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Is SACU Ready for a Monetary Union?

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ABSTRACT

Attaining a monetary union is an ambition for most African regional economic communities. Although studies have been undertaken on the costs and benefits of monetary unions, there has been little focus on the viability of a Common Monetary Area for member states of the South African Customs Union (SACU). The paper seeks to determine the challenges SACU may face in working towards achieving a monetary union objective. Given that SACU by itself has no criteria for evaluating macroeconomic convergence – a key prerequisite for realising a monetary union – the paper uses criteria formulated by the Southern African Development Community to answer this fundamental question. The study finds that it would be beneficial for SACU to establish a monetary union. In such a case, the South African Reserve Bank could continue formulating a monetary policy for a possible SACU monetary union. A key challenge in obtaining this goal is the disparity across SACU member states and their poor macroeconomic performance over the years. Further studies would help to provide deeper insight on SACU's readiness for a monetary union. These include a cost-and-benefit analysis of the possibility of a monetary union using the conventional criteria of optimal currency areas; and further statistical tests on the significance of the marginal macroeconomic convergence so far realised within SACU.

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ABBREVIATIONS AND ACRONYMS

ASEAN	Association of Southeast Asian Nations
BCEAO	Central Bank of West African States (*La Banque Centrale des Etats de l'Afrique de l'Ouest*)
BEAC	Bank of Central African States (*Banque des États de l'Afrique Centrale*)
BNLS	Botswana, Namibia, Lesotho and Swaziland
CEMAC	Central African Economic and Monetary Community
CFA	African Financial Community (*Communauté Financière Africaine*)
CMA	Common Monetary Area
DRC	Democratic Republic of Congo
EAC	East African Community
EACB	East Africa Central Bank
EAMU	East African Monetary Union
ECA	Economic Commission for Africa
ECB	European Central Bank
ECDPM	European Centre for Development Policy Management
EMU	European Monetary Union
GDP	gross domestic product
GIIPS	Greece, Ireland, Italy, Portugal and Spain
IMF	International Monetary Fund
REC	regional economic community
RMA	Rand Monetary Area
SACU	South African Customs Union
SADC	Southern African Development Community
SARB	South African Reserve Bank
WAEMU	West African Economic and Monetary Union

INTRODUCTION

As regional economic communities (RECs) strive to deepen their level of integration, an increasing number are considering forming a monetary union.[1] Of the 14 RECs that existed in 2001, nine have expressed the objective of attaining a full economic union (monetary and fiscal integration).[2] In Latin America the Mercosur countries,[3] the Andean Community[4] and the Central American Common Market countries[5] have held informal discussions on their monetary union ambitions. Similar intentions have been voiced within the Caribbean Community (CARICOM)[6] for a Caribbean single currency and a proposed 'Amero' or NAFTA dollar in North America,[7] while the Association of Southeast Asian Nations (ASEAN) has conducted a feasibility study on a common ASEAN currency. After a trial period of several years, in 2010 the Gulf Cooperation Council launched a new plan for a currency area, to be called the Gulf dinar.[8] Of course, the European Monetary Union (EMU) has always been a prime example of reference for monetary unions, given its unprecedented scope and success.

In the Southern African context, the Southern African Development Community (SADC)[9] has established a framework for outlining procedures and milestones that need to be realised for achieving the necessary macroeconomic convergence for a unified Common Monetary Area (CMA). This form of monetary union is already active in the Southern African Customs Union (SACU), which maintains national currencies but has a unified monetary policy that is pegged to a regional anchor currency.

Studies have been conducted on the benefits of a monetary union and the use of currency areas in Africa, but little work has been done on the readiness of SACU for a monetary union, assuming it decided to upgrade the CMA. The paper seeks to contribute to filling that knowledge gap by identifying challenges or hurdles SACU may face in moving towards a monetary union. Key to this is the question of convergence. Monetary unions limit the capacity of individual states to manage their own financial affairs by centralising monetary policy, and as such a union without convergence can give rise to inappropriate policies and expose countries to damaging idiosyncratic shocks.

