

A consideration of alternatives to expedite macro-economic convergence of countries in the SADC region

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At the outset this paper aims to clarify any uncertainty about the macro-economic convergence criteria and goals of countries in the Southern African Development Community (SADC). Countries in the region show satisfactory progress with the achievement of the goals in as much as six countries achieved all four goals set for 2008 already by 2005, one country achieved three of the goals, three achieved two of the goals, another two achieved one goal and Madagascar, who joined SADC only in 2005, and Zimbabwe did not achieve any of the goals for 2008 by 2005.

The experience in Europe since 1857 shows that monetary union and the adoption of a single currency is a challenging prospect for any region. Judged in terms of the European experience, SADC does not face insurmountable challenges in its quest for monetary unification and a single central bank.

In the interest of the introduction of a monetary union and a regional central bank by 2016, this paper suggests four initiatives to enhance progress by SADC countries experiencing difficulty with the achievement of the convergence goals. First, the timely publication of macro-economic data should be ensured. Secondly, the measurement of inflation should be harmonised between countries and the credibility of inflation figures should be assessed. Thirdly, SADC countries outside the Common Monetary Area (CMA) should consider fixing their exchange rates to the South African rand. Lastly, the macro-economic convergence criteria should be clarified.

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* This paper reflects the personal views of the authors

Introduction

Sustained economic growth is one of the challenges facing Africa in its efforts to overcome poverty and high levels of unemployment or underemployment. To this end the achievement of macro-economic stability is a necessary precondition. The achievement of the macro-economic convergence goals of countries comprising the Southern African Development Community (SADC) will underpin the objective of sustained macro-economic stability. This paper proposes four initiatives that could enhance the achievement of the convergence goals in the SADC region.

The paper is arranged as follows: section one describes briefly the SADC region, its economic targets and its macro-economic convergence goals. Successes of SADC countries in achieving the goals for macro-economic convergence criteria are assessed in section two. Section three analyses the findings in respect of SADC. The conclusions and recommendations follow in section four. This paper deals only with the economic aspects underpinning convergence, implying that political considerations¹ are not discussed.

2 A brief overview of the SADC region

The SADC region is the largest group of countries in Africa aiming at convergence. SADC comprises Angola, Botswana, Democratic Republic of the Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. The activities of SADC are co-ordinated by a secretariat in Gaborone, Botswana (Background information on SADC, 2000). SADC has set various goals for its member countries. Its main economic goals are (Background information on SADC, 2000; SADC Website, [S.a.]):

- development and economic growth;
- poverty alleviation;
- improvement of living standards;
- harmonisation of socio-economic policies; and
- the establishment of suitable institutions and mechanisms for the mobilisation of resources to implement the programmes of SADC.

SADC countries have agreed on a number of targets to enhance co-operation and integration in the region and to support its various goals. These targets are embodied in SADC's *Regional Indicative Strategic Development Plan* which was launched on 12 March 2004 in Arusha, Tanzania (Gaolathe, 2004: 4; ISS, [S.a.]). The targets can be summarised as follows (see for instance Mboweni, 2003; Southern African Development Community, [S.a.]):

- Target 1: a SADC free trade area by 2008;
- Target 2: completion of negotiations on a SADC Customs Union by 2010;
- Target 3: completion of negotiations on a SADC common market by 2015;
- Target 4: diversification of industrial structure and exports to enhance value addition across all economic sectors by 2015;
- Target 5: macro-economic convergence targets for inflation rates, budget deficits as a ratio of gross domestic product (GDP), and nominal value of public and publicly guaranteed debts as a ratio of GDP;
- Target 6: achievement of other financial indicators, i.e. reserves/import cover, central bank credit to government, domestic savings levels, domestic investment levels, interconnected payment and clearing systems, currency convertibility, dual and cross listings on regional securities exchanges, liberalisation of exchange control, and increased credit extension to women and SME's; and
- Target 7: establishment of a SADC monetary union by 2016.

In setting macro-economic convergence criteria, SADC has also agreed to "... a set of indicators that will allow monitoring of progress towards ... convergence" (Masson & Pattillo, 2005: 114). This aligns SADC with initiatives aimed at promoting "... economic development in Africa. Article 44 of the Abuja Treaty calls for the harmonisation of economic policies across the African continent. The Treaty emphasises two important pillars of economic integration across the African continent: the promotion of intra-Africa trade and the enhancement of monetary co-operation. The African Monetary Co-operation Programme (AMCP) seeks to operationalise the monetary co-operation mandate of the Abuja Treaty. In the main, this involves a single monetary area, encompassing a common currency and a common central bank ... (for Africa) ... by the year 2021" (Mboweni, 2003). In aiming for a monetary union and a central bank by 2016, SADC countries are aligned to the broader objectives for Africa.

