CURRENCY CONVERTIBILITY AND PAYMENTS ARRANGEMENTS BETWEEN THE COMMON MONETARY AREA AND THE PREFERENTIAL TRADE AREA FOR EASTERN AND SOUTHERN AFRICAN STATES

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ABSTRACT

This thesis analyses the impediments of inconvertible currencies on intra-regional trade within the Eastern and Southern African region. Currency inconvertibility is a non-tariff trade barrier which limits and distorts international trade expansion. Therefore, alternative arrangements that may be used in order to remedy this problem are considered.

Exchange rate misalignment is identified as a major cause of currency inconvertibility. It is shown that the implementation of macroeconomic policies and exchange rate regimes which are not complementary cause exchange rate misalignment resulting in balance of payments disequilibria leading to currency inconvertibility.

Since the preconditions for transformation to full currency convertibility have not been met by most countries in the region this thesis suggests a mechanism that will enable the use of local currencies for intra-regional trade (partial currency convertibility). The most viable arrangement under the prevailing conditions in the Eastern and Southern African region is the reserve fund to which member countries contribute a fraction of their international reserves. This contribution will be determined according to the levels of intra-regional trade in which they engage. This arrangement will guarantee that even if a member state cannot honour its payments' obligation it will be able to draw on the facility to make payment. The advantages of this facility are that it will guarantee that payments for intra-regional trade will be made and that the contributions by member countries will be more affordable than the other arrangements as well as its potential for assisting in creating closer economic relations in the region. The thesis concludes, however, that member countries should be encouraged to move towards full currency convertibility and hence an arrangement for purposes of intra-regional currency convertibility should be strictly transitionary.

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LIST OF ACRONYMS

ALADI -	The Latin American Integration Association
BLSN -	Botswana, Lesotho, Swaziland, Namibia
CAMA -	Central American Monetary Arrangement
CFA -	Communité Financière Africane
CPI -	Consumer Price Index
EU -	European Union
EMA -	Europen Monetary Arrangement
EPU -	European Monetary Union
ERER -	Equilibrium Real Exchange Rate
ESAF -	Enhanced Structural Adjustment Facility
GDP -	Gross Domestic Product
GNP -	Gross National Product
GRA -	General Resource Account
LDC -	Less Developed Country
NAFTA -	North American Free Trade Agreement
OGIL -	Open General Import License
PTAPU -	Preferential Trade Area Payment Union
PPP -	Purchasing Power Parity
PTA -	Preferential Trade Area for Eastern and Southern African States
RER -	Real Exchange Rate
RERMIS -	Real Exchange Rate Misalignment Index
RMA -	Rand Monetary Area
SACU -	Southern African Customs Union
SAF -	Structural Adjustment Facility
SDR -	Special Drawing Right
SITC -	Standard Industrial Trade Classification
SWIFT -	Society for Worldwide Interbank Financial Transmission
UAPTA -	Unit of Account Preferential Trade Area

CHAPTER 1

INTRODUCTION

The economic challenges which face the East and Southern African region are immense. Recent political changes which have taken place in other regions (e.g. Eastern Europe) have made a strong impression on the political and economic outlook in Africa. The world-wide move towards democratisation has also changed the economic conceptualisation of international trade. Governments in the region which were opposed to free trade in the past (to a large extent for political reasons) are now accepting the advantages of interacting in world trade.

A substantial move of focus with respect to economic aid, away from East and Southern Africa to other regions has taken place. New avenues for investment in Eastern Europe, previously not open, are now becoming more attractive than those in the Sub-Saharan region. Furthermore, the last few years have seen significant political changes in South Africa. This has made it acceptable for other countries in the region to commit themselves to political relations and open trade with South Africa.

