earlier, the benefits accruing to joining a Monetary Union are entailed in reduction in the transactions costs derived from trading goods and services among the countries using different currencies.

Devarajan and de Melo (1987) did identify the long run benefits of participation in a Monetary Union. It was intimated that currency convertibility confers several benefits, including notably: (i) the advantage of minimizing speculation in capital flows and exchange rate risk that capital flight induces; and obviously (ii) potential increases in foreign direct investments. Additionally, other studies using the concepts of comparative analysis and trend analysis evaluated the performance of existing monetary unions (e.g. Guillaumont*et al* - 1988 and Chipeta and Mkandawire -1994). For Jenkins and Thomas (1996), they focused precisely on the question of whether the southern African countries were ready to form a Monetary Union. Their conclusion, based on the status of convergence of macroeconomic variables, was that the region was not yet ready for a Monetary Union.

Indeed the issue of macroeconomic convergence preoccupied those who were trying to assess whether countries which are in a regional bloc are in fact coming together or not. In other words, assessing whether a region like SADC is suitable or not in forming a Monetary Union. Some of the studies cited above have delved into this concern.

T.D Agbeyegbe (2003) refers to Sparks (2002) who tried to determine the future of monetary integration in southern Africa. Based on the data for the period from 1995 to 1998, Sparks focused on six potential criteria that he deemed as essential for establishing a credible monetary union (namely: inflation rates, public debt as percentage of GDP, foreign economic assistance per capita, foreign economic assistance as a percentage of GDP and trade, and

currency exchange rate fluctuations). In these criteria, Sparks found scarce evidence of convergence. Thus his conclusion was that if there is no more convergence, and thus successful formation of a monetary union for the SADC region stands little chance.

In another opinion by McCarthy (2005) reasoned that a single regional central bank, a single exchange rate or and a uniform interest rate regime are not viable in the SADC bloc, and even went further to say they are not desirable. The argument is that most African countries are overly and variably exposed to external shocks due to their over reliance on a single or two primary products. Therefore, they need freedom to allow them to react to these shocks by applying exchange and interest rate policy options that they can manage.

It seems that most of the studies conducted on MEC in SADC were of the view that further measures for convergence were still required. This is the platform of the current study, measuring whether improvement in performance of many convergence factors over time would eventually trigger a credible proposal for the SADC region into forming a veritable Monetary Union.

3.4 An Overview on Other African Regional Integration Blocs

Africa is not alone in aspiring for regional integration; other parts of the world have also adopted the idea of regional integration. This is due to globalization and the advent of the World Trade Organization (WTO). The biggest bloc in Africa is the African Union (AU), which consists of all the African countries and is seen as an umbrella catering for the whole continent. This bloc plans to have a common currency area and a central bank by 2025.

The African continent has several regional economic communities. Table 2 gives a snapshot of progress of integration of the economic blocs within Africa. The table also highlights the existing plans in these blocs concerning the issue of a Monetary Union.

Table 2: Review of Progress on African Integration Blocs

Area	Economic Bloc	Status in the formation of a Monetary Union
Central Africa	Central African Economic and Monetary Community (CEMAC)	Convergence has been achieved. It aims at becoming an economic union by 2015
	Economic Community of Central African States (ECCAS)	Implementing a free trade area with a view to eventually attain full economic union status
Eastern Africa	The East African Community (EAC)	It has progressed on to a Common Market and processes towards having a monetary union have as well commenced – with plans launching it by July 2012
Northern Africa	Community of Sahel-Saharan (CEN-SAD)	It has studied the feasibility of free trade and pursues selected sectoral integration
	Arab Maghreb Union (UMA)	It has an economic union but it is yet to become a free trade zone
Western Africa	Economic Community of West African States (ECOWAS)	Its monetary union is UEMOA and it aims for an economic union through monetary union, tariff reduction and macroeconomic convergence.
	The Manor River Union (MRU)	It seeks to integrate various sectors but its function has been affected seriously by political turmoil in each of the member countries respectively in Liberia, Sierra Leone and Guinea
Southern Africa	Southern Africa development Community (SADC)	Macroeconomic Convergence criteria have been set and the member countries are aiming at forming a monetary union by 2016.
	Southern African Customs Union (SACU)	The countries have formed a Common Monetary Area (CMA) and a common external tariff is adopted.
Other groupings	Common Market for Eastern and Southern Africa (COMESA)	Macroeconomic convergence criterion has been set. Integration has been slow due to hardships in attaining the planned levels of the macroeconomic variables.

NB: Table 7 further below shows the constituent members of each block

CHAPTER FOUR

ANALYSIS OF SUITABILITY OF A MONETARY UNION USING EMPIRICAL DATA[11]

The aspect of the current study on macroeconomic stability is considered crucial in leveraging the success of the process to monetary unification. As proposed earlier, the macroeconomic variables considered in this study are ***Inflation, Budget Deficits, External Account*** *and* ***Public Debt***.

The issue of overlapping membership is also interjected in the study. What are its implications – ositive and negative towards formulating a monetary union for a single regional bloc? It would appear that African countries seem to have unflinching belief in regional integration in achieving economic growth; with this concept then this issue of overlapping membership may not be surprising.

In testing for an optimum currency status and the prevailing conditions of the macroeconomic variables, the following conditions and explanations are taken into consideration.

The Degree of Openness:

The more open an economy is, the larger the benefits of joining a currency union will be, *ceteris paribus* (McKinnon, 1961). Hence degree of openness is measured basing on the values of exports and imports of the member countries, both with other member countries and the rest of the world. The formula to apply is as follows: $OPEN_{i,j} = \frac{(\frac{totaltrade}{GDP})_i + (\frac{totaltrade}{GDP})_j}{2}$

Such that:

i represents one country; and *j* represents the second country;

The degree of openness is then considered higher once the value of total trade (exports and imports) for country I and of country j is higher, once divided by 2.

