Monetary Union: the Experience of the Euro and the Lessons to be learned for the African (SADC) Monetary Union

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1. Introduction

In June 2004 the writer presented a paper at a conference *On the euro outside the euro-zone: the South African perspective*.[1] The paper addressed the lessons that southern Africa could learn from European Union (EU) monetary integration and specifically whether the region can take their cue from the euro. The backdrop to the paper was the apparent success at the time of the European Monetary Union (EMU), on the one hand, and on the other, the declared intention of the African Union (AU) and other regional integration arrangements such as the Southern African Development Community (SADC) to evolve into monetary union in the final stages of linear regional integration. In the latter regard the eurozone was widely considered to be a role model of monetary integration and an exercise that could and should be replicated in Africa.

The sceptical views expressed in the paper (which later also featured in a series of tralac hot seat comments) were not based on inherent weaknesses of the euro as regional currency. The euro was accepted to be a stellar phenomenon in European integration. The argument was that conditions in Southern Africa and Africa as a continent did not meet the requisite conditions for successful monetary integration such as macroeconomic convergence, which was a fundamental building block of the eurozone, and furthermore, that in regions of disparate economies exposed to diverse external shocks a loss of policy space in exchange and interest rate determination would be inappropriate.

Recent developments in the EUM, however, have revealed that the euro construct has fundamental weaknesses which strengthen the argument that monetary union is a step in the process of regional integration that calls for extreme caution. Hence, this paper extends the argument in support of caution in deciding on monetary union by emphasising certain conditions that the euro crisis has revealed as crucial for monetary union to work. [2] The role model, which started out with acclaim, has in its operation exposed certain structural weaknesses in design. These weaknesses and the conditions for successful union that they imply add more stumbling blocks in the way of achieving monetary union in an African setting.

[1] See McCarthy (2004).

[2] The author wishes to acknowledge the valuable comments of Prof. Stan du Plessis of the Department of Economics, University of Stellenbosch, on a draft of the paper.

The conclusion of the paper is that it is unlikely that African countries will meet these conditions. In working toward this conclusion the paper in Section 2 briefly defines monetary union within the context of the linear model of regional integration, which places it in a particular sequence of deeper integration. Subsequently, in Section 3, attention is given to two monetary integration arrangements in Africa – the Common Monetary Area (CMA) in southern Africa and the CFA (Communauté Financière Africaine) franc of francophone Africa – that have their roots in colonial history. It will be argued that these two arrangements cannot be offered as evidence that monetary union can work in Africa. Before discussing the recent euro experience and the lessons that this experience has to offer African policy makers in Sections 5 and 6, the benefits and costs and the conditions of success (the optimal currency area) are briefly reviewed in Section 4. A conclusion is presented in Section 6.

2. Monetary union and the linear model of regional integration

The establishment of a monetary union is one of the final stages in the linear model of regional integration. To make this point abundantly clear a brief consideration of the model will be helpful in understanding where monetary integration fits into the overall scheme.[3]

Goods and non-factor services are traded internationally. The global economy also increasingly experiences international factor flows of both capital and labour. Regional economic integration essentially represents efforts to remove barriers to the cross-border flow of goods and factor and non-factor services between the member states of an integration arrangement. It is expected that this geographically restricted liberalisation will contribute to welfare creation associated with an increase in trade while it will also facilitate growth and development through increased investment and competition.

Integration can take on different forms. Conventionally it starts with the removal of border barriers to trade in goods within a defined region. In the system of multilateral trade management by the World Trade Organisation (WTO) the principle of non-discrimination, embodied in the most-favoured-nation (MFN) clause,[4] is a key canon. However, the General Agreement on Tariffs and Trade (GATT) allows exceptions to the MFN clause, one of which is contained in Article XXIV of the

[3] The overview that follows draws on McCarthy (2011).
[4] The MFN clause determines that with respect to duties on trade 'any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties' (GATT 1947: Article 1).

GATT. This allows the establishment of free trade areas and customs unions within which trade in goods is free while tariff barriers are maintained against non-member states. In the case of a customs union the member states share free trade in goods and a common external tariff vis-à-vis non-members.

Regional economic integration can be extended by including trade in services, both non-factor services such as financial, commercial, transport and professional services and unrestrained capital and labour flows. Trade in services is typically constrained by national regulations which need to be amended and harmonised to facilitate cross-border activity, should this be the intention of the integration arrangement. At the multilateral level, trade in non-factor services falls under the WTO's General Agreement on Trade in Services (GATS), which in Article V accommodates economic integration in allowing member states to enter into an agreement to liberalise trade in services, subject to certain conditions being met.

The conventional model of linear integration ignores trade in non-factor services up to the stage of customs union formation, but in building on the customs union by adding the free flow of labour and capital a common market is created as a next step in deeper integration. Integration reaches its pinnacle when monetary and fiscal integration is added to a common market, thus creating an economic union.

African integration planning and the European experience have been based on this linear model of a step-wise movement through consecutive stages in the integration of goods, labour and capital markets, and finally monetary and fiscal integration. The different sequential steps, in summary, are: first, the formation of a *free trade area* characterised by intra-regional free trade but with each member state having separate tariffs on imports from the rest of the world and trade controlled by a set of rules of origin to prevent trade deflection (duty-free imports from the rest of the world through the member state with the lowest tariff);[5] second, adding a common external tariff to create a *customs union*, which effectively removes the problem of trade deflection to which a free trade area is exposed; third, adding the intra-regional free flow of factors of production in what is known as a *common market*; and finally, an *economic union* which adds the integration of monetary and

[5] It is also possible to identify a lower level of integration in the form of preferential trading arrangements, often of a bilateral nature. This would allow free trade in selected lines of goods, which for these goods might also be restricted through tariff quotas, that is, duty free entry up to a defined volume or value of goods, after which the tariff will apply.

fiscal affairs. The convention is that neighbourhood regional integration arrangements are established.[6]

African regional integration arrangements are characterised by the ambitious goals they have adopted in planning integration. Of 14 regional economic communities that existed in 2001, nine have a full economic union as the specified objective; one (the Common Market of Southern and Eastern Africa – COMESA) aims to become a common market; another, the Southern African Customs union (SACU), is an established customs union and is to remain that; while the remaining three aim for intra-regional free trade or regional cooperation, with the East African Community (EAC) aiming to become a political union (ECA 2004: 29). These agendas are seen as being in line with the desire of the African Economic Community to transform the African economic landscape and to achieve over three decades 'a strong united block of nations' (ECA 2004: 28). An important phase is the strengthening of the constituent building blocks of regional economic communities, communities that 'should evolve into free trade areas and customs unions, eventually consolidating and culminating in a common market covering the continent' (ECA 2004: 28).[7]

The African Union and the majority of African regional integration arrangements are very explicit in aiming for monetary union as part of a final integration destination. For the continent as a whole, the Abuja Treaty of 1991 called for the establishment of the African Economic Community by 2027. The treaty envisaged an African central bank, a common currency, complete mobility of factors of production and free trade in goods and services in this community.[8] In the case of SADC, which was established as a trade integration arrangement in 1992, a road map exists that envisages a comprehensive monetary union, incorporating a single currency and a regional central bank, to come about in 2018.

