

Monetary Integration in Africa



6.1 Introduction

Regional economic cooperation in Africa dates as far back as the beginning of the last century. The cooperation primarily focussed on the facilitation of international trade and payments, as well as infrastructure. In the process of deepening cooperation, African countries have formed a number of regional economic communities with overlapping memberships. However, the presence of these groupings is yet to translate into a substantial increase in trade within the continent. While the share of African countries' exports to other African countries grew from about 4 per cent in the 1980s to 12 per cent in the first half of the 2000s, this growth is very low compared to other regional groupings outside the continent. More efforts are needed to promote trade within the various regional economic communities. In addition, there has been very little manufacturing or intra-industry trade, with petroleum, cotton, livestock, maize and cocoa accounting for most of the trade within the continent.

Africa has had a chequered experience of monetary and financial cooperation, dating back to the pre- and post-colonial eras

Among the prescriptions that policymakers could choose to promote and address the challenges impeding the flow of goods and services within the continent is the creation of a stable macroeconomic environment. This could be achieved if member countries of the RECs commit to follow economic programmes that include the effective management of inflation and public finance stability, so that the actions of investors and entrepreneurs can translate into sustainable economic growth and development. This is why most of the RECs are pursuing macroeconomic convergence programmes to support regional integration initiatives, particularly in the area of trade and monetary cooperation.

Africa has had a chequered experience of monetary and financial cooperation, dating back to the pre- and post-colonial eras. This chapter will focus on the current monetary cooperation arrangements being pursued by the African regional economic communities, preceded by a brief historical background of Africa's experience with monetary and financial integration.

6.2 Africa's experience with monetary cooperation

Monetary cooperation between different countries in Africa has been going on for a long time. During the colonial period, French and British colonies had in place common monetary arrangements. At the time, these arrangements were established to facilitate the administration of the colonies and the collection of seigniorage, rather than to promote exchange rate management and fiscal policy.

In the British colonies, the monetary arrangement involved a currency board with the colonial currency pegged to and backed by the pound sterling. However, the British colonial administration received its seigniorage revenues through interest earned on investment of the reserves in British Government securities. In the case of the French colonies, the colonial franc was pegged to the French franc and backed by a convertibility guarantee of the French Treasury.

The British and the French monetary cooperation arrangements were not the same. The British currency boards were rooted in English central banking and therefore performed functions similar to those of the Bank of England. The French currency boards in the colonies followed the guidelines and principles of French central banking. Hence, like the Banque de France, the French currency boards lent significantly to the local banking system as the currencies were backed by the French Treasury.

During the colonial period, a number of monetary arrangements existed in the Eastern and Southern Africa regions. In East Africa, a common currency area was established in 1919 for Kenya, Uganda and Tanganyika (now Tanzania) with the creation of the East African Currency Board (EACB). Tanganyika joined in 1920 after it became a British territory and the same year EACB was given the responsibility of issuing the legal currency for Kenya, Uganda and Tanganyika. In 1936, Zanzibar joined the common currency area. During the Second World War, the East African shilling was used as legal tender in Somaliland as well as in parts of Ethiopia and Eritrea, and in 1951 Aden was included in the currency area.

As part of its functions, EACB issued the East African shilling as a local currency in exchange for the pound sterling at a fixed rate of 20 shillings per pound sterling. EACB also issued limited loans to participating governments, even though Tanganyika and Uganda did not benefit much from this credit facility.

Between 1960 and 1965, important changes took place at EACB. In 1960, the Board's operational centre was moved from London to Nairobi and appointees of the participating countries replaced the members of the Board who had been nomi-

nated by the British Government. In the following years, activities of the Board were expanded and modernized. The Board strengthened its role as a central bank by introducing new policies and methods for credit, banking and other currency operations.

Following the independence of participating countries, the East African monetary arrangement became a subject for consideration. Studies were commissioned to salvage the East African Monetary Union¹. But the political decision by member countries led to the disintegration of the East African currency system. The Finance Ministers of Kenya, Tanzania and Uganda announced in 1965 that separate currencies and national central banks would be created for each country. Consequently, in 1966/67, the functions of EABC were terminated in all three countries following the issuance of national currencies by Tanzania (in June 1966), Uganda (in August 1966) and Kenya (in September 1966). In 1969, the East African shilling ceased to be legal tender.

A monetary system similar to that of East Africa was established for the Federation of Southern Rhodesia (now Zimbabwe), Northern Rhodesia (now Zambia) and Nyasaland (now Malawi). A Southern Rhodesia Currency Board (SRCB) was established in 1938 by a colonial Act. The functions of SRCB included:

- The issuance of local currency in exchange for pound sterling at a fixed rate of one-to-one
- The management of the pound sterling reserves that were placed in a “currency fund” which was invested either in British government securities or held in liquid form in England
- Limited investment in bonds and stocks issued by the three participating governments.

A currency board replaced SRCB in 1954. Two years later in 1956, the Bank of Rhodesia and Nyasaland was created by the federal parliament. It played the role of a central bank by:

- Regulating the monetary system of the federation
- Exercising the sole right to issue notes and coins
- Exchanging local currency to pound sterling at a fixed rate of one to one
- Maintaining 25 per cent in gold as a means of safeguarding the external value of the local currency
- Fixing the minimum cash reserve, liquidity ratios and rate of discount/rediscount as a means of controlling bank credit expansion.

¹ A study by Mr. Blumenthal (a German banker) in 1962 recommended the continuation of the East African currency area with a supranational central bank replacing the EACB and with each country establishing its own central bank. Another study by the IMF made a similar recommendation.

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The Federation of Rhodesia and Nyasaland dissolved in 1963 and was followed by the closure of the Bank of Rhodesia in 1964. The assets and liabilities of the Bank were distributed among the central banks of the three countries. As in the case of the EAC, the Federation failed for political and economic reasons. Member countries felt that there was unequal distribution of benefits from the federal arrangement. Southern Rhodesia was considered to be deriving more fiscal, industrial and commercial gains to the detriment of Northern Rhodesia and Nyasaland, which were relatively underdeveloped and did not make as much use of the monetary system and its facility. This led to the decision by the three governments to create their own central banks that would enable them to exercise their autonomy on monetary and fiscal matters.

South Africa, Basutoland (Lesotho), Bechuanaland (Botswana) and Swaziland had their own currencies during colonial time. But after 1881, the pound sterling became the standard currency in these countries and remained in use until 1961.

The Reserve Bank of South Africa was established in 1921. It started issuing its own currency (the South African pound) in 1923, which was accepted as legal tender in the other countries. There was no exchange control in these countries. In 1961, the rand was introduced as the currency of South Africa and was used in Lesotho and Swaziland under a customs union agreement.

In 1974, the Rand Monetary Agreement (RMA) was signed and the rand became the only legal tender in the RMA zone, which included Botswana, Lesotho, South Africa and Swaziland. However, Botswana pulled out from RMA in 1975.

Lesotho and Swaziland – which became independent in 1966 and 1968, respectively, felt that the RMA deprived them of instruments of monetary control. This feeling became more compelling in 1985 when the rand was faced with severe depreciation vis-à-vis major currencies. Consequently, the RMA was amended in 1986, giving Lesotho and Swaziland more autonomy.

6.2.1 Monetary cooperation after independence

Most of the British colonies abandoned monetary cooperation when they gained their independence. Some of the French colonies continued to maintain the colonial system of monetary cooperation after independence. These are the monetary unions in West and Central Africa. The franc-based currencies in these unions have only been devalued once against the French franc (by 50 per cent in January 1994).

Post-independence saw most of the African countries setting up their own central banks which issued national currencies in large part to assert the sovereignty of the countries after independence. This meant that the currency board arrangements that

were put in place during the colonial era were abolished and replaced with national central banks. It must be noted that in West Africa, Sierra Leone and the Gambia continued to operate their own currency board-type arrangements for a few more years after independence until 1971 when Gambia left the sterling peg. The East African Currency Board, which covered Tanzania, Uganda and Kenya, also retained its common currency until 1966 when it was replaced with sovereign currencies because of fiscal imbalance and dissatisfaction with the distribution of benefits within the East African Community.

It must be noted that the franc-based currency unions or the currency boards that operated in Africa appear to be very different from the arrangements of the European Monetary Union system. Both the currency boards and monetary unions operated on a fixed peg, which is different from the floating exchange rate of the euro. A notable exception is the South African rand zone, where Lesotho, Namibia, Swaziland and, for a time, Botswana have their currencies pegged at par with the South African rand. Under this arrangement, the member countries of the zone allow the rand to circulate alongside their currencies and receive a payment in lieu of seigniorage. The sharing of seigniorage and the flexibility of the peg vis-à-vis the outside world makes the rand zone very similar to the euro zone.

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6.2.2 Challenges of monetary policies in post-independence Africa

With the abandonment of currency boards and the creation of sovereign central banks, the conduct of monetary policy varied from one independent African country to another. Most of the policies followed in post-independent Africa were weak, with a few exceptions. Honohan and O’Connell (1997) indicate that post-independence monetary policy in Africa took sharply different routes in different countries. Some countries pursued policies that rationed and controlled goods and services, while others embarked on massive government expenditure at the expense of uncontrollable inflation. Chamley and Honohan (1993) show that, by and large, the increased government expenditure was financed either through financial repression or through inflation quasi-tax.

The negative consequence of financial repression and high inflation was felt in the 1980s, and to rectify the appalling situation, African governments, on the advice of the Bretton Woods institutions, removed the controls and reduced central bank-financed government expenditures. These moves were meant to institute a market-oriented monetary policy.

Hanohan and Lane (2000) point out that market-oriented central banking did not last for long as African governments relied on the monetary system for resources.

These governments borrowed heavily from the banking system, resulting in high nominal interest rates and persistent and substantial excess returns.

6.2.3 Challenges of the CFA zone

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Although the franc-based monetary unions were established in West and Central Africa for political expediency, they are built on a solid institutional foundation. Hanohan and Lane argue that the underlying economic philosophy of the franc zone was based on open and competitive market principles. The multinational central banks governing the zone are independent of the member countries and have stringent rules for monetary financing of fiscal deficits. Consequently, the inflation rates in the zone are the lowest in Africa. In addition, the zone has open and liberalized capital accounts and encourages the operations of foreign-owned banks. Despite the sound framework of single currency, freedom of capital movements and multinational central banks, the CFA zone suffered severe crises in the 1980s.

Before the mid-1980s, the franc zone countries enjoyed solid economic performance. The fixed exchange rate with France reduced any macroeconomic uncertainty and encouraged external investment. The growth rates of the economies in the zone were high and CFA franc notes were used by trans-boundary traders in preference to unstable and inconvertible local currencies in neighbouring countries such as Ghana and Nigeria. The banking system of the zone functioned better than those of neighbouring countries and consequently attracted significant deposits of flight capital from those countries.

However, economic prosperity of the zone did not last forever. In the mid-1980s, the banking system in the zone collapsed due in part to the rigidities of its institutional mechanisms. Political pressures from governments forced the banks to lend to state-owned enterprises, regional and political groupings, governments' own suppliers.

Consequently, in the early 1990s, almost all of the economies in the zone went into deep recession. At the same time, parallel markets in the zone opened up as capital movements were blocked and international payments had become extremely difficult. Furthermore, a majority of the banks failed and depositors of the remaining banks had difficulty accessing their funds for years. Banks that continued to exist started to discriminate against their deposit and lending customers. The environment also provided limited operations of inter-bank markets. The central banks also faced difficulties in covering their operating expenses, because of the loans they had made to the failed banks. Hence, the CFA came under heavy pressure, leading market participants to anticipate a devaluation of the currency.

The part played by the banks in the crises cannot be overlooked. Most of the banks operating at the time were jointly owned by the national governments and one of

four major French-based banks, with key senior management being French nationals seconded from the parent banks in France. Hanohan and Lane (2000) argue that the objective of the French shareholders of the banks was nothing more than profit maximization. They were more concerned about protecting the commercial interests of their French customers in Africa. Although the banks were supposed to be autonomous, the structure of the ownership and control by government functionaries made it easier for commercially doubtful lending to take place.

Furthermore, the banks were not constrained by loanable resources. Despite the difficulties in mobilizing deposits, they were able to lend through the funds secured from the two regional central banks. Although the central banks were restricted from lending to governments, they were free to refinance loans through the banking system, effectively providing the banks with loanable resources. The interest of the central banks to preserve the quality of their own balance sheets (in order to ensure adequate revenue to meet their substantial operational expenses) was not sufficient to limit their lending to the banks. The statutory arrangements were understood by parties to provide the central bank with a government guarantee for lending to banks. Although independent, the central banks acted as the agents of the fiscal authorities, refinancing politically directed or government-inspired bank loans that could never be repaid.

The challenges of monetary policy in the CFA zone clearly demonstrate that rule-based monetary and banking arrangements do not guarantee sound monetary policy. The rules in the franc zone at the time appeared very rigid and perhaps induced banking practices that violated sound banking principles. However, Hanohan and Lane (2000) suggest that three rules were in place to guarantee favourable outcomes and appeared to immunize the zone against the consequences of mistaken policies in other areas.

First, the exchange rate rule was used as a tool for macroeconomic stability. However, the rule could not cope with the pro-cyclical public sector wage policy and the policy of raising official purchasing prices of cash crops, particularly coffee and cocoa. This made labour in the formal sector uncompetitive, and the crop credits provided by the banks for the purchasing of crops at unrealistic prices were not being repaid. The inability of the banking system to find a satisfactory mechanism to fund merchants' working capital also contributed to the failure of the system.

Second, the rule that the banking sector could not lend to the government more than a fraction of its annual revenue needs acted as a safeguard against inflationary pressures. However, the rule was circumvented by indirect borrowing through public enterprises and other associated bodies and through the payment of government arrears to its suppliers. The consequence was an increasing degree of illiquidity in the system as payments discipline collapsed.

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Third, the rule that each national government was responsible for the debts of any insolvent bank to the central bank delegated bank regulation to national authorities. While this rule was aimed at preventing central banks from lending to unsound banks, it failed to inspire national responsibility. This led to massive bank insolvency, amounting to at least 10 per cent of zone-wide GDP. External shocks and the recession only exacerbated the poor lending decisions and consequent insolvency of the banks.

It should be noted that the franc zone worked very well for two decades and offered protection against macroeconomic instability before the crisis. It was just a few months before the crisis that it was discovered that institutional structures and mechanical rules could not withstand political interference and pressures and the volatility of the external environment. The lessons learned here suggest that there is a strong need to have consistent macroeconomic and financial fundamentals to support a fixed exchange rate system, irrespective of other institutional rules. In other words, mechanical application of automatic rules is no guarantee for a well-functioning banking system.

Although the rules governing the franc-zone were put in place to guard against monetary instability, they have not been robust enough to alleviate the impact of fiscal mismanagement. In fact, the exchange rate peg has exacerbated the real economic effects of imprudent fiscal and financial policy. That is why Collier (1991) suggests that institutional arrangements governing regional central banks have to be adequate to guarantee their role as quasi-external “agencies of restraint” on the national governments. Furthermore, it has to be recognized that monetary unions or rules-based monetary systems such as currency boards have their limitations and must be applied with caution.

6.2.4 Recovery of the CFA zone

To deal with the challenges of the French franc crisis, the CFA franc was devalued in 1994. Since then the region has witnessed several years of recovery and comparatively rapid economic growth, as well as lower-than-expected pass-through of imported inflation into domestic consumer price indexes (CPIs).

The banking crisis in the CFA franc zone was also addressed by introducing new institutional arrangements in the early 1990s, including the centralization of responsibility for bank supervision in the two regional banking control commissions. This centralization provides a new multinational “agency of restraint” to political pressures and interference.

The pegging of the currencies in the zone to the euro instead of the French franc also provides confidence in the monetary arrangements in the zone as it ensures greater nominal and real exchange rate stability on average vis-à-vis trading partners. Since the peg to the euro, the CFA zone has not faced any significant new challenges.

Following the success of EMU and the desire to strengthen the continental integration agenda, most African regional economic communities are pursuing monetary cooperation programmes, in the hope that a common currency would protect African countries from contagious or correlated capital movements and financial crises.

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6.3 Monetary cooperation arrangements of the regional economic communities

This section begins with a review of the current monetary framework of the regional economic communities, followed by an assessment of their monetary cooperation arrangements, focussing on established macroeconomic convergence criteria. It concludes with an assessment of the challenges and constraints in implementing the convergence criteria.

6.3.1 Monetary arrangements of Southern African Development Community (SADC)

SADC has designed a framework of macroeconomic convergence targets for its members. However, monetary cooperation amongst them began in 1980 when the Southern African Development Coordinating Conference (SADCC) of nine member countries was formed to pursue common regional development projects, particularly infrastructure projects, so as to minimize the dependence of member States on the apartheid-based South Africa. After the independence of Namibia and South Africa in the early 1990s, SADCC was transformed in 1992 into the Southern Africa Development Community (SADC), with a focus on regional economic integration and development. Membership also grew from nine to fourteen, until Seychelles pulled out more recently.²

The strategic goals of SADC, as contained in its *Regional Indicative Strategic Development Plan* (RISDP), are as follows: promoting equitable, self-sustaining economic growth and socio-economic development in the subregion with the view of alleviating poverty; strengthening common cultural, social and political values, as well as

² The nine founding members of SADC are Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe. The current members of SADC are the nine founding members and Democratic Republic of Congo, Madagascar, Mauritius, Namibia and South Africa.

maintaining democracy, peace, security and stability; and achieving complementarity and sustainable environmental and resource utilization. Despite the lack of a framework for SADC on macroeconomic convergence, Maruping (2005) indicates that a Memorandum of Understanding (MOU) has been drawn up on the subject.