[11] DATA used for analysis**:** Annual macroeconomic data from 1980 to 2004. The choice of the period is driven by data availability concerns. Data on monetary union for SADC is obtained from the Ministries of Foreign Affairs and International Corporation and of Finance and National Planning for member countries. Other supplementary data have been sourced from the central banks of all member countries, World Bank statistics and IMF's International Financial Statistics database

Diversification of the Products and Similarity in Industrial Structure:

The argument is that, a larger production variety allows diversifying negative terms of trade away. Meaning that, for a country producing a small variety of goods and exporting only a few of them, a decline in exports revenue would result in relatively higher labour unemployment (or higher idle resources) than in a more diversified economy. In this connection, the formula from Herfindhal index

$H_{i,j,k,t} = \sum (S_{ik} - S_{jk})2$ is applicable, provided an availability of empirical data.

Such that:

S indicates the industries in an economy.

The index is ranged between 0 and 1 and for values below 0.25, they imply low diversification whereas index values which are higher than 0.25, they imply high diversification.

Inflation:

Differentials in inflation rates will change the purchasing power of currencies of potential members. Thus, the more convergent inflation rates are among economies aspiring to form a Monetary Union, the more appropriate will be for them to form the union.

Budget Deficits:

Member country central bank is often expected to be the main source to finance government deficits. In this way, budget deficits are converted into increases in the general price level and are assessed basing on the percentage increase in the price levels.

Public Debt and External Account:

These two variables are measured and explained basing on the prevailing status on the current accounts for each country under the period of the study. The balance of payments accounts for each country are analyzed in order to come up with a coefficient that will explain the conditions for all countries.

CHAPTER FIVE

ANALYSIS OF OPTIMAL CONDITIONS FOR SADC MONETARY UNION

In order to examine the extent to which SADC is suitable for a monetary union, the OCA criterion is used. Based on annual data (statistical analysis) and the case studies that have been carried out by other scholars, the evidence is presented on the following factors as they prevail within the regional bloc, namely: degree of openness, similarity of the industrial structure and the degree of product diversification and similarities in inflation.

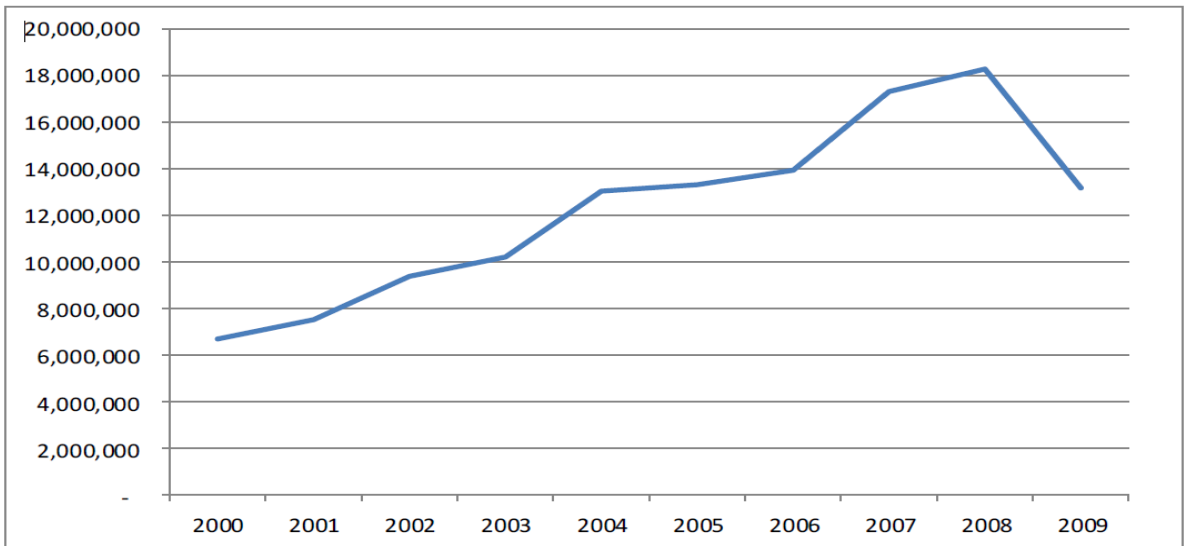
5.1 Prevailing Factors

5.1.1 Degree of Openness:

Regional groups of trading partners are created in order to enhance trade, hence to stimulate economic growth. A measure of a country's degree of openness is the fraction of its GDP devoted to imports and exports. A value of zero for a degree of openness indicates that the country has a closed economy. The higher the level of openness, the more likely it is that foreign countries have a strong effect on the economic variables of the home country.

In the above context, the SADC Trade Protocol was established in 1996 and its implementation commenced in September, 2000. The trade protocol aims at achieving free trade among its members (almost complete elimination of tariffs on intra-SADC trade by 2012). The key question is: to what extent has the trade protocol enhanced intra-regional trade? To answer this question, Figure1 represents intra-SADC trade data for 2000 to 2009.

Figure 1: Total Intra-SADC Trade (2000-2009) in US$ ('000)



Source: USAID Technical Report, 2011.

For the whole bloc of SADC, total trade among the member countries has been increasing since 2000; it was US$ 806 billion in 1999, and then it moved to US$ 11.6 billion in 2000. Between 2001 and 2004, the increase was 1.7 percent to 2 percent each year, with US$ 11.7 billion as the value for 2001 to US$ 16.0 billion in 2004. In 2005, there was a great fall in the total trade to US$ 5.3 billion and this was by US$ 1.0 billion of exports and US$ 4.3 billion of imports within the bloc. By 2009, intra-SADC trade reached US$ 18 Billion. The economic crisis of 2008-09 had a significant impact on intra-SADC trade as trade fell by more than 27 percent during that period (USAID Technical Report, 2011).

The pattern of dependence of the region for trade divides member countries into two groups: Firstly, Malawi, Mozambique, Zambia, and Zimbabwe – which depend heavily upon SADC, particularly for imports. These countries source upwards of 50 percent of their imports from other SADC countries and sell more than 20 percent of their exports to the region. Then the remaining countries in SADC, which maintain much stronger trade relationships with the rest of the world. SACU sources only 5.6 percent of its imports from the region. SADC accounts for a much higher percentage (10.5) of SACU exports, which leads to large trade imbalances between SACU and the rest of SADC (World Bank 2011).