A solution to some of the region's economic problems may result from the incorporation of South Africa into regional trade. With a new political dispensation in the making, other countries in the region are regarding South Africa as a viable political and economic ally. South Africa has the largest and most advanced economy in East and Southern Africa which, through trade, has the potential of augmenting the rest of the region's well-being as well as that of its own. South Africa's advantageous position derives from:

(a) a wealth of human, natural and financial resources;

(b) a highly developed infrastructure of roads, railways and ports;

(c) advanced banking and telecommunications systems; and

(d) increasingly strong ties with the countries of Europe, Asia and America.

Regional economic co-operation has gained momentum in recent years and both developed and developing countries are looking to create trading blocks. The most powerful trading blocks are the European Union (EU) and the North American Free Trade Area (NAFTA). These trading blocks, which are in effect gigantic markets, impose tariffs on external trade. This will, unquestionably, have a negative effect on the economies of developing countries if they have to compete with these blocks individually.

These developments, more than ever before, bring about the necessity of eliminating regional tariff and non-tariff[1] barriers, in Eastern and Southern Africa. One of these non-tariff trade barriers - currency inconvertibility, which is the focus of this thesis, - is a result of the nonacceptance of local currencies for settlement of regional trade payments. Since most Central Banks in the region do not guarantee the convertibility of local currency balances which are held by foreigners into any other currency, regional trade is often settled in foreign currencies (or convertible currencies such as the US dollar). The inconvertibility of currencies may then divert potential regional trade to outside the region where currency convertibility is assured.

Difficulties with payments for international trade can be attributed to the fact that most countries have their own individual currencies.[2] These monies can be permitted, by the government of a particular country, to be used for trade transactions in different ways. At the one extreme, governments may legislate that their currencies are to be inconvertible, that is, not freely exchangeable for other currencies, thereby restricting foreign trade. At the other extreme, the government can choose to eliminate all restrictions on foreign trade and make its currency perfectly convertible.

Currency inconvertibility is often a result of balance of payments difficulties. Lack of foreign

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[1]It has been found that non-tariff barriers are more of an impediment to intra-regional trade than tariffs (SADCC, 1991).

[2]It is clear that if all countries were to use the same currency this barrier to trade would be eliminated. This is not to say that a single world currency is ideal as the theory of optimal currency areas demonstrates. This is not a viable condition for economic as well as political reasons.

currency, often as a result of misaligned exchange rates, leads governments to follow the route of currency inconvertibility rather than implementing the correct exchange rate and other macroeconomic policies. Ideally, in terms of expanded international trade, currencies should be made fully convertible for current account transactions.[3] However, transformation to full currency convertibility may be problematic if the preconditions are not met. Therefore, it may be necessary to implement a transitional arrangement on the way to full currency convertibility. The transitional arrangement may take the form of non-monetary arrangements such as imposing other trade restrictions or allocating a fixed amount of foreign exchange through the market, or monetary arrangements using a clearing mechanism for regional trade payments.

In the Eastern and Southern African area there are two monetary arrangements which assist in eliminating the problem of currency inconvertibility among its members (or partial currency convertibility). These are the Preferential Trade Area for Eastern and Southern African States (PTA)[4] and the Common Monetary Area (CMA).[5] However, the two arrangements are separate and do not create currency convertibility for the area as a whole. Effectively, since Lesotho and Swaziland are members of both arrangements it is only those PTA currency balances held by South Africans (excluding Lesotho and Swaziland) which are inconvertible. Since the rand is a fully convertible currency, all rand balances held by PTA members are guaranteed convertibility.

Chapter two discusses the definition of currency convertibility and the extent to which PTA currencies are convertible. This is followed by an examination of the motivation for currency inconvertibility. The benefits from a fully convertible currency and the costs that may be

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[3]See chapter two for the exact definition. There is no discussion of capital account convertibility.

[4]By the end of 1994 the PTA was made up of 22 countries: Angola, Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. However, at the commencement of the study Eritrea, Madagascar, Namibia, and Seychelles were not members and therefore the analysis does not consider these countries. It is believed that the omission of these countries will not detract from its findings.