The paper begins with a review of the CMA theoretical framework, and a practising example of this in the form of SACU. It then analyses the possible costs and benefits that a monetary union could offer compared with a CMA. The question of the state of convergence between member states will be identified as a key determinant of the benefits of a monetary union, with this fact demonstrated by comparative case studies of EMU and the African Financial Community (CFA). The paper examines the level of convergence within SACU, and therefore its preparedness for a monetary union, before offering its final conclusions and policy recommendations.

COMMON MONETARY AREA FRAMEWORK

The perceived need to fast-track regional integration has motivated a proliferation of RECs. Although RECs help to facilitate integration, they also set limits on the extent of integration. Just as free trade agreements often maintain selective barriers to trade, monetary arrangements often stop short of a full currency union. In the case of SACU, the point of compromise is the freely transferrable, pegged-currency regime of a CMA. There is increasing economic debate on the benefits and costs of such an arrangement.

In a CMA, there exists a de facto or anchor currency that is accepted as a medium of exchange within the monetary area. This anchor currency is accompanied by rules that govern a CMA's operations, such as limiting the mandate of local central banks within a CMA (notably the financing of fiscal deficits through monetary expansion, so-called quantitative easing); maintaining sound macroeconomic performance; and uniform guidelines for prospective and existing members. Other rules relate to the governance of inflation rates – both current and expected – and keeping a CMA's internal exchange rates within the margins of the de facto currency.[10] Debates continue about the possibility of extending these rules to regulate deficits and debt, and on how to vary deficit ceilings along the business cycle.[11]

Decision making under a CMA is therefore constrained by both the rules and reliance on the anchor currency. Although there are often mechanisms to promote consultation among member states, a central bank or currency board, in particular the central bank of the member state with the anchor currency, becomes the primary decision-making organ.

Box 1: Key decision-making processes and functionalities of a CMA[a]

- Small CMA member countries have a right to issue national currencies through their respective central banks. Currencies of CMA member countries and the anchor currency are the only legal tender for the respective member countries.
- Central banks of CMA member states are required to maintain foreign reserves at least equal to their total local currencies in circulation.
- There are no restrictions on the transfer of funds, except for liquidity requirements for financial institutions.
- CMA member states are free to invest in the dominant country's capital and monetary markets through specified securities.
- There are exchange control regulations that govern the issuing and receipt of gold and foreign exchange by authorised dealers in the CMA.
- The dominant country compensates the smaller countries for their forgone seigniorage,[b] given that the smaller countries' currencies are not legal tender in the wider CMA.
- There is a commission with equal representation from CMA member states consisting of technocrats and monetary authorities. The commission holds regular consultative meetings to discuss and reconcile member states' monetary and foreign-exchange policy interests.
- Besides the commission, there is a tribunal that arbitrates disputes arising from CMA implementation.

a For a discussion on the institutional framework and features of a CMA, see Wang JY *et al.*, 'The Common Monetary Area in Southern Africa: Shocks, adjustment, and policy challenges', IMF (International Monetary Fund) Working Paper, WP/07/158, 2007, http://www.imf.org/external/pubs/ft/wp/2007/wp07158.pdf.

b This is the difference between the value of money and the cost to produce it.

Source: Authors' compilation.

Interest rates of smaller countries often follow that of the anchor country's, regardless of prevailing economic conditions, in an effort to eliminate currency mismatching.[12]

COMMON MONETARY AREA IN SACU

In the case of the SACU CMA, the South African rand acts as the anchor currency, and the policies of the South African Reserve Bank (SARB) are widely influential among the CMA states of Namibia, Lesotho and Swaziland. Botswana is the only member of SACU to stand outside the CMA, instead managing its currency based on a basket of currencies, of which the South African rand holds an approximate 60% weighting.

In response to a changing regional political, economic and social environment, SACU and CMA members have signed new agreements and amended old ones, as presented in Table 1.

