

# INTERNATIONAL JUBILEE CONFERENCE ON THE ECONOMIC EMPOWERMENT OF SOUTHERN AFRICA.

## Conference Paper Abstract

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### Topic

The Determinants of Exchange Rate Flexibility and The Theory of Optimum Currency Areas: An Application to SADC.

### Abstract

The improvement of intra-SADC trade and integration are two of a number of aims of the region. The means of achieving these aims include the formation of a Free Trade Area with reductions in tariff barriers between members of the region. The Free Trade Area is underway in SADC and the members are currently negotiating the reduction of tariffs between themselves. The benefits of such an arrangement are yet to be realised and the region to be aware of further steps that can be taken to improve integration in the region. Optimum currency area theory and the theory on monetary unions can go a long way in explaining ways in which regional integration can be improved. According to these theories, regions that form optimum currency areas should unify their monetary policies, fiscal policies and exchange rate policies to improve integration. This results in a number of benefits to the region including the elimination of exchange risk, reduction in transaction costs, etc. The aim of this research is to assess if SADC forms an optimum currency area in terms of exchange rate arrangements between its members and the country's characteristics that determine such

areas. Holden, Holden and Suss (1979) developed an exchange rate model where they analysed the determinants of the flexibility of an exchange rate. These determinants are the openness of an economy; the level of economic development; the diversification of the external sector; geographical concentration of trade; the mobility of capital and the inflation differential. These factors form the foundation for achieving an optimum currency area. In this study, the model by Holden, et al (1979) is adapted in order to determine whether SADC forms an optimum currency area or not. This will assist in advising the policymaking process on the direction towards which the SADC region should move.