[5]The CMA includes Lesotho, Namibia, and Swaziland. Since Namibia has joined after the commencement of the study the analysis will not consider it. This does not in any way detract from the analysis itself.

associated with transformation are considered and the preconditions for currency convertibility are established.

The choice as to the mechanism to be used for making international trade payments is closely related to the country's exchange rate regime. It may be pressure on the balance of payments which motivates governments to make their currency inconvertible which is a result of the exchange rate regime being inappropriate or badly managed.

Chapter three assesses the appropriateness of different exchange rate regimes for the economic conditions of Less Developed Countries' (LDCs). The viability of different exchange rate regimes and their effects on currency convertibility are examined. It is shown that where governments attempt to maintain an exchange rate regime which is inconsistent with their macroeconomic policies, the result may be currency inconvertibility. However, the choice of an exchange rate regime inconsistent with the macroeconomic policy is undesirable at the outset and unsustainable in the long-run. Sooner or latter adjustments will have to be made. It follows therefore that currency convertibility can help avoid policy inconsistency and the misallocation of resources implied by this.

Chapter four considers levels of trade and potential for trade among South Africa and the PTA. It is imperative to consider South Africa's present and future trade with PTA members as it has implications as to which payments arrangement is viable and whether it is necessary at all. Although difficulties for assessing the exact levels of trade are apparent a general indication of trade levels is possible. Despite the fact that levels of trade between South Africa and PTA members have been low, potential for future expanded trade does exist.

Chapter five reviews the history and evolution of the Rand Monetary Area (RMA) and the CMA, and how those arrangements led to currency convertibility among the participating members. It is then argued that the economic conditions of Lesotho and Swaziland are such that they can both maintain a partially convertible currency without the CMA agreement. This chapter illustrates the importance of a transitional mechanism creating partial currency

convertibility (where full convertibility does not exist) for improved and more advanced regional trade, as a stage towards full currency convertibility.

Chapter six investigates the other arrangement in the East and Southern African region which enables partial currency convertibility among member countries - the PTA Clearing House. It first describes the general objectives of the PTA, and then focuses on the objectives of the PTA Clearing House and how these are achieved. It is apparent that although the PTA Clearing House is a well functioning facility (no payments default has been experienced since its inception and settlements have been made timeously) the level of utilisation of it is low. The main reasons for the low utilisation of the PTA Clearing House are to be found in export incentive schemes, private sector resistance as to the advantages of the Clearing House, discouragement by commercial banks, and intra-regional trade imbalances.

Since the utilisation of the PTA Clearing House is low it is necessary to consider whether PTA members would not be well advised to transform their currencies to fully convertible currencies rather than allowing only partial currency convertibility. It is found that most PTA currencies have not met the preconditions for transformation to full currency convertibility. Of particular relevance are their misaligned exchange rates and their inadequate levels of international liquidity.

Given the lack of currency convertibility between the CMA and the PTA trade finance is risky and therefore restricted and expensive. Chapter seven looks at the types of risks that are involved in international trade finance and how currency inconvertibility increases this risk. It is shown that PTA members are perceived by the international financial community as being highly risky countries to trade with (not only for currency convertibility reasons).

In order to demonstrate the restrictiveness of currency inconvertibility on trade finance a brief comparison is made between the use and the costs of different trade finance instruments between countries with convertible currencies and those without. It is apparent that only the less risky and more costly instruments for trade finance are used for trade in the PTA. Looking at the

costs of guaranteeing trade finance instruments and the confirmation costs charged by South African banks indicates the restrictive nature of currency inconvertibility.

Chapter eight examines possible transitional payments arrangements between the CMA and the PTA. It argues that a gradual approach to full currency convertibility is necessary as a one step approach may be so detrimental to an economy that it will have to revert to currency inconvertibility thereby worsening its initial position. It suggests that imposing other non-trade barriers as a transitional arrangement may not succeed in the PTA as they have been unsuccessful in the past. Therefore, a look is taken at possible monetary arrangements which will create partial currency convertibility and enhance intra-regional trade in the CMA-PTA region.