At this point we return to the discussion of monetary union as the main theme of this paper. A useful point of departure in categorising the monetary integration of sovereign states is to identify the two essential features of monetary integration (Robson 1998). The first is that exchange rates of

[6] Many free trade agreements, as preferential trading arrangements, exist between countries that are not neighbours.

[7] It is informative that to date none of the regional integration arrangements has actually progressed to a fully fledged customs union with completely free trade behind a common external tariff between member states. SACU, dating back to 1910 and hence the oldest operating customs union in the world, has a historical legacy that dates back to colonial times and is an exception to the rule.

[8] In 2001 the political momentum of regional integration increased when the Constitutive Act of the African Union entered into force. The AU was formally launched in April 2002 at a summit meeting in Durban, South Africa.

currencies within a region must be permanently fixed with respect to each other but jointly variable to other currencies. The second characteristic is that full convertibility of currencies must exist. This implies that no exchange controls will exist on either current or capital transactions in the area.

To ensure the immutability of these two characteristics, monetary arrangements will have to meet two other requirements. First, the fixed nature of the exchange rates will require monetary policies to be consistent with this objective, which in turn will require that the instruments of monetary policy assigned to the region must be exercised solely by its monetary authority. This implies a loss of autonomy for member states in this field and thus a serious restriction of their policy space. Second, since the exchange rate of the region's currencies must vary jointly against external currencies, responsibility for exchange rate policy must also be assigned to the region. The same applies to the management of the region's balance of payments with the rest of the world and to the pool of foreign exchange reserves.

When these requirements are met, according to Robson (Robson 1998: 191), 'the resulting arrangement can be described as one of complete monetary integration, or of monetary union. In effect there would then be a single currency, although nominally differentiated currencies might continue to coexist…'

3. The Common Monetary Area and the CFA franc zone

Variation in the degree of the regional integration of markets in goods and services is a well-known phenomenon. Although less extensively recorded in the literature, the degree and nature of monetary integration can also vary, albeit within a narrower range of possibilities compared to the integration of goods and service markets. The focus of this paper is on monetary union in the sense of a single currency being adopted in a region with a regional central bank accepting responsibility for the issue and management of the region's currency. By definition this implies a single regional (short term) interest rate and exchange rate for the currency. However, in Africa there are two monetary integration arrangements of long standing that do not meet the requirements of full and comprehensive monetary union, namely the Common Monetary Area (CMA) which integrates the money and capital markets of Lesotho, Namibia and Swaziland (LNS) into that of South Africa, and

the CFA franc zone which has the CFA franc linked to the euro, subsequent to its earlier and historical link to the French franc.[9]

The CMA has the South African rand as its anchor currency. Historically it evolved from what was known as the Rand Monetary Area (RMA). The CMA operates in terms of the Multilateral Monetary Agreement (MMA) and three supporting bilateral agreements between South Africa as the one party to each agreement and respectively Lesotho, Namibia and Swaziland (LNS) as the other party. The main characteristics of the CMA are as follows (McCarthy 2009):

- LNS issue their own national currencies which are legal tender only within their respective domains. The MMA determines that the coin and note issues in each country must be clearly distinguishable in appearance from the currency issued by other member states. The LNS currencies are pegged at par against the rand. The South African rand is legal tender throughout the CMA. Within LNS, the respective national currencies and rand are convertible through authorised dealers. In practice, all traders keep a mix of both currencies in their cash tills and are willing to provide change in either the national currency or rand. Although the national currencies are not legal tender in South Africa there is a growing tendency among South African traders in the border areas to accept the currency of the smaller countries.

- The bilateral agreements of South Africa with Lesotho and Namibia require the central banks of the latter two countries to keep foreign reserves at least equal to the national currency in circulation. Rand balances held in a Special Rand Deposit Account with the South African Reserve Bank (SARB) form part of Lesotho and Namibian foreign reserves. The provision of foreign reserves as a cover for national currency in circulation is not contained in the Swaziland bilateral agreement but experience has been that the Central Bank of Swaziland maintains foreign reserves in excess of currency in circulation (Wang et al. 2007: 10 n7).

- Since the rand is legal tender in LNS they are compensated for seigniorage foregone. The formula that applies is a payment equal to two-thirds of the annual yield on the most recently issued long-term South African government bonds multiplied by the estimated volume of rand circulating in the particular country.

[9] An interesting case of monetary integration in Africa, which falls outside the scope of this paper, is the de facto dollarization of the Zimbabwean monetary system, with the US dollar having replaced as circulating currency the Zimbabwean dollar that was rendered worthless by a devastating hyper inflation.

- Article 3 of the MMA provides for the free flow of funds, whether for current or capital transactions, within the CMA. The exception to this rule is prescribed investments which local financial institutions are compelled to maintain. These are seen as a means of mobilising domestic savings for development purposes.

- The CMA Agreements effectively require LNS to maintain foreign exchange control measures that in all material aspects are similar to those that apply in South Africa. However, they are responsible for authorising foreign transactions of local origin.[10]

- Residents of LNS have access to the South African money and capital markets through provisions that allow LNS public securities to be held as part of the prescribed investments of South African financial institutions, in accordance with the prudential regulations that apply in LNS. To support the orderly management of financial markets the LNS governments must reach agreement with the South African authorities on the conditions, timing and other relevant terms in respect of the issue or conversion of public securities. South Africa may not withhold agreement without reasonable cause.

- Although the central banks of LNS, since the introduction of their own currencies, have been responsible for their own monetary policies, the smaller member countries have lost their ability to implement these policies independently of the monetary policy adopted by the South African Reserve Bank. The SARB is not represented on the boards of the LNS central banks (and neither are LNS central banks represented on the Board of the SARB and its Monetary Policy Committee); and although no formal arrangements for common interest rates in the CMA exist, interest rate movements in LNS are synchronised with changes in the Reserve Bank's repurchase rate (bank rate), which means that *de facto* a single monetary policy set by the SARB applies throughout the CMA.