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The MOU, which requires the signature of at least two thirds of the membership to become effective, lays down the institutional framework for the monitoring and surveillance mechanisms, macroeconomic indicators and targets, data requirements, and monetary and fiscal policy cooperation parameters for the member countries. The MOU was designed to ensure that member States achieve financial and economic stability, strengthened institutional structures and sound macroeconomic policies.

The drafters of the MOU believe that, without guidance on the targets of macroeconomic variables in the SADC zone, member States would not achieve optimal fiscal balances and would therefore experience high deficits, unsustainably high or rising ratios of public debt to gross domestic product, wide external current account and financial imbalances, and market distortions resulting in high rates of inflation and stifling of growth amongst SADC member countries.

Although there is no legal framework on macroeconomic convergence criteria, a Committee of Central Bank Governors of the member States provides guidance on macroeconomic convergence in the SADC region. The committee asks member States to use the following macroeconomic convergence criteria and benchmarks: inflation rate to reach single digit by 2008, 5 per cent by 2012 and 3 per cent by 2018; ratio of budget deficit to GDP should not exceed 5 per cent by 2008, with 3 per cent as an anchor, and within a 1 per cent band by 2012 through to 2018; and nominal public debt-to-GDP ratio should be less than 60 per cent by 2008 and beyond to 2018.

Table 6.1
Macroeconomic convergence criteria

Criteria	2008	2012	2018
Inflation rate (per cent)	Single digit	5 per cent	3 per cent
Fiscal deficit as per cent of GDP	< 5 per cent	Between the range of 2 per cent and 4 per cent anchored at 3 per cent	
Government debt as per cent of GDP	< 60 per cent of GDP	< 60 per cent of GDP	

Source: SADC Secretariat

There are several reasons why the SADC Committee of Central Bank Governors is concerned about macroeconomic convergence in the zone. First, SADC is focused

on pursuing developmental programmes aimed at promoting sustainable economic growth in the region. In order for the economies in the region to achieve their full potential, an enabling environment that includes sound monetary policy needs to be established. Hence, the central banks have an important role to play in facilitating growth and development in the zone.

Second, SADC is a regional integration area (RIA) made up of countries with unequal economies. The theory of regional integration as an instrument of development, and the experience of RIAs like the European Union, suggest that small economies would eventually converge to the bigger economies when these economies are fully integrated. In other words, regional integration allows lesser-developed member States to “catch up” to the more developed ones.

Third, macroeconomic convergence could be instrumental in driving the process of regional integration. In the EU, macroeconomic convergence is considered important for economic integration and criteria (conditions) have been determined for joining the economic and monetary union. Although monetary integration in SADC is a long-term goal, macroeconomic convergence is an important ingredient for market integration in a RIA.

In addition to various protocols that provide the legal framework for monetary and financial cooperation, SADC tracks progress in harmonization and convergence processes among its member States through the following roadmap and milestones: elimination of exchange rate controls; establishment of a free trade area by 2008; establishment of a customs union by 2010; establishment of a common market by 2012; and establishment of a monetary union by 2016.

There is enormous disparity between the economies of SADC countries, in terms of income levels and distribution; macroeconomic performance, fiscal deficits; public debt-to-GDP ratios; rates of inflation; financial sector development and stability; human resources; and infrastructure development. In addition, there is no strong political commitment to implement and monitor concrete programmes of action to improve the macroeconomic environment in the SADC zone.

Despite the challenges, there are success stories from the Southern African Customs Union (SACU) and Common Monetary Area (CMA), whose members are also in SADC, and where a customs union has been established and de facto monetary integration exists among four of the five members.³ In recent years, SADC has embarked on programmes that would improve efficiency and effectiveness and macroeconomic policy coordination among its member States. These actions have

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³ The four countries are Lesotho, Namibia, South Africa and Swaziland. The fifth member of SACU, which is not part of the CMA, is Botswana. Under the CMA, Lesotho, Namibia and Swaziland have their currencies tied to the South African rand.

contributed to sound policies in the SACU member States and Mauritius, with low rates of inflation and convergence of key macroeconomic variables. Post-conflict economies in SADC are also moving rapidly towards lower levels of inflation, with a notable exception being Zimbabwe, which has the highest level of inflation in the SADC zone as well as poor economic performance.

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Some of the poorer economies in the SADC zone, including the Democratic Republic of Congo and Tanzania, have attained the regional inflation targets. Angola, Malawi, Mozambique, Zambia and Zimbabwe are yet to achieve single-digit inflation rates, but some of them could do so by 2008 if the current inflation reduction trends are maintained, except for Zimbabwe, which would have to halt and reverse the trend and make much more marked progress in this regard. SACU member States, Tanzania and Mauritius have already achieved the targets ahead of the 2008 schedule.

For other indicators of convergence, the performance is again mixed. The poorer member States have their current fiscal deficit-to-GDP ratio above the target level. These countries tend to be highly donor-dependent and tend to have high fiscal deficits (excluding grants), which would be unsustainable if donor support were not available. The fiscal imbalance is partly the result of expansionary fiscal policies or serious economic crises and delays in the poor economies receiving Highly Indebted Poor Country (HIPC) debt relief. As a result of the poor fiscal imbalance, most of the economies also show weak current account balances as well as high debt-to-GDP ratios.

Against the background of the macroeconomic targets set up by SADC, an assessment of the macroeconomic performance of the Member States of the community shows mixed results. Table 6.2 reports on the growth performance of member States from 2001 to 2005. The table shows that Angola, Botswana, Democratic Republic of Congo, Mozambique and Tanzania have registered strong growth performances in recent years, growing above 6 per cent in the last few years.

Factors responsible for this strong showing include sound macroeconomic policies; strong world demand for commodities such as diamond (Botswana), oil (Angola) and copper (Democratic Republic of Congo); and relative peace and security (Angola, Democratic Republic of Congo, and Mozambique). The poor-performing economies in the zone are those of Zimbabwe and Seychelles, where growth rates have declined.

Table 6.2**Growth performance in SADC**

Country	2001	2002	2003	2004	2005
Angola	3.14	14.49	3.31	11.18	20.61
Botswana	5.18	5.59	6.32	5.92	6.19
Congo, Dem. Rep.	-2.10	3.50	5.70	6.60	6.50
Lesotho	3.21	3.50	3.09	3.15	1.20
Malawi	-4.97	2.86	6.07	7.12	2.55
Mauritius	5.56	2.71	3.19	4.70	4.57
Mozambique	13.10	8.16	7.90	7.49	7.70
Namibia	2.40	6.67	3.48	5.95	3.50
Seychelles	-2.21	1.30	-6.30	-1.99	-2.30
South Africa	2.74	3.69	2.98	4.47	4.87
Swaziland	1.79	2.90	2.40	2.10	1.80
Tanzania	6.24	7.24	7.12	6.69	6.97
Zambia	4.89	3.30	5.12	5.41	5.20
Zimbabwe	-2.70	-4.40	-10.40	-3.80	-6.50
SADC	2.59	4.39	2.86	4.64	4.49

Source: UNECA and World Development Indicators.

“ Zimbabwe experienced extremely high inflation during the period under review, perhaps due to the consequences of the sanctions imposed by Western governments on the country ”

Table 6.3 clearly shows that inflation in the SADC region remains very high, averaging around 36 per cent between 2001 and 2005. Zimbabwe experienced extremely high inflation during the period under review, perhaps due to the consequences of the sanctions imposed by Western governments on the country. Angola is also experiencing very high inflation, due to excessive demand for goods and services generated by higher oil and commodity revenues. It must be noted that Lesotho, Mauritius, Namibia, Seychelles, South Africa and Tanzania registered single-digit inflation in recent years due to the pursuance of aggressive monetary policies by their respective monetary authorities. It is very important that member States of SADC should be encouraged to pursue aggressive price stability policies so as to create the enabling environment needed for sustainable economic activities.

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Table 6.3
Inflation rates in SADC

Country	2001	2002	2003	2004	2005
Angola	108.48	120.51	102.54	42.71	43.52
Botswana	6.31	-0.05	2.76	6.10	8.73
Congo, Dem. Rep.	383.92	31.93	13.15	6.15	21.51
Lesotho	6.66	8.47	6.00	6.33	3.17
Malawi	25.62	16.38	9.25	12.52	15.45
Mauritius	4.04	6.61	5.93	5.88	4.76
Mozambique	15.98	17.02	8.96	9.04	6.43
Namibia	14.13	11.42	-0.63	2.92	2.00
Seychelles	5.46	4.25	5.91	3.91	0.98
South Africa	7.67	10.51	4.44	5.59	4.75
Swaziland	10.56	12.54	12.14	10.44	4.88
Tanzania	7.17	6.45	5.62	8.07	3.74
Zambia	24.31	19.86	19.81	20.05	19.02
Zimbabwe	76.57	123.25	411.10	349.87	237.74
SADC	49.78	27.80	43.36	34.97	26.91

Source: UNECA and World Development Indicators.

In assessing the net FDI inflow in the SADC subregion, the literature suggests that stable macroeconomic environments encourage such flows. Table 6.3 indicates that the SADC region attracts substantial levels of FDIs, with South Africa and Angola accounting for most in recent years. The economic growth performance of South Africa and Angola is related to the net inflow of FDI, although Angola has registered high inflation in recent years. Democratic Republic of Congo, Mozambique and Tanzania appear to also attract high levels of FDI. Mozambique and Democratic Republic of Congo FDI flows go the development of their extractive industry. Tanzania's attraction of FDIs is due to its stable macroeconomic environment, as attested by its relative low inflation and the sustainable and moderate growth of its economy.

Table 6.4**Net foreign direct investments (FDI in millions of US dollars) to SADC**

Country	2001	2002	2003	2004	2005
Angola	2,145.47	1,672.09	3,504.70	1,449.23	-1,303.86
Botswana	22.14	403.42	417.99	391.06	278.59
Congo, Dem. Rep.	77.21	136.78	323.13	668.39	402.00
Lesotho	116.99	84.09	115.71	123.49	91.91
Malawi	19.30	5.90	3.9	-0.68	3.00
Mauritius	-27.67	32.07	62.63	13.89	39.15
Mozambique	255.42	347.58	336.70	244.70	107.85
Namibia	na	na	na	na	na
Seychelles	64.74	47.72	58.43	38.01	82.38
South Africa	7,270.34	735.21	783.14	701.42	6,257.33
Swaziland	28.43	88.79	-60.91	70.58	-16.18
Tanzania	467.20	429.80	526.80	469.90	473.40
Zambia	71.70	82.00	172.00	239.00	259.00
Zimbabwe	3,8	25.90	3.80	8.70	102.80
SADC	808.85	314.72	480.62	339.83	521.34

Source: UNECA and World Development Indicators.

“COMESA has embarked on a monetary cooperation arrangement that aims to establish a common monetary zone with strong monetary stability to support its integration and sustained economic growth agenda”

6.3.2 Monetary arrangements of Common Market for Eastern and Southern Africa (COMESA)

COMESA has embarked on a monetary cooperation arrangement that aims to establish a common monetary zone with strong monetary stability to support its integration and sustained economic growth agenda. Ultimately, COMESA hopes to transform the zone into a monetary union.

The decision to create a monetary union within the Preferential Trade Area of Eastern and Southern African States (PTA) was taken as far back as 1989, even though the Heads of State and Government concretized it only in 1992 with the adoption of a Monetary and Fiscal Policies Harmonization Programme. Based on a gradualist approach, this programme constituted the framework of economic integration in the region and was articulated around four stages spanning a period of more than 30 years:

- *Stage 1* (1992-1996): Consolidation of existing instruments of monetary cooperation and implementation of policy measures aimed at achieving macroeconomic convergence.
- *Stage 2* (1997-2000): Introduction of limited currency convertibility and an informal exchange rate union.

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The fundamental rationale of macroeconomic and monetary integration in COMESA is to create the conditions for sustained economic development of the subregion”

- *Stage 3* (2000-2024): Formal exchange rate union and coordination of economic policies by a common monetary institution.
- *Stage 4* (2025 onwards): Full monetary union involving the use of one common currency issued by a common central bank.

The four-stage programme of economic integration adopted by the PTA was endorsed by COMESA, when the PTA was officially transformed into COMESA in 1994. Its implementation was reviewed with the definition of specific criteria to achieve macroeconomic convergence (COMESA, 1995 and Harvey et al. 2001). Since COMESA was conceived as an instrument of a comprehensive programme of cooperation and integration, its activities covered a variety of fields beyond trade and macroeconomic policies, including research in science and technology, peace and security and physical infrastructures development.

The fundamental rationale of macroeconomic and monetary integration in COMESA is to create the conditions for sustained economic development of the subregion. The objective is thus to achieve deep forms of integration and, most notably, to establish a monetary union and a full economic community through the:

- Liberalization of the exchange systems of member States to promote intraregional trade and cross-border capital flows;
- Harmonization of national policies to correct misalignments, strengthen macroeconomic adjustment and performance;
- Achievement of currency convertibility;
- Mobilization of financial resources to expand trade and support development projects (COMESA, 2003); and
- Promotion of intraregional trade and cross-border capital flows in COMESA started with the restructuring of the Clearing House into a Regional Payment and Settlement System (REPSS). The REPSS, which was launched in 2007, is a multilateral system that converts all payments in local currencies to a “settlement currency” based on a fixed daily rate for transfer between countries.

With a view to encouraging sustainable monetary stability in the zone, COMESA promotes monetary harmonization programmes on a consistent basis. Specific convergence targets based on agreed criteria are used to monitor progress by each member State. The criteria address macroeconomic policies, external debt situations and adapted Maastricht criteria. Each criterion has a number of quantitative indicators serving as targets (table 6.4). In a number of cases, efforts are made to coordinate national programmes so as to help meet the targets.

The revised macroeconomic convergence criteria that were adopted by the seventh meeting of Ministers of Finance held in Lusaka, Zambia on 17 November 2005 contain the following elements:

Table 6.5
Revised convergence criteria in COMESA

Convergence criteria	Stages of implementation		
	Stage 1 (2005-2010)	Stage 2 (2011-2015)	Stage 3 (2016-2018)
Primary criteria			
Overall budget deficit/GDP ratio (excluding grants)	Not more than 5 per cent	Not exceeding 4 per cent	Not exceeding 3 per cent
Annual average inflation rate	Not exceeding 5 per cent	Not exceeding 3 per cent	Not exceeding 3 per cent
Central bank financing of the budget deficit	Minimise towards 0 per cent	Eliminate	Eliminate
External reserves (in months of imports)	Equal to or more than 4 months of imports of goods and services	Equal to or more than 5 months of imports of goods and services	Equal to or more than 6 months of imports of goods and services
Secondary criteria			
Stable real exchange rates	To be achieved and maintained	To be achieved and maintained	To be maintained
Market-based positive real interest rates	To be achieved and maintained	To be achieved and maintained	To be maintained
Achievement and maintenance of sustainable real growth rate of real GDP	Not less than 7.0 per cent	Not less than 7.0 per cent	Not less than 7.0 per cent
Debt reduction initiative on domestic and foreign debt; i.e. reduction of total debt as a ratio of GDP	To be kept at a sustainable level	To be kept at a sustainable level	To be sustained
Total domestic revenue to GDP ratio	Not less than 20 per cent	At least 20 per cent	At least 20 per cent
Current account deficit (excluding grants) as a per cent of GDP	To be reduced to a sustainable level	To be maintained and sustained	To be maintained and sustained
Achievement and maintenance of domestic investment rate	At least 20 per cent	At least 20 per cent	At least 20 per cent
25 Core principles of bank supervision and regulation based on agreed action plan for harmonization of bank supervision for the COMESA region	To be implemented	---	---
Core principles for systematically important payment systems, by modernizing the payment and settlement system	To be adhered to	---	---
Liberalization of capital account		Gradual	Full

Sources: ECA and COMESA Secretariat.

Progress towards adherence to the convergence targets is very mixed

“On the average, inflation in the COMESA subregion remains very high, exceeding 20 per cent for each year under review”

Primary criteria

Budget deficit: Fiscal imbalances are generally the result of spending growing faster than revenues. COMESA countries continue to be challenged by their resource needs to reduce poverty as set out in their Poverty Reduction Strategy and their commitment to achieve macroeconomic stability in the context of their limited national resources. Despite these difficulties, most members of COMESA are on the right track. In 2004, the average fiscal deficit-to-GDP ratio (excluding grants) for COMESA was 5.9 per cent. Comoros, Kenya, Seychelles and Swaziland registered a ratio of less than 5 per cent, which is in compliance with COMESA’s revised macroeconomic convergence criteria.

These countries managed to achieve fiscal adjustment through revenue-enhancing and expenditure-cutting measures, even though the overall result varied from country to country. Where most countries fared poorly was in the availability of deep financial markets and domestic savings to finance large budget deficits. Data on deficits suggests that fiscal stabilization still has to be achieved in most countries (Democratic Republic of Congo, Eritrea and Zimbabwe).

Inflation: On the average, inflation in the COMESA subregion remains very high, exceeding 20 per cent for each year under review. However, it must be pointed out that inflation has been decreasing since 2001, from 35 per cent in 2001 to 22.40 per cent in 2005. Despite the negative impact of high oil prices on inflation, Burundi, Comoros, Djibouti, Egypt, Ethiopia, Kenya, Mauritius, Namibia, Rwanda, Sudan and Uganda have managed to keep inflation generally in single digits, mainly due to prudent monetary policies. The inflation performance of Zimbabwe needs to improve drastically so as to spur sound economic growth.