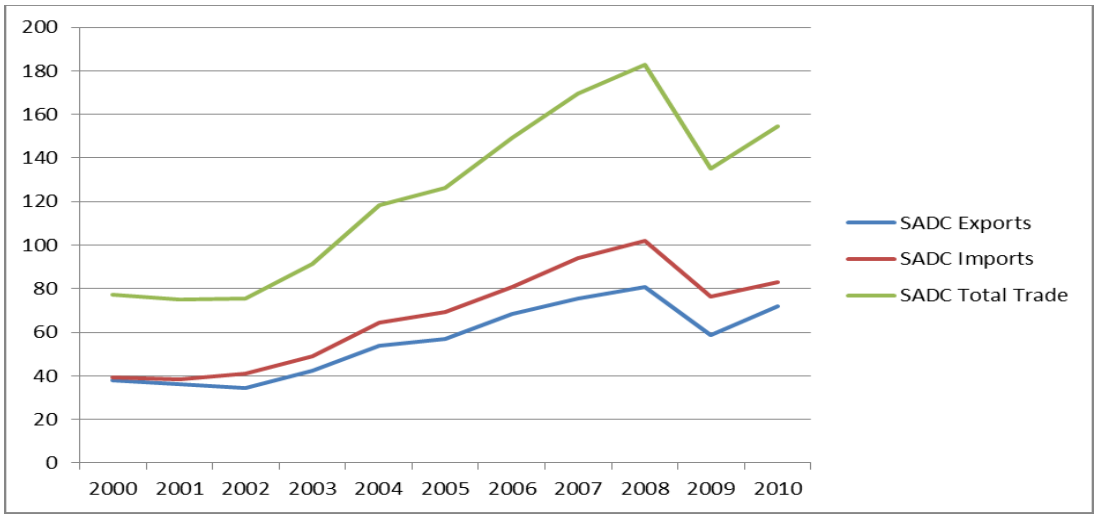
After assessing the prevailing export patterns of SADC members, one would find that a similar pattern would emerge. Thus overall, only 21.2 percent of SADC members' exports go to other SADC members' markets. On the other hand, Lesotho and Swaziland export heavily to SADC at

54 and 74 percent respectively, while Mozambique sends 46 percent of its exports to the SADC markets, and over 60 percent to South Africa. For Malawi, Zambia and Zimbabwe their export dependency on SADC is respectively 21, 20 and 24 percent, while South Africa sells 24 percent of its exports to the SADC countries. The least countries dependent on the SADC market for export are Angola, Mauritius, Namibia and Tanzania, where export shares account for only 0.1, 1, 17 and 4 percent respectively.

The pattern of SADC imports exhibits almost similar asymmetries basically. South Africa, Mauritius and Tanzania rely hardly on imports from SADC, while smaller economies like Malawi and Zambia rely more heavily on SADC for their imports. South Africa is by far the largest source of imports of SADC members.

From the analysis it can be deduced that for a majority of countries, intra-SADC trade is low; but this is partly a consequence of low levels of economic development and also the consequence of lack of historical connection influenced by colonial legacy. Once conditioned on certain income levels, SADC countries have experienced an increase in openness comparable to other developing countries. This is represented in Figure 2, showing that the contributions of trade to GDP lie within the range of 25 percent only for the whole bloc, which is still very low.

Figure2: SADC Trade with the Rest of the World (in Constant 2000 US$ Billion)[12]

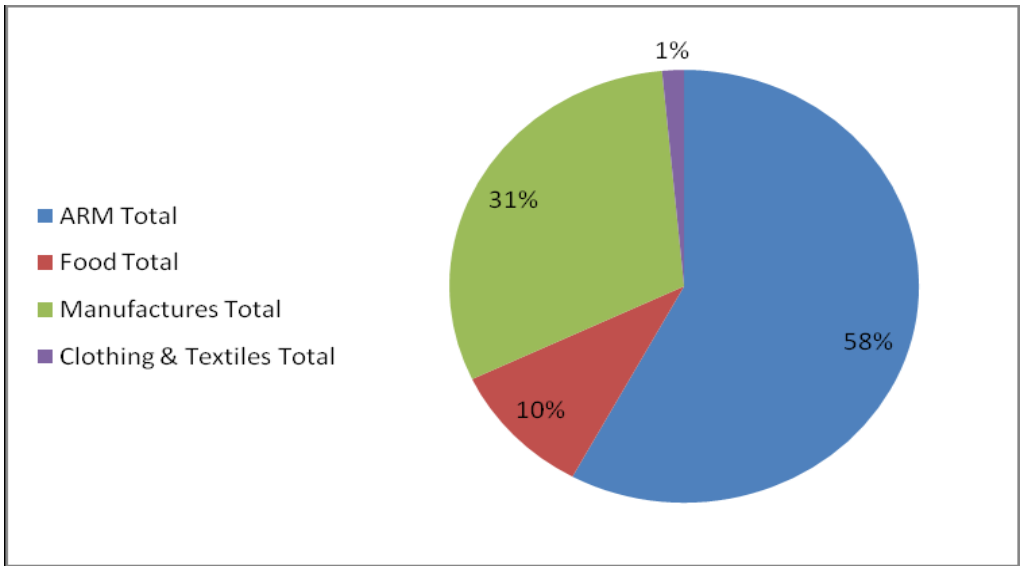


Source: USAID Technical Report, 2011

[12] The data excludes Lesotho who had not reported to COMTRADE (which was the source of USAID data)since 2002. Data for Namibia were also not available for 2009 and 2010; Data for Swaziland were not available for 2008 and 2008 and data for Zimbabwe were not available for 2003 and 2010.

Sector-wise, four broad sectors account for 98 percent of intra-SADC trade, namely: Agricultural Raw Materials (ARM); Food; Manufactures; and Clothing and Textiles. As illustrated in Figure3 below, until 2009 ARM dominated, intra-SADC trade accounting for nearly 60 percent of the total. This breakdown has been roughly constant over the period.

Figure 3: Sector Shares in Total Intra-SADC Trade (2005-2009)



Source: USAID Technical Report, 2011

5.1.2 Similarity of the Industrial Structure and the Degree of Product Diversification:

The other dimension that may be crucial in analyzing the suitability of a currency union formation is the industrial structure of the countries wanting to form the union. The other factor is also their production patterns. Due to lack of data in some of the countries both factors are handled concurrently in this study.