Table 1: CMA and SACU: Major events in history

Period	Monetary agreements	Customs union
Pre-1960	Informal monetary union. Following the establishment of SARB in 1921, the South African pound became the common currency.	Arrangement became effective in 1910.
1960s	Countries became independent (except Namibia). The rand replaced the pound in 1961.	A new agreement, outlining the revenue-sharing formula, was reached on 11 December 1969. It stipulated that the shares of the smaller members were determined based on the revenue-sharing formula, with the residual allocated to South Africa.
1974–75	South Africa, Botswana, Lesotho and Swaziland signed the Rand Monetary Area (RMA) treaty on 5 December 1974. Swaziland set up its own monetary authority and introduced its national currency, the lilangeni, pegged at par to the rand. Botswana opted to withdraw from the RMA in 1975.	
1980	Lesotho established its own central bank and issued its national currency, the loti, at a one-to-one rate to the rand, in January 1980.	
1986	South Africa, Lesotho and Swaziland signed the CMA Trilateral Agreement in April 1986, replacing the RMA.	

Period	Monetary agreements	Customs union
1989	The CMA was amended to remove exchange restrictions arising from the limitations on conversion of balances upon termination of the agreement or withdrawal of one party.	
1992–1993	Namibia became independent in 1990. The Multilateral Agreement replaced the Trilateral Agreement when Namibia joined the CMA in 1992. It issued its national currency, the Namibian dollar, in 1993.	
2003	After 17 years of interruption, Swaziland re-authorised the use of the rand as legal tender alongside the lilangeni in the country.	Revised SACU Agreements and the formation of a new revenue-sharing formula with a development component.

Source: Adopted and updated from Wang JY *et al.*, 'The Common Monetary Area in Southern Africa: Shocks, adjustment, and policy challenges', IMF Working Paper, WP/07/158, 2007, http://www.imf.org/external/pubs/ft/wp/2007/wp07158.pdf.

All SACU and CMA states are also members of SADC, and the future of the CMA is largely contingent on the evolving monetary integration of the larger grouping. The SADC Regional Indicative Strategic Development Plan sets out a target to realise a SADC monetary union by 2016 and a common currency by 2018. This seems ambitious, given the frameworks and institutions that are required for a monetary area operation.

Even if this timeframe was feasible, there remains uncertainty as to whether the benefits of deeper monetary integration outweigh the costs. Linking a local currency to an anchor currency can improve macroeconomic stability as opposed to operating under a flexible exchange rate. Under a flexible exchange rate regime, commodity prices often become unstable, and can in turn create disturbances in smaller SADC economies, particularly if their currencies are depreciating; thereby resulting in general price-level volatility. However, although a CMA would have a better capacity to cope with these disturbances,[13] it would have less capacity to deal with the idiosyncratic shocks and development challenges that might only occur in certain member states, which would have lost their capacity to tailor monetary policy to their needs through the centralisation of monetary control. Individual countries could face the effects of differentiated external shocks due to differences in their production, consumption and expenditure patterns; market characteristics (monopolistic/competitive); and level of openness, among others. Asymmetric shocks could cause havoc to individual economies under independent currencies. Box 2 summarises the costs and benefits of a monetary union.

Box 2: Benefits and costs of a common currency

Benefits	Costs
• Ties domestic inflation to partner's inflation or targeted currency area inflation rate – establishes an anchor for monetary policy and imports credibility. • Decreases transaction costs. • Improves microeconomic efficiency by increasing price transparency between partners. • Eliminates costs associated with exchange rate uncertainty vis-à-vis partner countries – eg hedging. • Can reduce the risk premium on interest rates in the home country – currency and inflation risk. • Can be a catalyst for further economic integration – endogeneities. • Protects against domestic lobbies promoting exchange-rate manipulation. • Reduces risk of speculative attack on home country currency.	• Loss of ability to maintain an independent monetary policy. • Loss of exchange rate adjustment flexibility to terms of trade, and other shocks. • Shocks to partner countries can be transmitted to home country. • Loss of national sovereignty. • Weakened accountability of policy makers to national citizenry. • Loss of seigniorage (under dollarisation). • One-off changeover costs.