In the consideration of progress with macro-economic convergence, an analysis of these targets, and particularly targets 5 and 6, is somewhat problematic. The goals stated in terms of target 5 are clearly macro-economic convergence criteria. However, some of the goals stated in target 6, particularly goals regarding reserves/import cover and central bank credit to the government, can also be regarded as convergence criteria, although they are not primarily identified as such, while other of the goals stated in target 6 are clearly not convergence criteria.

A further review of the literature on SADC reveals a *Memorandum of Understanding* (MoU) between SADC countries that deals with macro-economic convergence (Southern African Development Community, 2002). This MoU states in section 3 that macro-economic convergence in the SADC region will be measured and monitored in terms of the (i) rate of inflation in each country; (ii) ratio of the budget deficit to GDP; (iii) ratio of public and publicly-guaranteed (i.e. government) debt to GDP; and (iv) balance and structure of the current account (Southern African Development Community, 2002). The MoU defines some of the convergence criteria or elements of the criteria as follows (Southern African Development Community, 2002):

- budget deficit is the difference between government's expenditure and receipts from revenue and grants;
- inflation means the rate of change of the general price level using a headline index;
- public and publicly guaranteed debt comprises loans to government and includes loans to public enterprises and private companies enjoying government guarantees; and
- current account reflects transactions in goods, services, income and current transfers between residents of one country and another.

Table 1
Macro-economic convergence criteria and goals for SADC

Criteria	2008	2012	2018
Inflation rate	Single digits	5%	3%
Budget deficit	5% or less of GDP	3% of GDP as anchor, with a range of 1%	3% of GDP as anchor, with a range of 1%
Government debt	Less than 60% of GDP	Less than 60% of GDP	Less than 60% of GDP
Current account	Single digits	Single digits	Single digits

Sources: Adapted from Mboweni (2003), Mboweni (2005), Rossouw (2006a), Rossouw (2006b), SADC (2003).

This paper uses for purposes of analysing progress with convergence the four criteria stated in the MoU, although these criteria show some overlap with targets 5 and 6 in SADC's *Regional Indicative Strategic Development Plan*. Convergence goals (see for instance Mboweni, 2003; Rossouw, 2006a; Rossouw, 2006b²) were set for 2008, 2012, and 2018 for these indicators in SADC's *Finance and Investment Protocol* (SADC, 2003). The macro-economic convergence goals for the relevant years are summarised in table 1.

Progress with the achievement of the macro-economic convergence goals is monitored by the Committee of Central Bank Governors (CCBG) in SADC. As South Africa has been entrusted with sectoral responsibility for finance and investment in SADC (Background information on SADC, 2000), the CCBG is chaired by the Governor of the South African Reserve Bank, Mr T. T. Mboweni.

The next section analyses the current status of SADC countries in respect of achieving these macro-economic convergence criteria.

3 Assessment of macro-economic convergence in SADC

Although the first goals in terms of convergence should be reached by 2008, the analysis in terms of available data in table 2 shows that considerable progress has already been made to achieve the goals. The analysis in terms of available data shows that six countries achieved all four goals set for 2008 already by 2005, one country achieved three of the goals, another three achieved two of the goals, two achieved one goal and two countries, including Madagascar, who joined SADC only in 2005 did not achieve any of the goals for 2008 by 2005.

The Common Monetary Area (CMA) partners of South Africa have reaped considerable benefits from their policies of fixing their currencies to the South African rand. This raises the question whether the other SADC countries should also adopt the same exchange rate policy in the period running up to the introduction of a single regional currency. The introduction of nominal exchange rate anchors for monetary policy in the SADC region, embodied in the fixing of exchange rates to the rand (albeit at different rates for particular countries), can bring advantages for countries in the region that are not members of the CMA (see for instance Mishkin, 2004; or Nielson et al., 2005) in the period running up to monetary unification. Exchange rate targeting does not come without disadvantages (see for instance Friedman, 1968; International Monetary Fund, 2005; or Metzger, 2004), the most important of which is the loss of flexibility or autonomy in adjusting domestic monetary policy to take cognisance of domestic economic conditions. However, with the ultimate aim of introducing a monetary union and a single currency in the region, these consequences will inevitably follow, implying that exchange rate fixing will merely expedite the inevitable.