Table 6.6**Inflation rates in COMESA**

Country	2001	2002	2003	2004	2005
Burundi	5.46	1.77	11.55	8.27	16.67
Comoros	8.63	4.17	5.13	1.77	2.30
Congo, Dem. Rep.	383.92	31.93	13.15	6.15	21.51
Djibouti	1.76	0.63	1.97	3.12	3.11
Egypt, Arab Rep.	1.88	2.37	6.87	11.58	5.37
Eritrea	13.88	15.29	11.94	22.26	14.90
Ethiopia	-4.79	-4.59	12.22	9.62	5.99
Kenya	1.55	-0.87	6.13	10.06	4.28
Madagascar	7.27	15.28	2.76	14.30	18.34
Malawi	25.62	16.38	9.25	12.52	15.45
Mauritius	4.04	6.61	5.93	5.88	4.76
Rwanda	0.16	-0.01	8.70	12.03	7.14
Seychelles	5.46	4.25	5.91	3.91	0.98
Sudan	2.47	8.21	9.17	14.77	12.14
Swaziland	10.56	12.54	12.14	10.44	4.88
Uganda	6.50	-3.85	9.77	6.22	7.82
Zambia	24.31	19.86	19.81	20.05	19.02
Zimbabwe	76.57	123.25	411.10	349.87	237.74
COMESA	34.89	19.26	33.27	28.42	22.40

Source: UNECA and World Development Indicators.

On the contrary, countries such as Kenya (11.5 per cent), Madagascar (13.8 per cent), Malawi (11.6 per cent), Rwanda (12 per cent), Zambia (18 per cent) and Zimbabwe (282 per cent) went through double-digit inflation primarily due to higher food prices. Excluding the Democratic Republic of Congo and Zimbabwe, which were affected by hyperinflation, the number of countries with single-digit inflation rose significantly between the first and second half of the 1990s. According to the figures of the 1990s up to 2004, the overall regional dispersion of inflation seemed to be on a decreasing trend. Madagascar, Malawi and Zambia were able to curb inflation relative to the previous sub-period.

In particular, Zambia made a strong correction to its inflationary stance, which had degenerated into hyperinflation between 1992 and 1993. The Democratic Republic of Congo was a conflict-affected country that needed to finance high levels of fiscal spending through an inflation tax, which contributed to hyperinflation in that country. Zimbabwe bucked the regional trend and exhibited ramping inflation coupled with a variety of other problems, including a large budget deficit.

“Excluding the Democratic Republic of Congo and Zimbabwe, which were affected by hyperinflation, the number of countries with single-digit inflation rose significantly between the first and second half of the 1990s”

“ Exchange rate arrangements in COMESA (except for the EAC countries) vary from country to country ”

External reserves: On the average, the level of reserves in COMESA could cover three months of imports of goods and services in 2004 as compared to just under three months in 2003. This result was possible because of higher levels of capital flows (official development assistance and debt relief measures). Countries such as Ethiopia, Rwanda, Mauritius and Uganda were able to meet COMESA's requirement by maintaining external reserves that could cover four months of imports of goods and services.

Secondary criteria

Exchange rate policy: The COMESA monetary harmonization programme calls for a progressive dismantling of exchange controls and the introduction of a market-determined exchange rate regime. Accordingly, most COMESA countries have made progress in moving towards market-determined exchange rates. Overvaluation of currencies that characterized the 1980s and early 1990s has been reduced. Different exchange regimes exist in COMESA. Swaziland has its currency pegged to the South African rand, which floats independently. Nine countries have freely floating exchange rate regimes, although it is difficult to confirm that there is no government interference.

Exchange rate arrangements in COMESA (except for the EAC countries) vary from country to country. This heterogeneity reflects the different views by countries about currency exchange regimes. The process of economic integration is ultimately aimed at the formation of currency unions. It implies that countries engaged in the process must move towards a system of fixed – and later irrevocable – parities.

The process of implementation of a system of fixed exchange rates in a REC must be gradual. Flexible exchange rates have the advantage of easing the impact of fiscal adjustment and absorbing exogenous shocks. Pegging the exchange rate is a strategy to lock in the progress achieved on macroeconomic stabilization. Furthermore, the risk that the peg would be a target of speculative attacks is quite limited, since most African countries are not significantly integrated into global financial markets. However, to avoid distortions of the path of domestic development, countries are advised to move to a peg only once some basic conditions have been met:

- (a) Domestic inflation must have been stabilized to a relatively low level, so as to avoid the negative real exchange rate consequences of the inflation gap vis-à-vis the reference country;
- (b) Fiscal stabilization must have been achieved;
- (c) A consistent stock of international reserves must exist; and

- (d) The economic institutions and arrangements such as an independent central bank and strong budgetary procedures must have been established. It is also desirable that appropriate instruments for banking supervision and surveillance should have been put in place.

The domestic currency should be pegged to a major international currency (euro, US dollar or yen). The consistency of international trade flows suggests that most African countries ought to peg to the euro, especially if Great Britain joins the EMU. However, to avoid fluctuations among the major currencies generating undesirable appreciations or depreciations of the domestic currency, the peg could be referred to a composite basket.

All countries in each REC should move towards a stable peg against an international reference currency. This will occur at different speeds for different countries, depending on their initial situation and on the time required to achieve the conditions for the sustainability of the peg. The adoption of a bilateral peg against the international reference will de facto produce a system of fixed exchange rates within the REC, and one where parities between members of the REC are determined based on the bilateral exchange rates against the international reference.

Before creating a currency union, it would be desirable to let the fixed exchange rate system work for several years (seven to ten years are advised). The long transition period will also allow RECs and member States to set up the institutional and technical arrangements required by a currency union. Eventually, following the example of the European Monetary System, fluctuation bands (in the range of no more than ± 15 per cent around the central parity) could be established to provide a minimum margin for stabilization. Only countries that, for the last three years, have been able to maintain that parity without the need to impose restrictions on the free flow of foreign exchange would be admitted to the currency union.

A hard-peg arrangement against an international currency (or a basket of currencies) should also be adopted by the common central bank as an anchor for regional monetary policy. Countries in the union should be continuously monitored in their adherence to convergence criteria, with sanctions applied to non-complying countries. Mechanisms for flexibility of the type previously discussed should, however, remain in place. Countries that did not initially qualify for participation in the union could be admitted subsequently once they have satisfied the convergence criteria and have maintained a stable parity against the reference international currency for a period of at least three years.

The target for limited currency convertibility among COMESA member countries has not materialized yet throughout the subregion. Swaziland, which belongs to the Common Monetary Area (CMA) or the rand zone, operates on the basis of a lim-

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The policy of convertibility in EAC is so far considered to be a success story, although EAC authorities acknowledge that there are potential risks that could be attributed to increased counterfeiting and losses arising from exchange rate fluctuations
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ited currency convertibility arrangement. The same applies to the members of the East African Community (EAC), Kenya, Tanzania and Uganda, which have adopted and implemented a policy making their national currencies fully convertible against one another. The acceptance of each other's currency not only facilitates the flow of trade and investment by reducing transaction costs, but also serves as an important instrument that promotes regional cooperation and economic integration and lays the groundwork for a smooth transition to a single currency.

The policy of convertibility in EAC is so far considered to be a success story, although EAC authorities acknowledge that there are potential risks that could be attributed to increased counterfeiting and losses arising from exchange rate fluctuations. Such risks are, however, deemed inherent in the nature of dealings involving convertible international currencies.

As for the removal of exchange restrictions, many COMESA member countries have accepted Article VIII of IMF and have removed restrictions on their current account. Efforts are also being made to remove restrictions on intra-COMESA trade. By and large, COMESA member States have made significant efforts to liberalize their financial markets.

Interest rate policy: All countries in COMESA have liberalized their interest rates. In some countries, real lending rates are still high and the margin between lending and deposit rates is quite wide, indicating inefficiencies in the financial system.

Growth: Between 2001 and 2005, the COMESA bloc grew at an average rate of about 4 per cent (table 6). This is below the required 7 per cent level of growth to achieve the MDGs, and is also low when compared to other developing countries and emerging economies.

Table 6.7**Growth performance in COMESA**

Country	2001	2002	2003	2004	2005
Burundi	2.06	4.45	-1.22	4.83	0.91
Comoros	3.33	4.15	2.47	-0.24	4.23
Congo, Dem. Rep.	-2.10	3.50	5.70	6.60	6.50
Eritrea	9.23	0.66	6.09	1.86	0.50
Ethiopia	7.93	-0.01	-3.09	12.30	8.73
Kenya	3.80	0.55	2.98	4.85	5.81
Madagascar	6.02	-12.67	9.79	5.26	4.60
Malawi	-4.97	2.86	6.07	7.12	2.55
Mauritius	5.56	2.71	3.19	4.70	4.57
Rwanda	6.72	9.38	0.95	3.95	5.99
Seychelles	-2.21	1.30	-6.30	-1.99	-2.30
Sudan	6.10	6.40	5.60	5.20	8.00
Swaziland	1.79	2.90	2.40	2.10	1.80
Uganda	4.94	6.34	4.72	5.49	6.57
Zambia	4.89	3.30	5.12	5.41	5.20
Zimbabwe	-2.70	-4.40	-10.40	-3.80	-6.50
Djibouti	2.05	2.62	3.20	3.84	3.20
Egypt, Arab Rep.	3.52	3.19	3.11	4.18	4.94
COMESA	3.07	2.92	2.36	4.44	4.47

Source: UNECA and World Development Indicators.

“Overall, improved macroeconomic stability, higher external demand for commodities, better agricultural production, significant increase in ODA, debt relief measures and improved peace and security account for part of the improved growth performance in the COMESA zone”

Except for 2002 and 2003, Ethiopia's economy has been growing at a rate of over 7 per cent each year. The Democratic Republic of Congo has also been experiencing very high growth, perhaps due to increased external demand for its commodities. The strong global demand for oil is contributing to the robustness of Sudan's economy, which is growing above 5 per cent each year. Modest economic growth has been posted by Mauritius, Rwanda and Egypt. Overall, improved macroeconomic stability, higher external demand for commodities, better agricultural production, significant increase in ODA, debt relief measures and improved peace and security account for part of the improved growth performance in the COMESA zone.

Debt reduction: Debt service has been on a decreasing trend at the regional level since the mid-1980s. The average external debt-to-GDP ratio of COMESA fell from 62.4 per cent in 2003 to 55.4 per cent in 2004, because some countries (Ethiopia, Madagascar and Uganda) have reached the HIPC completion point regarding their debt relief. Many countries have also seen their ODA shares increase substantially.

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Despite these encouraging signals, the MDGs remain underfinanced and most COMESA countries have not made real progress on most of the goals as scheduled”

Several COMESA countries participate, or are expected to participate, in the HIPC initiative for debt relief. This is likely to have a significant impact on debt service statistics at both the national and the regional level. As projected by IMF for the period 2001-2003, debt service as a percentage of GDP in countries with debt relief arrangements was expected to be 50 per cent lower than the others. A similar effect was predicted for debt service as a percentage of export earnings. Despite these encouraging signals, the MDGs remain underfinanced and most COMESA countries have not made real progress on most of the goals as scheduled.

Current account deficit (excluding grants): Most COMESA countries are running deficits on their current account, excluding grants. Exports of goods and services as a percentage of GDP increased from 34.9 per cent to 39.5 per cent, while imports of goods and services also increased from 41.2 per cent of GDP to 43.8 per cent.

Domestic investment and savings rates: Average investment performance in COMESA has improved from 13.8 per cent of GDP in 2003 to 16.3 per cent in 2004. This achievement is below the COMESA target ratio of 20 per cent of GDP and varies from country to country. However, most countries registered a performance of less than 20 per cent of GDP, suggesting that COMESA countries need to implement a set of policies to achieve higher investment and growth.

The average COMESA savings rate as a percentage of GDP was 12.6 per cent in 2004 as compared to 7.4 per cent in 2003. Most countries have a performance in savings of less than 10 per cent of GDP, which is not sufficient to finance the level of investment required for rapid and sustained growth. Furthermore, it is important to note that the relatively high interest rates observed above did not improve domestic savings and possibly hurt domestic investment.

Table 6.8 presents the net FDI into the COMESA zone, showing that Egypt and Sudan have been attracting most of the FDI to the zone in recent years. Sudan's FDIs are for the development of its oil industry. Democratic Republic of Congo attracts substantial FDI to its extractive industry. The FDI into Ethiopia are also very substantial. Not surprisingly, the FDIs into Democratic Republic of Congo, Sudan and Ethiopia account for their strong growth performance in recent years. It must be noted that despite the recent stability in Burundi, FDI flow into the country remains very low.

Table 6.8**Net foreign direct investments (FDI in millions of US dollars) to COMESA**

Country	2001	2002	2003	2004	2005
Burundi	0.01	0.01	0.05	0.04	0.58
Comoros	1.12	0.430	1.00	-0.1	1.00
Congo, Dem. Rep.	77.21	136.78	323.13	668.39	402.00
Djibouti	3.35	3.5	14.22	38.54	22.65
Egypt, Arab Rep.	509.90	646.90	237.40	1,253.30	5,375.60
Eritrea	12.10	20.00	22.00	-7.87	11.38
Ethiopia	349.40	255.00	465.00	545.10	265.11
Kenya	5.30	27.62	81.74	46.06	21.21
Madagascar	93.06	8.29	7.44	19.64	28.88
Malawi	19.30	5.90	3.90	-0.68	3.00
Mauritius	-27.68	32.07	62.63	13.89	39.15
Rwanda	4.46	2.61	4.66	7.66	8.03
Seychelles	64.74	47.72	58.43	38.01	82.38
Sudan	574.00	713.18	1,349.19	1,511.07	2,304.64
Swaziland	28.43	88.79	-60.91	70.58	-16.18
Uganda	151.50	184.65	202.19	222.21	257.06
Zambia	71.70	82.00	172.00	239.00	259.00
Zimbabwe	3.80	25.90	3.80	8.7	102.80
AVERAGE	215.12	208.08	339.61	322.25	413.92

Source: UNECA and World Development Indicators.

“The key objectives of the WACH were to promote the use of the currencies of member countries in intra-ECOWAS trade and to encourage the member States to pursue trade liberalization schemes that support and strengthen monetary and economic cooperation in the subregion”

6.3.3 Monetary arrangements of the Economic Community of West African States (ECOWAS)

Monetary cooperation in the West African subregion began in 1975 with the Economic Community of West African States (ECOWAS) establishing the West African Clearing House (WACH) to provide a multilateral clearing mechanism for trade within the subregion.

The key objectives of the WACH were to promote the use of the currencies of member countries in intra-ECOWAS trade and to encourage the member States to pursue trade liberalization schemes that support and strengthen monetary and economic cooperation in the subregion. Under the operations of the WACH, the use of foreign exchange was substituted for an artificial currency unit, the West African Unit of Account (WAUA). The WAUA was linked to the special IMF drawing right. The WAUA served as the benchmark for determining the relative strength of the currencies in the WACH payment and clearing system. The operations of the WACH required that member States commit to unrestricted conversion of their

national currencies into the WAUA for transactions so as to avoid currency inconvertibility in the subregion.

In 1996, the WACH was transformed into the West African Monetary Agency (WAMA), paving the way for a single monetary zone in the subregion and making the multilateral settlement, clearing and payment system more efficient. With the collaboration of the Committee of Central Bank Governors and the WAMA, the ECOWAS traveller's cheque was introduced in 1998 and went into circulation the following year to facilitate intra-community trade and other business transactions. However, it was phased out in the aftermath of less restrictive exchange controls accompanying increased economic liberalization under the structural adjustment programmes in member States.

Despite the good intentions of the leadership of ECOWAS, the WACH had a number of difficulties. Ojo (2003) suggests that these challenges included operational inadequacies; the ineffectiveness of the system as cumbersome documentation requirements by central banks delayed crediting exporters' accounts; the absence of a short-term financing facility; and the absence of trade promotion instruments such as bills of exchange and traveller's cheques. WACH also failed to promote the use of national currencies in intraregional trade.

In its effort to create a common currency in the zone, ECOWAS in 1987 adopted a comprehensive Monetary Cooperation Programme (MCP). The main objective of the MCP is to promote a harmonized monetary system that would support the sustainable growth of the economies in the ECOWAS zone. Through the MCP, the subregion is expected to achieve a common convertible currency that would subsequently be managed by a common central bank.

To achieve the objectives of the MCP, ECOWAS has implemented a number of measures, including exchange rate realignment and harmonization; adoption of an ECOWAS exchange rate mechanism; liberalization of exchange controls and maintenance of fiscal discipline; and adoption of a market-oriented approach to monetary management. Consequently, member States are expected to follow a set of primary and secondary convergence criteria, as presented in table 6.9.

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In its effort to create a common currency in the zone, ECOWAS in 1987 adopted a comprehensive Monetary Cooperation Programme (MCP)
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Table 6.9**ECOWAS macroeconomic convergence criteria**

Convergence criteria	Priority	Parameter	Target date
Budget deficit	Primary	4 per cent, maximum	2003
Central bank finance of fiscal deficit	Primary	10 per cent, maximum	2003
Inflation rate, annual	Primary	5 per cent, maximum	2003
External reserves	Primary	6-month imports, minimum	2003
Domestic debt	Secondary	Liquidate outstanding and no new	Open
Tax revenue/GDP	Secondary	20 per cent, maximum	Open
Wage bill/Tax revenue	Secondary	35 per cent, maximum	Open
Exchange rate	Secondary	Stabilize real rate	Open
Interest rate	Secondary	Maintain positive real rate	Open
Capital expend./Tax revenue	Secondary	20 per cent, minimum	Open

Source: UNECA and the ECOWAS Secretariat

It should be noted that the maximum budget deficit does not include grants and the maximum central bank financing of the budget deficit is based on the previous year's tax revenue.

The MCP has faced a number of challenges that have delayed its implementation. Member States, perhaps due to the lack of political commitment, have failed to adopt the desired policy frameworks that would lead to convergence. Furthermore, the required monetary harmonization has not been achieved. Consequently, the date for the single monetary zone was shifted three times from 1992 to 1994, to 2000 and again to 2004.