Source: Adopted from Hunt C, *A Fresh Look at the Merits of a Currency Union*, Reserve Bank of New Zealand: Bulletin, 68, 4, 2005, http://www.rbnz.govt.nz/research/bulletin/2002_2006/2005dec68_4hunt.pdf.

The trade-off between greater stability and more domestically appropriate policies is particularly important in the case of a region as diverse as SADC, particularly if monetary control remains largely in the hands of South Africa. The size and influence of the country and the sophistication of SARB, means that South Africa would in all likelihood remain very influential. However, the South African economy is very different to those of the region, facing different types of shocks and development challenges, and thus possibly requiring a different monetary policy.

SADC's Committee on Central Bank Governance adopted initiatives that need attention, as it marches towards the desired monetary integration (see Table 1). However, the predominance of South Africa's economy and its advanced financial system compared with other SADC member states – as well as the majority of these countries' dependence on foreign aid – raises the question of whether there is a place for the CMA under the SADC ambitions of monetary integration, when this would imply a revised framework or an expanded CMA.[14] It remains to be seen if resource-rich countries such as Angola, Zambia and the Democratic Republic of Congo (DRC); countries with high per capita income such as Mauritius, Mozambique and Seychelles; and countries experiencing fiscal pressure such as Swaziland and Malawi, would be willing to peg their currency to the rand. Zimbabwe's continued use of multiple currencies aimed at restoring confidence in the country's monetary system suggests that its joining the CMA remains unfeasible in the foreseeable future.

One of the greatest threats to a monetary union is therefore the existence of large structural differences between member states, which can give rise to the type of idiosyncratic shocks and challenges that a regional monetary policy is not equipped to handle. However, given the requisite level of convergence between economic fundamentals, monetary unions can avoid this problem and be better equipped to tackle common challenges. To demonstrate the role of convergence in the success of monetary unions, the paper will now turn to case studies of the EMU and the CFA.

CASE STUDIES OF MONETARY UNIONS AND CONVERGENCE

The European Monetary Union

EMU is an umbrella term for the group of policies aimed at converging the economies of all members of the EU in three stages. Both the 17 eurozone states and the 10 non-euro states are EMU members. A member state, however, needs to reach the 'third EMU stage' before being able to adopt the euro currency, and as such the 'third EMU stage' has also become largely synonymous with the eurozone. The EU is perhaps the best example available of an optimal currency union, and for years the success of the euro epitomised the hypothetical benefits of a monetary union. The euro helped to maintain monetary discipline, keep inflation rates low, and decreased cross-border transaction costs. This was despite the incredible diversity of the EU, incorporating a range of different-sized economies, with different economic structures and facing different development challenges; all operating under a Stability and Growth Pact, which provided insufficient incentives to abide by convergence guidelines.

The 2008 financial crisis provided exactly the kind of shock that centralised monetary control struggles to handle. The crisis hit all of Europe and triggered a common reaction. The European Central Bank (ECB) certainly had a greater capacity to respond than individual nations would have had. However, the crisis affected different European states differently, and although the likes of Germany, France and many Eastern European states had the capacity to cope with the crisis, heavily indebted GIIPS (Greece, Ireland, Italy, Portugal and Spain) countries were threatened with economic collapse. Even within this vulnerable group there were broad differences, with Greece, for example, having a heavily indebted national government, whereas Spain faced a heavily indebted private sector.

There is widespread debate over how countries in crisis should react. Although this point is certainly not settled, one option would certainly be to devalue their currency as a means of reducing debt obligations and improving export performance, with the ensuing decreasing debt loads and increasing growth helping to restore confidence in the solvency of the nation. Whether this would work in the case of the GIIPS countries, or even the most extreme case of Greece, remains a highly contentious question. However, one thing is certain: GIIPS does not have the option of making use of such a strategy because of the EMU. If similar shocks were to hit a more unified Southern African region, the same question of lack of capacity to manage these shocks would arise. This is particularly important in a region that is more crisis prone with far less capacity to provide the type of massive fiscal stimulus that the EMU used to circumvent biting questions about its inability to revalue individual currencies.