The PTA Clearing House is found to be inappropriate when adding South Africa to it. Since the PTA Clearing House has been only partially successful, to a large extent because of intra-regional trade imbalances, incorporating South Africa will only exacerbate the problem. South Africa will increase intra-regional trade imbalances which may make it unwilling to join such an arrangement. Therefore, a Payments Union is considered which will be structured in such a manner that it will encourage intra-regional trade while allowing for short-term finance for countries that may not be able to make payments timeously. The difficulties of introducing a PTA Payments Union (which includes South Africa) are that it may impede the progress towards achieving full currency convertibility by disrupting the lifting of certain exchange controls and regulations as well as the large contribution which South Africa would have to make. A third possibility is the introduction of a reserve fund to which each member will contribute and countries that cannot honour their payments requirements will be able to draw. This facility could also be made available to members for global balance of payments difficulties purposes. The problem with this is that South Africa will be by far the largest contributor to the reserve fund making it, potentially, a financier of other members to the fund. It is therefore apparent that unless other member countries indicate that they have serious intentions to meet the preconditions for full currency convertibility and take the necessary measures to do so no arrangement will be successful. In other words they have to get their exchange rates right.

CHAPTER 2

CURRENCY CONVERTIBILITY DEFINITIONS AND PRECONDITIONS

2.1 Introduction

The potential gains from trade and the effect of restrictions on trade are well documented. Limitations on trade, particularly in LDCs, usually result from government policies aimed at gaining political popularity rather than economic realities. A specific problem arises when it comes to the payment for trade between countries. An exporting country will accept payment in the importing country's currency only if that currency is convertible or needed for reciprocal trade. The concept of currency convertibility is a broad one and has been used by different authors to indicate different degrees of convertibility. Some authors such as Green and Isard (1991) have used it, in its broader sense, to indicate the ability of residents and nonresidents to exchange a domestic currency for foreign currency without limit regardless of how the balances have arisen. Others such as Gold (1979) and Gilman (1990) have used the narrow definition of a convertible currency as given by Article VIII, sections 2(a) and 4 of the articles of agreement of the International Monetary Fund (International Monetary Fund, 1966, p.196) which read as follows:

Article VIII, Section 2(a)

"*Avoidance of restrictions on current payments*. - (a)...no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions."

Article VIII, Section 4

"*Convertibility of foreign held balances*. - (a) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents

(i) that the balances to be bought have been recently acquired as a result of

current transactions: or

(ii) that their conversion is needed for making payments for current transactions.

The buying member shall have the option to pay either in currency of the member making the request or in gold". (Or, in practice, payments can be made in another currency such as United States dollars or German marks).

The narrower IMF definition will be used in this thesis. Only current account convertibility is considered here. Full (current account) currency convertibility is defined as: **the ability of residents and nonresidents to exchange domestic currency for foreign currency when the balance arises from current account transactions *regardless* of the country from which the balances have arisen.** Partial currency convertibility, on the other hand, is defined as: **the ability of residents and nonresidents to exchange domestic currency for foreign currency when the current account balances have arisen from trade with a *specified* country or countries.**[6]

The motivation for the refusal of an exporter to accept an inconvertible currency is clear. As long as s/he is not sure of the usefulness of the currency s/he will not accept it. The currency will become useful only if the authorities guarantee convertibility, or if imports from the trading partner cover export receipts.

2.2 Currency Convertibility in the CMA and the PTA

Table 2.1 shows that all but three of the nineteen countries that belong to the PTA or the CMA either peg their currency or allow it to float on a managed basis and only three of these countries have accepted Article VIII. Although table 2.1 gives a general idea as to the exchange arrangements and restrictions, a more detailed account as to restrictions on visible trade payments in the CMA and PTA is given in appendix A.[7] The most stringent restrictions on imports are imposed by Angola, Ethiopia, Mozambique, Uganda, and

[6]Internal convertibility, where residents are allowed to hold domestic holdings of certain assets denominated in foreign currencies, is not considered here as it is not relevant to the PTA and CMA.