The structure of production of SADC countries is a clear representation of a developing region where large shares of GDP originate in the primary sectors of production. Thus in SADC countries agriculture and mining sectors contribute an average of over 50 percent of total region GDP. Statistics on SADC show that only Mauritius and South Africa have sizeable manufacturing sectors, at approximately 25 percent of GDP. The share of manufacturing sector to GDP in the rest of the member states averages less than 15 percent. In addition to having a small manufacturing sector, SADC economies do not produce a diversified range of manufactured products. They produce products such as foodstuffs, beverages, tobacco, textiles,

clothing and footwear, which are agricultural-resource based. As a result, SADC economies are vulnerable to volatilities emanating from developments in the international markets.

Food processing is also an important sector in SADC, accounting for approximately 16 percent in Tanzania, 12 percent in Zimbabwe and 11 percent in Zambia, Malawi and Mozambique. The mining sector accounts for a great portion of the GDP in Botswana (28 percent) and accounts for 21 percent for the rest of the SADC bloc (reflecting natural resources and mineral endowments in the bloc). Machinery and equipment production has a low share of output in most countries, with the extreme being Mozambique with a share of 0.7 percent. Botswana and South Africa have a higher share of approximately 7 percent and 9 percent respectively (2005).

In likeness of the above production structure within the bloc, the trading pattern portrays the same trends. This implies that trade composition is consistent with the hypothesis of international comparative advantage (the Heckscher-Ohlin model), which postulates *inter alia* that trade is based on the factors of production. A country with capital abundance will produce and export more of capital intensive commodities and import more of labour intensive commodities and vice versa for a country with labour abundance. In this case then, for the whole SADC bloc, machinery and equipment and basic intermediaries form a large share of total SADC imports and a small share of total exports (with the exception of South Africa and Botswana).

Within the SADC regional bloc, the comparative advantage phenomenon is experienced differently among the countries in terms of the production and the trading sectors. This difference can be explained as being due to great differences in the size of the countries as well as their general economic structures (such as the GDP levels, the levels of macroeconomic variables, stabilities of the economies, sector composition etc). Countries with similar trade structures, and which are relatively diversified, would face similar changes in terms of trade, and hence it becomes suitable for common policies. In this case then, the monetary union might at least be feasible.

The degree of product diversification in the SADC bloc as a whole is very low and the industrial structure in the member countries varies considerably. This casts doubt on the potential benefits to be derived from a Monetary Union for the SADC bloc.

5.1.3 Similarities in Inflation:

The inflation rates in all the 14 SADC member countries have been quite dissimilar. Generally, countries such as Angola, the Democratic Republic of Congo and Zimbabwe are characterized by high inflation rates, while countries that have been able to maintain a single-digit inflation rate are few, such as South Africa, Botswana and Mauritius. A further discussion on the inflation rates in the region is in *Section 5.2.1*.

This disparity in the inflation rate regimes reflects in the way that the countries conduct their economic policies, which have unfavourable implication on the appropriateness of forming a Monetary Union.

According to the analysis in the OCA theory, the factors that impinge on the suitability or otherwise of forming a Monetary Union are: the Degree of Openness, Similarities in the Production Structure, and in Inflation levels, all which have been mentioned and clarified in this document already. In this context, the SADC bloc has failed to meet these criteria. Basing on the OCA theory criterion, Monetary Union will not be economically beneficial to the SADC regional bloc members.

5.2 Major Macroeconomic Indicators

A Memorandum of Understanding (MoU) on Macroeconomic Convergence (MEC) was signed in 2002 by SADC member countries. In the MoU, SADC identified four (4) major macroeconomic conditions (targets) that are to be observed, studied and controlled in order to form a suitable environment for a monetary union within the region. This initiative was not designed specifically to support the process of monetary union. Instead, it reflects a broader objective of achieving macroeconomic stabilization in the region as a whole, as a prerequisite for achieving sustainable economic growth, as well as reducing the volatility in exchange rates and divergence in other key economic variables (Jefferis, 2007).

Table 3 presents the identified macroeconomic targets that are to be met by the member states. The time frame for the attainment of the target indicators is also shown in the table. This aspect has aroused considerable discussions among economists and policy analysts.

Table 3: Macroeconomic Convergence Indicators in SADC, 2008 - 2018

Target Variables\ Target Year	2008	2012	2018
Core Inflation (%)	9	5	3
Budget Deficit (as % of GDP)	5	3	1
External Debt (as % of GDP)	60	60	60
Current Account Deficits (as % of GDP)	9	9	3
Growth Rate (%)	7	7	7
External Reserves (Import cover in number of months)	3	6	6
Domestic Savings Rate (% of GDP)	25	30	35

Sources: SADC Secretariat, 2012.

This report addresses the first four targets in Table 3, namely: Inflation, Budget Deficit, External Debt and Current Account Deficit (in shade), which are more crucial in attaining an effective monetary union for the SADC region.

5.2.1 Core Inflation in SADC:

The information in Table 4 brings out the average inflation rates in SADC countries up to 2008, thus covering the first phase of the targeted period for formation of the monetary union. Further discussion on the 2nd phase of implementation from 2008 to 2012 will be derived from Figure 4. In most countries, the prevailing inflation rates are very high. The question then is: is the single-digit inflation rate criterion feasible for the SADC countries by 2008, and to be further lowered by year 2012 and yet further by 2018? It seems unlikely that this target will be achieved, given the information presented in Table 4.