The African Financial Community franc zones

The two CFA franc zones pre-date the eurozone by 54 years, having their roots in the colonial era. The CFA zones were created during the French colonisation of North and West Africa, and split between two zones. The West African Economic and Monetary Union (WAEMU) covers Benin, Burkina Faso, Côte d'Ivoire, Senegal, Togo, Mali, Niger and Guinea-Bissau. The Economic and Monetary Community of Central Africa (CEMAC) covers Cameroon, Gabon, the Central African Republic, the Republic of Congo, Equatorial Guinea and Chad. Each area has a central bank, the Central Bank of West African States (BCEAO) and Bank of Central African States (BEAC) respectively, both of which are independent of their member states and which have stringent rules for monetary financing of fiscal deficits. The CFA franc exchange rate is pegged to the euro through a guarantee of convertibility by the French Treasury, with the relationship between the two further managed by requirements on the holding of reserves by the two central banks.

The CFA areas are powerful examples of monetary unions that have shown incredible durability even in a highly unstable region, and which seem to validate many of the benefits of such a union, with the region showing consistently low and stable inflation rates. Although there have been periods of instability during revaluations of the currency by the French Treasury, most noticeably in 1994, the region has remained largely stable. Growth rates are perhaps less convincing, with WAEMU in particular trending below the levels of non-oil gross domestic product (GDP) growth found on the rest of the continent. However, given the instability and complexity of the region, it would be hard to pin this underperformance on the currency area.

A key component of the longevity of the CFA areas has been the level of convergence between the member states. A study by the Economic Commission for Africa (ECA) shows that the dispersion of the fiscal balance for the CEMAC and WAEMU countries was very low, and that income per capita showed positive, if limited, convergence in both regions.[15] There are major differences in the economic structure of CFA states, most noticeably being that many are oil exporters while others are oil importers, which are largely reliant on cash crops such as cocoa and coffee. This divergence can be incredibly important, since these commodities are exactly the kind that are vulnerable to external shocks and require constant management. The CFA areas are, however, largely successful in managing this – in no small part due to the fortunate historical accident that all oil exporters are grouped into CEMAC, whereas none are in WAEMU. The use of subgroups that take cognisance of the economic structure of member states therefore supplements the fundamental convergence found within the region. There remains major divergence, however, in the wealth of the various countries. The regions include very large and sophisticated economies such as those of Senegal and Côte d'Ivoire, as well as tiny countries such as Guinea-Bissau and extremely economically vulnerable countries like Mali. Mali has a per capita GDP of approximately 6% of Gabon's, a figure that dwarfs the largest SACU difference, in which Lesotho's per capita GDP stands at 14% of South Africa's. Overall, although the CFA area highlights the importance of economic convergence in key areas such as policy and commodity reliance, it also highlights that states at very different stages of development can coexist in a monetary union. Table 2 summarises key features of the monetary unions explored thus far.

Table 2: Main features of selected monetary unions

	WAEMU	CEMAC	EMU	CMA
Number of countries	8	6	17	4
Single currency	Yes	Yes	Yes	No, but rand is a de facto currency
Common central bank	Yes (BCEAO) but French Treasury has influence	Yes (BEAC) but French Treasury has influence	Yes (ECB) but national central banks execute monetary policy	No, but SARB has influence
Common pool of reserves	Yes	Yes	Yes	No
Regional surveillance of fiscal policy	Yes	Yes	Yes	No
Free trade area	No	No	Yes	Yes
Common external tariff	Yes	Yes, in principle	Yes	Yes
External current account convertibility	Yes	Yes	Yes	Yes
Degree of capital mobility within the region	Low, in principle free	Low, in principle free	High	High
External exchange rate anchor	Yes, pegged to the euro	Yes, pegged to the euro	No	No

Source: Adapted and updated from Wang JY *et al.*, 'The Common Monetary Area in Southern Africa: Shocks, adjustment, and policy challenges', IMF Working Paper, WP/07/158, 2007, http://www.imf.org/external/pubs/ft/wp/2007/wp07158.pdf.

