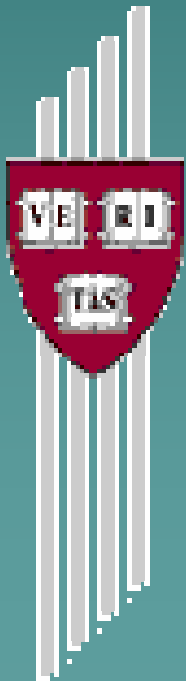


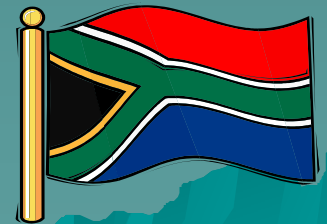


Prospects for Monetary Union in Southern Africa



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Three big developments regarding monetary unions in the last 10 yrs.

1. Although most proclamations by political leaders of plans for full economic or monetary union had turned out empty, there are now some genuine successful examples.
2. Although economists had previously made little distinction between fixing the exchange rate and joining a monetary union, there turns out to be a big difference.
3. Rose (2000): the effect of monetary union on trade among members is statistically significant and economically important.

1. Successful examples of MU

1. Most importantly: EMU. Now a model to others elsewhere.
2. Also CFA zone, ECCA, and the rand zone (CMA).
3. On the one hand, current plans in some regions seem unlikely to be met when constraints are confronted:
 1. GCC union planned for 2010. But Oman dropped out (Dec 06).
 2. Africa's own multiple plans for currency unions – within SADC, COMESA, and W.Africa – could be stepping stones to AMU (Yehoue, 2003), but sound suspiciously impractical.
 1. Some countries belong to more than one prospective monetary union
 2. Nigeria & 4 other Anglophone countries in W.Africa missed their 2003 & 2005 target dates for creating Eco, casting doubt on plans to then join with CFA.
4. On the other hand, Europe too went through a long process:
 1. A succession of arrangements (Snake, ERM, EMU), and missed dates.
 2. In the meantime, the gradual process of convergence, a requirement for MU membership, is in any case a useful institutional framework to improve macroeconomic policies in participating countries.
 1. Inflation
 2. Exchange rate
 3. Budget deficits and debt

2. Monetary union >> Fixed exchange rate

1. There turns out to be a big difference between fixing your exchange rate and joining a monetary union.
2. A peg can be changed, and frequently is.
3. Even a currency board is not permanent (Argentina).
4. But getting out of a monetary union is hard. Some Italian politicians today would like to, but can't, legally or economically. Good?
 1. In theory => a more "credible commitment."
 2. The experience of Ecuador with dollarization (prices/inflation/interest rates have failed to converge to US levels) suggests the credibility theory was overdone.

3. Monetary union turns out to have a significant effect on trade

- ◆ Andrew Rose (*Ec.Policy*, 2000) showed for the first time, using bilateral gravity data for 200 countries and regions, that the effect on trade among MU members is statistically significant and economically important.
- ◆ After all the critiques, the basic finding of a significant effect remains. ^{1/}
 - Empirical implausibility (but *something* has to explain home bias)
 - Small countries (in any case, for Africa, we are talking small)
 - Endogeneity of MU decision (but: 1 Rose controls; 2 Chironga ,2006)
- ◆ Also, evidence suggests no diversion of trade away from non-members.
 - So MU boosts growth
 - e.g., Frankel & Rose (*QJE*, 2002)

^{1/} Baldwin (2005) surveys critiques of Rose; Frankel (2005) responds.

Summary of Pros and Cons of MU

For anchor country alone

◆ Pros

- Possible gain of seignorage
- Development of economic backyard
- Reining in of irresponsible policies by neighbors

◆ Cons

- Possibility of having to make transfers
- Possibility of political resentment by neighbors

Summary of Pros and Cons of MU

For all members:

◆ Pros

- Promotion of trade and investment
- Nominal anchor (esp. for historically less stable members)

◆ Cons

- Loss of monetary independence
- Loss of ability to adjust automatically to idiosyncratic shocks

Is Southern Africa fundamentally well-suited for monetary integration?

Traditional Optimum Currency Area criteria:

- ◆ Small size and dependence on trade?
yes, esp. the other CMA members
- ◆ Symmetric shocks?
 - *SADC Macro Convergence Workshop, Glenburn Lodge, 2001: Moz. & Lesotho most correlated with SA .*
 - *Nel (2006): Swazi., Botswana, & Moz. among top 5 in co-movements with SA for both GDP & prices.*
 - *+ others such as Zimbabwe & Congo; but their inflation and debt currently disqualify them.*
 - *Khamfula & Huizinga (2005): add also Namibia, Mauritius, Malawi.*
- ◆ High labor mobility? *yes, between S.A. & its neighbors (tho obviously not high enough to equalize incomes -- McDonald, et al, 1998)*
- ◆ Fiscal transfer system to cushion shocks?
no, unless you count customs transfers within SACU

What about high mineral export share?

- ◆ Some confusion:
 - On the one hand, cited criteria for OCA include
 - ◆ high tradeable/GDP share (McKinnon, 1964) and
 - ◆ diversification, according to Kenen (1969)
 - On the other hand, textbook theory says high terms of trade volatility – which minerals create – require floating currency to accommodate external shocks.
- ◆ Resolution:
 - Southern Africa's terms of trade volatility tends to be shared => supports
 - ◆ common currency among members, but
 - ◆ one that floats vs. \$ and €

A criterion I want to add to OCA list: Emigrants' remittances

- ◆ In some countries, remittances are a major component of balance of payments
 - Outward: Gulf countries, S.Africa...
 - Inward: S.Asia, Phil., SADC neighbors...
 - ◆ Remittances received by developing countries grew 73% 2001-05, reaching a total of \$167 b. – WB (2006).
 - ◆ 26% of GDP in Lesotho in 2004 (>100% in early 80s – Petersson, 1998)
- ◆ Evidence remittances respond to income differential (host vs. country of origin)
 - Clarke & Wallstein (2004), Kapur (2003), and Lake (2005)
 - But not Sayan (2006)
- ◆ Counter-cyclicalities =>
remittances are important stabilizer, allowing countries to give up individual monetary policies
- ◆ I want to compute cyclical correlation for South Africa.
 - Where can I get bilateral remittance data?
 - Correlation would support MU in southern Africa

What about macroeconomic convergence?

- ◆ Inflation & debt are far too high in Angola, Congo, Zambia, & esp. Zimbabwe to join MU.
- ◆ All the more reason to include them in a (long) transitional framework where they agree to pursue convergence criteria.
 - Even if they never get there, the institution will help provide some much-needed discipline in the meantime
 - The institutional rules must be written flexibly enough to allow countries to delay joining, or even to drop out, as appropriate.
 - Political links can be a motivation (as they were in Europe); but making political solidarity the actual criterion for joining would doom MU to certain failure.

But will SADC countries attain macro targets set (in MoU Aug. 2002) for MU in 2018?

<u>Criterion</u>	<u>2008</u>	<u>2012</u>	<u>2018</u>
◆ Inflation CORE	9%	5%	3%
◆ BDeficit/GDP	<5%	3 _{+/-1%}	3 _{+/-1%}
◆ Govt debt	< 60% GDP		
◆ Current Acct/GDP	3-9%	3-9%	3%

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