Table 4: Average Inflation Rates (%) in SADC, 1980-2008

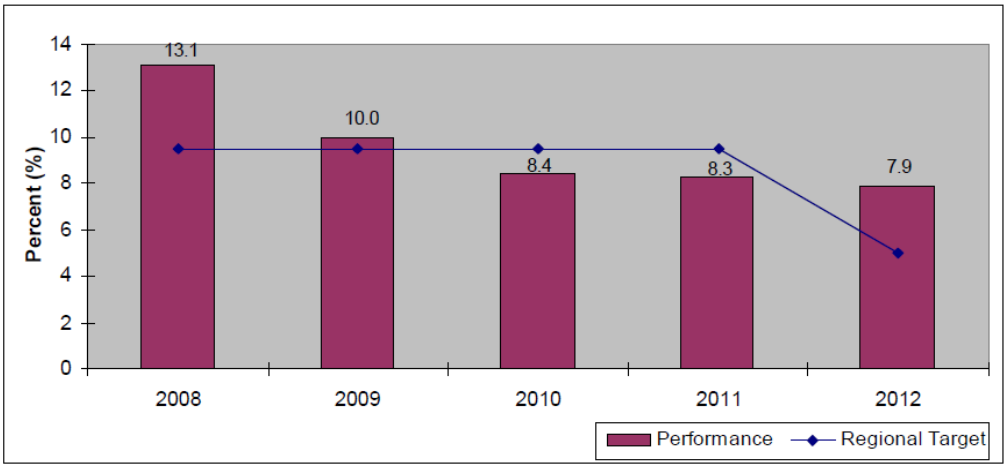
Country	1980-89	1990-95	1996-2000	2001-2004	2005-2008
Angola	*na*	870.3	340.9	112.6	14.1
Botswana	10.8	12.5	8.3	7.01	9.5
Lesotho	13.8	12.9	7.8	7.8	6.8
Malawi	16.8	30.8	30.5	12.8	10.9
Mauritius	11.2	8.2	5.8	5.5	7.8
Mozambique	45.1	47.5	12.6	14.3	9.3
Namibia	13.0	11.8	8.2	7.8	5.9
South Africa	14.6	11.8	6.7	5.20	5.1
Swaziland	14.2	12.7	8.6	7.8	7.9
Tanzania	30.1	28.9	12.5	4.8	7.1
Zambia	38.4	117.7	30.7	20.9	11.8
Zimbabwe	12.8	25.9	37.3	467.9	312.5

na: not available. DRC and Madagascar excluded.

Source: CRRFSA, IFS, World Bank, KIU, Central Bank annual reports and South African Reserve Bank

On an average, the annual inflation rate for the SADC bloc started showing improvements as of 2008, compared to the previous years. Only Zambia, Angola and Malawi were with double digit inflation. Zimbabwe was a special case. As shown in Figure 4, the average inflation rate was above the target of 9 percent.

Figure 4: SADC Inflation (%), 2008 – 2012



Source: SADC Secretariat, 2012

Though as per Figure 4, the region started experiencing a downward trend in inflation from 2008, during this time there were still signs of inflationary pressures in most member states.

These inflationary pressures were mainly influenced by increases in both food and fuel prices. Generally, regional inflation averaged 8.3 percent in 2011, almost the same level of 8.4 percent in 2010 (see also Table 1). This is the lowest recorded average inflation for the region in recent years. However, inflation increased somewhat in most member countries in 2011 over 2010 levels. If the inflationary pressures continue unchecked, the likelihood of most member countries meeting the regional target of inflation (of less than 5 percent by 2012) will be compromised. Only Namibia, Seychelles, South Africa and Zimbabwe had their inflation equal or less than 5 percent in 2011.

The stability of countries with respect to political and economic environment plays a major role in maintaining low levels of inflation. This has been evident in the case of countries that have been registering declining rates of inflation for a longer period such as Botswana, South Africa, Swaziland, Lesotho, Namibia and Mauritius; unlike Zimbabwe and DRC that have not.

5.2.2 Fiscal Deficit in SADC:

SADC countries that have at times suffered from imported inflation, they mostly used budget deficits financed by central banks. The major problem is in identifying the actual budget deficit since within the member countries these deficits are shown after the receipt of grants from donors, and thus are considered normal, seen as good as government revenue for reducing the inflationary impact of government spending. This attitude is of course misguided as heavy dependence on grants to reduce budget deficits may not be sustainable in the long run.

In this respect, over a number of years, most SADC member countries have recorded more deficits than surpluses. Nonetheless,, in 2004 Angola, Lesotho, Mozambique, Swaziland and Zimbabwe recorded improvements in their budget deficits, while Zambia and Mauritius registered deficit rates that remained unchanged at around 4 percent and 6 percent respectively. Table 5 shows the most current information on this aspect. In 2008, all SADC member countries, apart from Angola and Malawi, were within the SADC target for that date.
The negative figures are to depict deficit. And positive figures explains surplus.

reading the text, I have realized that the Malawi figure of 6.5 in year 2008 is actually not supposed to be a negative. Since by that year, its Malawi and Angola plus few others who realized a fiscal surplus.

Your take on Tanzania's scenario is correct. Since 2004, Tanzania hasnt realized fiscal surplus. and the negative signs depict that

Table 5: Fiscal Deficits (as % of GDP) in SADC Countries, 2007-2011

Country	2007	2008	2009	2010	2011
Angola	-2.1	8.8	-9.1	1.5	3.5
Botswana	0.0	4.2	-5.7.	-9.3	-9.3
Lesotho	-3.1	4.7	-3.8	-5.8	-13.3
Malawi	-0.7	6.5	-5.7	1.9	-0.7
Mauritius	-4.3	-3.3	-3.1	-4.5	-4.3
Mozambique	-4.3	-2.5	-5.4	-3.7	-6.4
Namibia	-0.29	2	1.9	-4.2	*na*
South Africa	-0.4	0.9	-0.7	-5.5	-4.2
Swaziland	2.6	-1.5	-7.1	-14.3	*na*
Tanzania	-9.6	-1.7	-4.3	-7.5	*na*
Zambia	-1.7	-2.5	-2.6	-3.1	-2.9
Zimbabwe	-17.6	*na*	0	-2.9	0

NB (i) na: not available; (ii) DRC and Madagascar are excluded; (ii) minus sign denotes deficit .
Source: CRRFSA, IFS, World Bank, KIU, Central Bank annual reports and South African Reserve Bank