MACROECONOMIC CONVERGENCE IN THE SACU REGION

To build a solid and sustainable monetary union, macroeconomic convergence is therefore an important prerequisite. The successful transition of a bloc from a simple REC to a monetary union presupposes that countries fulfill different convergence criteria.

At present SACU does not have macroeconomic convergence criteria. In the absence of this, the convergence criteria of SADC can be used for the analysis of their performances. The use of the SADC criteria can be justified by the fact that all SACU members are also members of SADC and therefore they are obliged to respect those criteria. The SADC criteria list progressive targets of inflation, fiscal deficit, national debt, and the holding of reserves. These criteria are presented in Table 3.

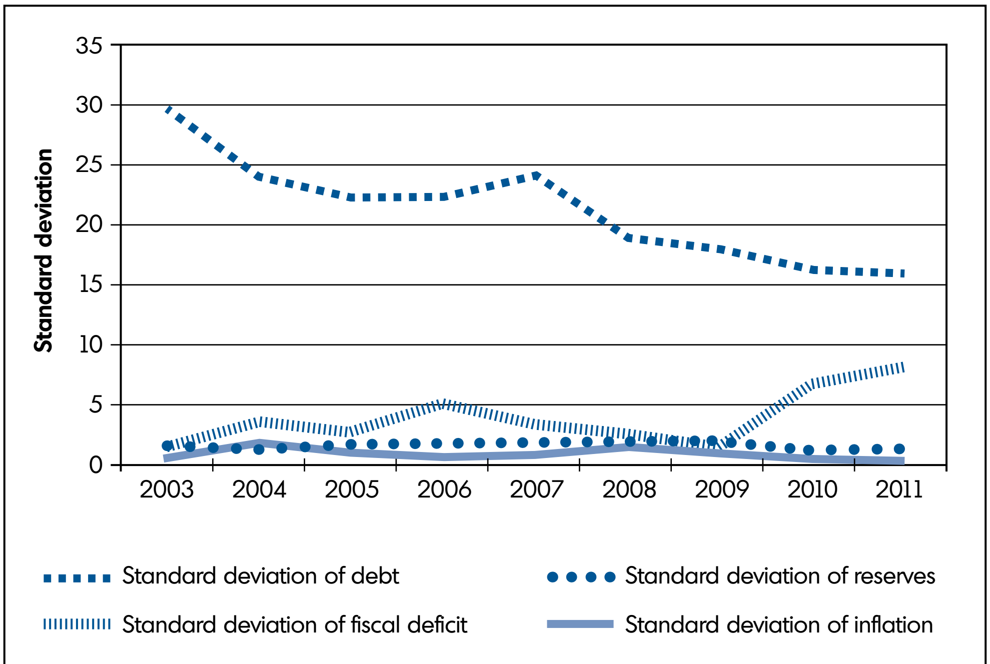
Table 3: Macroeconomic convergence criteria

Indicator	Timeline		
	2008	2012	2018
Inflation	Single digit	5%	3%
Fiscal deficit	< 5%	Between 2% and 4%, anchored at 3%	Between 2% and 4%, anchored at 3%
National debt	< 60%	< 60% of GDP	
Reserves	3 months of imports of goods and services		

Source: Adapted from Mbao FZ, 'Re-examination of SADC macroeconomic convergance criteria', Bank of Zambia Working Paper, 2011, http://www.sadcbankers.org/Lists/News%20and%20Publications/Attachments/148/Re-exam%20of%20MECcriteria%20BoZ.pdf.

The convergence in macroeconomic indicators suggests that monetary and fiscal policies are well co-ordinated. The co-ordination of those policies is a necessary foundation for moving the REC through the various phases of integration towards establishing a monetary union. Figure 1 shows the standard deviations of the different criteria from 2003–11. A low standard deviation suggests a low volatility in a criterion, and therefore indicates a greater convergence of member economies of a REC to a given target.