[7]Payments restrictions are official actions directly affecting the availability or cost of exchange, or involving undue delay on payments to member countries, other than restrictions imposed for security reasons.

Zimbabwe. Imports into these countries require an import license. The granting of such licenses depends on the receipts of foreign exchange. Comoros, Somalia, and Zambia require import licenses for only some imports. Imports into Burundi, Djibouti, Kenya, Malawi, Mauritius, Rwanda, and Somalia are mostly free of licensing requirements other than for purposes of security and statistical reasons. However in Kenya, although licenses are not required, a foreign exchange allocation is necessary. Furthermore, it is important to note that in the cases of Malawi and Tanzania, although most import controls have been done away with, trade finance difficulties and bureaucratic delays in gaining access to foreign currency are restrictive.

The issue here is that although in certain cases licences are not required, no PTA members apart from Djibouti and Swaziland have accepted Article VIII of the IMF. Therefore, even if licences are not required a foreigner exporting goods to any of these countries faces the danger of not receiving payment in a convertible currency.[8]

[8]Trade finance instruments which deal with overcoming this problem will be discussed in chapter 7.

TABLE 2.1
Features of Exchange and Trade Systems of the PTA and CMA Members (December 31 1992)

	ANGOLA	BURUNDI	COMOROS	DJIBUTI	ETHIOPIA	KENYA	LESOTHO	MALAWI	MARITIUS	MOZAMBIQE	RWANDA	SOMALIA	SUDAN	SWAZILAND	TANZNIA	UGANDA	ZAMBIA	ZIMBABWE	SAFRICA
Acceptance of Article VIII	–	–	–	●	–	–	–	–	–	–	–	–	–	●	–	–	–	–	●
Exchange Arrangement																			
1. pegged to:																			
(a) U.S. dollar	●			●	●								●						
(b) SDR											●								
(c) French franc			●																
(d) S.A rand							●							●					
(e) Basket of currencies		●				●		●	●						●			●	
2. Managed Float												●							●
3. Independent Float										●						●	●		
Payments Restrictions																			
1. Current transactions	●	●	●	-	●	●	-	●	●	●	●	●	●	●	●	●	●	●	●
2. Capital transactions	●	●	●	-	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Surrender or repatriation of export proceeds	●	●	●	–	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●

Source: Exchange Arrangements and exchange Restrictions Annual Report (IMF, 1994).

2.3 The Motivation for Currency Inconvertibility

McKinnon (1979, p.40) associates currency inconvertibility with fixed exchange rates.[9] He argues that governments of LDCs lack the political power and the administrative capability to allocate resources through a centralised mechanism, as in centrally planned economies.[10] Nevertheless there has been a tendency, in the past, to use this system rather than decentralising economic decision making.

These governments use the market for foreign exchange as an instrument for internal economic control[11] by regulating the clearing of international trade payments. This is done because of the relative ease of monitoring imports and exports compared with commerce in the domestic hinterland. Being the foreign exchange authority a government can:

"1) Allocate import licences and the associated economic rents to particular firms and individuals while excluding others.

2) License in favour of particular importable (exportable) commodities...so as to reduce (raise) their domestic-currency prices relative to the potential imports that are disallowed.

3) Raise general revenue for the government by:

- *i) Auctioning off licences to import to the highest bidder.*
- *ii) Raising the domestic-currency price of foreign exchange charged to importers above that paid to exporters.*
- *iii) Formally levying tariffs or other taxes on potential importables.*

4) Introduce multiple exchange rates, such that different imports can enter at several different prices for foreign exchange; or export proceeds can be sold for domestic money at favoured or less favoured rates of exchange". (McKinnon, 1979, p.41)

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[9]This is not to say that a fixed exchange rate regime necessitates an inconvertible currency, but that it may result in an inconvertible currency under certain macroeconomic policies.

