South Africa's experience of regional currency areas and the use of foreign currencies

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1. Introduction

This paper focuses almost exclusively on South Africa's current and potential experience of regional currency areas in the Common Monetary Area (CMA) and the Southern African Development Community (SADC). There is no evidence that foreign currency is being used in any meaningful way inside South Africa. Thus no official and very little unofficial dollarisation has taken place in South Africa notwithstanding significant exchange control liberalisation in recent years. On the contrary, the South African rand is used extensively as legal tender in other countries comprising the CMA while anecdotal evidence points to the rand being accepted as payment in some other countries in SADC. However, no statistics are available to corroborate the extent to which the rand is used outside the CMA.

There are various regional integration initiatives involving the southern African region, each with its own programme of action. South Africa is not directly involved in all these initiatives. South Africa, for instance, is not a member of the Common Market for Eastern and Southern Africa or the Cross-border Initiative. However, as their objectives are focused on regional economic integration, they overlap with the objectives of regional initiatives to which South Africa actively subscribes, such as the recent decision by African heads of state on the creation of an African Union and a common monetary bloc as well as the Southern African Customs Union.

Of most relevance to this paper, however, is South Africa's membership of the CMA with Lesotho, Swaziland and Namibia. Some attention is also given to SADC. The Declaration and Treaty establishing the SADC in 1992 does not specifically refer to a regional currency area. Nonetheless, monetary integration may be one way in which economic integration could be furthered. This could culminate in the creation of a regional monetary union. While monetary integration in SADC may be regarded as a long-run objective, for reasons that will be explained, the importance of this initiative merits some attention.

2. The Common Monetary Area

Background

The present close monetary cooperation between South Africa, Lesotho, Namibia and Swaziland is based on the Multilateral Monetary Agreement (MMA) creating a common monetary area between these countries. This agreement has had a long historical development which started even before the Union of South Africa was formed in 1910. After the establishment of the South African Reserve Bank (SARB) in 1921, the South African pound became the sole circulating medium and legal tender in the geographical area that is today called the CMA, but including Bechuanaland (Botswana).

The advantages for the countries involved in this informal arrangement included stability of exchange rates, which helped to foster the high level of trade in the area. There were, however, significant drawbacks such as the lack of monetary policy discretion for the smaller countries and no formal

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framework for consultation. The other member countries also did not share with South Africa in the seigniorage involved.

After protracted negotiations, a formal monetary agreement was signed in December 1974 between South Africa, Swaziland and Lesotho, known as the Rand Monetary Area agreement, and the rand remained legal tender in all these countries. At that time, Botswana decided not to join the formalised arrangements, opting instead to pursue an independent monetary stance with its own national currency and central bank. The Common Monetary Area (CMA) replaced the Rand Monetary Area in July 1986 under the terms of a Trilateral Monetary Area Agreement between the three countries accommodating changes in the position of Swaziland. This trilateral agreement was replaced by the present MMA in February 1992, when Namibia formally joined the CMA, of which it had been a de facto member from the beginning.

The objectives of the Multilateral Monetary Agreement

Besides describing the monetary arrangements in the CMA, the main objectives of the MMA can be summarised as the sustained economic development of the CMA with special emphasis on the advancement of the less developed member states and the acquisition of equitable benefits for all members. It is particularly interesting to note that the MMA recognises that each of the contracting parties is responsible for its own monetary policy and the control of its financial institutions.

The salient features of the Common Monetary Area

Some of the major features of the CMA are the following:

- All four member countries have their own central banks and are responsible for monetary policy. While some deviations in interest rates and inflation rates are possible, however, the SARB effectively formulates monetary policy for the CMA. The other members consequently also indirectly adhere to an inflation targeting monetary policy framework owing to South Africa's adoption of inflation targeting in 2000.
- The monetary arrangements explicitly provide for consultation. The contracting parties hold regular consultations to facilitate and ensure continued compliance with the MMA and reconcile different interests in the formulation and implementation of monetary and foreign exchange policies for the CMA. For this purpose, and any matter arising from the MMA, a Common Monetary Area Commission was established consisting of a representative and some advisers from each member country. Prior to meetings of the SARB's Monetary Policy Committee, senior research officials from the four countries meet to exchange economic information.
- There are no restrictions on the transfer of funds, whether for current or for capital purposes, between the areas of the contracting parties. The free movement of capital within the CMA is potentially one of the major benefits that the smaller states can derive from membership. It means that there is no restriction on cross-border investments from South Africa and so contributes to economic development and economic integration.
- All four members of the CMA (as well as Botswana) belong to the Southern African Customs Union. As a consequence, capital and goods are highly mobile across the CMA region. This is less true for labour mobility, as normal immigration procedures and requirements are in place among the CMA members.
- As Lesotho, Namibia and Swaziland depend heavily on trade with South Africa, a major benefit from the CMA arrangements is the fixed and predictable exchange rate with the rand.
- The South African rand serves as legal tender that is widely used and accepted in the participating countries. Under the terms of the MMA, the other member states are entitled to issue their own national currency and all three countries have made use of this provision. These currencies serve as legal tender only in the issuing country.
- The currencies of these countries have been pegged to the South African rand at par since their introduction and their banknotes are freely convertible into rand but are not legal tender in South Africa. Swaziland cancelled the legal requirement of a 1:1 linkage between the rand and the lilangeni in 1986. In practice, this link has, however, been maintained. Since 1986, the rand has also not been de jure legal tender in Swaziland.