Figure 1: Dispersion of inflation, fiscal balance, debt and reserves in the SACU monetary union, 2003–11



Source: Authors' computation from IMF, 'eLibrary Data', http://elibrary-data.imf.org.

Data reveals a continual decrease in the inflation rate over the period under review, and inflation is expected to reach a level of 5.75% in 2011. There is therefore evidence of a trend towards the 2012 inflation rate target of less than 5% (< 5%). It is also important to note that the variability of inflation was relatively low and stable during the period under review. This suggests a tendency among SACU countries to have convergence in macroeconomic policy, particularly in monetary policy, during the specified period of time. This convergence is facilitated by the peg to the rand, which plays both an important role in the monetary stabilisation of the region and the spread of a common monetary policy, through the influence of SARB.

The second criterion is debt as a percentage of GDP, which should be lower than 60%. In fact, the ratio of debt to GDP is low and has been relatively low for the whole period, meeting the target of less than 60% (< 60%) of GDP. Even Lesotho, which had a high ratio at the beginning of the last decade (66.8% in 2003), has made substantial efforts to reduce this ratio and fulfill the requirement. The dispersion of debt has decreased significantly over time, suggesting convergence among members.

The third criterion is related to the fiscal balance as a percentage of GDP. By 2008 almost all the countries reached the target of less than 5% (< 5%). However, the fiscal deficits of 2009 and projections for 2010 and 2011 show that it will be difficult for countries to reach the target of 3% in 2012. In fact, the dispersion analysis reveals a strong volatility of fiscal deficit in the SACU monetary union. This deficit is also increasing over time owing to the lack of fiscal discipline of some members, such as Lesotho and Swaziland.

The last criterion is the reserve requirement, in terms of months of imports of goods and services, which have been increasing in the whole region over the period. However, the economic outlook for 2012 showed that Swaziland has faced a decrease in its reserves since 2010. The weak economic outlook was, in part, a manifestation of low foreign-reserve levels to an extent that in 2011 the reserves did not cover the recommended three months of imports. Nevertheless, our calculations reveal a low level of variability of reserves and a decrease in variability over time. This suggests that there is convergence in the region as far as the reserves are concerned.

The results of other studies largely confirm our findings. A study conducted by the ECA in 2008 using statistical tests on the robustness of inflation and fiscal deficit convergence in SADC countries revealed a tendency towards convergence in monetary and fiscal policies among SADC countries over time. As SACU countries are also members of SADC, we can conclude from the results of the ECA study that there is a convergence among the SACU countries as far as the monetary and fiscal policies are concerned.

In analysing macroeconomic convergence in the SACU region, Maleke[16] found a strong convergence in monetary policy but not in fiscal policy. A study on macroeconomic performance in the SADC region also shows that inflation has been lower in the RMA zone than in other member countries. The inflation rate during 1990–2002 was estimated on average at 9.2% in the CMA zone, 801% for all non-CMA countries, and 27.8% for the non-hyperinflation non-CMA countries (excluding the DRC, Angola and Zimbabwe). The strong performance of CMA member countries is attributed to the fact that monetary policy has been conducted by only one monetary authority, SARB.

Accordingly, despite the fact that the CMA is not a full monetary union because members do not have a single currency and single central bank, it is important to note that monetary integration in this CMA is considered high, with CMA members generally able to withstand shocks. This is further justified in part by the fact that the CMA has survived for a long period, although Botswana left the monetary area in 1975. Scholars[17] believe that Botswana decided to withdraw from the RMA mainly because it wanted to retain the ability to formulate and implement its own monetary policy and to adjust the exchange rate in response to shocks affecting its economy. However, Botswana has maintained close links between its national currency, the pula, and the rand through a currency basket peg, with the rand taking approximately 60% of the weight.

CONCLUSION

In view of the progress already realised by the CMA under SACU, it could be worthwhile for countries to move towards a full monetary union by using a single currency. South Africa, particularly SARB, could then continue to play the leading role in this process, capitalising on the experience of the CMA. The experience of the EMU and CFA franc zones highlight the importance of convergence as a necessary prerequisite for a working monetary union. Although there remains a substantial divergence in the size and structure of SACU economies, there is a strong convergence in key macroeconomic variables such as inflation, debt levels, and reserve holdings – much of which is facilitated by the high level of monetary policy convergence already at work within the CMA.