SADC countries showed the largest degree of macro-economic convergence in respect of containing budget deficits in terms of data for 2005. Only one country did not achieve this goal by 2005. Nine SADC countries achieved by 2005 already the current account deficit goal set for 2008.

Table 2
Achievement of macro-economic convergence criteria set for 2008 in terms of 2005 data

Country	Budget deficit (< 5 % of GDP)	Current account (single digits % of GDP)	Government debt (< 60 % of GDP)	Inflation rate (single digits)
Angola	7,3	15,7	37,8	18,5
Botswana	1,2	15,7	4,4	8,6
DRC	-1,2	- 4,4	158,7	21,3
Lesotho	2,0	- 6,8	49,9	3,5
Madagascar	-10,3	- 10,9	87,0	18,4
Malawi	-1,2	- 34,0	105,4	15,4
Mauritius	-5,0	- 5,2	58,3	4,9
Mozambique	-3,5	- 11,1	70,0	6,4
Namibia	-1,1	7,1	33,6	2,2
South Africa	-0,8	- 3,8	36,6	3,9
Swaziland	-1,8	0,3	16,9	4,8
Tanzania	5,0	- 6,9	63,8	4,4
Zambia	-2,6	- 11,8	64,5	15,9
Zimbabwe	N/A	- 12,0	110,2	585,8

Sources: Adapted from Banco de Moçambique (2005), Bank of Namibia (2006), Committee of Central Bank Governors (2005), SA Reserve Bank (2007).

The analysis shows that SADC countries still experience problems with the level of government debt as only seven countries achieved by 2005 the goal set for 2008. Some countries in SADC experience also problems with unavailable aggregated data for internal and external public debt (Banco de Moçambique, 2005: 16) and problems in ascertaining government debt guarantees.

In respect of inflation, more than half of the SADC countries achieved by 2005 the convergence target for 2008. It is somewhat disconcerting that nine SADC countries had single digit inflation figures by 2004 (Rossouw, 2006a: 385), but only eight achieved this goal by 2005. However, inflation rates of countries cannot be compared without the necessary circumspect owing to differences in measurement methodology, implying that the comparison and convergence of inflation rates pose a particular challenge for SADC countries. Country-specific issues, e.g. decisions about the inclusion or exclusion of owner-occupied housing cost in the index used to measure changes in price levels, or methods used to adjust for quality improvements, might distort comparisons (see for instance Cournède, 2005). Moreover, if SADC countries adopt inflation targeting as a nominal anchor for monetary policy, thus aligning them to the monetary policy approach of South Africa, similar alignment of the specification of the rates of inflation used for targeting purposes will become an important issue.

Related to differences in the measurement of inflation between countries, is the question whether the general public believes that the rate of inflation is an accurate indicator of price increases in an economy. While the measurement of inflation expectations has received considerable attention in the literature (see for instance Bryan & Ventaku, 2001a; De Wet, 2003; Kershoff & Smit, 2002; Mishkin, 2001; Saunders, 2003; or Sveriges Riksbank, [S.a.]), little has been published on the credibility of inflation figures (see for instance Rossouw & Joubert, 2005a; Rossouw & Joubert, 2005b; or Rossouw & Padayachee, 2006). The credibility of inflation figures can be jeopardised when one currency is replaced with another, as has happened in Europe since 2002 (Issing, 2006). This is a risk facing the SADC region after the introduction of a single currency, and timely steps aimed at enhancing inflation credibility are accordingly called for.

Table 3

Composition of SADC's GDP by 2004, number (out of four) of convergence criteria for 2008 achieved by 2005 and weighing of achievement of convergence criteria

Country	GDP in US\$ millions in 2004*	Percentage contribution	Number of criteria achieved by 2005	Weighted achievement of criteria
Angola	19 800	6,5	2	0,130
Botswana	6 868	2,2	4	0,088
DRC	6 300	2,1	2	0,042
Lesotho	1 396	0,5	4	0,042
Madagascar	15 700	5,1	0	0,0
Malawi	1 879	0,6	1	0,006
Mauritius	6 287	2,1	4	0,084
Mozambique	5 933	1,9	2	0,038
Namibia	5 500	1,8	4	0,072
South Africa	213 097	69,7	4	2,788
Swaziland	2 522	0,8	4	0,032
Tanzania	10 361	3,4	3	0,102
Zambia	5 408	1,8	1	0,018
Zimbabwe	4 530	1,5	0	0,0
SADC	305 581	100,0	2,50**	3,44

* Local currency values converted to US dollar at average official exchange rates or purchasing power parity rates. Where relevant, best estimates were used.