Assessing the performance of the economy of the ECOWAS zone shows that the growth performance was modest, averaging about 4 per cent between 2001 and 2005, which is clearly below the 7 per cent needed to achieve the MDG 1 (table 6.10). Post-conflict Sierra Leone is experiencing high growth due to sound macroeconomic management and strong external demand for its extractive commodities. Strong external demand for crude oil has boosted Nigeria's growth performance, averaging above 6 per cent every year from 2003.

Sound fiscal and monetary management of the Ghanaian economy has yielded great benefits, as witnessed by its average GDP growth of about 5 per cent between 2001 and 2005. The political uncertainty in Côte d'Ivoire appears to be hurting the economy as its real GDP shrunk during 2001-2003. The growth performance of the Gambia and Senegal has also been very strong since 2003, with solid agriculture yields, good macroeconomic policy and tourism accounting for part of the strength in the economies.

“Assessing the performance of the economy of the ECOWAS zone shows that the growth performance was modest, averaging about 4 per cent between 2001 and 2005, which is clearly below the 7 per cent needed to achieve the MDG 1”

“ The inflation performance of the ECOWAS region is relatively good, averaging less than 9 per cent each year from 2001 to 2005 ”

Table 6.10
Growth performance in ECOWAS

Country	2001	2002	2003	2004	2005
Benin	5.00	4.50	3.90	3.10	3.90
Burkina Faso	5.90	4.40	6.50	3.90	4.80
Cape Verde	3.80	4.60	6.20	4.50	5.80
Côte d'Ivoire	-0.03	-1.44	-1.56	1.76	1.80
Gambia, The	5.80	-3.25	6.95	5.10	5.00
Ghana	4.00	4.50	5.20	5.60	5.90
Guinea	4.00	4.20	1.20	2.67	3.33
Guinea-Bissau	0.20	-7.10	0.60	2.20	3.50
Liberia	2.90	3.70	-31.30	2.60	5.30
Mali	12.10	4.15	7.44	2.19	6.08
Niger	7.10	3.00	5.32	0.00	4.50
Nigeria	3.10	1.55	10.69	6.00	6.94
Senegal	4.69	1.12	6.55	6.17	5.13
Sierra Leone	18.20	27.40	9.20	7.40	7.50
Togo	-0.18	4.14	2.70	3.00	2.80
ECOWAS	5.11	3.70	2.64	3.75	4.82

Source: UNECA and World Development Indicators.

The inflation performance of the ECOWAS region is relatively good, averaging less than 9 per cent each year from 2001 to 2005 (table 6.11). Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal and Togo, all member States of the CFA zone, registered very low rates of inflation during the years in review. This is due primarily to the peg of the CFA to the euro, which itself accounts for the low and stable inflation of Europe. The central banks of the Gambia, Ghana, Guinea and Nigeria have to work hard to improve the inflation rate in their respective countries, as they all posted double-digit inflation in the years under review.

Table 6.11
Inflation rates in ECOWAS

Country	2001	2002	2003	2004	2005
Benin	3.14	7.70	1.72	0.29	1.80
Burkina Faso	5.19	3.68	2.22	0.91	2.14
Cape Verde	2.70	1.81	1.60	0.87	0.34
Côte d'Ivoire	4.25	5.08	1.31	0.66	3.55
Gambia, The	15.13	16.10	27.29	14.23	4.28
Ghana	35.05	22.69	28.75	14.35	14.96
Guinea	4.79	2.69	12.59	21.39	28.84
Guinea-Bissau	-5.08	3.59	-3.26	2.10	7.63
Liberia	11.61	26.25	8.93	2.86	9.01
Mali	-0.30	16.04	1.28	-0.61	2.45
Niger	3.98	3.00	-0.37	1.59	6.57
Nigeria	10.74	3.88	20.82	19.91	26.85
Senegal	2.54	2.73	0.68	1.88	2.58
Sierra Leone	1.76	-3.63	8.31	15.98	13.08
Togo	3.06	1.49	-3.25	3.40	3.81
ECOWAS	6.57	7.54	7.24	6.65	8.53

Source: UNECA and World Development Indicators.

The ECOWAS subregion attracts substantial levels of FDIs, with Nigeria taking full advantage to strengthen its oil-producing sector. Despite the political uncertainty, Côte d'Ivoire attracted high levels of FDIs during the period under review. Surprisingly, inflow of FDIs did not translate into strong growth performance in Côte d'Ivoire. Ghana, Liberia and Mali also received modest levels of FDIs that coincided with their strong economic performance.

“The ECOWAS subregion attracts substantial levels of FDIs, with Nigeria taking full advantage to strengthen its oil-producing sector”

“ To support investment and promote financial cooperation in the region, ECOWAS has established a number of regional banks ”

Table 6.12

Net foreign direct investments (FDIs in millions of US dollars) to the ECOWAS region

Country	2001	2002	2003	2004	2005
Benin	50.91	17.89	48.28	108.18	21.00
Burkina Faso	8.83	15.03	29.12	14.35	19.50
Cape Verde	9.11	14.81	14.78	20.30	54.44
Côte d'Ivoire	272.68	212.63	165.35	282.98	265.72
Gambia, The	35.48	42.83	21.90	56.75	51.93
Ghana	89.30	58.90	136.75	139.27	106.50
Guinea	1.68	30.00	78.97	97.90	102.00
Guinea-Bissau	0.40	0.36	4.01	1.73	10.00
Liberia	8.30	2.80	372.22	206.85	193.96
Mali	121.73	243.80	132.26	101.00	159.02
Niger	22.90	2.40	14.91	26.33	11.93
Nigeria	1,190.63	1,874.04	2,005.39	1,874.03	2,013.37
Senegal	31.94	78.05	52.49	77.03	54.00
Sierra Leone	9.84	10.41	8.62	61.15	58.55
Togo	63.58	53.36	33.73	57.33	2.69
AVERAGE	127.82	177.37	207.92	208.35	208.31

Source: UNECA and World Development Indicators.

To support investment and promote financial cooperation in the region, ECOWAS has established a number of regional banks. In 1975, it formed the ECOWAS Fund for Cooperation, Compensation and Development (EFCCD), to serve as a source of finance for the compensation of revenue losses accompanying regional trade liberalization. It is also responsible for the promotion of balanced regional economic development, providing support to less-developed member States of the community. EFCCD has been reconstituted as the ECOWAS Bank for Investment and Development (EBID). The two subsidiaries of EBID are the ECOWAS Regional Development Fund (ERDF) and the ECOWAS Regional Investment Bank (ERIB), which focus on public and private sector financing respectively.

The ECOWAS Bank Group (Ecobank) has also been established to strengthen regional financial cooperation. Ecobank, a parent holding company, has subsidiaries in twelve countries across West and Central Africa. It was established to provide commercial banking and other financial services to individuals and private and public sector organizations. The ERDF is the major shareholder of Ecobank. The Ecobank Foundation, a philanthropic arm of the bank, is also involved in supporting scientific, cultural and humanitarian causes across the region.

6.3.3 Monetary arrangements of East African Community (EAC)

In 1993, Kenya, Tanzania and Uganda, the three original members of the EAC, signed the agreement establishing the Permanent Tripartite Commission for East African Cooperation.⁴ In 1996, the East African Cooperation Secretariat was inaugurated in Arusha, Tanzania. The Treaty establishing the East African Community was signed in November 1999 and entered into force in July 2000. In Article 5(2), the Treaty states that “... the Partner States undertake to establish among themselves and in accordance with the provisions of this Treaty, a customs union, a common market, subsequently a monetary union and ultimately a political federation in order to strengthen and regulate the industrial, commercial, infrastructure, cultural, social, political and other relations of the Partner States to the end that there shall be accelerated, harmonious and balanced development and sustained expansion of economic activities, the benefit of which shall be equitably shared”.

“ The Treaty establishing the East African Community was signed in November 1999 and entered into force in July 2000 ”

More specifically, Article 82(1) says that “... Partner States undertake to cooperate in monetary and fiscal matters in accordance with the approved macroeconomic policies harmonization programmes and convergence framework of the Community in order to establish monetary stability within the Community aimed at facilitating economic integration efforts and the attainment of sustainable economic development of the Community. To this end the Partner States shall:

- Cooperate in monetary and financial matters and maintain the convertibility of their currencies as a basis for the establishment of a monetary union
- Harmonize their macroeconomic policies especially in exchange rate policy, interest rate policy, monetary and fiscal policies
- Remove obstacles to the free movement of goods, services and capital within the Community”.

Furthermore, Article 83(2) adds that “..... Member States undertake to:

- Remove all exchange restrictions on imports and exports within the Community
- Maintain free market determined exchange rates and enhance the levels of their international reserves
- Adjust their fiscal policies and net domestic credit to the government to ensure monetary stability and the achievement of sustained economic growth

⁴ It has to be noted that EAC membership expanded in July 2007 to include Burundi and Rwanda. The information used in the preparation of this section was obtained before the expansion.

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The Kenyan,
Tanzanian
and Ugandan
shillings are freely
convertible within
the East African
subregion
”

- Liberalize their financial sectors by freeing and deregulating interest rates with a view to achieving positive real interest rates in order to promote savings for investment within the Community and to enhance competition and efficiency in their financial systems
- Harmonize their tax policies with a view to removing tax distortions in order to bring about a more efficient allocation of resources within the Community”.

In pursuit of the objectives of the Treaty mentioned above, Partner States agreed on a number of macroeconomic convergence criteria aimed at integrating their economies for a sustainable monetary union as follows:

- Low and stable inflation rate at single digit of less than 5 per cent;
- High and sustainable rate of growth of real GDP at 7 per cent as the minimal annual target;
- Reduce current account deficit-to-GDP ratio to a sustainable level;
- Reduce budget deficit-to-GDP ratio (excluding grants) to less than 5 per cent;
- Raise national savings-to-GDP ratio to at least 20 per cent in the medium term;
- Build gross foreign exchange reserves to a level equivalent to six months of imports in the medium term;
- Maintain low market-determined interest rates;
- Maintain stable market-determined exchange rates;
- Pursue debt reduction initiatives to reduce both domestic and foreign debt; and
- Maintain prudential norms of banking regulation, strict supervision, improved corporate governance and transparency of all financial transactions.

The policy reform programmes adopted by Partner States to achieve the above macroeconomic criteria helped in getting the following results:

- **Currency convertibility of the shilling of the three Partner States:** The Kenyan, Tanzanian and Ugandan shillings are freely convertible within the East African subregion. This has facilitated the flow of trade and investment by reducing transaction costs and has also served as an important instrument for promoting regional cooperation and economic integration. It is paving the way for a smooth transition to a single currency in the subregion in a foreseeable future.

- **Harmonization of macroeconomic policies:** Priority is being given to the harmonization of macroeconomic policies, particularly in exchange rate, interest rate, monetary and fiscal policies. The central banks of the three Partner States meet regularly to harmonize their policies and share experiences and information regarding budget, revenue and other economic policies.
- **In the area of growth, the result achieved is mixed:** The growth performance of the EAC zone has been modest, recording around 5 per cent each year, from 2001 to 2005 (table 6.13). The economies of Tanzania and Uganda have been growing very strongly since 2001. Kenya's growth in 2002 was very slow, posting a mere 0.55 per cent. However, the Kenyan economy has been robust since 2003.

“Compared to other parts of Africa, the EAC zone continued to post single-digit inflation throughout the years under review”

Table 6.13
Growth performance in the EAC region

Country	2001	2002	2003	2004	2005
Kenya	3.80	0.55	2.98	4.85	5.81
Tanzania	6.24	7.24	7.12	6.69	6.97
Uganda	4.94	6.34	4.72	5.49	6.57
EAC	5.00	4.71	4.94	5.68	6.45

Source: UNECA and World Development Indicators

- **Inflation:** Compared to other parts of Africa, the EAC zone continued to post single-digit inflation throughout the years under review (table 6.14). Inflation rates posted by the member States are also very impressive, indicating that their respective central banks are pursuing very sound monetary policies. It is important for the central banks to continue with their policies so that EAC can achieve its target of keeping inflation below 5 per cent.

Table 6.14
Inflation rates in the EAC region

Country	2001	2002	2003	2004	2005
Kenya	1.55	-0.87	6.13	10.06	4.28
Tanzania	7.17	6.45	5.62	8.07	3.74
Uganda	6.50	-3.85	9.77	6.22	7.82
EAC	5.07	0.57	7.17	8.12	5.28

Source: UNECA and World Development Indicators

- **Current account and fiscal deficits:** Current account and fiscal deficits (excluding grant) were contained below 5 per cent in 2002 in Kenya and Tanzania, whereas Uganda's twin deficits rose to more than 13 per cent in the same year.

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In a bid to improve the subregion’s macroeconomic performance, the EAC Ministers of Finance in 2006 approved the terms of reference for a comprehensive study on the EAC monetary union and single currency”

Several reasons could be given for the mixed macroeconomic performance of Partner States, including:

- Lack of enforcement, as there is no penalty for defaulting countries;
- Relevance of some variables is questionable;
- Terms such as “sustainable” or “stable” need to be clearly defined, since they are of a general nature and are difficult to measure;
- The computation and definition of the variables need to be harmonized in all three Partner States; and
- There is no clear roadmap (milestone) leading to a single currency.

In a bid to improve the subregion’s macroeconomic performance, the EAC Ministers of Finance in 2006 approved the terms of reference for a comprehensive study on the EAC monetary union and single currency. Among other things, the study is expected to take into consideration the experiences of other subregions such as the rand zone, the CFA zone, the euro convergence criteria (see box 1), the stability and growth pact of the euro zone and Gordon Brown’s five economic tests for the United Kingdom to join the euro zone (box 2).

Box 6.1 **The Euro Convergence Criteria**

The final judgment as to which member States fulfilled the necessary conditions for the adoption of the euro was made by the Council, meeting in the composition of the Heads of State or of Government on 2 May 1998. The assessment of the degree of convergence achieved by the member States was done by reference to the following criteria:

- a. Price stability: the average rate of inflation, observed over a period of one year before the examination, should not exceed by more than 1.5 percentage points that of, at most, the three best-performing member States in terms of price stability;
- b. Government financial position: the deficit should not exceed 3 per cent of the gross domestic product (GDP), unless it has declined substantially and continuously, and reached a level that comes close to 3 per cent. In addition, the public debt should not exceed 60 per cent of GDP, unless it is sufficiently diminishing and approaching 60 per cent at a satisfactory pace;
- c. Observance of the (normal) fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System (EMS), without severe tensions for at least two years; and
- d. Durability of convergence: the average of the long-term interest rate, observed over a period of one year before the examination, should not exceed by more than 2 percentage points that of, at most, the three best-performing member States in terms of price stability.

In addition to these economic criteria, the member States’ national legislation, including the statutes of its national central bank, had to be compatible with the Treaty and with the Statute of the ESCB.

Box 6.2

Gordon Brown's Five Economic Tests for Joining the Euro Zone

- a. Convergence: are business cycles and economic structures sufficiently in step that the United Kingdom can live comfortably with euro-area interest rates?
- b. Is the economy sufficiently flexible to deal with "asymmetric shocks", that is, changes in the economic environment that affect some countries more than others?
- c. Will the euro encourage companies, especially foreign ones, to invest, by eliminating the exchange rate risk within the euro zone?
- d. The impact of the euro on the financial services industry; and
- e. Will the euro boost growth and jobs?

Has the stable macroeconomic environment in the EAC zone translated into FDI flows into the zone? Table 6.15 shows that the zone attracts modest levels of FDI, with Tanzania attracting the most, followed by Uganda. Despite its strong business environment, Kenya does not attract sufficient FDI.

Table 6.15

Net foreign direct investment (FDI in millions of US dollars) to EAC

Country	2001	2002	2003	2004	2005
Kenya	5.30	27.62	81.74	46.06	21.21
Tanzania	467.20	429.80	526.80	469.90	473.40
Uganda	151.50	184.65	202.19	222.22	257.06
AVERAGE	208.00	214.02	270.24	246.06	250.56

Source: UNECA and World Development Indicators.

6.3.4 Monetary arrangements of the Economic and Monetary Union of Central Africa (CEMAC)

CEMAC is one of the oldest subregional groupings in Africa. Member countries are Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea and Gabon. It was established under French colonial rule as a way of forging monetary and economic integration between the member States.

Although the countries are contiguous, the infrastructure network in the region is very poor, making intra-CEMAC trade very difficult and isolating the countries from one another. Indeed, some of the countries have more economic links with Nigeria and Democratic Republic of Congo, both of which are not in the grouping, than with each other.

“Although the countries are contiguous, the infrastructure network in the region is very poor, making intra-CEMAC trade very difficult and isolating the countries from one another”

“
It must be noted that while most colonies severed their monetary relationships with the former colonial power after independence, the CFA zone’s monetary arrangements remained largely unchanged after independence”

The steep history of CEMAC and UEMOA is rooted in French colonial Africa. It began with the formation of the Afrique Occidentale Française (AOF) in 1898, made up of Senegal, Guinea, Côte d’Ivoire, the Sudan (later Mali), Dahomey (later Benin), Upper Volta (later Burkina Faso), Mauritania and Niger. The Afrique Equatoriale Française (AEF) was also created in 1910 and was made up of Chad, Oubangui-Chari (later the Central African Republic), Congo and Gabon. The French part of Cameroon was governed separately by France under a United Nations mandate and remained outside the federation. France’s African colonies began to assert their right to self-determination after World War II, and their formal arrangements with France ended with their independence.

Despite the newly gained independence of the French colonies in Africa, the CFA franc created under colonial rule continued to be used. In December 1945, the Colonies Française d’Afrique (CFA) franc was created to maintain the exchange rates for AEF and AOF with the dollar. The acronym CFA was later renamed as the Coopération Financière Africaine in Central Africa and Communauté Financière Africaine in West Africa. It must be noted that while most colonies severed their monetary relationships with the former colonial power after independence, the CFA zone’s monetary arrangements remained largely unchanged after independence.