- The implementation of the CMA is facilitated by a Common Monetary Area Commission in which each member state has a representative supported by advisors. The commission meets

[10] Under current foreign exchange control measures, residents must surrender their foreign exchange receipts to authorised dealers who, apart from working balances, are required to sell the foreign exchange to the national central bank. There are restrictions on current transactions of residents and none, both current and capital, on non-residents. The restrictions on the transaction of residents are to ensure that capital flows are not disguised as current payments. Consequently, limits are placed on the value of current transactions such as travel allowances for tourists and business people, and gifts to non-residents. The South African Reserve Bank is in the process of liberalising foreign exchange control.

regularly to discuss and reconcile interests with regard to monetary and exchange rate policy issues. Disputes that might arise can be dealt with by a tribunal provided for in Article 9 of the MMA. Given the anchor role that the SARB plays in determining the monetary policy of South Africa – effectively the monetary policy of the CMA – an important arrangement is the meeting of senior researchers from the central banks of the four member states to exchange economic information before the periodic meetings of the SARB Monetary Policy Committee (Van Zyl 2003).

It is clear that the CMA is a unique hybrid of monetary integration. It evolved in a colonial regime that brought political independence to a number of territories that shared an integrated economy, which is dominated by South Africa. Trade integration was from early on accommodated through SACU, which is also an excise union.[11] Four member states of SACU – South Africa, Lesotho, Namibia and Swaziland – serve as an example of variable geometry and an exception to the convention of strictly adhering to the linear model of integration by adding a particular and unique form of monetary integration to a customs and excise union.

Botswana, the fifth member of SACU, is not part of the CMA. Botswana used to belong to the RMA but in 1974 it announced its intention to withdraw from the RMA. The pula was introduced as sole legal tender in Botswana in August 1976. The current practice of pula exchange rate determination, adopted in May 2005, is that of a crawling peg. Small adjustments are continuously made to the exchange rate against a basket of currencies to allow the pula to move in line with expected future inflation rate differentials. Because of the large share of imports from South Africa, the basket is heavily weighted in favour of the rand which has meant that the rand/pula exchange rate, compared to the rand/US dollar rate, has been very stable.

Another well-known African monetary integration arrangement with roots that can be traced to colonial times is the CFA franc zone. The CFA was created in December 1945 when France ratified the Bretton Woods Agreement. At the time the abbreviation CFA stood for Colonies Françaises

[11] SACU is an excise union as well as a customs union essentially because of the porous borders between the member states and consequently the difficulties in managing separate excise regimes. However, the fact remains that this adds an element of fiscal integration to the customs union, which is not in line with strict adherence to the linear model of integration. It must be emphasised that SACU has not been the outcome of pro-active plans to integrate independent neighbouring states, but is a historical legacy that evolved as a means to deal with separate political entities within an economically integrated region. SACU does not represent a model of integration that can be replicated elsewhere in Africa.

d'Afrique (French colonies of Africa) but currently it stands for Communauté Financière Africaine (African Financial Community). Fundamental differences between the CFA franc zone and the CMA are found in the fact that the franc zone is not a single area sharing a single currency, and in the fact that the currency peg is not to a currency of the region as is the case with the rand being the anchor currency of the CMA. The CFA franc zone is in fact two separate regions, each with its own currency and central bank, which share the common bond of having had France as a colonial power. In West Africa there is the CFA franc issued by the central bank (Banque Centrale des États de l'Afrique de l'Ouest) of the eight-member West African Economic and Monetary Union (UEMOA) and in central Africa there is the CFA franc issued by the central bank (Banque des États de l'Afrique Centrale) of the six-member Economic and Monetary Community of Central Africa (CEMAC). The two currencies are effectively pegged at par via each being pegged to the euro at 655.957 CFA francs = 1 euro. The euro peg was calculated at the European monetary union from the fixed exchange rate of 100 CFA francs = 1 French (new) franc = 0.152449 euro. Neither of the two regions' currency is legal tender in the other or in France.

Reserves for the two regions of the CFA franc zone are pooled at their respective central banks and attributed to each of the constituent member states, as is the monetary circulation. Having a fixed peg limits the ability of the two central banks to have an independent monetary policy. Monetary management is guided by a reserve cover ratio of foreign exchange reserves (of which 65 percent is to be held with the French Treasury in an operations account) to the short-term liabilities of the central bank. When the reserve ratio falls below 20 percent for three consecutive months, the central bank takes emergency measures to protect the parity by increasing official interest rates and reducing refinancing ceilings.

The central banks are not responsible for the supervision of the regions' banking systems. Each region has its own supervisory institution. Banks in each of the two regions need banking permits which allow them to open branches in any country within the particular region, although in practice banks do not operate across national borders.

The CFA zone has always been more than a monetary integration arrangement. The influence of France in the economic and noneconomic spheres of the francophone countries has been pervasive, although it can be argued that this influence is waning.

The two African monetary integration arrangements, characterised by links to anchor currencies, are unique examples of monetary integration which evolved as historical legacies of colonial times. They cannot be compared to the arrangements that are envisioned when the African Union and regional arrangements such as SADC and the EAC hold monetary union out as a destination in the integration process. Monetary union and the adoption of a common regional currency, issued and managed by a regional central bank, is the goal and in proactively planning these steps little can be gained from considering the experience of special monetary integration arrangements that trace their origins to unique historical, pre-independence developments.

How realistic and appropriate is the goal of monetary union and are there lessons to be learned from the current euro crisis? Before the euro experience is reviewed, consideration is first given to the benefits and cost of monetary union and the conditions for success.

4. Benefits and costs of monetary union and conditions for success

Benefits

The linear model of regional integration, as has been noted earlier, portrays deeper regional integration as a linear process of consecutive steps in which the establishment of a monetary union superimposes monetary integration on integrated product and factor markets. The benefits expected from integration are greater effectiveness of market integration in realising the positive welfare effects of trade creation and the dynamic benefits of growth and increased competitiveness, as well as greater efficiency in allocating factors of production in a larger, regional economy.

Monetary union with its single currency in a common market has a special contribution to make in improving the effectiveness of integration. This is done by reducing the transaction costs of trade and investment. The common market becomes absolute: no constraints exist on cross-border trade and investment in a region where a single unit of account and means of payment will have a substantial positive impact on facilitating comparisons of market prices, planning and making transactions, and on the conclusion of commercial and investment-related contracts. Not only are the cost and cumbersomeness of currency conversions removed but a major source of uncertainty, namely possible unforeseen variations in the exchange rate, is eliminated. The benefits to trade are obvious, but so is the benefit to be expected for cross-border investment, as well as foreign direct investment (FDI) from outside the region. Investment, both FDI and by firms within the region, will

not only benefit from greater market opportunities that integration offers but also from the macroeconomic stability that monetary union is expected to bring about across the region.

From the perspective of macro-economic management, monetary union and its limitation on policy discretion (see next section) has the benefit of a smaller risk premium for those countries that enter the union with comparatively higher rates of interest. In the EMU, Greece and Italy, for example, eliminated the bond market consequences reflected in higher interest rates because of poorer macro-economic management by becoming part of the EMU.