- Although Namibia and Lesotho issue their own currencies, these issues have to be fully backed by prescribed rand assets. This is currently not true for Swaziland.
- Under the MMA, the government of South Africa must make compensatory payments to the other contracting parties. These payments represent an imputed return on the rand currency estimated to be circulating as legal tender in their areas. As Swaziland suspended the use of rand as legal tender in 1986, it has since not been entitled to any payment under this arrangement. Thus in accordance with the objectives of the MMA, Namibia and Lesotho also share in seigniorage to the extent that the rand is used as legal tender in their territories.
- As is evident from the features discussed above, the MMA is characterised by flexibility to accommodate the changing needs of the contracting parties. Various bilateral agreements have been entered into over time, mostly between South Africa and one of the other member states, to provide for greater autonomy for the other countries within the framework of continued monetary cooperation in the region. The coexistence of bilateral and multilateral arrangements is an important aspect of the CMA.
- Owing to the parity maintained against the rand by currencies of other contracting parties, all countries in the CMA have the same exchange rate against outside currencies. The small CMA members, with the exception of Swaziland, do not have the option of changing their exchange rates to attain or maintain external competitiveness.
- The contracting parties to a large extent share a common pool of foreign exchange reserves under the control of the SARB and, to an increasing extent, under the control of the South African authorised dealers in foreign exchange (banks). The central banks and authorised dealers in foreign exchange in the member countries have access to the foreign exchange market in South Africa. Under the MMA, the SARB will on request make the required foreign exchange available.
- The system of exchange control in force in South Africa, as amended from time to time, is in all material aspects substantially in agreement with measures applied by the other three member states relative to non-CMA countries. The contracting parties are obliged to enter into consultation on related matters, particularly where control provisions of another contracting party are evaded.
- Institutions in the public and private sector in Lesotho, Namibia and Swaziland, subject to relevant financial laws and policies applicable to counterparts in South Africa, have the right of access to the South African capital and money markets.
- The member countries will permit, through normal clearing systems, the repatriation of notes and coin issued by them which may circulate in another CMA country.
- A feature of the CMA, which is obviously not encapsulated in the MMA, is that the economies of Namibia, Lesotho and Swaziland are small in comparison to that of South Africa. These three countries combined produce less than 4% of the total GDP of the CMA region. At the same time, their financial systems lack the high level of sophistication of the South African financial system.
- The data in Table 1 indicate considerable macroeconomic convergence among the four members of the CMA. In the case of inflation, some of the differences that do occur can be explained by different weights in the indices used.

Some issues relevant to the Common Monetary Area

From the preceding summary of the history and salient features of the CMA, a few important issues can be discerned:

- The CMA arrangements have developed over many years and the MMA is a formalisation of a de facto situation. As has been explained, the monetary arrangements have been flexible enough to allow one member, Swaziland, to change its relationship with the CMA. It should in principle be possible for Swaziland to fully participate again, should it so wish. For a new country without the shared history, however, to join the CMA would be a more complicated process.

- The CMA is to a large extent dominated by South Africa owing to the size of its economy and its sophisticated financial system. Nonetheless, the national sovereignty of the other member states has been respected by their having their own central banks and currencies. Should the CMA be expanded, however, by allowing other countries to join, it remains to be seen whether the extensive consultation inherent in the CMA arrangements will remain adequate. Any new member country might want to have a more direct input into monetary policy for the region.
- While the smaller member states derive significant benefits from the current arrangements, it should be acknowledged that the South African rand has been very volatile in the international currency markets for a number of years. The smaller member states have automatically been exposed to this volatility, although a large proportion of their foreign trade is with South Africa and is therefore isolated from such volatility.