** Number of criteria achieved added together and divided by number of countries.

Sources: Adapted from Banco de Moçambique (2005), Bank of Namibia (2006), Bank of Zambia ([S.a.]), Central Bank of Swaziland ([S.a.]), Committee of Central Bank Governors (2005), IMF (2006), IMF Report (2005), Newspaper Country ([S.a.]), S A Reserve Bank (2006), S A Reserve Bank (2007).

An assessment of the achievement of convergence criteria in relation to the contribution of SADC countries to the GDP of the region, shows an even larger degree of convergence, as is evidenced by table 3. This is a reassuring finding, as economic stability in larger economies in SADC will have positive spillover effects for smaller economies. An area for concern, however, is the fact that the most recent economic data available for certain SADC countries, albeit incomplete in certain instances, is for 2004 or 2005³. A further concern is the reliability of statistics, as the same figures (e.g. the GDP of a particular country for a particular year) sometimes differ when obtained from more than one source (Bank of Namibia, 2006: 16).

The next section compares the achievements and initiatives of SADC to difficulties experienced in establishing monetary unions in Europe.

4 Analysis of SADC's achievements

Masson & Pattillo (2005) recently made an assessment of progress towards the macro-economic convergence goals in African regions. In respect of SADC, they reached the conclusion that “(t)he concept of full monetary union among the SADC countries of southern Africa seems infeasible at this stage ... “ (Masson & Pattillo, 2005: 9), citing as one of the reasons for this conclusion that SADC countries are still a long way “... from having converged with the macro-economic stability of South Africa and its CMA partners” (Masson & Pattillo, 2005: 9). Masson & Pattillo (2005: 128) also reiterate the earlier conclusion reached in 1996 by Jenkins & Thomas that “... the apparent lack of convergence of the southern African economies over time and the current divergence of policy and stability indicators suggest that southern Africa is not yet ready for regional monetary integration” (Jenkins & Thomas, 1996: 23).

Although table 3 confirms the conclusion of Masson & Pattillo (2005) about a higher degree of convergence between CMA countries than between SADC countries, their overall assessment is too pessimistic when progress towards macro-economic convergence is considered. The assessments in tables 2 and 3 above bear testimony to the achievement already by 2005 of convergence goals set for 2008. Moreover, South Africa's role in SADC, highlighted in table 3, and its compliance with the convergence criteria, imply that a positive spillover effect to other countries can follow, particularly if the CMA-arrangement can be extended to other countries in the region.

Monetary unions are never established without difficulty and face continued challenges, as is evidenced by the experience of countries in Europe. Although it is nearly impossible to date the earliest attempts to achieve political and economic unification in Europe, “(t)wo thousand years of European history bear witness to continual attempts to convert Europe ... into a political and economic union” (Vanthoor, 1996: xiii). Vanthoor (1996: 4) traces modern attempts to a united Europe to the introduction of a federal government in Switzerland in 1848. In his analysis of developments since 1848, Vanthoor (1996: 141-145) identifies the following previous monetary unions in Europe, other than the latest monetary union resulting in the European Central Bank and the acceptance of the Euro as a single currency:

- German-Austrian monetary union from 1857 to 1867 between Germany, Austria and Liechtenstein;
- Latin monetary union from 1865 to 1926 between Belgium, France, Italy and Switzerland, which Greece also joined since 1869; and
- Scandinavian monetary union from 1873 to 1931 between Sweden and Denmark (at the time including Iceland), which Norway joined in 1877.

Vanthoor cites a number of reasons for the disbanding of these earlier monetary unions. By way of summary, however, the German-Austrian monetary union ended in 1867 when a political and economic agreement was reached between Austria and Hungary. The Latin monetary union ended because Switzerland refused to accept as legal tender silver five franc coins minted outside its borders. The Scandinavian monetary union effectively ended when it was decided that certain coins of member countries would no longer be legal tender in all the member countries in the monetary union (Vanthoor, 1996: 31;41;141-145).