[10]It became apparent, from recent past events in Eastern Europe that it is not political power or administrative capability that are the problem but rather the system itself.

[11]Internal economic control refers to the authorities control over domestic economic variables such as the level of prices and employment. (Mckinnon, 1979, p.41)

As markets are segmented and different individuals are meant to see different prices for exportable or importable goods, currency inconvertibility is imperative. If domestic firms and individuals were allowed to use the local currency for imports through the commercial banks, government control would be frustrated.

A critical reason for currency inconvertibility is that of balance of payments constraints (e.g. shortage of reserves or lack of export base). In the case where there is a shortage of foreign reserves and a current account deficit which is not complemented by sufficient capital inflows the authorities will make the currency inconvertible so as to reduce the current account deficit. As balance of payments disequilibria are generally caused by inappropriate exchange rates, currency overvaluation can be seen as a major cause of currency inconvertibility.

Under conditions of currency inconvertibility the clearing of payments for international trade transactions are generally done by the Central Bank or by commercial banks which are highly regulated and closely controlled by the authorities. The Central Bank collects all the foreign currency received from exports, as residents are not allowed to hold foreign currency, and then sells the foreign currency to licensed importers.[12] This restricts commercial banks from creating a unified market for both spot and forward foreign exchange transactions.

2.4 Benefits and Costs of a Convertible Currency

Currency convertibility may be associated with both benefits and costs to an economy. As mentioned above, it is well accepted that engaging in international trade holds benefits for an economy. Since currency inconvertibility is a barrier to free trade, making the currency convertible will bring with it direct and indirect benefits. Possible direct benefits include greater choice of consumption, increased consumption, increased consumer satisfaction, and increases in domestic output by improving access to production inputs and modern technology.

[12]PTA countries are now allowing limited retention of foreign exchange proceeds. This will be discussed further in chapter 6.

Following McKinnon's (1979) argument the important indirect benefits of currency convertibility arise from a more competitive environment where prices are determined by market forces. A more competitive environment should lead to production and investment decisions which are consistent with a country's comparative advantage. A convertible currency will create such an environment as it exposes domestic producers to competition from abroad and helps to introduce the relative prices for different goods prevailing on world markets. The competitive environment and correct price signals will create a more efficient allocation of factors of production creating economies of scale where the advantage lies. Economic concentration is reduced when it exists for reasons other than economies of scale such as the size of the domestic market. Increased competition can also promote innovation and quality improvements in the domestic industry. Profit maximisation will induce management to introduce new technologies and efficient production structures. (Green and Isard, 1991)

As a counter to the benefits of currency convertibility the associated costs should be considered. The risk that is attached to making a currency convertible is twofold. (1) *Unemployment and idle capacity*. The opening of the current account might make imports attractive to the extent that demand for locally produced goods and services is significantly reduced, resulting in idle capacity and unemployment. (2) ***Reduction in real wage levels***. The adjustment of the exchange rate will increase the price of imports reducing the risk of idle capacity and unemployment. However, the increased price of imports will translate into lower real wages with negative effects on the economy. Unemployment and idle capacity, and reduction in the real wage level will result in a negative impact on the standard of living. Although these conditions should change in the long-run, when the advantages discussed above come into effect, they may be unsustainable for political reasons.[13]

2.5 Preconditions for Currency Convertibility

In order for an economy to reap the benefits of a convertible currency while minimising the

[13]Political agendas are often short-term rather than long-term. The reason is that a government will find it very difficult to persuade its voters that short-term hardships may lead to higher future standards of living.

risks of macroeconomic instability certain preconditions must be met. Three basic preconditions for a successful transformation to currency convertibility are considered here. These are: (1) an appropriate exchange rate; (2) an adequate level of international liquidity; and (3) sound macroeconomic policies.