Costs

The potential cost for a country that joins a monetary union is embodied in the loss of policy space. The deepening regional integration is characterised by an escalating loss of policy sovereignty. Adopting the common external tariff of a customs union means that individual member states lose the ability to use the tariff as an instrument of trade and industrial policy. Freedom of intraregional factor flows in the establishment of a common market means that national independence in having national labour market policies is largely sacrificed while free regional capital flows will constrain the national ability to regulate capital markets as part of national economic development policy.

Should a country join a monetary union it sacrifices the ability to use monetary policy as a means of stabilising the economy. Specifically, the country's central bank transfers its ability to use the nominal exchange rate and short-term interest rate as instruments of macroeconomic stabilisation to the regional central bank, which operates as a supranational institution. The burden of national macroeconomic stabilisation will now fall on fiscal policy exclusively, which in the real world of policy design and implementation tends to be less flexible as well as socially and politically more difficult than using monetary policy. This much will become clear when the euro experience is brought into the picture.

If the desire for national sovereignty per se is ignored, sacrificing policy sovereignty is not necessarily a cost, a cost that will be realised at all times and under all conditions. However, it becomes a cost once we cross the threshold into the integration of disparate economies exposed to asymmetrical and diverse external economic shocks. For example, in a monetary union of member states with wide variations in the composition of import and export trade, the burden will fall on national fiscal policies to adjust to major and diverse changes in the terms of trade, fairly rapid changes in regional

capital and labour movements, and on changes in competitiveness to stabilise a member state that has been exposed to an external shock.

Imagine a monetary union of X (a major copper producer and exporter), Y (an oil exporting country), and Z (a country with a fairly diversified output and trade structure). Major international developments leaves the oil price largely unaffected but the copper price falls by 40 percent with a dramatic impact on X's terms of trade. Country X is worse off in terms of what it can buy with a basket of export goods. Prior to monetary union the standard demand management response to such a situation would be a currency devaluation accompanied by an increase in interest rates. Under a regional single currency regime these options do not exist, requiring the government of X to reduce government spending (for example, on social services) in an effort to bring aggregate demand in line with supply. If X represents one of the many commodity exporting developing countries with a narrow tax base, the copper industry will be a major source of tax revenue. The fall in the price of copper will dampen this source of revenue, thus aggravating the burden that expenditure cuts will have to bear.

This is not a complete picture of the consequences of not being able to depend on the exchange and interest rates as adjustment mechanisms in the event of external shocks. The asymmetry of conditions can be sharper. For example, the oil price might have increased because of supply problems in the Middle East, while X, in the wake of previously high copper prices might have irresponsibly consumed the mineral rent by granting a growing number of civil servants large salary increases, while also increasing expenditure on social services. However, the example will suffice to make the point that it is difficult to cope with asymmetrical external shocks if the menu of policy instruments available to a national government has been reduced severely. This can be regarded as a cost or downside of monetary union.

Conditions for success

At this point the narrative requires consideration of the conditions required to achieve successful monetary union. These conditions, which are derived from the theory of the optimum currency

area,[12] determine the requirements needed to accommodate or counter the possible costs associated with monetary union.

In considering the optimality of a monetary union, in other words, the conditions that need to be met in order to have a sustainable and effective monetary union, three questions have to be answered:

- First, what types of forces are member states exposed to that can disturb their macroeconomic equilibrium, specifically current account imbalances?
- Second, how closely are the member states' factor markets integrated?
- Third, how closely are their fiscal systems integrated?

A fourth question concerning macroeconomic conditions prior to joining or forming a monetary union is crucial: to what extent do the member states converge in terms of fundamental macroeconomic variables such as the size of government deficits (expressed as a percentage of Gross Domestic Product – GDP), current account balances and inflation? It stands to reason that economies with substantial differences in these variables could hardly form the basis for a viable monetary union. But assuming that the prior conditions of convergence are met, the successful operation of the union will depend on the answers to the three questions posed above.

If the member states are exposed to asymmetrical external disturbances, the development of current account imbalances is likely, in which case cross-border labour and capital flows as well as fiscal transfers will be required to stabilise the regional economy. The latter flows and transfers, which have to bear the brunt of stabilisation in the absence of the exchange rate as policy variable, will require substantial factor market and fiscal integration to be effective. However, labour flows are not without cost: it is costly for workers once retrenched to change jobs and even more costly to move to another country. In developing and also in developed countries, the focus of public opinion and media attention often falls on labour migration, creating the impression of the smooth and virtually costless relocation of workers, ignoring the cost of this migration.

But fiscal integration also brings to the fore an important condition, which, depending on the national psyche, could be regarded as a cost or downside of monetary union. In order to have intra-

[12] Robert Mundell (1961: 657-665) published a pioneering article on optimum currency areas.

union fiscal discipline and transfers, fiscal integration to the point of substantial fiscal union is required, which means that fiscal union complements monetary union in the establishment of an economic union. But can a country that has sacrificed its sovereignty with respect to the exchange rate, the interest rate and finally its ability to decide on taxes and government spending at the highest tier of government still be regarded as independent? Clearly not, and this explains why economic union with its fiscal integration is only possible if it is accompanied by political integration. An economic union of countries requires at least the formation of a federal state such as the United States of America, or what is hoped for by some, the United States of Europe.

5. The euro crisis

European monetary integration and the establishment of the eurozone, managed by the European Central Bank (ECB), represented a spectacular step towards deeper integration within the EU. This created a two-part EU: the eurozone member states, which in time came to include 17 EU countries and the remaining 10 EU member states that included some countries, such as the United Kingdom, Sweden and Denmark, that qualify for membership but have decided to remain outside the zone.

As noted earlier the introduction of the euro has been seen as role model in Africa, a development that could and should be replicated in the process of African economic integration. However, the euro has in recent times experienced a serious dent in its reputation. Toward the end of 2011 the currency union found itself in a deep crisis, with some observers even believing that it could bring about the end of the zone, at least in its current form. The current and widely held perception is that the crisis serves to illustrate shortcomings in the architecture of the zone, with an impact that is not restricted to member states only but is now a source of contagion that could create serious problems for the world economy.[13] How does one explain this situation and what lessons can be learned for monetary integration elsewhere in the world, notably Africa?

[13] It is unlikely that African banks and financial institutions will be directly affected by the euro crisis since their balance sheets will not significantly be exposed to holdings of euro country government bonds or depend on European banks for access to liquid reserves. However, should the euro crisis cause a sharp downturn in EU economic activity this will have a negative impact on the demand for African exports. Although the share of Sub-Saharan Africa's exports destined for Europe has declined from 33.8 percent in 2000 to 27.9 per cent in 2008, Europe remains an important destination (http://comtrade.un.org/pb/). For many African economies this share could be significantly higher. An additional negative outcome of poor economic conditions in Europe will be a decline in aid destined for African countries. In some cases, European governments are committed to a fixed percentage of national income allocated to foreign aid. The British commitment to foreign aid equal to 0.7 percent of national income, is an example of this. A decline in national

It is beyond the scope of this paper to review the eurozone crisis in any detail. What is required is the identification of crucial developments and factors that could be relevant as guidelines in assessing the appropriateness of proceeding to monetary union in the Africa.