A deciding factor ending earlier monetary unions in Europe was a lack of a single currency. The current monetary union has overcome this difficulty by introducing a single currency, the Euro, on 1 January 2002. The European experience seems to indicate that the opportunity cost of leaving a monetary union is very high for a particular country once a single currency has been introduced. This is evidenced by the fact that Austria, Belgium, France, Germany, Greece, Italy and Portugal did not comply with the convergence criterion for the budget deficit by 2005. In addition, four of these countries also did not comply with the criterion for government debt as percentage of the GDP by 2005 (ECB Convergence Report, 2006). These countries nevertheless retained their membership of the European Union.

In their planning for monetary unification, countries in the SADC region have already agreed to introduce a single currency. This will ensure that the region avoids one of the deciding factors that contributed to the termination of earlier monetary unions in Europe.

The conclusions and recommendations drawn from this paper follow in the next section.

5 Conclusions and recommendations

By 2005 a considerable degree of convergence has already been achieved by SADC countries. This assessment leads to the first conclusion that compliance will increase even further in the period running up to 2008, indicating that the region is on track to reach its objectives for 2016. Difficulties facing countries participating in regions with convergence goals are not insurmountable if the authorities embark on the use of sound policies in their concerted efforts to achieve these goals.

The second conclusion is that a single central bank in SADC will contribute to regional economic stability, which is a precondition for the sustained economic growth and job creation required not only in SADC, but also in the rest of Africa. The challenge facing South Africa, given its economic role in SADC, is to ensure the necessary domestic macro-economic stability to foster continued progress towards the achievement of the convergence goals.

The last conclusion is that the SADC region will avoid one of the deciding factors that led to the end of the earlier monetary unions in Europe with the timely introduction of a regional currency. The cost for a country of leaving a monetary union once a single currency has been introduced, seems to exceed the cost of adopting policies to ensure continuous progress towards compliance with the convergence criteria. In terms of macro-economic convergence, the region is on track to achieve its goals of a regional central bank and a single currency, and is therefore aligned with the economic objectives of the African Union.

Based on the analysis and the conclusions, four initiatives that can enhance progress towards the achievement of the convergence goals of SADC are proposed for consideration by SADC countries. First, SADC countries face challenges in respect of the publication of macro-economic data. The timely publication of data is necessary to monitor progress with the achievement of the convergence goals. It would, for instance, be unacceptable for the SADC region to report only by 2010 in terms of available data for 2008 whether the convergence goals were achieved. Discrepancies in figures obtained from different sources should also be addressed. Ideally the website of the SADC Secretariat should become an authoritative source of data on SADC countries. The availability of timely and accurate data is a precondition for monitoring progress with the achievement of the convergence goals.

Secondly, the measurement of inflation should be harmonised between SADC countries, as inflation rates cannot be compared without the necessary circumspect. Country-specific issues might distort comparisons, as no international best practice for the measurement of inflation have been universally adopted. SADC countries will have to agree on the best regional approach to follow, particularly if more countries than only South Africa adopt a policy of inflation targeting.

In reviewing the measurement of inflation, SADC countries will also have to consider the credibility of inflation figures. It will not be enough simply to measure inflation expectations in the region, but the credibility of inflation figures should also be enhanced by means of communication strategies improving the general understanding of the measurement of inflation. If the measurement of inflation is not well understood, the introduction of a single currency might bring people under the impression that prices increase more rapidly than reported by the rate of inflation, thus limiting the benefits of sustained low inflation.

Thirdly, SADC countries outside the CMA should consider adopting the same exchange rate regime as CMA countries in the period running up to the introduction of a single currency. The introduction of a nominal exchange rate anchor for monetary policy has brought considerable advantages for countries in the CMA. Its broader adoption will pave the way for currency arrangements culminating in the introduction of a single currency in the SADC region.

Lastly, SADC countries should reassess the region's macro-economic convergence criteria and goals, as some of the criteria are somewhat confusing. There can be no doubt that the convergence criteria and goals should be clearly stated in the interest of transparency and the assessment of compliance. A lack of clarity does the region a disservice in as much as it conceals satisfactory progress with the achievement of macro-economic convergence goals.

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¹ For a discussion of political considerations impacting on developing countries, sources such as Hogendorn (1987), Rossouw (2007), Sen (1999) or Tanaiste & Harney (2004) can be consulted.

² Assessed in terms of the MoU, Rossouw (2006a) and Rossouw (2006b) erroneously included also central bank credit extension to the government as one of the macro-economic convergence criteria.

³ Also see Bank of Namibia (2006: 16) in this regard.