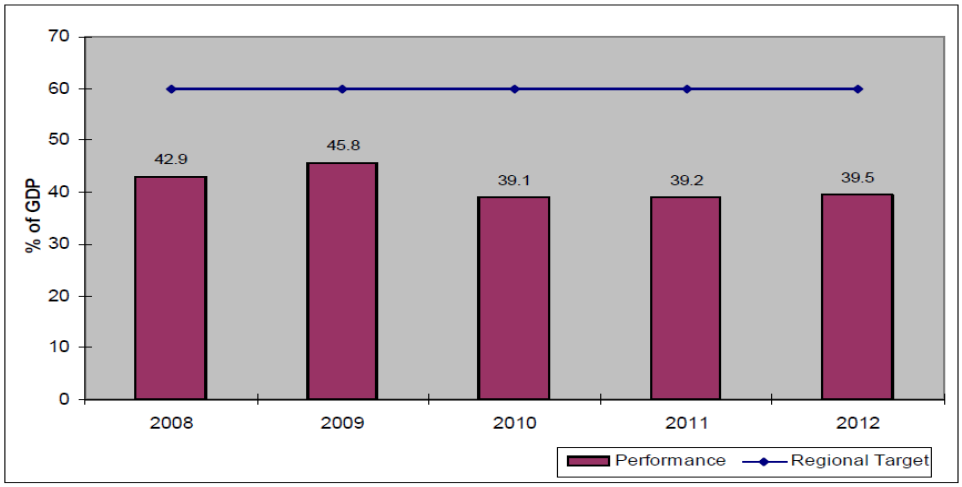
Yet achieving a low fiscal deficit of GDP (say of 3 percent), is not absolutely necessary or even sufficient to enjoy the macroeconomic stability and thus reach the convergence objective set by SADC. Countries like Mozambique of low income category that are getting large concessional aid would not need such a low deficit in order to achieve macro-economic objectives if they remain within reasonable margins of debt sustainability. This is not the same for countries like South Africa that have a high risk of generating imbalances in their private investment-savings arrangements and need to guard against large shifts in private capital flows.

5.2.3 External Debt:

On the other hand, SADC economies with exception of South Africa either have or risk triggering severe macroeconomic instability as they depend on large aid inflows which may be interrupted due to donors' dissatisfaction with macroeconomic policy positions or home country financial crisis. In SADC, the agreed external debt limit is 60 percent of GDP, for all member countries by 2008 to 2018.

In 2008, seven countries had remained within the set target of the SADC region, with the average for the region at around 42.9 percent. The average has been falling ever since as seen in Figure -5-By 2010 the region's situation was at 39.1 percent (% of GDP) with only Seychelles and Zimbabwe recording their levels above the regional target of 60 percent of GDP in 2011.

Figure 5: SADC External Debt, 2008 - 2012



Source: SADC Secretariat, 2012

5.2.4 Public Debt in SADC:

Table 6 portrays the average levels of public debt within SADC. It shows that Zimbabwe, Mauritius, South Africa, Lesotho, Malawi, Mozambique and Tanzania have large levels of public debt as a percentage of GDP. Nonetheless, all member countries, with the exception of Zimbabwe and DRC, had by 2008 met the SADC target on public debt. Botswana, Namibia, Zambia, Angola and Swaziland had low average debt levels by 2011. But the five countries represent 42 percent of all the SADC countries, which implies that the region as whole enjoyed a relatively low level of debt.

Table 6: Public Debt (as % of GDP) in SADC Countries, 2007-2011

Country	2007	2008	2009	2010	2011
Angola	26.1	17.6	22.6	21.7	17.6
Botswana	6.5	4.3	6.9	13.6	23.7
Lesotho	53.4	55	40.1	36.8	34.8
Malawi	145	31.6	40.8	35	34.7
Mauritius	62.8	51.9	59.3	45	na
Mozambique	4.5	40.5	43.7	45.1	na
Namibia	7.3	18.9	18	27.4	*na*
South Africa	31.6	31.4	31.5	39.4	42.3
Swaziland	25.8	16	12	14.4	na
Tanzania	63.1	31.5	40.9	43.2	na
Zambia	4.8	26.7	26.4	21.3	20
Zimbabwe	26.6	147.7	109.8	103	105

na: not available

Sources: CRRFSA, World Bank, IFS, Central Bank annual reports and the Committee of SADC Central Bank Governors

5.2.5 Overall Performance and Assessment on Attaining the Set Target by 2012 and until 2018:

Overall, on the performance of the MEC in the SADC region, the analysis shows that there has been a marked improvement in macroeconomic performance across the entire region in recent years (past 2008), especially on fiscal deficit balances as well as on the public debt for the member countries. Global food and fuel price developments have driven inflation rates in most SADC members a little above the single-digit convergence criterion. But positive changes started being realized as of 2009.

By 2012, the MEC targets have not been fully attained by all member countries, though few positive performances have been realized. Hence, towards the year 2018, the possibilities to fully realize the set macroeconomic targets for the SADC region are as follows:

- **Inflation**: By looking at the inflation pressures at the current moment, one can predict that inflation is not likely to be excessive in all SADC economies, save for the currency weakness pushing up import prices. Nonetheless, the situation is relatively uncertain. The global response to the economic crisis has involved massive monetary expansion

and debt issuance, which could in the medium-term lead to the re-emergence of inflationary pressures.

- **Fiscal Deficits**: Slower growth and lower levels of international trade are likely to reduce government revenues, while expenditures are likely to increase as governments face demands for larger social safety net provision. Hence fiscal deficits are likely to grow, posing financing challenges for governments. Policy responses will need to include measures to encourage domestic savings, as well as fiscal reforms to improve revenue collection. Higher borrowing requirements may lead to higher interest rates, which can lead to a crowding out problem for private investment, but will help to encourage savings. Monetary financing of deficits would as a result generate inflationary pressures.

- **Public Debt**: To the extent that fiscal deficits are financed by increased borrowing, public debt is likely to rise. When combined with constrained international capital flows, this is likely to mean mostly domestic debt, which may be more expensive than foreign debt but has the advantage of not being exposed to currency risk.

- **External Account**: Balance of Payment balances are expected to alter as per the anticipated decline in export levels in all economies. Reduced capital inflows will make such deficits more difficult to finance. Larger deficits will have to be financed by drawing down foreign exchange reserves (SADC Secretariat, 2009).

Following the above assessment regarding the SADC region, depicting rising fiscal deficits and public debt, increasing current account deficits, declining foreign exchange reserves, combined with declining inflation rates, it will be necessary to install a set of MEC indicators that help the bloc to move in the right direction.

5.3 Overlapping Membership

SADC Member States participate in several overlapping regional and bilateral trade arrangements, with the Southern Africa Customs Union (SACU) and COMESA being the most prominent. Tanzania also is a member of the East Africa Community (EAC). The creation of different Regional Integration Initiatives (RIIs) in the region (as is the case throughout the continent) was greatly influenced by the first wave of regional integration, based on the model of the European Economic Community (EEC). This situation of multiple and overlapping

membership became more complex in the early 1990s. A close examination within southern Africa shows that there are a number of regional integration agreements and bilateral agreements taking place. The overlapping phenomenon of SADC member countries is shown in Table 7.