2.5.1 An appropriate exchange rate

The exchange rate regime a country adopts must allow for the real exchange rate to be compatible with sustainable long-term balance of payments equilibrium. This means that domestic prices must be roughly aligned with international prices. This will usually entail a depreciation of the overvalued official exchange rate to the more depreciated (closer to the equilibrium real exchange rate) parallel market.

There are two important reasons why it is necessary to have an appropriate exchange rate before transformation to currency convertibility. First, without the realignment of the overvalued currency the efficiency and competitive advantages mentioned in section 2.3 will be lost. Secondly, if currency convertibility is allowed while the currency is overvalued, speculative pressures arising from an expected depreciation will make currency convertibility unsustainable.

2.5.2 Adequate international liquidity

Inadequate international liquidity will make transformation to currency convertibility difficult even if the exchange rate is on a path consistent with a current account balance. Without sufficient international liquidity[14] a country might be unable to maintain a stable macroeconomic environment for domestic producers and consumers, because of the difficulty of stabilising both the exchange rate and the interest rate in the face of adverse short-term disturbances to the volumes or prices of exports or imports. Furthermore, inadequate

[14]These comprise foreign exchange reserves and access to foreign financing.

international liquidity may be seen as a weakness to adjust to an unforseen external shock encouraging speculative actions against the currency. (Green and Isard, 1991, p.10)

2.5.3 Sound macroeconomic policies

The macroeconomic policies implemented must be such that an environment of macroeconomic stability is created which is conducive to reform. Such policies would help restrain overall demand in line with a country's productive and debt servicing capacity. (Gilman, 1990, p.33) If these are not in place, the doubts about the authorities' willingness and ability to exercise macroeconomic control will arise. These will then lead to external payments imbalances and to unsustainable speculative pressure. (Green and Isard, 1991, p.10)

The three preconditions for currency convertibility are closely related to the exchange rate. Allowing for real exchange rate equilibrium will assist in maintaining an equilibrium current account, assist in protecting international reserves and also impact on the effect of macroeconomic policies on the economy. It is therefore necessary to look at the appropriate exchange rate regime for allowing currency convertibility.

CHAPTER 3

CHOICE OF EXCHANGE RATE REGIME

3.1 Introduction

As was indicated in chapter 2 an important precondition for transformation to full currency convertibility is following an exchange rate regime which will minimise long-term balance of payments disequilibrium. Also, it was argued that the rationale for currency inconvertibility is protecting the balance of payments. This chapter argues that following an inappropriate exchange rate regime is the reason for balance of payments difficulties, which in turn results in currency inconvertibility. It is therefore necessary to consider the appropriate exchange rate regime for currency convertibility. This chapter looks at the optimal exchange rate regime in the context of macroeconomic and microeconomic efficiency focusing on: (1) insulating properties of the exchange rate; (2) the feasibility of the different exchange rates; and (3) macroeconomic policy under different exchange rates.

3.2 The Optimal Exchange Rate Regime

There is no unambiguous answer to the question of what the optimal exchange rate regime is. The appropriate choice of an exchange rate regime depends on the objectives of exchange rate policy, the source of shocks to the economy, and the structural characteristics of the economy in question. The latter include the degree of capital mobility, the degree to which prices and wages are rigid, and the degree of openness.

Establishing the optimal exchange rate regime necessitates the formation of optimality criteria. This thesis, as is common in the theoretical literature on exchange rate regimes,

will concentrate on both macroeconomic stability[15] and microeconomic efficiency objectives to determine the optimality of the exchange rate regime. This will enable an evaluation of the different exchange rate regimes as a tool for achieving macroeconomic policy objectives.