In the mid-1980s, severe domestic policy and exogenous shocks hit the CEMAC area hard. However, the CFA was devalued to mitigate the negative shock and provide stability. Consequently, the area went into a protracted depression that saw per capita income fall by over 17 per cent. Member States reacted to the macroeconomic imbalances by pursuing an “internal adjustment strategy,” as an alternative to devaluation. However, as explained in box 4, the strategy failed and forced the countries to devalue the CFA franc in 1994, which allowed the economies in the region to recover.

Box 6.3

The Internal Adjustment Strategy

The CEMAC countries adopted an “internal adjustment strategy” in response to severe external shocks that struck the region in the 1980s. The collapse of crude oil prices as well as other commodity prices in 1986 had a severe negative impact on the economies of the CEMAC member States. In 1986, the terms of trade for CEMAC countries plunged by 40 per cent, remaining depressed until 1993. In a bid to restore competitiveness and promote growth, and to rectify the macroeconomic imbalance, member countries adopted a combination of expenditure-switching and expenditure-reducing policies.

Expenditure-switching policies were needed to alter relative prices and shift demand and resources towards the production of tradable goods, while expenditure-reducing policies – primarily monetary and fiscal in nature – were needed to reduce domestic absorption and increase domestic savings. Expenditure-switching policies are normally carried out through exchange rate depreciation to reduce imports and boost exports. However, the CEMAC countries did not want to devalue and instead embarked on an “internal adjustment strategy,” which tried to deflate domestic prices in order to achieve the required depreciation in the real exchange rate. This strategy involved a combination of deflationary macroeconomic policies, internal structural reforms and “second-best” trade policies.

However, the real depreciation that was required was too deep, such that deflation of domestic prices needed to be followed up by some level of nominal devaluation. The consequence of the “internal adjustment strategy” was a severe recession in the CEMAC zone, with the per capita GDP of member States falling by 3.9 per cent between 1985 and 1993, and falling government revenue. Compounding the problem was the withdrawal of external financial support as donors became increasingly dissatisfied with the slow pace of reforms. This led to a fiscal crisis, which in turn caused serious liquidity and solvency problems for the banking system through the accumulation of government and public enterprise arrears.

A substantial increase in non-performing private sector loans caused by the depression also strained the banking system. As the economic crisis deepened and devaluation appeared increasingly inevitable, capital flight from the area accelerated, undermining the financial system further. Significant restrictions on international payments imposed during this period did not help improve the situation. The banking sectors of many of the CEMAC countries were insolvent on the eve of the devaluation.

The Heads of State and Government were left with no option but to devalue the CFA franc in 1994.

“The coordination of monetary programmes in the region is carried out by the Central Bank of Central African States (BEAC), which was created in 1972 as a regional central bank”

The coordination of monetary programmes in the region is carried out by the Central Bank of Central African States (BEAC), which was created in 1972 as a regional central bank. BEAC was charged with the responsibility of issuing currencies and pooling the external reserves of member States. It functions through an operations account with the French Treasury, which is used to manage the fixed parity between the CFA franc and the French franc and is governed by monetary accords between France and BEAC. Some of the accords require BEAC to abide by a set of rules of monetary and fiscal discipline designed to reduce the risk of accumulating large balance of payments deficits that would have to be corrected by extensive financing from the operations account. BEAC is also responsible for overseeing macroeconomic and financial stability in the zone.

In order to preserve the value of the CFA and ensure macroeconomic stability, CEMAC in 2002 adopted a macroeconomic framework, which requires member States to ensure that:

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The average growth performance of CEMAC was very modest between 2001 and 2005
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- Inflation does not exceed 3 per cent;
- Total debt as a percentage of GDP is not greater than 70 per cent;
- External debt payment arrears are not negative;
- Domestic debt payment arrears are not negative;
- Budget deficit as a percentage of GDP is not negative;
- Deficit financed by the central bank is less than 20 per cent of the previous year's fiscal revenue;
- Wage bill as a percentage of tax revenue is less than 35 per cent; and
- There are no domestic and external arrears on the current account.

The average growth performance of CEMAC was very modest between 2001 and 2005 (table 6.16). With the exception of 2002 and 2004, growth for the entire zone remained below 5 per cent. The high-performing countries in the zone are Chad and Equatorial Guinea, which posted double-digit GDP growth during the years in review, mainly due to the performance of the oil sector. The growth performance of Central African Republic and Gabon is very weak, with the former posting negative growth rates in 2002 and 2003.

Table 6.16
Growth performance in the CEMAC region

Country	2001	2002	2003	2004	2005
Cameroon	4.51	4.01	4.03	3.70	2.04
Central African Republic	1.50	-0.80	-7.60	1.30	2.20
Chad	10.42	8.38	14.91	29.50	5.57
Congo, Rep.	3.80	4.60	0.80	3.60	9.20
Equatorial Guinea	1.45	17.62	14.70	9.98	na
Gabon	2.50	0.00	2.60	1.40	2.20
CEMAC	4.03	5.63	4.91	8.25	4.24

Source: UNECA and World Development Indicators.

Although the zone as a whole has not been able to keep inflation below 3 per cent, it has managed to post single-digit inflation (table 6.17). In 2001, 2004 and 2005, Chad registered double-digit inflation, partly due to increased pressures for goods and services to support increased activities in the oil sector. The top inflation performers in the zone are Cameroon, Congo, Gabon and Central African Republic.

Table 6.17***Inflation rates in the CEMAC region***

Country	2001	2002	2003	2004	2005
Cameroon	4.5	2.8	0.6	0.3	1.9
Central African Republic	3.8	2.3	4.2	-2.1	2.9
Chad	12.4	5.2	-1.8	-5.3	7.9
Congo, Rep. of	0.4	3.8	-1.3	3.6	2.8
Equatorial Guinea	8.8	7.6	7.3	4.2	5.0
Gabon	2.1	0.2	2.3	0.4	-0.2
CEMAC	4.4	3.0	1.3	0.6	2.9

Source: UNECA and World Development Indicators.

“Chad and Equatorial Guinea attracted most of the FDIs mainly for the development of their oil sectors”

Table 6.18 reports the net FDI flows into the CEMAC zone between 2001 and 2005. Chad and Equatorial Guinea attracted most of the FDIs mainly for the development of their oil sectors. Despite Cameroon and Gabon being the biggest economies in the zone, they do not attract substantial levels of FDIs.

Table 6.18***Net foreign direct investments (FDIs in millions of US dollars) to the CEMAC region***

Country	2001	2002	2003	2004	2005
Cameroon	73.29	601.75	219.75	0.29	18.00
Central African Republic	5.18	5.64	3.27	-12.68	6.00
Chad	459.87	924.06	712.65	478.15	705.00
Congo, Rep. of	77.21	331.15	323.12	-8.52	724.02
Equatorial Guinea	945.02	323.39	1,430.66	1,664.06	1,860.00
Gabon	-89.09	38.97	157.99	319.51	300.00
AVERAGE	245.25	370.83	474.57	406.80	602.17

Source: UNECA and World Development Indicators.

6.3.5 Monetary arrangements of West African Economic and Monetary Union (UEMOA)

UEMOA was established in 1994, and comprises the following countries: Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo. The history of UEMOA dates back to 1962 with the establishment of the West African Monetary Union (UMOA), composed of the French colonies in West Africa. UEMOA was born in 1994 out of a merger between the West African Monetary Union (UMOA) and the West African Economic Community (CEAO).

The credibility and international convertibility of the CFA franc are guaranteed through the euro, to which it is anchored

The main objectives of UEMOA are:

- To reinforce the competitiveness of the economic and financial activities of member States in the context of an open and rival market and a rationalized and harmonized judicial environment;
- To ensure the convergence of the macroeconomic performance and policies of member States with the institution of a multilateral control procedure;
- To create a common market among member States based on the free movement of people, goods, services and capital and on the right of people exercising an independent or remunerated activity;
- To establish a common external tariff as well as a common commercial policy;
- To institute coordination of national sector-based policies with the implementation of common market actions, especially in the following domains: community-based land reclamation, environment, transport, infrastructure, telecommunications, human resources, energy, industries, mines and crafts; and
- To harmonize the legislations, especially, the fiscal systems of the member countries.

UEMOA is a single monetary zone backed by a convertible currency, the CFA franc, which is issued by the Central Bank of West African States (BCEAO). BCEAO is the common central bank for the eight member States. Besides the issue of the common currency, BCEAO is also responsible for the pooling of foreign exchange reserves; the unrestricted circulation of the common currency and freedom of capital movements within the territory of the member States; the harmonization of monetary and banking legislation; the free and unlimited convertibility of CFA franc into euros at a fixed parity guaranteed by France; the concentration of the Union's foreign currency-denominated assets in the operations account of the French Treasury; and the application of a common regulation against third-party countries.

The credibility and international convertibility of the CFA franc are guaranteed through the euro, to which it is anchored. To ensure convertibility between the CFA franc and the euro, the French Treasury maintains an operations account on behalf of BCEAO. Recently, the need to maintain a common monetary policy called for financial discipline on the part of each country belonging to the Union. Accordingly, UEMOA, with the endorsement of the Heads of State and Government of the member States, has adopted the Convergence, Stability, Growth and Solidarity Pact. The Pact establishes a multilateral surveillance system aimed at ensuring greater economic policy cohesiveness among members and outlines a set of primary and secondary criteria to be satisfied.

Box 6.4

Multilateral surveillance mechanism

UEMOA has recognized that the convergence of member States' economic policies is one of its priorities (see article 65 of the treaty). Therefore, the Union has to avoid excessive budgetary deficits, respect budgetary discipline and harmonize its tax policies, as prescribed by the treaty.

The theoretical process of multilateral surveillance is enshrined in the treaty: if a member State does not meet the requirements of the annual economic policy goal, the treaty stipulates that the UEMOA Commission should provide an explanation to the Council, outlining corrective measures that the Member State should take. Upon approval by the Council of Ministers, the Commission has 30 days to set up a detailed programme for the member State to follow. The programme would need the blessing of the Union, which would also have to assist the member State in raising the resources needed to address the issue.

If the affected member State fails to implement the programme, the Commission can propose negative sanctions against the member State to the Council. These sanctions range from publication of a Council communiqué detailing the situation of the member State (to literally discredit it), to the withdrawal of all Union support and freezing of all intervention of BCEAO in favour of the member State.

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A monetary union
calls for some
coordination of
budgetary policies
of member
countries
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The macroeconomic convergence policy of UEMOA consists of the primary and secondary criteria referred to earlier. The primary criteria focus on the budget deficit; the reduction of inflation; the ceiling on total public external debt; and the internal and external arrears. The secondary criteria deal with variables such as the wage bill-to-tax revenue ratio; public investment; fiscal revenues and current account deficits. The macroeconomic policies of member States are coordinated through the multilateral surveillance mechanism.

A monetary union calls for some coordination of budgetary policies of member countries. Divergent budgetary policies can lead to tensions within the monetary union, especially when they can give rise to competitive capital movements between countries. The convergence provisions in the UEMOA zone are encapsulated in the multilateral surveillance mechanism. In applying these provisions, the Union pursues general as well as specific objectives. Article 4 of its treaty stipulates that the Union is aimed at:

- “Reinforcing the competitiveness of economic and financial activities of member States within the framework of an open and competitive market and a rationalized and harmonized juridical environment”; and
- “Ensuring the convergence of performances and of economic policies by the institution of a multilateral surveillance procedure”.

To ensure budgetary discipline as well as macroeconomic stability, UEMOA has imposed the following convergence criteria on its member States:

“ A review of the current inflation performance of the UEMOA zone indicates that the zone as a whole is meeting its inflation target of less than 3 per cent ”

Primary criteria:

- a ratio of global budgetary deficit to GDP of no more than 4 per cent
- an annual inflation rate of less than 5 per cent
- A budgetary deficit financed by the central bank of no more than 10 per cent of the previous year's fiscal revenues; and
- Some exchange reserves (gross external reserve) representing at least six months of import of goods and services.

Secondary criteria:

- A fiscal revenue/GDP ratio of at least 20 per cent;
- A wage bill/fiscal revenue ratio of no more than 35 per cent;
- Real exchange rate stabilization; and
- Investment on own resources/fiscal revenue of at least 20 per cent.

A review of the current inflation performance of the UEMOA zone indicates that the zone as a whole is meeting its inflation target of less than 3 per cent (table 6.19). With the exception of 2001, most of the member States stayed below the target for most of the period under review. It is remarkable to observe that throughout the period, all member States posted single-digit inflation rates, due to the strong linkage between the CFA franc and the euro, with the countries registering similar low levels of inflation as those in the euro zone. This clearly demonstrates the advantage of a monetary union.

Table 6.19
Inflation rates in the UEMOA region

Country	2001	2002	2003	2004	2005
Benin	4.0	2.4	1.5	0.9	2.3
Burkina Faso	4.9	2.3	2.0	-0.4	3.7
Côte d'Ivoire	4.4	3.1	3.3	1.4	3.8
Guinea-Bissau	3.3	3.3	-3.5	0.9	1.8
Mali	5.2	5.0	-1.3	-3.1	3.4
Niger	4.0	2.6	-1.6	0.2	7.9
Senegal	3.0	2.3	0.0	0.5	-0.5
Togo	3.9	3.1	-1.0	0.4	5.1
UEMOA	4.1	2.9	1.3	0.5	2.6

Source: UNECA, BCEAO and UEMOA Commission.

Table 6.20 reports on the budget deficits of member States as a percentage of their GDP. The minimum primary target is set at zero. The region as a whole has not been very successful in achieving this objective, although it has not deviated too far from the target. The best performers are Mali, Senegal and Togo, which maintained budget surpluses for most of the period under review. Guinea-Bissau is the only member State that had difficulties in meeting the target for each year under review.

Table 6.20
Budget deficit/GDP (percent) in the UEMOA region

Country	2001	2002	2003	2004	2005
Benin	1.0	0.8	-0.2	0.5	1.1
Burkina Faso	-2.7	-2.3	-0.7	-1.5	-1.7
Côte d'Ivoire	1.4	0.2	-2.0	-1.1	-0.6
Guinea-Bissau	-10.6	-4.4	-5.1	-9.1	-9.5
Mali	-0.6	-0.1	1.0	0.1	0.3
Niger	-3.2	-2.6	-2.2	-2.2	-1.7
Senegal	-1.0	1.5	1.5	1.5	0.5
Togo	1.3	0.3	2.6	2.6	0.6
UEMOA	0.2	0.0	-0.5	-0.3	-0.4

Source: UNECA, BCEAO and UEMOA Commission.

One of the primary targets of UEMOA is for each Member State to ensure that its total public debt as a percentage of GDP does not exceed 70 per cent. Table 6.21 shows that the zone has been struggling to achieve this target, although it was successful in 2004 and 2005. Benin, Burkina Faso, Mali and Senegal have performed very well in achieving this target. However, Guinea-Bissau, and to a lesser extent Côte d'Ivoire and Togo, would have to work hard to keep their debt level at less than 70 per cent of GDP.

Table 6.21
Ceiling on total public debt/GDP (per cent) in the UEMOA region

Country	2001	2002	2003	2004	2005
Benin	59.1	49.4	41.1	41.1	45.8
Burkina Faso	71.4	49.6	48.0	46.2	41.5
Côte d'Ivoire	118.1	86.1	82.7	84.1	79.3
Guinea-Bissau	405.0	399.8	399.8	321.0	264.0
Mali	90.0	83.4	71.4	66.5	68.0
Niger	96.3	95.1	86.7	75.5	66.4
Senegal	-	70.6	63.9	50.3	48.0
Togo	135.6	111.2	108.1	96.5	94.2
UEMOA	98.3	79.7	73.5	68.9	65.5

Source: UNECA, BCEAO and UEMOA Commission.

“ One of the primary targets of UEMOA is for each Member State to ensure that its total public debt as a percentage of GDP does not exceed 70 per cent ”

Table 6.22 shows that had it not been for the poor performance of Côte d'Ivoire, Guinea-Bissau and Togo, the entire zone would have achieved the target of non-accumulation of internal and external arrears. These countries, particularly Côte d'Ivoire and Guinea-Bissau, would have to take corrective measures so as to achieve the target.

“As pointed out earlier, UEMOA also maintains secondary convergence criteria”

Table 6.22
Internal and external arrears in the UEMOA region

Country	2001	2002	2003	2004	2005
Benin	0.0	0.0	0.0	0.0	0.0
Burkina Faso	0.0	0.0	0.0	0.0	0.0
Côte d'Ivoire	491.2	143.3	614.9	521.5	311.3
Guinea-Bissau	405.0	399.8	399.8	321.0	264.0
Mali	0.0	0.0	0.0	0.0	0.0
Niger	7.3	2.6	0.0	3.2	0.0
Senegal	0.0	0.0	0.0	0.0	0.0
Togo	30.1	60.2	66.5	72.0	0.0
UEMOA	570.4	216.7	706.1	609.7	311.3

Source: UNECA, BCEAO and UEMOA Commission.

As pointed out earlier, UEMOA also maintains secondary convergence criteria. The variables monitored are: wage bills-to-tax revenue; public investment-to-tax revenue; tax revenue-to-GDP; and current account deficit-to-GDP.

Table 6.23 reports on the wage bill of member States as a percentage of tax revenue. The criteria require that member States' wage bills should not exceed 35 per cent of their tax revenue. The table shows that the zone as a whole was slightly above the target each year. Senegal and Mali are the only countries that met the target each year of the review period. With the exception of Guinea-Bissau, the rest of the member States are marginally above the target and therefore would require less effort to bring the variable back to the required target. On the other hand, Guinea-Bissau needs to take serious corrective measures to address its precarious situation.