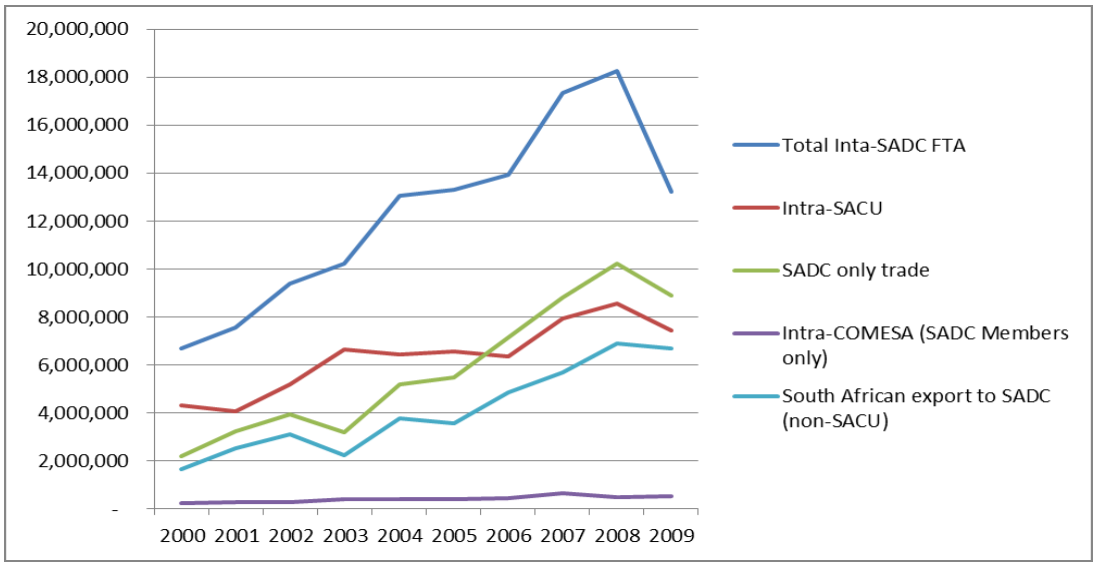
Table 7: Overlapping Membership (Involving the SADC Member Countries)

Country	SACU	COMESA	EAC	SADC
Angola		x		x
Botswana	X			x
DRC		x		x
Lesotho	X			x
Madagascar		x		x
Malawi		x		x
Mozambique				x
Namibia	X			x
South Africa	X			x
Swaziland	X	x		x
Tanzania			x	x
Zambia		x		x
Zimbabwe		x		x

x: membership. Source: Compilation by the author

Being a member in more than one regional bloc has its benefits as well as disadvantages. This arrangement has some advantage in case of a number of countries: for instance as the dominant economy of SADC, South Africa finds its participation in all the blocs critical. But the most negative impact lies in hindering the formation of stronger regional ties. Figure 6 shows the extent of trade that is conducted by the SADC member countries with other regional trade arrangements.

Figure 6: Intra-SADC Trade disaggregated by Regional Trade Agreement (2000-2009) in US$ ('000)



Source: USAID Technical report, 2012

As per Figure 6, intra-SACU trade more than doubled between 2000 and 2009, while trade among SADC and COMESA members remained roughly flat over the period at US$ 0.5 billion. Export levels from South Africa were the main source of the rise in SADC trade (under the arrangement of SADC FTA). Further, the non-SACU countries have increased their share of intra-SADC trade over the period.

In spite of the above achievement, the major question will be asked: *Why should countries belong to more than one regional group?* This question has received a number of answers to date, and some of them include the following ideas:
According to the UNECA[13], having membership in several communities could maximize the benefits of integration while minimizing the losses by spreading risks through participating in more than one bloc. Countries with weak economies would give priority to this potential benefit as they would gain in each regional economic community.

On the other hand, the overlapping in regional economic blocs also tends to dissipate collective efforts aimed at the common goal of the African Union. Moreover, it tends to blur the goals of integration, thus leading to counterproductive competition among the countries and institutions. Thus overlapping membership imposes greater transaction costs through wasteful duplication of

[13]UNECA document on: Subregional Blocs as Regional Building Blocs *in new.uneca.org/Portals/aria/aria1/Chap3.pdf*

efforts. Consider a country belonging to more than one regional bloc on how much it would have to cope with so many meetings, policy decisions, procedures and schedules, let alone the multiple financial obligations.

Another issue that has emerged is with respect to the current Economic Partnership Agreement (EPA) negotiations with the EU, the process that amounts to overlapping membership among the EPA aspirants and the SADC members. In this respect, South Africa has already negotiated its EPA agreement with the EU while the SADC members are divided. Several SADC members are joining up with a selection of COMESA members in pursuit of the agreement with the EU (e.g. Malawi, Mauritius, Zambia and Zimbabwe as well as DRC and Madagascar) and the others are negotiating as SADC, like Angola, Botswana, Lesotho, Mozambique, Namibia and Swaziland. Tanzania is negotiating in the context of the EAC bloc.

Within southern Africa, there is also the Rand Monetary Arrangement (RMA) with member countries that have their currencies tied (one-to-one) to the Rand currency of South Africa. As seen earlier, all members of SACU are as well members of SADC. No doubts with such entanglement, it is doubtful if a full Monetary Union for SADC countries would be realistic. South Africa and together with the other members of SACU who already have formed a monetary union would face a significant welfare loss, if the SADC arrangements are to proceed. An attempt is made below to summarize by showing who will be possible gainers and losers within SADC resulting from a Monetary Union:

***Gainers**:* Angola, Botswana, DRC, Malawi, Mozambique, Zambia, Zimbabwe
***Losers**:* South Africa, Lesotho, Namibia, Swaziland
Doubtful Cases: Tanzania, DRC, Mauritius and Madagascar

With SACU having its own cohesive Monetary Union arrangement, it is not going to be feasible for SADC to sustain another Monetary Union within its rank especially during the formative period of the SADC Monetary Union. Apart from this, consider a country like Tanzania: whereas she is a member of the EAC (with Kenya, Uganda, Rwanda and Burundi), at the same time, she is a member of SADC, Currently, the EAC region is implementing a Common Market – How is it then possible for Tanzania to continue having further regional integration attachments in SADC while it is already in a Customs Union with other four countries within the EAC arrangements? The only solution to this confusion is possibly through the formation of the COMESA-EAC-SADC FTA (Tripartite) arrangement.

