Mr. Stals examines the role of financial cooperation in the development of the Southern African Development Community Lecture by the Governor of the South African Reserve Bank, Dr. C. Stals, presented to the Harvard Institute for International Development in Boston on 1/5/97.

1. Background to the formation of SADC

The Southern African Development Community found its origin in 1980 when nine[1] countries in Southern Africa decided jointly "to pursue policies aimed at economic liberation and integrated development of our national economies". One of the main objectives of the association at that stage was to make the economies of these countries less dependent on South Africa -- a country that was then an unwanted ally because of its unacceptable internal political and social policies.

After major political and social reforms in South Africa led to the fully democratic election of a Government of National Unity in April 1994, South Africa also joined SADC, to become the eleventh member, after a newly-independent Namibia already joined in 1990. Mauritius was the next country to join SADC, which now has twelve members with a total population of about 136 million people.

In August 1992, a revised Treaty for SADC was approved by a Summit Meeting of the Heads of State of the participating countries. Included in the main objectives of the Community are the following economic goals:

To achieve development and economic growth, alleviate poverty, enhance the standard and quality of life of the peoples of Southern Africa, and support the socially disadvantaged through regional integration; To promote and maximise productive employment and utilisation of resources of the region, and to achieve sustainable utilisation of natural resources and effective protection of the environment.

To achieve its objectives, SADC shall

- Harmonise political and socio-economic policies and plans of member States.
- Mobilise the peoples of the region and their institutions to take initiatives to develop economic, social and cultural ties across the region, and to participate fully in the implementation of the programmes and operations of SADC and its institutions.
- Develop policies aimed at the progressive elimination of obstacles to free movement of capital and labour, goods and services, and of the peoples of the region generally among member States.
- Promote the development of human resources.
- Promote the development, transfer and mastery of technology.
- Improve economic management and performance through regional co-operation.

The Treaty provides for other political, social and cultural objectives which are not of direct relevance for the enhancing of financial co-operation in the region.

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1 Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe.

2. South Africa’s position within SADC

The South African economy is by far the most advanced in the region. Although the total South African population of 42 million people accounts for but 31 per cent of the total population of all SADC countries together, the South African economy contributes about 80 per cent of the total gross domestic product of about $170 billion produced in the twelve member states. South Africa also accounts for almost 70 per cent of the combined total exports of $43 billion of the SADC region.

South Africa’s dominance is even more pronounced in the financial markets. South Africa is about the only country in the region with well-functioning and independent specialised financial institutions such as banks, long- and short-term insurers, private sector pension funds, mutual funds, participation mortgage bond schemes and mining and industrial finance houses. With a total market capitalisation of about $280 billion, the Johannesburg Stock Exchange dominates the capital markets of the region, and with a daily turnover of about $7 billion, the foreign exchange market in Johannesburg is providing an increasing service for international settlements for a number of other countries of the region. With a turnover of more than $700 billion last year in the South African bond market and a growing market for derivatives, South Africa is in a favourable position to provide sophisticated financial services for the whole SADC region.

This dominating position of the South African economy has certain advantages, but at the same time makes harmonious regional co-operation more complex. Some of the other partners in SADC hold an understandable fear that their economic independence will be jeopardised by a too aggressive policy of economic integration of the region.

The role that South Africa plays within SADC must therefore be approached with tact and ingenuity. South Africa was given the responsibility for managing and developing the Finance and Investment Protocol[2]. For this purpose, there is a Council of Ministers of Finance that meet from time to time under the chairmanship of the South African Minister of Finance to give guidance to a programme for closer financial co-operation amongst the participating countries in SADC. Two sub-committees were also established, one a Committee of Treasury Officials, and the other a Committee of Governors of Central Banks and their officials, with clearly defined terms of reference for each one of these Committees.

3. The work and functions of the Committee of Governors of Central Banks

When South Africa was given the special task of administering the Finance and Investment Protocol for SADC, the South African Reserve Bank saw in this arrangement a great opportunity for closer co-operation amongst the central banks of the region. In the beginning, however, it proved a major task to get recognition from the political leaders for the need of an independent Committee of Governors of Central Banks. In many of the participating countries the central bank is regarded, and often unfortunately also used, as just an extension of the Treasury Department of the central government. In succeeding to get the approval for the establishment of this Committee of Governors an important seed was sown in each one of these

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[2] There are a number of other Protocols, co-ordinated by other countries, for example: Inland Fisheries (Malawi), Marine Fisheries and Resources (Namibia), Livestock Production and Animal Disease Control (Botswana), Environment and Land Management (Lesotho), Energy (Angola), Mining and Labour and Employment (Zambia), Tourism (Mauritius), Industry and Trade (Tanzania), Food, Agriculture and Natural Resources (Zimbabwe), Human Resource Development (Swaziland), and Culture and Information as well as Transport and Communication (Mozambique).

countries for the acceptance of the undeniable advantages, also for the politicians, of an independent central bank.