Nevertheless, the co-ordination of fiscal policy is still a possible weakness in the CMA. The biggest problem concerns Lesotho and Swaziland, given that their fiscal deficits respectively reached 20% and 14% of GDP in 2010 and are expected to be 21% and 13% of GDP in 2011. A strong emphasis should be placed on finding a solution to this issue before considering furthering monetary union ambitions in the region, like the use of a single currency.

In order to ensure that the benefits of a monetary union in the SACU and SADC zones outweigh the costs, a high level of convergence is required, and further studies are needed to establish whether these zones fulfill enough of the conventional criteria for an optimum currency area. Although the paper's analysis has revealed the existence of convergence in many of the macroeconomic criteria (inflation rate target, debt as a percentage of GDP and imports reserves requirement) in the CMA zone, further statistical tests on the robustness of convergence of the different criteria are needed to confirm whether or not there is a tendency for convergence of monetary and fiscal policies among CMA countries over time.

ENDNOTES

1 For discussions on proposals of monetary unions around the world among various RECs see, for example, Masson, PR & C Pattillo, *Monetary Union in West Africa (ECOWAS): Is It Desirable and How Could It be Achieved?*, Occasional Paper, 204. IMF, 2001; Laabas B & I Limam, *Are GCC Countries Ready for Currency Union?* Kuwait: Arab Planning Institute, 2002; Robson WBP & D Laidler, *No Small Change: The Awkward Economics and Politics of North American Monetary Integration*, CD Howe Institute Commentary Discussion Paper, 167. 2002.

2 McCarthy C, *Monetary Union: The Experience of the Euro and the Lessons to be learned for the African (SADC) Monetary Union*. Stellenbosch: TRALAC, 2012, p. 5.

3 These include Argentina, Brazil, Paraguay, Uruguay and Venezuela as full members; as well as Bolivia, Colombia, Equador, Peru and Chile as associate members of Mercosur.

4 Consisting of Bolivia, Colombia, Ecuador, Peru and Venezuela (which withdrew from the Community in 2006).

5 Discussions among the Central American Common Market countries have included Costa Rica, El Salvador, Guatamala, Honduras and Nicaragua.

6 The 15 Caribbean islands – Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Lucia, Suriname, St Kitts and Nevis, St Vincent and the Grenadines, and Trinidad and Tobago.

7 The North American countries include Canada, Mexico and the US.

8 The Gulf Cooperation Council was founded in 1981, comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, with an initial goal of realising a monetary union. This ambition has not yet been realised owing to various challenges.

9 SADC draws its membership from Angola, Botswana, the DRC, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe, http://www.sadc.int/member-states, accessed 17 April 2013.

10 Meeting such guidelines and rules often demonstrates political commitment and fairness by member states to uphold underlying conditions. For a discussion on this see Asonuma T, Debrun X & PR Masson, 'Welfare effects of monetary integration: the Common Monetary Area and beyond', IMF Working Paper, WP/12/136, 2012, http://www.imf.org/external/pubs/ft/wp/2012/wp12136.pdf. The discussion includes the benefits for Lesotho of using the rand as a de facto currency.

11 For discussions see Hawkins J & PR Masson, *Economic Aspects of Regional Currency Areas and the Use of Foreign Currencies*, BIS (Bank for International Settlements) Papers, 17. Basel: BIS, May 2003, pp. 4–41; Masson, PR & C Pattillo, *op cit.*

12 Intuitively, since income is in the same currency, there is no real scope for independent national monetary policy; in addition, stabilisation mechanisms are typically put in place.

13 See, for example, Lesotho's macroeconomic conditions and potential challenges under a fixed exchange rate as discussed by Tabo F, *Regional Currency Areas and the Use of Foreign Currency: Lesotho Experience*, BIS Papers, 17. Basel: BIS, pp. 128–33, 2003.

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