The root cause of the euro's problems is that the zone covers a group of disparate economies and simply does not meet the conditions of an optimum currency area. A *Financial Times* columnist recently aptly described the situation: '...today's crisis is structural, stemming from the euro's flawed design and particularly the misguided notion that a common monetary policy could work without integration of other policies – and not just fiscal policy... lashing 17 disparate economies together monetarily and expecting them to march in step was ludicrous' (Rattner 2011). President Sarkozy of France in an address to party supporters implicitly raised similar thoughts: 'There can be no common currency without economic convergence without which the euro will too strong for some, too weak for others, and the eurozone will break up' ('Sarkozy and Merkel demand' 2011: 59).

The EU countries that initially formed or later joined the European Monetary Union had to meet important convergence criteria with respect to inflation, interest rates, budget deficits, national debt and exchange rates[14] and were subsequently subject to a uniform monetary policy under a regime of a short-term central bank rate set by the ECB and a single market-determined exchange rate. However, eurozone participation brought together countries with substantial differences in competitiveness which did not converge. The operational rules of the eurozone provided for macroeconomic convergence but not for economic convergence. The end result has been a divergence between member states with stable and competitive economies experiencing current account surpluses and fiscal discipline, exemplified by Germany, and economies that were not competitive, with large government and current account deficits, exemplified by Greece.

Deficits and the replacement of maturing bonds have to be funded in the capital market by issuing euro-denominated government bonds. While all euro states are subject to the same ECB rate, essentially a short-term rate, interest rates in the capital market are determined by market forces, which meant that the disparities between member states came to be reflected in growing divergences in sovereign debt rates. The interest rates that investors came to expect on the bonds of

income will bring about a fall in the value of the share of income devoted to foreign aid, which will add to the discretionary falls in aid allocations by governments that find themselves in fiscal problems.

[14] For the purposes of this paper the contention that the Greek government compiled and provided data which did not accurately reflect the true extent of the government deficit is ignored.

the weaker economies grew to levels that far exceeded those on the bonds of the stronger economies. It was not unusual for the spread between the rates of German and Greek bonds (the premium on Greek bonds) to exceed more than 20 percentage points. Since new bond issues can only be placed in the capital market at current market rates, the high interest rates demanded of the weaker euro economies result in an unsustainable fiscal liability. Interest on public debt must be paid from tax revenue which means that high and increasing interest rates represent a severe fiscal strain in economies that are expected to lower their fiscal deficits. Since the fiscal strain cannot be absorbed, external assistance from various sources such as the International Monetary Fund (IMF) and European Stabilisation Fund is required to support the deficit economies.

The euro's exposure to the views that exist and to positions taken in capital markets has also served to illustrate the powerful force and danger of contagion. Since prices in the capital market are determined by the forces of supply and demand, a weakening in demand can be driven by market perceptions of the likelihood of future capital losses should interest rates increase. Market fears are contagious and are reflected in lower prices paid for government bonds of countries expected to face difficult times. In the eurozone, Ireland and Greece were given external bail-out assistance but when Italy came into the firing line of negative expectations through contagion a precarious situation developed. The rate on Italian debt at one stage increased to above seven percent in capital markets, which is generally regarded as an unsustainable fiscal burden. Compared to Ireland and Greece, Italy is a large European economy with financial needs and a stock of debt that cannot be accommodated through external assistance and intervention. Furthermore, the size of the economy and its debt would leave European banks, which hold government bonds as a large part of bank capital, with huge losses on their balance sheets should there be a debt default or if banks are forced to accept so-called 'haircuts' (cutting the value of bonds) on their bond holdings. The banking system in Europe and further afield would be severely exposed to possible failure, which would create extreme strains in the economies of Europe and in the wider world economy. The only short-term solution to this problem of a lack of confidence is for the ECB to intervene as lender of last resort for Europe's banks by accepting the lower-quality bonds as collateral for loans to the banks to provide liquidity in the banking system.

The discourse on eurozone developments has brought to the fore an interesting interplay of views on the role of the central bank. Among the leading members of the zone, France has become a vocal protagonist of ECB intervention through purchases of the government bonds of member states that

find themselves in need of support. Effectively, this means that the debt is monetised with the central bank acting as lender of last resort to governments. However, the ECB is a regional central bank and has to deal with the strong opposition of Germany to such a move. The devastating hyperinflation of the 1920s and its consequences have embedded a strong fear of money creation and associated inflation in the German psyche and have provided the support for a constitutional guarantee of the independence of the Bundesbank, its monetary discipline, and the subsequent strength and superior reputation of the Deutsche mark as a sound currency. For Germany, sound money is the begin-all of macroeconomic policy and consequently the monetary union and the euro were accepted on the firm condition that these elements would be the building blocks of the ECB. Mario Draghi, the new chairman of the ECB, has in the midst of the euro crisis, confirmed that the central bank will act as lender of last resort for Europe's banks but not for governments.

The German view is that structural reform is required in the eurozone, reform that would build fiscal discipline into the system, and not ECB intervention accompanied by the collectivising of eurozone debt by issuing eurozone bonds ('stability bonds', also referred to as eurobonds), a proposal put on the table by the European Commission and strongly favoured by France. These bonds would have the 17 euro members sharing debt risks, which will lower the interest cost for countries such as Greece but raise the cost for Germany.

Independence of a regional central bank

The independence and accountability of a regional central bank is a facet that might be of considerable importance when a regional central bank is considered for an African region such as SADC. In a single country, which could be a federation, the independence of a central bank can be constitutionally enshrined or it can be determined through a law that establishes the central bank as a statutory, independent body. But independence is not an absolute prerogative; in the final instance a central bank can only maintain its independence if the public wishes it to be independent and no cleverly designed charter or treaty can solve the problem of defining 'public' when independent countries sacrifice their monetary sovereignty to a regional central bank. In the case of a regional central bank being established the only solution would be for the independence of the central bank to be enshrined in an intergovernmental agreement (a treaty) that can only be changed through a unanimous decision of member states.

But what, more precisely, is meant by structural reform? Such reform could be seen to contain many elements but essentially what Angela Merkel, the German chancellor, means by this is reopening the Lisbon Treaty by adding elements of fiscal union to the monetary union. Apparently, a fully fledged fiscal union is not currently being considered; the German preference is for limited treaty changes that will impose fiscal discipline on eurozone member states with scrutiny over eurozone national budgets and the provision of sanctions if countries do not comply. The EU bond proposal of the EC also contains treaty changes that would provide for serious new EU powers that will allow the overriding of national budgets and for non-compliant countries to be taken into 'administration'.