CHAPTER SIX

CONCLUSION AND RECOMMENDATIONS

6.1 Discussion

It is observed that, within Africa, there ought to be great concern over undertaking steps for a Monetary Union rather too quickly, without ensuring that policy prerequisites are in place, especially those relating to fiscal policy (Jenkins and Thomas, 1996; Derbun*et al.* 2002). Of the four SADC MEC criteria, only the inflation target can possibly be met by the SADC members. For the other three MEC indicators – fiscal deficit, public debt and current account deficit – the sustainable levels differ from country to country. On the other hand, it is proposed that inflation be assigned a higher status than the other three indicators, for a variety of reasons:

- it is the only one for which a target value can be assigned that is not country specific;
- it is of particular importance in attaining a stronger Monetary Union; and
- inflation provides an overarching indication of the degree of stability and consistency in macroeconomic policy implementation – i.e. it is a good indicator of outcomes.

Inflation should therefore be the primary MEC indicator; with targets that should be strictly adhered to for a stronger and beneficial Monetary Union in the SADC region. Fiscal balance, public debt and current account deficit should be secondary indicators that are more flexibly interpreted.

This concluding section can further be recast in light of the identified research questions implied in the study objectives stated in the 1st Chapter:

6.1.2 Research Question One:

Is SADC Suitable for a Monetary Union?

This study used the OCA theory in answering this question. The results on the criteria were drawn basing on the evaluations of its important factors. The level of openness in the bloc portrays an unsuitable environment for the formation and adoption of a monetary union. The level of intra-regional trade is still low and hence, unless the level of intra-SADC trade increases,

monetary union would not be beneficial for the member countries. The industrial and production structures in the economies of member countries also do not suggest any benefits out of a monetary union for SADC. Bold choices should therefore be made regarding monetary and exchange rate policy, since as already noted most SADC countries have floating exchange rates.

6.1.3 Research Question Two:

To what extent has MEC Criteria been attained in SADC?

The deadlines for the attainment of the proposed major macroeconomic variables (inflation, budget deficits, public debt and external account) are too ambitious (Bunyi, 2005). In this study, it is clear that most of the member countries do not appear to have convergence (pertaining to the monetary union objectives) as part of their economic policy. This makes the idea of monetary union harder to be sold.

In other words, it suggested that the potential benefits from monetary union are limited. Taking South Africa, for instance, it is by far the largest and most industrialized economy in the SADC bloc. Intra-regional trade is thus one-sided with South Africa serving as a major source of manufactured products in the region without a reciprocal flow of imports from the other nations.

With this then, should countries converge in terms of their macroeconomic indicators? It can be looked at in this way: a low rate of inflation is desirable, and a sustainable level of debt and fiscal management is as well desirable. But answering the above question is not so easy and direct, because this issue is based more on the aspect of macroeconomic stability rather than on macroeconomic convergence. Hence, a thorough assessment of the desirability of macroeconomic convergence is recommend to be conducted, as well as an economic analysis of costs and benefits of such analysis.

6.1.4 Research Question Three:

What does Overlapping of Membership in SADC imply for a Monetary Union?

This research question has generated a number of other questions on the issue of overlapping regional memberships. The discussion on this issue in the earlier part of this document showed clearly how SADC member countries were committed to more than just one bloc. The answer to the posed question above has argued that an economy cannot operate smoothly with more than one currency that is adopted and accepted as legal tender. If this is the case then, and SADC countries belong to different regional blocs, the intention of forming a single SADC monetary union cannot succeed. In other words, the whole bloc of SADC is not ready for a monetary union. To make matters worse, most of its members are in some regional blocs that have in fact progressed further than the SADC region itself by evolving harmonized monetary arrangements. As it was proposed earlier, this study advocates for looking into the possibility of forming a tripartite arrangement among several regional communities.

6.2 Recommendations

Most African regional blocs project similar objectives in moving into single monetary arrangements and they are also faced with almost similar obstacles in this endeavor. The SADC bloc is no exception. In view of the information of current study above, the following recommendations on the SADC bloc are considered relevant:

- The existence of overlapping memberships, as well as bilateral trade arrangements, must be revamped to try to reduce unnecessary duplication of efforts. If not, the SADC members will remain mired in conflicting regional agreements and commitments, and actual progress on evolving into the SADC monetary union will be hard to achieve;

- From an economic point of view, in order to accelerate economic growth, particularly through more investments and employment, there is need for increased cooperation and co-ordination within SADC. The priority in this should be in the formulation and implementation of harmonized macroeconomic policies;

- More trade among the member countries should be promoted more vigorously. This can be done through efforts in eliminating the existing Non-Tariff Barriers (NTBs) which have been labeled as serious impediment within the SADC region, as well as in other regions;

- There should particularly be more robust efforts to harmonize fiscal policies for all member countries and accord high importance to strengthening fiscal institutions;

- There is a need to coordinate Customs procedures and regulations; and within this rubric attempt to forge ahead with establishment of a fiscal risk sharing mechanism in the context of the SADC process to develop a deeper integration in the finance and monetary areas;

- The SADC regional bloc has to strengthen its legal and regulatory frameworks in public finance management; and

- Finally, this study strongly recommends the formation of a tripartite coordination arrangement involving COMESA-EAC-SADC Free Trade Area. Though it is not going to solve all the existing problems, but to a larger extent, it will alleviate some of the prevailing concerns which hinder the SADC region to prosper as per its set targets – and in so doing bring benefits to EAC and COMESA regions member countries.

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The Economic and Social Research Foundation (ESRF)
51 Uporoto Street (Off Ali Hassan Mwinyi Road), Ursino Estate
P.O.Box 31226
Dar es Salaam, Tanzania.
Tel: (+255) 22 2760260, 2760751/52
Mobile: (+255) 754 280133
Fax: (+255) 22 2760062
Email: esrf@esrf.or.tz
Website: www.esrftz.org