Table 6.23**Wage bill/tax revenue (percentage) in the UEMOA region**

Country	2001	2002	2003	2004	2005
Benin	32.7	31.9	33.5	38.0	36.1
Burkina Faso	46.1	42.8	41.6	37.3	38.3
Côte d'Ivoire	41.4	42.3	45.3	44.0	46.5
Guinea-Bissau	76.9	88.5	85.8	139.0	135.1
Mali	29.1	30.5	30.4	30.9	32.3
Niger	40.3	38.3	37.5	35.2	32.8
Senegal	30.7	31.7	30.1	29.5	30.8
Togo	45.1	44.7	34.8	32.0	34.9
UEMOA	37.8	38.0	38.1	37.4	38.4

Source: UNECA, BCEAO and UEMOA Commission.

“The best performer for the years under review is Burkina Faso, whose public investment each year accounted for at least 30 per cent of its tax revenue”

In the case of the public investment-to-tax revenue indicator, the requirement for the UEMOA member States is to keep it above 20 per cent. Table 6.24 indicates that, with the exception of 2004 and 2005, the zone as a whole has not met the target. The poor showing of the zone overall is due to Côte d'Ivoire, Guinea-Bissau and Togo not being able to achieve the target. The best performer for the years under review is Burkina Faso, whose public investment each year accounted for at least 30 per cent of its tax revenue. It is worth noting that the performance of Niger and Senegal was very strong in 2004 and 2005.

Table 6.24**Public investment/tax revenue (percentage) in the UEMOA region**

Country	2001	2002	2003	2004	2005
Benin	22.4	19.3	23.2	21.5	24.1
Burkina Faso	29.8	36.0	33.1	45.4	36.5
Côte d'Ivoire	7.2	12.4	10.5	9.8	9.6
Guinea-Bissau	17.0	5.8	0.8	15.2	11.2
Mali	22.0	20.5	22.4	22.7	22.5
Niger	19.7	25.5	26.6	35.0	42.0
Senegal	20.5	23.5	24.1	30.0	34.8
Togo	6.5	7.4	7.6	7.5	10.5
UEMOA	15.2	18.6	18.6	21.4	23.0

Source: UNECA, BCEAO and UEMOA Commission.

“
 In order to minimize the pressure on the fixed rate between the CFA franc and the French franc, UEMOA requires the member States' current account deficits to be less than -5 per cent of their GDP”

In order to ensure that member States derive enough revenue for public expenditure, a secondary requirement UEMOA imposes on each State is that its tax revenue should be greater than 17 per cent of its GDP. Table 6.25 indicates that, with the exception of Senegal, none of the member States was able to achieve this target. The overall average of the zone falls short for each year under review. Perhaps member States need to expand their tax base and improve the efficiency of their tax collection.

Table 6.25
Tax revenue/GDP (percentage) in the UEMOA region

Country	2001	2002	2003	2004	2005
Benin	14.2	14.4	14.9	14.6	15.6
Burkina Faso	11.7	10.6	10.8	11.8	10.6
Côte d'Ivoire	16.8	15.2	14.9	15.2	14.3
Guinea-Bissau	10.1	8.6	9.2	7.6	9.2
Mali	12.9	13.8	14.2	15.4	15.8
Niger	9.5	10.3	11.0	11.6	12.2
Senegal	17.1	18.1	18.2	18.4	18.4
Togo	13.5	11.1	14.6	14.9	12.5
UEMOA	14.9	14.4	14.6	15.0	14.9

Source: UNECA, BCEAO and UEMOA Commission.

In order to minimize the pressure on the fixed rate between the CFA franc and the French franc, UEMOA requires the member States' current account deficits to be less than -5 per cent of their GDP. Table 6.26 shows that, with the exception of 2002, the zone on average met the target in each year under review. Côte d'Ivoire is the only member State that was not able to achieve the target, perhaps due to the political uncertainty that has plagued the region for some time now.

Table 6.26
Current account deficit /GDP (percentage) in the UEMOA region

Country	2001	2002	2003	2004	2005
Benin	-7.5	-8.3	-9.7	-6.3	-5.3
Burkina Faso	-14.5	-11.8	-12.7	-11.7	12.4
Côte d'Ivoire	-0.9	6.4	2.0	1.8	2.4
Guinea-Bissau	-	-10.4	-8.6	-10.1	-19.9
Mali	-12.4	-6.1	-9.3	-7.0	-7.3
Niger	-9.1	-10.2	-11.6	-11.0	-10.2
Senegal	-6.7	-8.2	-8.6	-8.6	-7.9
Togo	-15.4	-10.0	-9.8	-6.1	-12.5
UEMOA	-6.8	-2.9	-5.5	-4.8	-4.7

Source: UNECA, BCEAO and UEMOA Commission.

Assessing the growth performance of the economies of the UEMOA zone shows that growth has been very modest, averaging around 3.4 per cent between 2001 and 2005, which is clearly below the 7 per cent needed to achieve the MDG 1 (table 6.27). Senegal and Mali are the best-performing economies in the zone, followed by Burkina Faso and Benin. The performance of Côte d'Ivoire was lacklustre, perhaps due to its political uncertainty. Overall, the sound macroeconomic convergence criteria do not appear to have translated into good economic performance.

“ Assessing the growth performance of the economies of the UEMOA zone shows that growth has been very modest, averaging around 3.4 per cent between 2001 and 2005, which is clearly below the 7 per cent needed to achieve the MDG 1 ”

Table 6.27
Growth performance in UEMOA

Country	2001	2002	2003	2004	2005
Benin	5.00	4.50	3.90	3.10	3.90
Burkina Faso	5.90	4.40	6.50	3.90	4.80
Côte d'Ivoire	-0.03	-1.44	-1.56	1.76	1.80
Guinea-Bissau	0.20	-7.10	0.60	2.20	3.50
Mali	12.10	4.15	7.44	2.19	6.08
Niger	7.10	3.00	5.32	0.00	4.50
Senegal	4.69	1.12	6.55	6.17	5.13
Togo	-0.18	4.14	2.70	3.00	2.80
UEMOA	4.35	1.60	3.93	2.79	4.06

Source: UNECA and World Development Indicators.

The UEMOA zone attracts modest levels of FDI. Table 6.28 indicates that most of the FDI goes to Côte d'Ivoire and Mali. However, the inflow of FDIs into Côte d'Ivoire did not translate into strong growth performance. Mali's FDI appears to be correlated to its modest economic performance. Guinea-Bissau attracts the least FDI in the UEMOA area.

Table 6.28
Net foreign direct investment (FDI in millions of US dollars) to UEMOA

Country	2001	2002	2003	2004	2005
Benin	50.91	17.88	48.28	108.18	21.00
Burkina Faso	8.83	15.03	29.12	14.35	19.50
Côte d'Ivoire	272.68	212.63	165.35	282.98	265.72
Guinea-Bissau	0.40	3.56	4.01	1.73	10.00
Mali	121.73	243.80	132.26	101.00	159.02
Niger	22.90	2.40	14.91	26.33	11.93
Senegal	31.94	78.05	52.49	77.03	54.00
Togo	63.58	53.36	33.73	57.33	2.00
UEMOA	71.62	78.34	60.02	83.62	67.98

Source: UNECA and World Development Indicators.

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of a process of
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”

The analysis shows that the convergence performance in UEMOA falls short of expectations. None of the member States has succeeded in meeting the eight targets set for the convergence pact, the stability and the growth and solidarity objectives. The general impression is that budgetary targets are difficult to achieve. Senegal is the only economy that met five budgetary criteria in 2005, namely the budget deficit-to-GDP ratio, the non-accumulation of internal and external arrears, the public investment-to-tax revenue ratio, the wage bill-to-tax revenue ratio and the tax revenue-to-GDP ratio.

Mali met four; Benin, Niger and Togo met three each, while Burkina Faso met two. Guinea Bissau met one, while Côte d’Ivoire achieved none of the budgetary targets. This poor performance could be due to the weak economic growth in the zone; the fragile public finances reflected by the accumulation of debt arrears; the deterioration of budget balances; and socio-political instability in some member States.

6.3.6 Progress report on the West African Monetary Zone

In 2000, as part of a process of “fast-tracking” its integration agenda, ECOWAS established a second monetary zone in the region. Under the declaration, five non-UEMOA members of the community (Gambia, Ghana, Guinea, Nigeria and Sierra Leone) would form a common currency union by 2003. However, the launch date of the common currency for the non-CFA zone, which was pushed back to 2005, would now be in 2009. Under the ECOWAS programme of monetary union, the two monetary zones (the CFA and non-CFA zones) would be merged into one monetary union under a common currency and a common central bank — designated as the West African Central Bank (WACB) — at a future date. The process towards the establishment of the West African Monetary Zone (WAMZ) gave rise to the West African Monetary Institute (WAMI), which is responsible for preparing the groundwork for the launch of a single West African monetary union.

WAMI, which is based in Ghana, started its operations in March 2001 to prepare member States for monetary union. WAMI has been carrying out a number of technical studies for the establishment of a common central bank and the introduction of a common currency. These studies include the monitoring of the macroeconomic performance and movement towards convergence of member States and harmonization of laws governing financial institutions in the zone. WAMI is also charged with the design of an exchange rate mechanism; a foreign exchange reserve management system; a payment system; and the design and technical preparation of a common currency and common central bank for the zone.

Since the establishment of the WAMZ in 1999, many efforts have been made towards the establishment of a single currency for the zone. The initial phase of the

WAMZ programme (2001-2003) was characterized by generally poor macroeconomic performance, evidenced by the persistence of fiscal instability, high inflation and low levels of foreign exchange reserves accumulation. The dismal performance was due mainly to domestic and subregional factors, rather than developments in the global economy. During the second phase (2004-2005), macroeconomic performance improved markedly over the level in Phase 1, but that was not sufficient to launch the currency.

The Banjul Declaration of 2005, which postponed the introduction of the common currency to 2009, required member countries to meet, in addition to the primary and secondary quantitative convergence criteria, specific qualitative/structural benchmarks. These included the adoption of a common payment and settlement system anchored on the Real-Time Gross Settlement (RTGS) platform; integration of financial/capital markets; harmonization of statistical databases of the WAMZ; implementation of the ECOWAS Common External Tariff (CET) and the ECOWAS Trade Liberalization Scheme (ETLS); and use of WAMZ national currencies to finance intraregional trade on a bilateral basis (as a stop-gap measure), pending the introduction of the common currency in 2009.

Assessment of the status of convergence revealed that, for the first time since the project started in 2001, two countries – the Gambia and Nigeria – met all the four primary convergence criteria in 2006. Even in the countries that failed to meet all four criteria, significant progress was made towards convergence, a clear testimony to the markedly improved macroeconomic environment in the WAMZ, in sharp contrast to the situation in 2003 and 2005. Ghana and Sierra Leone met two criteria each, with Ghana narrowly missing the single-digit inflation criterion, while Guinea met one. Both Ghana and Sierra Leone did not achieve the fiscal benchmarks, partly reflecting their continued and increased reliance on external grants.

Indeed, the appropriate fiscal convergence ratio to be targeted continues to be a subject of debate in the WAMZ. In most of the countries (Ghana, Sierra Leone and the Gambia), donor (HIPC) grants are expected to continue to feature prominently in budgetary operations. Thus, the argument has been made that the exclusion of such grants in the definition of the criteria limits the ability of member countries to observe and sustain them. However, the history of lapses in fiscal management and the vulnerability of member countries to external and internal shocks have made the WAMZ authorities focus more on fiscal consolidation through improved revenue mobilization and efficient management.

“ Assessment of the status of convergence revealed that, for the first time since the project started in 2001, two countries – the Gambia and Nigeria – met all the four primary convergence criteria in 2006 ”

**Performance scorecard aggregate
Number of criteria met by country**

Primary Criteria						
	2001	2002	2003	2004	2005	2006
The Gambia	2	1	1	3	3	4
Ghana	1	0	2	2	2	2
Guinea	3	2	0	0	2	1
Nigeria	3	3	2	3	3	4
Sierra Leone	3	3	0	2	2	2
Secondary Criteria						
	2001	2002	2003	2004	2005	2006
The Gambia	2	1	1	3	3	3
Ghana	1	1	2	2	2	3
Guinea	1	2	1	1	1	1
Nigeria	3	2	3	3	3	3
Sierra Leone	1	1	0	1	1	1

An integrated financial system is a prerequisite for an efficient and effective monetary policy in ECOWAS

Financial sector integration

An integrated financial system is a prerequisite for an efficient and effective monetary policy in ECOWAS. The key strategy for financial sector integration in ECOWAS is predicated on the harmonization of banking regulations in accordance with the Basle Core Principle (BCPs), and the integration of the capital markets. Currently, all the WAMZ countries have adopted the BCPs as the basis for banking supervision. Also, work is currently under way on the integration of the Ghana and Nigeria stock exchanges, driven by the financial grant from the United States Department of Trade (USTDA). Furthermore, the WAMZ Convergence Council, which met in May 2007, gave approval for WAMZ national currencies to be used to finance intra-regional trade, pending the introduction of the common currency.

Payments System Integration

The WAMZ has made good progress in harmonizing the payment and settlement system of all its member countries. Two countries (Ghana and Nigeria) have an operational Real-Time Gross Settlement (RTGS) system. Acting on WAMI's request, the African Development Bank has agreed to finance the RTGS infrastructure for The Gambia, Guinea and Sierra Leone, in preparation for the adoption of a common payment system platform in the zone. WAMZ has also adopted a common cheque standard and a common payment system statute will soon be adopted.

Statistical harmonization

Work is ongoing in the area of statistical harmonization in the WAMZ. The Gambia, Guinea and Sierra Leone are working toward improved coverage for the consumer price index to cover both the rural and urban areas. The process of statistical harmonization is being driven by AFRISTAT and the ECOWAS Commission.

Legal instruments

Significant work has been done in this area. The West Africa Central Bank (WACB), the West African Monetary Zone (WAMZ) and the WAMZ Secretariat statutes have been signed by the Authority of Heads of State and Government of the WAMZ and are awaiting ratification and domestication by member States. Statutes for the payment and banking systems of the West African Financial Services Authority (WAFSA) and non-bank regulations have been drafted, but are yet to be signed by the Authority of Heads of State and Government.

Overall, the WAMZ project has regained the needed momentum and progress is rapidly being made towards satisfying the quantitative and structural criteria. The critical success factor remains stronger political support for the project.

“ Overall, the WAMZ project has regained the needed momentum and progress is rapidly being made towards satisfying the quantitative and structural criteria ”

Status of Compliance with the Primary Convergence Criteria: 2000 -June 2007

Primary Criteria	Consumer Price Inflation Rate (End Period)						Budget Deficit (excl. grants)/GDP								
	2001	2002	2003	2004	2005	2006	2007	2001	2002	2003	2004	2005	2006	2007	
Target	<10%						≤4%								
The Gambia	8.1	13.0	17.6	8.0	1.8	2.2	0.4	6.4	9.8	9.1	7.6	7.4	4.5	2.7	
Ghana	21.3	15.2	23.6	11.8	14.8	10.5	9.9	10.7	13.2	8.3	7.5	6.9	8.5	11.5	
Guinea	1.1	6.1	14.8	27.6	29.7	35.5	39.1	18.3	5.2	8.0	9.2	0.8	0.1	-1.8	
Nigeria	16.5	12.2	23.8	10.0	11.6	8.5	8.5	6.4	3.2	3.9	2.0	1.3	-1.6	-0.6	
Sierra Leone	3.4	-3.1	11.3	14.4	13.1	9.2	8.3	12.0	16.5	16.5	14.4	11.4	6.7	9.7	
WAMZ as 6th Economy	15.15	11.59	22.12	11.53	13.40	11.16	10.00	8.40	4.2	4.5	2.8	2.0	-0.7	2.0	
No. of Countries meeting Criterion	3	2	0	1	1	3	4	1	1	1	1	2	2	2	4

Primary Criteria	Central Bank Financing of Budget Deficit/Prev. Yr. Tax Revenue						Gross Reserves (in months of imports)								
	2001	2002	2003	2004	2005	2006	2007	2001	2002	2003	2004	2005	2006	2007	
Target	<10%						≤3								
The Gambia	80.7	22.4	63.1	0.0	0.0	0.0	0.0	0.0	7.2	2.9	4.6	5.2	4.1	4.9	
Ghana	0.0	12.1	0.0	0.0	0.0	0.0	0.0	0.0	1.4	2.6	4.9	4.0	3.6	3.7	
Guinea	0.0	27.1	16.1	23.1	0.0	0.0	81.6	4.2	4.4	3.4	2.8	1.4	2.0	0.8	
Nigeria	0.0	0.0	37.6	0.0	0.0	0.0	0.0	0.0	11.3	7.3	5.6	13.6	19.7	23.0	
Sierra Leone	8.9	0.0	22.0	0.0	0.0	0.0	13.3	11.8	3.3	-0.6	2.3	4.2	4.2	5.2	
WAMZ as 6th Economy	0.0	0.0	30.6	0.0	0.0	0.0	0.0	0.0	8.8	6.2	5.3	9.7	17.1	20.3	
No. of Countries meeting Criterion	3	3	2	4	5	5	3	4	4	2	4	5	4	4	3

Primary Criteria	Number of Criteria met by Country						
	2001	2002	2003	2004	2005	2006	2007
Target	4						
The Gambia	1	0	1	3	3	3	4
Ghana	1	0	2	2	2	2	1
Guinea	3	2	0	0	2	2	1
Nigeria	3	3	2	3	3	4	4
Sierra Leone	3	3	0	2	2	3	2
WAMZ as 6th Economy	3	3	2	3	3	3	4