However, these measures will not address the fundamental problem of the large differences in competitiveness between euro states and consequently the current account imbalances that exist. Much of the widespread scepticism that the eurozone will survive in its current form and membership intact is based on the belief that the substantial differences in competitiveness and severe current account imbalances cannot be solved in a sustainable way without a significant adjustment of currencies. This can only occur if a weak economy leaves the eurozone. Fiscal transfers and external assistance will only paper over the problem of built-in instability of a currency union of widely disparate economies.

A summit of the heads of government of the EU on 8 and 9 December 2011 did not produce an agreement by all 27 member states on reopening the Lisbon Treaty to negotiate changes that will allow the 17 eurozone countries to adopt new rules on fiscal integration and the stabilisation of the euro. The United Kingdom, in defence of the City of London as an important world financial centre, controversially exercised its veto, which means that the Lisbon Treaty cannot be changed, leaving as only viable route an intergovernmental agreement of potentially 26 EU states.[15] This introduces a legal quagmire: can the EU institutions that represent all 27 member states (the European Commission with its surveillance and enforcement powers and the European Court of Justice) be used by a group of countries acting outside the EU treaties in implementing the decisions and outcome of a an intergovernmental agreement concluded by a lesser number?

The agreement concluded by the 26 member states does not envisage full fiscal union. Three elements can be identified in the agreement on eurozone management. The first is a 'fiscal compact' providing for the enforcement of the principle of balanced budgets and an annual 'structural' deficit of no more than 0.5 percent of GDP and automatic fines for eurozone countries that breach a three percent deficit limit.[16] The second is to enhance the scope of intervention (strengthening the so-called firewall protecting the euro) to stabilise the euro through an enlarged European Financial Stability Facility (EFSF) and the new European Stability Mechanism (ESM) that will be replacing the EFSF in 2013, as well as an extra €200bn to be lent by eurozone and other EU states to the IMF to increase the fund's ability to assist euro countries in need of such support. Third, the ESM will not require the involvement of private bondholders in any future rescue operations.

It is far from clear what the future holds in implementing this agreement and how each of the signatory states will respond once the agreement has been scrutinised and digested. One conclusion seems clear: eurozone countries will end up with less fiscal sovereignty. The process might not start out as a fully fledged fiscal union but every eurozone country will have to comply with externally determined and monitored fiscal rules that create limits to the policy space within which a country can operate. The final outcome cannot be foreseen with certainty but considering the dynamic forces of regional politics at play and a serious commitment of some member states to deeper

[15] Not all the 26 heads of government signed the agreement unconditionally. Sweden, an important EU member that is not a eurozone country, will be taking the agreement to its parliament for consideration and a final decision.

[16] A 'structural' deficit is of a long-run, non-cyclical nature, arising from a fundamental imbalance in government revenue and spending.

integration, it is equally difficult not to see comprehensive fiscal union as outcome in the long run.[17] But as noted earlier, adding fiscal union to monetary union, and thus the establishment of fully fledged economic union, will also require political union. One thing is certain: the EU will undergo fundamental change, but not always on the basis of considered and proactive planning of the member states and the EU's governing structures; external forces (read 'market forces') are likely to enforce change through crisis management.

Financial markets, both in their capacity as primary and secondary markets, are crucial in funding private and public sector spending. What the euro crisis has vividly demonstrated is the importance of certainty as a force that drives market movements. As custodians of the public's savings, capital market institutions are forced to look ahead and form a judgement on what the future holds with respect to asset prices. The euro crisis has created a world of uncertainty for the markets, a world in which they immediately respond to any development or announcement that could affect their degree of anticipated risk. The consequence has been extreme market volatility and efforts to seek safe havens to provide protection in times of growing uncertainty, be these German bunds, gold or any other asset that is seen to be relatively safe. Since the eurozone and its difficulties are a major source of uncertainty, moves to address these difficulties will be critically assessed by the financial markets looking for clear signals on what the future holds.[18] What this amounts to is that changes to the architecture of the eurozone will have to pass the litmus test of market views on the sustainability and effectiveness of the changes. The collective wisdom of financial markets will judge every move that EU leaders make, starting with the agreement reached by the 26 member states.

The question remains: what lessons can we learn from the eurozone experience that can guide integration in Africa?

[17] The position taken by the UK government on the re-opening of the Lisbon Treaty and on other EU issues is largely based on a desire, apparently supported by the majority of the British public, not to be involved in closer integration in Europe. A substantial number of British citizens and organisations resent the loss of sovereignty brought about by the past transfer of powers to Brussels.

[18] Jacques Delors, who was president of the European Commission from 1985 to 1995 and is widely considered to be the farther of the euro, recently had this to say on markets and uncertainty: 'Markets are markets. They are now bedevilled by uncertainty. If you put yourself in the position of investment funds, insurance companies and pension funds, you will understand that they are looking for a clear signal' ('Euro doomed' 2011).

6. Monetary Union in Africa reconsidered

As noted earlier, monetary union is on the agenda of most African regional integration arrangements, including the overarching African Union, and furthermore it is a development that is expected within a relative short period of time. For SADC, monetary union after 26 years is ambitious, considering that the EU was more than five decades into its process of economic integration before it ventured to the point of monetary union and this after a gradual process of integrating monetary affairs in an established and operating common market.

Currently, the SADC free trade area that came about in 2008 is not fully operational for all member states and the customs union that was to have been established in 2010 has been postponed. It is safe to assume that 2018, noted in the SADC roadmap as the target date for monetary union, is an idle hope. However, the time taken to establish a monetary union in a linear process of integration is not the pertinent issue; if it is hypothesised that at some point in the future a monetary union could be a *fait accompli*, the main question is: will it be an appropriate development in itself that will give rise to the benefits noted earlier? Furthermore, what does recent euro experience, once regarded as the model of monetary integration, tell us in this regard?

First, monetary union requires more than *ex ante* macroeconomic convergence with respect to selected indicators such as inflation and government deficits; member states must also converge in their competitiveness. Furthermore, after forming or joining a monetary union, economic and macroeconomic convergence must be maintained.[19] Should imbalances arise, the second feature to note is the inevitable reliance on fiscal constraints to adjust the economy by removing the imbalances. When countries such as Greece, Portugal, Ireland and Spain found themselves in situations of serious imbalances with unsustainable and growing fiscal deficits, they could not rely on the interest rate and on exchange rate depreciations to improve competitiveness and bring about equilibrating changes in their economies. In the absence of central bank intervention they have to rely on fiscal austerity and external assistance. Improving government finance in weak economies in the short term could not come from increasing revenue by raising taxes but only from severe cutbacks in government spending. The social impact of this was immediate, with large numbers

[19] Economic convergence refers to the phenomenon of catch-up growth, that is, poorer countries catching up with richer countries in terms of indicators like per capita income. Essentially this is indicative of convergence in competitiveness.

taking to the streets in protest against cuts in spending on social benefits, services and the public sector wage bill.