Table 1

Statistics on SADC countries (2001)

	Real GDP[1]	Inflation[2]	Bank rate[3]	Government budget balance[4]	Monetary growth[5]	Current account balance[6]
Angola	5.2	116.1	150.0	–6.7[7]	159.0	–571
Botswana	9.6	6.6	14.3	8.8	22.4	440
Dem Rep of Congo[8]	–4.4	135.1	120.0[7]			–205
Lesotho	3.3[7]	6.9	15.0[7]	–2.2	14.0	–57
Malawi	1.8	27.5	46.8	–4.9[9]		–257[7]
Mauritius	6.3	5.4	10.5	–6.5[7]		–46[7]
Mozambique	1.5[7]	21.9	9.9	–1.1[9]	29.7	–586
Namibia	3.3[7]	9.3[7]	9.3	–5.3		50
Seychelles	2.9[9]	6.0	5.5	–9.9[7]		–52[7]
South Africa	2.2	5.7	9.5	–1.1	16.7	–196
Swaziland	2.2[7]	7.5	9.5	–1.5		45[7]
Tanzania	5.6	5.1	8.7	–0.1[9]	17.7	–414
Zambia	3.5[7]	25.9[7]	44.0[7]	–2.4[7]	67.5[7]	–578[7]
Zimbabwe	–6.8[7]	71.9	57.2	–21.8[7]		–201

[1] Annual percentage change. [2] Annual percentage change in CPI. [3] End-year. [4] As a percentage to GDP. [5] Annual percentage change in M3. [6] In millions of US dollars. [7] 2000. [8] Formerly Zaire. [9] 1999.

3. The Southern African Development Community

General overview

As was mentioned at the outset, creating a regional currency is not one of the immediate objectives of the SADC. Over time, however, it is to be expected that more attention will be given to the possibility of pursuing monetary integration. This will have implications for the CMA arrangements and consequently some discussion of the SADC seems warranted.

The SADC was founded in August 1992 as a successor to the former Southern African Development Co-ordination Conference that had been established in April 1980 to enhance coordination of development programmes and projects of member states with a view to reducing their economic dependence on South Africa. The SADC aims to achieve development and economic growth through regional economic integration. This objective is to be achieved by harmonising and coordinating the economic policies of member states and by creating appropriate regional institutions.

South Africa joined the SADC in 1994, and the following countries are currently members: Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

Each member state accepts responsibility for the management and development of a specific economic sector. The Heads of State of the SADC countries are the main policy decision-making body. In addition, a Council of Ministers meets regularly to review progress.

In 1995, a separate Finance and Investment Sector was created and allocated to South Africa. The Committee of Central Bank Governors in the SADC was also established in 1995. It reports to the Sectoral Committee of Ministers of Finance and deals with the development of well managed financial institutions and markets, cooperation regarding international and regional financial relations, and monetary, investment and foreign exchange policies.

Objectives such as promoting regional macroeconomic stability and prudent fiscal and monetary policies are important to the financial sector. The Committee of Central Bank Governors has adopted its own terms of reference and developed a number of initiatives and work programmes to be pursued. It was accepted from the outset that sound financial structures and markets were to be developed in each of the member states before the more challenging issues of macroeconomic development or financial integration could be addressed. Some of the projects and initiatives identified by the committee to pursue its objectives are:

- a statistical database containing comparable economic and financial statistics;
- a databank including detailed information on structures, polices and markets;
- solving possible problems relevant to the repatriation of banknotes and coins among SADC countries;
- development of national payment, clearing and settlement systems in SADC countries;
- monitoring of the required process of removing remaining exchange controls in SADC;
- coordination of training of central bank officials;
- implementation of compatible information technology systems;
- pursuing comparability in legal and operation frameworks of SADC central banks;
- harmonising of banking supervisory practices;
- closer cooperation between stock exchanges in the region;
- striving for uniformity of banking legislation and practices with the help of the SADC Banking Association; and
- a research study on the development of money markets in the SADC.

Some issues relevant to the SADC

Against the background of this rather brief overview, a few issues relevant to the SADC and relating to the topic of this volume stand out:

- The data in Table 1 provide clear evidence that macroeconomic convergence in the SADC still has a long way to go. Reference to just one indicator of stability, inflation, should suffice to show that the prospects of a regional currency area encompassing all countries in the SADC in the next few years are remote. Notwithstanding serious efforts on various fronts by the member states, much macroeconomic convergence needs to occur before monetary cooperation for the region can progress significantly.
- The economy of the SADC region is also characterised by the preponderance of South Africa. It should be mentioned, however, that while South Africa is responsible for some 65% of the GDP of SADC, Botswana, Mauritius and the Seychelles have a higher GDP per capita.

- In comparison to the other members of the SADC, South Africa has a highly developed financial system.

4. Conclusion

While stronger monetary cooperation within the SADC will be a slow process, this integration initiative will eventually create a major challenge for the CMA. It remains to be seen whether the CMA has a pivotal role to play in the larger SADC initiative. Monetary cooperation in the SADC could eventually entail an entirely different framework or it could come about by extension of the CMA arrangements to include more SADC countries as and when they are willing and able to join.

Expanding the membership of the CMA would be more complicated than in the past, because new members would not share the history of the South African currency being legal tender. The CMA arrangements have, however, in the past proved to be very flexible and this could be a big advantage.