Source: WAMZ Authorities & WAMI Staff

Status of Secondary Convergence Criteria

		2001	2002	2003	2004	2005	Jun-06	2006	Jun-07
Tax Revenue / GDP=20 per cent	The Gambia	13.9	14.1	13.8	18.1	17.8	20.4	18.8	20.7
	Ghana	17.2	17.5	20.2	22.4	21.9	18.3	21.4	20.7
	Guinea	10.3	10.9	9.8	9.9	12.1	12.3	10.9	12.2
	Nigeria	14.7	10.0	11.4	14.8	19.8	16.3	14.9	9.7
	Sierra Leone	14.5	14.0	11.5	11.0	10.4	10.8	11.6	10.6
	WAMZ	14.7	10.7	12.1	15.2	19.4	15.0	15.4	10.4
Wages/Tax Revenue=35 per cent	The Gambia	40.7	38.0	33.3	23.1	23.4	22.3	24.2	21.7
	Ghana	52.9	57.2	49.6	46.1	44.8	47.5	44.9	48.0
	Guinea	35.3	34.2	36.7	31.5	23.2	18.9	20.8	25.9
	Nigeria	28.0	47.2	26.9	21.9	17.9	23.2	19.6	26.6
	Sierra Leone	58.1	63.9	59.7	56.0	65.5	64.2	65.3	61.1
	WAMZ	30.8	48.1	30.8	25.6	21.2	25.6	22.7	30.2
Public Invest/Domestic Rev.=20 per cent	The Gambia	7.3	5.5	3.2	4.0	6.0	1.6	2.9	2.0
	Ghana	16.4	13.2	17.2	17.3	16.0	20.3	22.2	20.6
	Guinea	4.8	10.2	12.1	19.0	11.3	10.3	12.2	5.2
	Nigeria	71.1	83.2	55.9	30.6	41.8	41.8	40.8	45.0
	Sierra Leone	7.0	8.6	10.6	7.3	6.6	7.5	8.1	
	WAMZ	31.0	69.5	48.4	28.4	38.2	3.1	38.1	40.9
Real Interest > 0	The Gambia	-0.1	-5.0	-9.6	2.0	3.2	3.5	4.6	-0.4
	Ghana	-6.8	-2.2	-13.9	-2.3	-8.4	-4.1	-4.1	-3.6
	Guinea	7.1	1.3	-8.3	-19.2	-15.0	-20.8	-24.4	-3.6
	Nigeria	-13.1	-8.5	-20.6	-5.6	-8.3	-5.5	-5.3	1.0
	Sierra Leone	1.1	8.1	-5.8	-6.4	-4.0	-1.7	-0.5	-2.3
	WAMZ	-11.4	-7.9	-18.7	-7.2	-10.1	-7.1	-8.6	-3.4
Exchange Rate Stability (+=Dep.)	The Gambia	13.7	38.2	32.3	4.3	10.0	-0.3	10.4	-14.3
	Ghana	5.0	13.2	4.7	2.2	3.1	3.7	4.1	4.7
	Guinea	0.0	0.0	1.3	21.6	55.6	60.8	64.6	40.3
	Nigeria	3.0	10.6	7.7	-3.1	-3.0	-1.4	-0.3	-10.1
	Sierra Leone	23.2	2.2	16.4	10.4	12.6	16.2	13.8	14.2

Source: WAMZ authorities & WAMI staff.

6.3.7 Monetary arrangements of Arab Maghreb Union (UMA)

“
Despite the absence of formal targets, the economic performance of member States in the Union is very good”

The Arab Maghreb Union has not formally established a set of convergence criteria for its member States. However, it is currently making efforts to establish one. Among the issues being considered by AMU are:

- Harmonization of private rules and procedures, such as market conventions, self-regulations and contractual arrangements for producing, pricing, delivering and acquiring various payment instruments and services;
- Harmonization of laws and regulations governing the payment system, particularly inter-bank transfers within the community; and
- Harmonization of technical standards, network arrangements for transacting and clearing payment instruments, processing and communicating payment information, transferring funds between institutions, and payment instruments such as debit and credit cards as well as direct debit.

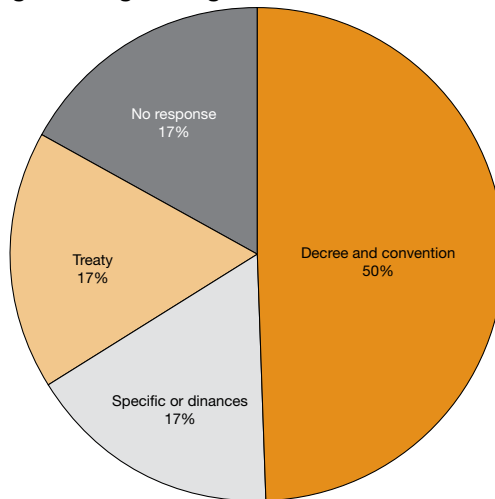
Despite the absence of formal targets, the economic performance of member States in the Union is very good. Inflation in the zone is very low and the growth performance is also very strong. The Union also attracts a great deal of foreign direct investments (FDIs) to support its manufacturing and oil-based industries.

6.4 Comparative analysis

This section attempts to summarize the discussion so far as well as to compare and contrast the performances of the regional economic communities (RECs) and the inter-governmental organizations (IGOs). The analysis presented in Section 3 shows that, out of the fourteen RECs and IGOs, only six have convergence criteria (COMESA, EAC, ECOWAS, SADC) or monetary unions (CEMAC and UEMOA), due perhaps to the historical past of the member States. Table 6.29 shows the countries that participated in monetary and financial integration arrangements during the colonial era.

Table 6.29**Countries involved in monetary and financial arrangements during the colonial era**

	Monetary and financial arrangements	Number and list of countries involved
CEMAC	Bank of Senegal	5– Central Africa Republic, Congo, Gabon, Chad, Cameroon, Equatorial Guinea
COMESA	East African Currency Board	5– Uganda, Kenya, Tanzania (Extended to Somaliland and part of Ethiopia at some stage)
EAC	East African Currency Board	5 – Uganda, Kenya, Tanzania (Extended to Somaliland and part of Ethiopia at some stage)
ECOWAS	Bank of Senegal	6– Senegal, Guinea, Côte d’Ivoire, Benin, Togo, Mali
SADC	Common Monetary Area	5– Botswana (initially until 1976), Lesotho, South Africa, Namibia and Swaziland
UEMOA	Bank of Senegal	7– Benin (former Dahomey), Burkina Faso (former Upper Volta), Côte d’Ivoire, Mali, Niger, Senegal, Togo

Figure 6.1**Legal instruments governing arrangements**

The legal arrangements supporting the participation by member countries in the arrangements during the colonial period ranged from treaties (SADC), decrees and conventions (CEMAC, ECOWAS and UEMOA) to specific ordinances (EAC) (Figure 6.1). During the colonial era, the main features of the arrangements ranged from currency boards based on the French franc or the pound sterling to free access to member States’ capital markets or convertibility of member States’ currencies (table 6.30). As noted in section 3, the monetary arrangements in the colonial era were purely to support the administration of the colonies and were not based on economics.

“During the colonial era, the main features of the arrangements ranged from currency boards based on the French franc or the pound sterling to free access to member States’ capital markets or convertibility of member States’ currencies”

“
Despite their desire
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of the RECs and
IGOs continued
the monetary
and financial
arrangements
immediately after
their independence”

Table 6.30

Main features of the monetary and financial arrangements

REC	Features of the arrangement
CEMAC	<ol style="list-style-type: none"> 1) The imperial decree, which authorizes the Bank of Senegal to handle transactions such as loans, discounts and issuing of currency in French Africa 2) The decree confers to the Bank of Senegal the privilege of issuing currency for the French territories of Western and Equatorial Africa
COMESA	<ol style="list-style-type: none"> 1) East African Currency Board- (a) 1 pound sterling = 20 East African shillings (shillings pegged to the pound (b) currency board operated as a central bank 2) The Monetary System of the Federation of Rhodesia and Nyasaland-(a) fixed one-to-one exchange rate with sterling (see COMESA document) 3) The Rand Monetary Area – monetary cooperation under a customs union agreement
EAC	<ol style="list-style-type: none"> 1) Currency board 2) 1 pound sterling = 20 East African shillings (shillings pegged to the pound; 2) Currency board operated as a central bank
ECOWAS	<ol style="list-style-type: none"> 1) Single currency for all colonies rather than a currency for each colony in each monetary arrangement 2) Monetary policy determined by the monetary authorities of the colonial governments 3) Currencies indexed to the currencies of colonial governments
SADC	<ol style="list-style-type: none"> 1) Liberalization of free movement of capital 2) The rand as interregional currency with legal circulation and tender among all member States; 3) Free access to South Africa capital market 4) Reserve Bank of South Africa managing the reserves of all member States
UEMOA	<ol style="list-style-type: none"> 1) France is the founder and spearhead of the franc zone 2) The Central Bank of West African States (BCEAO) issues CFA francs for member States 3) CFA franc pegged to French franc at a fixed rate 4) Convertibility of African currencies and transferability of capital within the zone 5) Central banks are grouped in the Franc Zone Monetary Committee.

Source: ECA

Despite their desire to dismantle most of the colonial arrangements, several of the member States of the RECs and IGOs continued the monetary and financial arrangements immediately after their independence. This decision was made in order to promote internal and external stability of the economies within the communities as well as to increase the flow of goods, services and capital, and to increase economic growth. Furthermore, the ultimate objective of these programmes and activities of monetary cooperation is to establish monetary unions (table 6.31).

Table 6.31**Main objectives of REC monetary cooperation**

REC	Main objectives of REC monetary cooperation
CEMAC	<ol style="list-style-type: none"> 1) To create the conditions for harmonious economic and social development 2) To create a single currency for all member States 3) Ensure internal and external stability of the common currency
COMESA	<ol style="list-style-type: none"> 1) Macroeconomic stability 2) Reduction of transaction costs 3) Free movement of persons
EAC	<ol style="list-style-type: none"> 1) Attainment of monetary union 2) Application of element of EAC Treaty that defines integration stages
ECOWAS	<ol style="list-style-type: none"> 1) Creation of a monetary union through the observance of a set of macroeconomic convergence criteria and implementation of a set of structural reforms all aimed at ensuring and sustaining macroeconomic stability of member States
SADC	<ol style="list-style-type: none"> 1) Attainment of macroeconomic convergence in the region 2) Harmonization of taxation policies and related matters 3) Harmonization of monetary policies 4) Convertibility of the regional currencies and elimination of exchange controls for the establishment of a single currency in the region 5) Establishment of SADC Monetary Union
UEMOA	<ol style="list-style-type: none"> 1) Manage monetary policy of member States; the policy is aimed at promoting economic growth 2) Strengthen the monetary union and economic integration of the Union's member States by increasing the competitiveness of their economies 3) Develop monetary discipline and solidarity 4) Promote commercial transactions and capital investments 5) Create macroeconomic stability

Source: ECA

In their bid to promote macroeconomic stability, the RECs and IGOs require their member States to satisfy macroeconomic convergence criteria. Member States accede to protocols or frameworks enshrined in MOUs to satisfy the strict convergence criteria. Most of the guidelines are consistent with those established by the Association of African Central Banks (table 6.32).

“ In their bid to promote macroeconomic stability, the RECs and IGOs require their member States to satisfy macroeconomic convergence criteria **”**

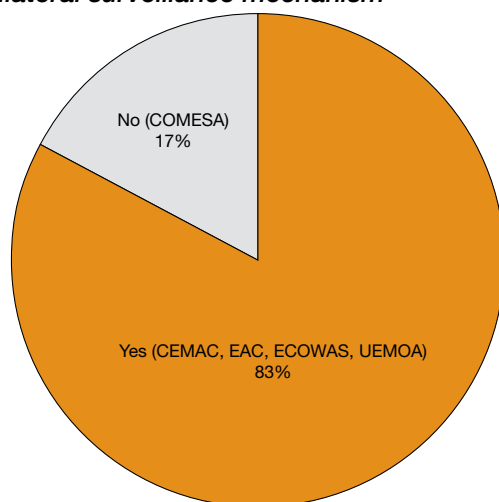
“
 The main features
 of the framework
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 the monetary
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 arrangement of the
 RECs and IGOs
 are convertibility of
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 currencies and
 harmonization of
 macroeconomic
 policies as well as
 the establishment
 of institutional
 organs”

Table 6.32
Current framework for macroeconomic policy convergence in RECs

REC	Current framework for macroeconomic policy convergence in RECs
COMESA	<ul style="list-style-type: none"> • Macroeconomic convergence criteria revised in 2005 to align with AACB (Association of African Central Banks) criteria
EAC	<ul style="list-style-type: none"> • Macroeconomic convergence criteria
ECOWAS	<ul style="list-style-type: none"> • Macroeconomic policy convergence in ECOWAS is within the framework of a multilateral surveillance mechanism based on compliance with ten macroeconomic convergence criteria
SADC	<ul style="list-style-type: none"> • Member States signed a MOU on macroeconomic convergence which became an annex to the Finance and Investment Protocol (FIP) • • There are also a number of MOUs on banking cooperation in SADC, including cooperation and coordination of exchange control, payment, clearing and settlement systems, cooperation in respect of SADC regulatory and supervisory matters, harmonization of legal and operational frameworks for SADC central banks. These also became annexes to the FIP
UEMOA	<ul style="list-style-type: none"> • Circulation of a common currency, CFA franc, issued and managed by a common central bank known as the Central Bank of West African (BCEAO) States • Convertibility of the CFA franc is guaranteed through the euro, to which it is anchored • To ensure convertibility between the CFA franc and the euro, the French Treasury maintains an operations account on behalf of the BCEAO

Source: ECA

The main features of the framework governing the monetary cooperation arrangement of the RECs and IGOs are convertibility of member countries’ currencies and harmonization of macroeconomic policies as well as the establishment of institutional organs. In the case of member countries of CEMAC and UEMOA, the established macroeconomic cooperation framework allows for the free circulation of capital and the use of common currencies (table 6.33).

Figure 6.2**Existence of multilateral surveillance mechanism****Table 6.33****Main features of monetary cooperation in RECs**

REC	Features
CEMAC	<ol style="list-style-type: none"> 1) Parity fixed with the French franc, the anchor currency, then with the euro since 1 January 1999 (1 euro= 655.957 FCFA) 2) Unlimited guarantee of convertibility of the FCFA into euro 3) Free movement of capital between the member countries of the franc zone 4) Pooling of the reserves of exchanges of member countries
COMESA	<ol style="list-style-type: none"> 1) Started in 1984 with creation of clearing house 2) Travel exchange (traveller's cheques) 3) Creation of PTA Bank 4) Ongoing work on new design of clearing house
EAC	<ol style="list-style-type: none"> 1) A set of macroeconomic convergence criteria 2) Each country to meet certain targets 3) The currencies of member countries are convertible
ECOWAS	<ol style="list-style-type: none"> 1) Adoption of a set of convergence criteria 2) Surveillance of convergence criteria 3) Establishment of four institutional organs for multilateral surveillance, namely the National Coordinating Committee, the Joint Secretariat of ECOWAS and WAMA, the Technical Monitoring Committee and the Convergence Council 4) Adoption of a two-way fast-track approach to monetary integration
SADC	<ol style="list-style-type: none"> 1) Harmonization of macroeconomic policies 2) Convergence toward targets: annual inflation rate, deficit/GDP, debt/GDP, current account/GDP

REC	Features
UEMOA	<ol style="list-style-type: none"> 1) Circulation of a common currency, CFA franc issued and managed by a common central bank known as the Central Bank of West African States (BCEAO) 2) Pooling of foreign exchange reserves 3) Unrestricted circulation of the common currency and freedom of capital movements within the territory of the member States 4) Harmonization of monetary and banking legislation 5) Free and unlimited convertibility of CFA franc into euro at a pegged parity guaranteed by France 6) Concentration of the Union's foreign currency-denominated assets in the operations account of the French Treasury 7) Application of a common regulation against third-party countries 8) The credibility and the international convertibility of the CFA franc are guaranteed through the euro, to which it is anchored 9) To ensure convertibility of between the CFA franc and the euro, the French Treasury maintains an operations account on behalf of the BCEAO

Source: ECA

To ensure that member States adhere to the macroeconomic convergence programmes and activities, most of the RECs and IGOs have put in place a multilateral surveillance mechanism (figure 6.2), to monitor coherence and convergence of the macroeconomic policies of member States (table 6.34).

Table 6.34
Multilateral surveillance mechanism objectives and features

REC	Objectives and features
CEMAC	<ul style="list-style-type: none"> • To ensure the convergence and coherence of the economic policies of member States • To verify the conformance of these economic policies with the common monetary policy
COMESA	<ul style="list-style-type: none"> • Bureau of central bank governors meets every year • Meeting is convened by COMESA and progress reports are submitted
EAC	<ul style="list-style-type: none"> • Yearly meeting of central bank governors - Presentations made by member countries; assessment of progress and recommendations for collective solutions to problems • Objective: To ensure compliance with the economic convergence criteria within the framework of a regional growth and convergence pact
ECOWAS	<ul style="list-style-type: none"> • Establishment of four institutional organs • Submission of a quarterly report on economic performance by member States • Formulation of multi-year convergence programmes • Production of half-yearly convergence reports for the REC • Maintenance of a statistical database
SADC	<ul style="list-style-type: none"> • According to the MOU on macroeconomic convergence, it is envisaged to establish a Macroeconomic Surveillance and Performance Unit within the Secretariat, and so far, an officer is attached to this Unit
UEMOA	<ul style="list-style-type: none"> • The Convergence, Stability, Growth and Solidarity Pact is a community instrument aimed at ensuring harmonized multilateral surveillance of macroeconomic policies in UEMOA. It is also aimed at strengthening the convergence of the economies of member States; supporting economic stability; accelerating growth; and deepening solidarity among member States

Source: ECA

The primary and secondary convergence criteria established by the RECs include agreed targets for macroeconomic variables such as budgetary balance, inflation and public debts. Although the principles are the same, there are some variations in the criteria from REC to REC (table 6.35).