Fiscal policy, unlike monetary policy with its indirect impact on relative prices, has a direct and immediate impact with repercussions in the political domain. In democracies, cabinet decisions on fiscal restraint have to be approved by a body representing citizens and there is no way that these representatives can 'hide' the painful decisions from their constituents. The electorate will also be aware not only of the consequences of required fiscal efforts to restore balance but will also hold collective views on the causes of the imbalances, which typically will be attributed to weak governance in the past. As the experience in all these countries has shown, the outcome is a change in government with new governments having to impose the unpopular fiscal measures required to restore a modicum of equilibrium.

Changing the jockey of an underperforming horse does not remove the inherent weaknesses of the horse; neither does it allow the new jockey to avoid the only techniques available to get the horse to run faster. The analogy holds for changes in government. Fiscal restraints have painful consequences and unless the underlying causes of a lack of competitiveness are removed they are bound to create a fertile ground for persistent political instability. It must be emphasised that the impact of monetary adjustment is not less painful; it is merely contended that fiscal austerity has a more direct impact with severe political repercussions.

Two avenues of escape from this dilemma exist. The first is to get those competitive economies with positive balances, with the additional support from international agencies such as the IMF and the World Bank and from surplus economies that do not belong to the monetary union, to fund the deficits of the weaker economies. This can be done through loans or the purchase of the public debt of the deficit countries as a means of allowing them access to capital market funding at affordable rates of interest.

A second escape route is intervention by the central bank of the region. When the central bank buys the bonds of the ailing economies their debt is monetised, a development which may not to be acceptable to the surplus member states. If the central bank is independent and committed to the typical central bank goal of protecting the value of the currency – which means that containing inflation is seen as its principal objective – the bank itself may be reluctant to intervene.

The scenario sketched so far allows a number of tentative conclusions when viewed from an African, and specifically SADC, perspective.

Relying on fiscal austerity to restore balance has a direct political impact. In the eurozone the currency crisis and reliance on fiscal constraint have had political consequences with democratic changes in the political guard. In Africa, not many, and in SADC only a small minority of states, have a history of a democratic change of government in the post-colonial era. If, in this setting, imbalances are to be addressed by fiscal constraint only, peaceful and democratic change in government is not likely in many cases; persistent political unrest, with masses protesting against declines in service delivery and more autocratic styles of government, is more probable.

Most African economies also have poorly developed financial systems without active primary and secondary bond markets. Captive bond markets can be created by legally compelling financial institutions to invest in the debt of the government at low rates that do not reflect market realities. However, the pool of public savings held by financial institutions tends to be relatively small and incapable of absorbing large amounts of government debt.

Many African countries rely on international aid transfers to cover deficits and in particular circumstances this could be a source of assistance. It is possible to envisage unconditional foreign aid to cover deficits of an African least developed country (LDC) in cases where, for example, these arise because of an unforeseen deterioration in the terms of trade following a sharp fall in the prices of export commodities. However, should the deficits be the outcome of profligate government consumption expenditure on items such as a growing wage bill, continuous access to unconditional foreign aid is unlikely.

But an important question raised by the eurozone experience, which illustrates that fiscal union is a necessary complement of monetary union, remains: will African states accept arrangements that restrict their fiscal sovereignty? The answer to this question can at best be speculative but if the experience of African states' poor commitment to regional arrangements and the loss of policy space this requires are anything to go by it is difficult to be optimistic.

The slow progress in meeting the targets of deeper integration set out by integration arrangements is a conspicuous feature of African regional integration, notably that of SADC. Many reasons have been given for this but one that is relevant to this paper is the loss of policy sovereignty integration

brings about. An important step in the linear process adopted by African integration arrangements is to establish a customs union, which requires member states to sacrifice national independence in setting import tariffs. Two perspectives or positions can be identified in this regard. For some countries, such as South Africa, the import tariff has always been seen primarily as an instrument of industrial policy, a way of protecting selected domestic industries against foreign competition.

However, for many less developed African economies import tariffs are an important, if not the most important, source of government revenue. This effectively places import tariffs within the domain of fiscal policy. Sacrificing tariff decisions (both levels and the distribution of customs revenue) to a supranational regional body implies a loss of sovereignty over an important source of revenue and, in this sense, represents a loss of fiscal sovereignty. This loss of policy space could partly explain the reluctance to progress more rapidly to deeper regional integration by countries that have a much shorter experience of independence than the European economies. To move toward some form of fiscal union would not only expand the loss of national control over revenue but also include external sanction over spending decisions. As developing countries – LDCs in many instances – African economies rightly attach substantial weight to the role of the government and its spending (patterns and levels) as an instrument of development. Fiscal union would be taking the process of integration a step too far to be acceptable to African economies.

The desire for fiscal sovereignty also counts against a popular argument in favour of monetary union, namely that a regional central bank could act as an agency of restraint, thus improving the credibility of macroeconomic policy. It has been argued that the pure economic arguments in favour of African monetary integration initiatives are few but they may 'on political economy grounds, be a second-best solution for African countries that are seeking to make a credible commitment to pursue sound monetary policies' (Guillaume and Stasavage 2000: 1391). If, however, it is accepted that effective monetary union requires strong elements of fiscal union, the agency-of-restraint contention loses some of its force as an argument of why countries would agree to monetary union.

A fundamental source of monetary union instability, clearly revealed by the experience of the eurozone, can be the disparate nature of the economies included in the union. In Africa, this primarily manifests not so much as differences in competitiveness but in exposure to diverse asymmetrical shocks because of differences in the composition of production and trade, which are characterised by dependence on one or two primary commodities as drivers of economic activity

and trade. As far as the product composition of trade is concerned, favourable commodity markets during 2000–2008 have added to concentration in trade by contributing to a fall in the share of sub-Saharan Africa manufactured exports in total merchandise exports. If the custom is followed of defining goods listed in the Standard International Trade Classification (SITC) 5 – 8 (Revision 3)[20] as manufactured products, the share of manufactured exports in total SSA merchandise exports declined from 16 percent in 2000 to 10 percent in 2008, with a commensurate increase in the share of primary commodity exports.

For SADC, the differences in the exposure to external conditions are revealed in divergent movements in the net barter terms of trade.[21] These differences are shown for SADC member states in Table 1.