A second major obstacle was overcome when approval was granted for the establishment of a small specialised Secretariat and Research Facility within the South African Reserve Bank to serve the Committee of Governors. This avoided the need for adhering to the cumbersome procedure of communicating within the central banking fraternity through the conduit of the SADC Secretariat, based in Gaborone, the capital of Botswana.

The SADC Finance and Investment Sector was formally established only in 1995, and the Committee of Governors held its first meeting on 24 November 1995 in Pretoria. Now, eighteen months later, this Committee can already look back on a number of accomplishments, and can report good progress with a number of projects being pursued in the interest of promoting economic development in the Southern African region. A number of Technical Subcommittees and Working Groups have been formed, consisting mainly of officials of the SADC central banks, to work on specialised projects.

4. The basic philosophy behind financial co-operation in the region

Before the Governors' Committee was established, SADC approached financial co-operation in the region on the basis of proposals made by European advisers, and was based mainly on the model of financial integration in the European Community. The folly of this approach was immediately grasped by the Governors at their first meeting. The divergencies in the stage of economic development of the members of SADC are so vast that there can be no talk at this juncture of a European type of economic integration in Southern Africa. The Governors' Committee therefore had to design its own model for sensible financial co-operation in the region. In drafting its own mission statement, the Committee designed a model for financial co-operation that was described as a "bottom-up" approach. This approach is based on building financial co-operation by laying an appropriate foundation in the form of an effective institutional framework for the financial system in each country. More grandiose schemes for the harmonisation or integration of macroeconomic monetary polices can be considered once central banks, private banking sectors and financial markets have been established and are functioning effectively in most of the participating countries.

A second challenge that had to be faced was the diverse roles and functions assigned by their Governments to the various central banks in the region. In finding an answer to the question of what contribution central banks can make towards the achievement of the goals of SADC, a consensus had to be found on what the task of the central banks should be in promoting optimum economic development and growth. There may not yet be full agreement on this daunting question, but the majority view now favours the contemporary approach of the more advanced economies that the central bank's responsibilities should be restricted to the creation and maintenance of a stable financial environment that will be conducive for sustainable economic growth. Central banks must protect the value of the currency. This is gospel, not only in more industrialised, but also in developing and emerging economies. Overall financial stability may not be a guarantee for, but certainly is a precondition for, sustainable economic growth.

5. The framework for financial co-operation within SADC

In terms of the bottom-up approach, the Committee of Governors kicked-off its work programme by exchanging views on the nature, structure and functions of each central bank in the region. In many developing countries, central banks, acting as extensions of Government Finance Departments, are often directly involved in normal commercial and development banking, and in many other macroeconomic activities such as export promotion, social upliftment programmes, and financing of government budgetary shortfalls. This, of course, often creates a conflict with the prime objective of central banking, and that is to protect the value of the currency. The powers of the central bank in such countries must first be reduced to improve the effectiveness of monetary policy.

In the second phase of its deliberations, the Committee of Governors is concentrating on the quantity and quality of private banking in the region. The establishment of sound and well-managed privately-owned banking institutions must be encouraged to provide financial services in a competitive environment. The two tiers of banking, that is central banking and private banking, must be separated on a clearly-defined basis.

In the third phase of financial co-ordination, the central bank Governors are working together in a joint effort to develop compatible and inter-linkable national payments, clearing and settlement systems for financial transactions. Eventually, the national systems must be linked to each other to provide for more effective cross-border settlement of inter-regional financial transactions. This project requires some co-operation in the development of compatible electronic data processing and technology systems in the twelve participating central banks.

In a fourth phase, more attention will be focused on the development of financial markets in the region. A lot of research work must be done on the introduction of appropriate legal institutional frameworks, the introduction of financial instruments and the improvement of technological systems and human resource skills in the foreign exchange, money and capital markets. Some rationalisation in the use of the existing markets to the advantage of the whole region will be necessary.

Only then will it become possible to consider greater harmonisation and even integration of macroeconomic financial policies such as interest and exchange rate policies, the management of bank liquidity and credit extension on a regional basis, and operations by central banks in a more integrated financial market environment.

6. The practical implementation of the programme for financial co-operation

The SADC Committee of Governors is determined gradually to implement its plan for greater financial co-operation over the next few years in the whole region. On the African Continent, many ambitious plans for economic co-operation exist on paper, but are never executed. The Governors' Committee has already embarked on the implementation stage, and is now actively involved in a number of the ground-work projects:

1. It has become necessary for the twelve Governors to have a better understanding of the regional economic environment within which they operate. For this purpose the Secretariat of the Governors' Committee established a statistical data base for essential economic time series from the twelve countries in the computer capacity of the South African Reserve Bank. It is the intention to connect all the central banks in due course with real-time on-line linkages to the data base.