Table 6.35
RECs macroeconomic convergence criteria

RECs	Primary criteria	Secondary criteria
CEMAC	<ul style="list-style-type: none"> - Budgetary balance must be non-negative - Annual inflation rate has to be less than 3 per cent - Rate of public debt has to be no more than 70 per cent - Non accumulation by the State of internal and external debt in the current period 	<ul style="list-style-type: none"> - Investment rate versus GDP - Ratio of payroll to total budgetary revenues - Current account on GDP
COMESA	<ol style="list-style-type: none"> 1) Ratio of fiscal deficit to GDP, excluding grants 2) Inflation rate 3) Reserve accumulation 	<ol style="list-style-type: none"> 1) Use of indirect monetary policy instruments 2) Interest rate policy 3) Achievement of market-determined exchanged rates 4) Growth 5) Savings 6) Investment 7) External current account, excluding grants 8) External debt
EAC	<p><i>(No differentiation between primary and secondary criteria)</i></p> <ol style="list-style-type: none"> 1) GDP growth rate: A high and sustainable rate of growth of real GDP, with 7 per cent as the minimal annual target by the year 2000 2) Inflation: Maintenance of low and stable underlying inflation to single-digit rates of less than 5 per cent by the year 2000 3) Current account deficit (excluding grants)/GDP: reduction of the current account as a percentage of GDP to sustainable levels 4) Budget deficit (excluding grants) /GDP: Reduction of budget deficit to less than 5 per cent by the year 2000 5) National savings/GDP: raising national savings-to-GDP ratio to at least 20 per cent in the medium term 6) Gross foreign exchange reserves in months of import of goods and services: Build gross foreign reserves to a level equivalent to six months of imports in the medium term 7) Maintenance of low and stable market-determined exchange rates 8) Maintenance of low market-determined interest rates 9) Pursuit of debt reduction initiatives to reduce both domestic and foreign debt, including statutory borrowing limits 10) Maintenance of prudential norms of banking regulation, effective supervision, improved corporate governance and transparency of all financial transactions 	

“The primary and secondary convergence criteria established by the RECs include agreed targets for macroeconomic variables such as budgetary balance, inflation and public debts”

“
The RECs and the IGOs have set up statutory organs with responsibility for carrying out and monitoring the macroeconomic convergence activities in the RECs
 ”

RECs	Primary criteria	Secondary criteria
ECOWAS	1) Inflation rate = 5 per cent 2) Ratio of budget deficit (excluding grants) to GDP (commitment basis) 4 per cent 3) Ceiling on central bank financing of budget deficit to 10 per cent of previous year's tax revenue 4) Gross reserves not less than 6 months of imports	. Prohibition of all domestic arrears and liquidation of all existing arrears . Tax revenue/GDP ratio ≥ 20 per cent . Salary mass/tax revenue ≤ 35 per cent . Capital expenditure/tax revenue ≥ 20 per cent . Real exchange rate stability . Positive real interest rate
SADC	. Inflation . Budget Deficit/GDP . Debt/GDP . Current Account/GDP	. Economic growth . External reserves/imports . Central bank credits/government . Domestic investment/GDP . Domestic savings/GDP
UEMOA	1) Budget deficit/GDP ≥ 0 per cent 2) Average annual inflation rate maintained at a maximum of 3.0 per cent per year 3) Ceiling on total public debt/GDP ≤ 0.0 per cent 4) Non-accumulation of internal and external arrears	1) Wage bill /tax revenue ≤ 35.0 per cent; 2) Public investment /tax revenue ≥ 20.0 per cent 3) Tax revenue/ GDP ≥ 17.0 per cent 4) Current account deficit/GDP ≤ 5.0 per cent

Source: ECA

The RECs and the IGOs have set up statutory organs with responsibility for carrying out and monitoring the macroeconomic convergence activities in the RECs. These organs include councils of ministers, RECs commissions/secretariats, convergence councils/secretariats, central banks, regional development banks and national committees. The number of times the organs met and their functions are summarized in tables 36 and 37.

Table 6.36

Roles and functions of the statutory organs in charge of carrying out and monitoring the macroeconomic convergence activities within the REC - part one (number of meetings in parenthesis)

RECs	Council of Ministers	Commission/ Secretariat	Convergence Council/ Secretariat
CEMAC	(2) The Council of Ministers formulates broad orientations for economic policy of the Union	The Commission / Secretariat prepares the documents The community organ prepares the work of the Convergence Council/Secretariat.	(2) The Convergence Council/Secretariat oversees the proper functioning of the community and national organs.
COMESA	(2) See COMESA Treaty.	See COMESA Treaty.	
EAC	The Council of Ministers meets at least twice a year	(Regularly) The Commission organizes meetings of the Council of Ministers and central banks	
ECOWAS		(2) The Commission / Secretariat is a joint secretariat of WAMA and ECOWAS. It ensures the compatibility of all the multilateral convergence programmes formulated by member States.	(2) Convergence Council: Comprises Ministers of Finance and governors of central banks of member countries. It monitors macroeconomic policies and performance.
SADC	(2) Council of Ministers: see SADC Treaty.		
UEMOA	(2)		

Source: ECA

Table 6.37

Roles and functions of the statutory organs in charge of carrying out and monitoring the macroeconomic convergence activities within the REC - part two (number of meetings in parenthesis)

	Central bank	Regional development bank	National committee	Other organs
CEMAC			The National Committee collects and ensures coherence of national statistical data, prepares and analyses information relative to each of the member countries.	(2) The community cell.
COMESA	(Frequently) See COMESA Treaty.			
EAC	(2) Central bank – assesses progress in convergence criteria, discusses problems and recommends collective measures.			
ECOWAS			(4) National Coordinating Committee: exists in every member State. It submits quarterly economic reports to the Joint Secretariat, and manages the database of country economic data.	(2) Technical Monitoring Committee: it comprises the Directors of Research of the central banks and senior Ministry of Finance officials. The committee examines the six-monthly reports on multilateral surveillance submitted by the Joint Secretariat before sending them to the Convergence Council.
SADC	(2) Central bank: See MOU on banking, legal operations and framework.		(12) National Committee: NR.	(2) Committee of Ministers of Finance and Investment: See MOU on macro; (at least twice) Senior Treasury officers and Macroeconomic Sub-committee/Secretariat: See MOU on Macro.
UEMOA				(1) The Conference of Heads of State and Government defines the broad orientations of UEMOA policies and when necessary adopts additional Acts for the Treaty; the UEMOA Commission is the operations centre for multilateral surveillance. As such, it is responsible for managing the database of surveillance measures; establishing a quarterly report on the international environment and submitting it to BCEAO and BOAD; (4) National Economic Policy Committees: assist the commission in collecting data and in preparing and analysing country-specific information.

The organs take their job very seriously, meeting at least once a year and in some cases once every month to review the programmes and activities of the member States. Attendance by member States at the mandatory meetings is very high (Figure 6.3).

Despite the challenges, the organs have been able to promote monetary cooperation and discipline within the RECs by setting up regional payment systems and clearing houses within the communities. Table 6.38 summarizes some of the main achievements.

“ Despite the challenges, the organs have been able to promote monetary cooperation and discipline within the RECs by setting up regional payment systems and clearing houses within the communities ”

Figure 6.3
Level of attendance at mandatory meetings

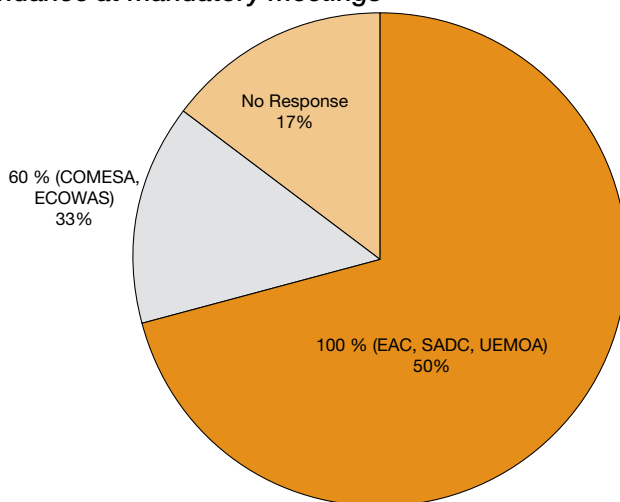


Table 6.38
Main achievements of organs in promoting monetary cooperation and discipline within the RECs

RECs	Main achievements
COMESA	1) Enhanced cooperation on monetary issues 2) Regional payment system almost operational 3) African trade insurance agency operational 4) PTA Bank, Clearing House, traveller's cheques created 5) Ongoing work for creation of COMESA Fund
EAC	NA - EAC has not reached the stage of monetary integration
ECOWAS	1) Promotion of macroeconomic discipline in member States 2) Promotion of the idea of original cooperation and monetary integration 3) Ensuring the incorporation of regional policies and programmes into national development strategies 4) Soliciting donor support to finance the monetary integration process
SADC	1) Approval of the Finance and Investment Protocol 2) Implementation plans of the relevant annexes 3) National macroeconomic convergence programmes
UEMOA	Organs are quite active, member States are seriously adhering to monetary policy

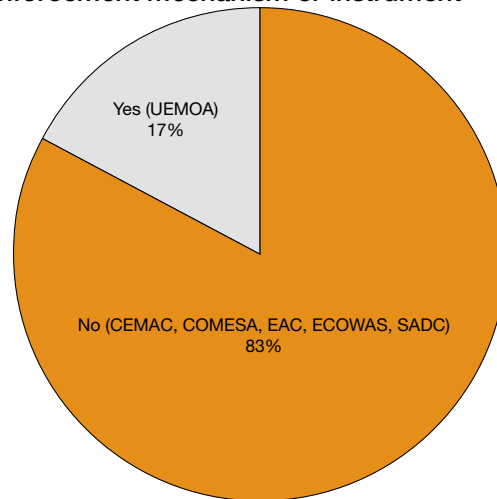
Source: ECA



The analysis carried out so far suggests that there is no mechanism designed by the RECs and IGOs for imposing sanctions on member countries that fail to meet the convergence criteria



Figure 6.4
Existence of an enforcement mechanism or instrument



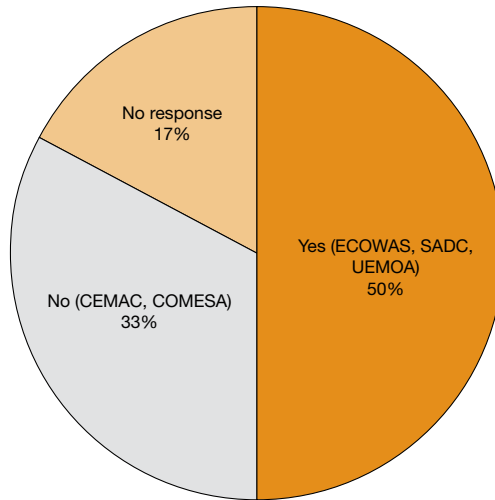
Although all the member States of the RECs have committed to macroeconomic stability, most the RECs do not have legal enforcement mechanisms that ensure compliance with the objectives of the macroeconomic convergence by member States (Figure 6.4). However, in UEMOA, during ordinary sessions, the Council of Ministers reviews the programmes and activities of the member States to see if the programmes conform to community objectives. The Chairperson of the Council then notifies non-performing member States, which are then required to revise their programmes. The decisions of the Council of Ministers are published in the official bulletin of UEMOA and the relevant countries are notified accordingly.

The analysis carried out so far suggests that there is no mechanism designed by the RECs and IGOs for imposing sanctions on member countries that fail to meet the convergence criteria. However, in the CEMAC area, the Council of Ministers publishes a *communiqué* on the performance of member States and announces publicly the withdrawal of support for non-performing member States.

Like CEMAC, UEMOA also imposes sanctions by publishing a *communiqué* of the Council of Ministers on the performance of the member States. The *communiqué* also stipulates measures that non-performing member countries should follow, with the Community withdrawing support to the countries that fail to comply.

Although UEMOA and CEMAC have these sanctions enshrined in their protocols, the sanctions are yet to be implemented. However, the RECs have indicated a desire to strengthen the surveillance mechanism as well as the capacity to impose strong sanctions on member States that fail to adhere to the criteria (figure 6.5).

Figure 6.5
Strengthening of RECs' surveillance



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 Despite the modest achievements, the RECs and the IGOs face significant challenges, although they are taking measures to address them
 ”

Despite the modest achievements, the RECs and the IGOs face significant challenges, although they are taking measures to address them, as shown in table 6.39. These measures include capacity-building, technical assistance to member countries, harmonization of statistics, and the organization of seminars and workshops to sensitize member States.

Table 6.39
Constraints in implementing the arrangements and measures taken to address them

RECs	Constraints	Measures
CEMAC	Elaboration of the three-year programme on convergence	Organization of sensitizing seminars
COMESA	1) Structural problems of member countries 2) Countries at different levels of development 3) Financial systems of countries at different levels of development 4) Statistical methods not standardized 5) Countries faced with external shocks	1) Harmonization of statistics (part of COMESA work programme for next year) 2) Sub-committee on financial system development created
EAC	1) Fiscal deficit is a major constraint 2) Dependence on grants for budgets	1) Capacity-building of customs revenue authorities 2) Improving efficiency of tax collectors
ECOWAS	ECOWAS does not implement these arrangements but makes it the responsibility of member States to implement them. Some of these constraints have varied depending on the programmes, including inadequate technical and financial capacity, inadequate implementation of ECOWAS protocols and conventions as a result of the absence of the proper legal framework, and the lack of political will.	Giving the REC supranational authority

“
The rationale for imposing macroeconomic convergence criteria on all member States of a REC is to avoid the distortionary negative economic effects that may arise from member States pursuing variant and inconsistent policies
 ”

RECs	Constraints	Measures
SADC	The process has just started and a number of member States are facing serious technical capacity problems to deal with the issues and adequately implement the programmes.	The Secretariat has embarked on a process to provide member States with technical assistance in developing their macroeconomic convergence programmes, as is the case for Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mozambique, Namibia and Zambia.
UEMOA	<ol style="list-style-type: none"> 1) Availability and transmission of data 2) Quality of information 3) Issue of permanent political impetus. 4) Lack of medium-term objectives with respect to convergence 5) Inefficiency of the sanctions mechanism 6) Lack of harmonization of procedures for elaboration of data for national accounts and public finances 	Not applicable

Source: ECA

6.5 Conclusion

In this chapter, we have taken a critical look at monetary cooperation and the performance of selected regional economic communities on macroeconomic convergence criteria. It was argued in the chapter that regional economic communities generally impose macroeconomic convergence criteria to guide the economic policies of member States. Member States are required to adopt sound macroeconomic policies and to commit to low inflation and prudent fiscal policies. The rationale for imposing macroeconomic convergence criteria on all member States of a REC is to avoid the distortionary negative economic effects that may arise from member States pursuing variant and inconsistent policies.

This is why the criteria force member States to implement policies that lead to convergence of key macroeconomic variables such as inflation, the budget deficit and the stock of public debt. In order to guarantee monetary stability, member States would have to undertake tough anti-inflationary policies and bear the associated output loss. Limits on budget and debt requirements ensure that member States adjust their fiscal policies in order to maintain an overall balance between spending and revenues from taxation and ensure fiscal prudence.

This analysis shows that African countries are experiencing enormous difficulties in meeting the desired macroeconomic convergence criteria set by the regional economic communities. Whereas some member States, particularly those that belong to monetary unions (CEMAC and UEMOA), have done well in maintaining relatively

low single-digit inflation, most countries are posting double-digit inflation and consequently struggling to achieve their desired inflation targets. By the same token, most of the countries have not been able to achieve the desired fiscal targets, due in part to negative external shocks, large budget deficits, lack of reliable statistics and poor growth performance (table 6.40).

Table 6.40
Reasons invoked for good/poor performance

REC	Good performance	Poor performance
EAC	Criteria are in line with IMF conditionalities	Budget deficit
ECOWAS	Preponderance of fiscal dominance in economic management in the region	Negative effects of external shocks, especially escalating global oil prices and falling world market prices for agricultural exports of member States
SADC	Almost all member States are under IMF and World Bank programmes	Lack of reliable statistical information
UEMOA		<p>Only one country respected the four criteria in 2005, due to</p> <ul style="list-style-type: none"> -Unfavourable revenue trends -Weak revenue due to corruption -Ivorian crisis -Three countries with socio-political crises -Weak growth in general -Slow structural reforms -Insufficient public information -Lack of/insufficient internalization of integration

Source: ECA

This raises the issue of the relevance of the convergence criteria. Macroeconomic convergence mechanisms are needed because the success of regional integration also hinges on member countries pursuing convergent macroeconomic policies. Misalignments of tariffs, inflation, exchange rates, debt-to-GDP ratios, rate of money growth and other vital macroeconomic variables between member countries would be disruptive to the regional integration process. In addition, these misalignments could lead to rent-seeking activities by governments and private individuals that could stifle legitimate investment opportunities.

This could contribute to the demise of the economy of a member country, thereby weakening the whole integration process. It is therefore imperative that the process of strengthening regional integration should include guidelines for the convergence of macroeconomic and trade policies of the entire regional space so as to strengthen the overall regional integration agenda.

Misalignments of tariffs, inflation, exchange rates, debt-to-GDP ratios, rate of money growth and other vital macroeconomic variables between member countries would be disruptive to the regional integration process

However, for the coordination of macroeconomic policies in the RECs to succeed, African countries should have a clear sense of their own development objectives and strategies and be fully committed to these goals. Member States should muster the political will to mainstream regional monetary and macroeconomic objectives into their national development strategies.

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*Member States
should muster
the political will
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