SADC countries have open economies, as revealed by their respective merchandise trade to GDP ratios, and to the extent that different movements in the net barter terms of trade are indicative of differences in exposure to external forces that the disparate changes in the terms of trade during a ten-year period (2000–2010) are conspicuous. On the improvement side of the scale there are countries at the top end, such as Angola and Zambia, that benefited from increases in the price of oil and copper respectively, whereas diamond-producing Botswana experienced a deterioration in its terms of trade because of the negative impact which the worldwide economic contraction has had on the price of diamonds.

Susceptibility to asymmetric external shocks is one reason to question whether it is appropriate to expect these economies to sacrifice the exchange rate and interest rate as policy variables. Such an expectation may be less than prudent. In fact, external shocks and the differences in economic structures and the challenges the countries face may require some divergence in these variables as instruments of adjustment. However, Table 1 raises the question whether the experience of Lesotho does not contradict this argument. As explained earlier, Lesotho is a member of the CMA and its currency, the loti, is linked to the South African rand at par. Since 2000, Lesotho has experienced a substantial deterioration in its terms of trade, but linked to the appreciating rand (the South African

[20] SITC 5 entails chemicals, 6 entails manufactured goods classified by material, 7 entails machinery and transport equipment and 8 entails miscellaneous manufactured articles. The trade data on which the calculations are based were obtained from Comtrade (2009).

[21] The net barter terms of trade is defined as the percentage ratio of export unit value indexes to the import unit value indexes, measured relative to a base year. In short, therefore, it is the export price index divided by the import price index and multiplied by 100.

terms of trade also improved significantly) the loti also appreciated, which is contradictory to what one would expect as appropriate given the deterioration in the terms of trade. However, a reasonable level of economic stability could be maintained because of Lesotho's SACU membership, which through the revenue distribution mechanism contributed an average of 59 percent of total government revenue during the fiscal years 2006/7 and 2007/8, allowing an average budget surplus of 12 percent of GDP.[22] This means that Lesotho, like Swaziland and Botswana, whose currency, the pula, closely follows the rand, could endure a currency linked to an appreciating rand because of the special dispensation that exists in the form of its SACU membership with its commensurate revenue dispensation.

Table 1: Net Barter Terms of Trade (NBTT) of SADC member states (2000 = 100)

	Merchandise Trade/GDP % 2008	2009 NBTT	2010 NBTT
Angola	102.9	171.7	213.4
Botswana	76.2	88.0	88.1
Congo DR	69.0	111.5	133.7
Lesotho	180.6	80.5	69.2
Malawi	58.3	97.9	89.9
Mauritius	75.1	81.0	73.2
Mozambique	68.1	96.3	108.1
Namibia	84.6	126.6	120.5
Seychelles	...	74.3	76.1
South Africa	65.2	139.2	140.7
Swaziland	140.6	110.2	107.1
Tanzania	47.9	118.3	124.9
Zambia	71.0	159.7	192.6
Zimbabwe	...	108.3	111.1

Source: World Bank (2010)

[22] See the following: Lesotho, Ministry of Finance and Development Planning, Background to the 2009/10 Budget: A Review of Economic Performance, 20003 – 2008; Economic Prospects, 2008 – 2012; and Medium Term Fiscal Framework, 2009/10 – 2011/12, Table 1.6.

The eurozone experience demonstrates the important role of capital markets and of market perceptions in adjusting to intraregional imbalances. Earlier, it has been noted that African economies in many instances do not have developed capital markets that trade in public debt. However, this phenomenon will add to the disparate nature of countries in a regional integration arrangement. In SADC, South Africa which has sophisticated financial markets that are on par with those of developed economies, is anticipated to form part of monetary union with countries like Malawi, Mozambique and Zambia where developed financial markets do not exist. Monetary union will require, and in the linear model of integration presupposes, the integration of financial markets. This could prove to be a conundrum of the first order with real issues arising in member states' willingness to accept a regional regulatory system and the likely dominance of South African institutions.

A further important lesson of the euro experience is the importance of political collaboration and cohesion between member states. Regional integration arrangements such as the EU and those found in Latin America and Africa are first and foremost motivated by political objectives but are constructed primarily by using economic building blocks. Politicians as policy makers have to deal with the loss of policy space, whether economic, social or political, that integration efforts bring about, and in Europe there is wide agreement that the current problems of the eurozone will have to be solved in the political domain, which is dominated by different national perspectives. It must be left to students of politics and African politics in particular, to form a firm view on whether Africa's political leaders will find it easier to cope with the challenges of monetary union, and what this further requires in terms of fiscal integration, than the eurozone leaders.

Considerations of national sovereignty become important and in this respect the observation by Robert Mundell (1961: 661) is apt: 'In the real world, of course, currencies are mainly an expression of national sovereignty, so that actual currency reorganization would be feasible only if it were accompanied by profound political changes'. In view of the poor real progress made with African regional integration,[23] it is hard to believe that African countries in general will be willing to accept the profound political changes required by monetary union. Also, considering the relative youth of the independent nation states in Africa and the efforts made to build national identities, many

[23] There is, to quote Geda and Kebret (2008: 357), 'consensus that regional integration efforts in Africa registered disappointing results'.

countries might be reluctant to sacrifice an important symbol of sovereignty, namely their own currencies.

7. Conclusion

The eurozone used to serve as a model arrangement to be replicated in Africa. However, recent experience has revealed serious shortcomings in the structure and operation of the zone, notably the need to complement monetary union with fiscal integration, the problems that arise if disparate economies are members of a common currency area, and the need for wise and strong political leadership to manage integration and deal with crises that could develop. These factors must be added as further complications to the downside of countries – exposed to asymmetrical external shocks – that have to sacrifice sovereignty in monetary policy, including exchange and short-term interest rates, to a regional central bank. In view of these considerations monetary union, especially within the time frame envisaged in African integration arrangements, is a step that should be considered with great caution, if at all.

Supporters of the goal of monetary union in African regional integration arrangements may be tempted to refer to the CMA and CFA franc zone, instances of monetary integration arrangements noted for their longevity, in support of the argument that monetary union can work in Africa. This would be false reasoning. Both these arrangements are not examples of monetary union of the form featured in this paper and anticipated by arrangements such as SADC, but are unique monetary integration exercises based on the principle of linked currencies, each firmly rooted in pre-independence history, and hardly replicable.

Scepticism about the wisdom of monetary union in the sense of having a regional central bank and a common currency in African integration arrangements does not imply scepticism about the benefits that are to be derived from increasing trade in services, including financial services. A critique of the linear model of integration adopted in the African context has been provided elsewhere;[24] suffice it note that a crucial point of criticism is that strict adherence to this model ignores in early pre-common market stages of integration the importance of intraregional trade in services in facilitating regional growth and development. Opening markets in the region to trade in financial services can contribute to enhancing economic efficiency by facilitating trade in goods and investment.

[24] See footnote 2.

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