2. To enable Governors to learn from the experiences of each other, a data bank with information on issues such as legislation, relationships with Governments, functions and responsibilities, management, policy objectives, procedures and instruments of monetary policy,

and administrative structures for each central bank, has been compiled and is now available to all the Governors.

3. Programmes are encouraged for the establishment of efficient and well-managed privately-owned banking institutions in all SADC countries. Assistance is being provided for the revision of the banking laws in some countries, and central banks are encouraged where necessary to withdraw themselves from private sector banking activity.

4. The South African Reserve Bank is playing a leading role in the development of the quality of, and capacity for, proper bank regulation and supervision. Some harmonisation is encouraged on policies such as bank licensing, minimum financial prudential requirements, and regular auditing of banking institutions. A joint effort is also being made to take the necessary action against illegal banking activities in the region, such as money laundering and pyramid schemes.

5. There is a great need for training and the development of skills in central banking in the region. The South African Reserve Bank has introduced a specialised Training Institute for Central Banking, and is now providing specialised courses in central banking and financial management for its own staff and officials of other central banks in the SADC region.

The central banks of the region also formed an East and Southern Africa Banking Supervisors Group (ESAF) to standardise bank regulation and supervision in the region. ESAF is providing specialised courses for the development of the financial regulatory capacity in the region.

There is also a more ambitious training programme provided through the Macroeconomic and Financial Management Institute (MEFMI). A number of Southern African countries, but not all members of SADC, participate in this venture. With its headquarters in Harare, MEFMI's operational mandate covers two broad areas:

"(i) In-depth capacity building, involving training, institutional development, networking and technical support, to strengthen countries' ability to manage their debt and external reserves;" and

"(ii) a training programme for public officials with duties relating to macroeconomic and financial management, providing courses in a wide range of high-priority fields." MEFMI has the support of a number of international institutions, such as the World Bank, and has the potential to make an important contribution to the development of desperately needed skills for the management of the economic transformation of African countries.

6. The removal of remaining exchange controls in the region is a major priority of the Governors' Committee. Arrangements have been introduced for the unrestricted repatriation of notes and coin used in participating countries amongst the members of SADC, and the movement towards an unrestricted flow of capital in the region is being promoted. South Africa is lifting its remaining exchange controls in respect of SADC countries faster than for the rest of the world. Two members, namely Zambia and Mauritius, have already removed all exchange controls in their countries.

7. Reference has already been made to the work that is being done in the area of electronic data processing and the development of a cross-border network for financial clearing, payment and settlement transactions. International assistance is now sought (through the World

Bank) for the development of the national payment and clearing systems in the less-developed economies of the region.

7. The road ahead

There is growing enthusiasm in Southern Africa for a regional approach to economic development issues. There are, unfortunately, more than one initiative for multi-national regional economic co-operation arrangements in Sub-Saharan Africa, initiatives that often compete with each other. In Southern Africa itself, the SADC and COMESA (the Common Market for Eastern and Southern Africa), groupings provide many overlapping services and some countries belong to both organisations, and others to only one of the two. The time has come for Governments in the region to consider a merger of the two competing regional groupings in a more viable single regional association.

Both SADC and COMESA have their own Secretariats with a strong bureaucracy that often inhibits initiatives because of unnecessary rigid procedural requirements. In the case of the Committee of Governors of SADC, we often live in sin because of non-compliance with the prescribed procedures of the SADC Secretariat. Forgiveness, however, can easily be extorted, as long as progress and successes can be claimed.

There is among some governments still a strong suspicion of the motives behind closer economic co-operation in the region. The question arises whether it is perhaps not a real danger that the powerful South African economy will exploit the smaller economies for its own advantage: South Africa has to act with great discretion in performing its role in the programme. South Africa obviously has a vested interest in the economic development of the region as a whole.

Internally, South Africa still has many serious economic problems that must be resolved to improve the living conditions of its own people. Unemployment is high, many communities live in great poverty, and there is a relatively wide spread between high and low incomes earned in the country. Many people therefore believe that South Africa should concentrate all its resources on the development of its own economy. There is, however, a basic fallacy in this approach. Whenever South Africa makes some progress in solving its own economic problems without a parallel development in other countries in the region, the unemployed from the other countries get sucked into the South African system. If South Africa is not prepared to accept more exports from other African countries and does not want to allow part of the South African savings to be invested in these countries, the country will have to absorb great numbers of unemployed people from the rest of the region.

The region of SADC is gradually becoming an attractive place for foreign investors. Its potential for economic development is vast, and undeveloped human resources and the exploding demand for goods and services emanating from people who are now being absorbed for the first time in a real market economy, must lure many multi-national institutions to the Southern Africa region. It depends on us how attractive we can make our own region for the outside world as a place for long-term, durable, and productive investment.