Collier and Joshi (1989, p.95) identify three important objectives of exchange rate policy. These are:

(1) External balance - Edwards (1989, p.16) defines the equilibrium external balance as the point where "*the intertemporal budget constraint that states that the discounted sum of a country's current account has to be equal to zero is satisfied*". This does not imply that the current account should be balanced at all points in time. Current account deficits are often desirable when financed by a sustainable inflow of foreign capital. The exchange rate regime affects the external balance through its effect on total spending and the competitiveness of tradable commodities. Both can be affected for example by an overvaluation of the domestic currency as imports become relatively cheaper - increasing total spending, and exports of tradable goods are reduced due to higher costs - thereby reducing international competitiveness.[16]

(2) Internal Balance is defined by Edwards (1989, p.16) as the point where "*the nontradable goods market clears in the current period, and is expected to be in equilibrium in future periods*". An economy is in a state of internal balance when employment and inflation are at the best attainable combination. Governments attempt to reduce inflation to the lowest level and increase employment, achieving employment at its "*natural*" level. Here too, as in the case of the external balance, the exchange rate regime affects the internal balance through the price of the domestic currency. For example an increase in domestic expenditure will lead to an

[15]Macroeconomic stability is defined in terms of the external and internal balance with the objective of minimising the variance of real output and the price level in the face of random external or domestic shocks.

[16]The model assumes price-taking. The decline in competitiveness comes through the increasing costs associated with the rise in non-tradable goods prices which are inputs in production.

overvaluation of the currency (assuming it is fixed).[17]

(3) Microeconomic efficiency refers to efficiency of resource allocation in the economy. The ideal would be for the limited resources to be employed in the most profitable industry, maximising real income. This may be affected to some extent if the real exchange rate is misaligned, distorting prices of tradable and nontradable goods. Collier and Joshi (1989, p.95) have cited the possibility of economic uncertainty, particularly on foreign exchange transactions, and the likelihood of the imposition of trade restrictions as two of the reasons for the exchange rate regime affecting microeconomic efficiency.

3.2.1 Insulating properties under different exchange rate regimes

The general argument in favour of a system of flexible exchange rates was initially prompted by the difficulties arising from the Bretton Woods agreement.[18] The conventional justification of this type of regime lay in the fact that external balance is achieved without interfering with the pursuit of internal economic objectives. Balance of payments imbalances will automatically be eliminated through changes in market prices for foreign exchange. As government does not have to intervene in the foreign exchange market in order to achieve an external balance it can control the money supply to achieve internal balance.

[17]An increase in domestic spending will result in the price of non-tradable goods going up while the price of tradable goods is constant. This is an overvaluation of the exchange rate.

[18]Much of the original advocacy for flexible exchange rates is credited to Milton Friedman.

When determining the most appropriate exchange rate regime for its insulating properties[19] it is important to identify the type and source of the shocks that the economy may face. These are:

i) Shocks originating externally -
   (a) Nominal shocks, where movements in the foreign price level may affect domestic prices; and
   (b) Real shocks, originating in the international goods market.

ii) Shocks originating domestically -
   (a) Nominal shocks, originating in the domestic money market; and
   (b) Real shocks, originating in the domestic goods market.

(i) External nominal and real shocks

When the shocks are nominal and originate externally the most appropriate exchange rate is a flexible one. Aghelvi, Khan, and Montiel (1991; henceforth A-K&M, p.5) show that under a flexible exchange rate regime when foreign prices change, domestic prices can be stabilised by a suitable adjustment in the exchange rate.

Friedman (1976, p.159) uses a simple asset market approach to explain the superiority of the flexible exchange rate regime as a mechanism for reconciling demand for and supply of a specific currency. He argues that this type of regime is superior to fixing the exchange rate, due to its insulating properties of foreign shocks on the domestic economy. If there is a change in the exchange rate and the reasons responsible for the change are regarded as temporary, holders of the country's currency will change their holdings in such a way that

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[19]Insulating properties are those which help to maintain economic stability in the economy (i.e., maintain the economy at a level as close to full employment as possible). These are in fact different from internal economic control since internal economic control does not necessarily mean economic stability in practice. Krueger (1985, p.130) defines the degree of insulation, I, as:

$$I=1-\frac{dv}{dv^*}$$

where dv is the change in the magnitude of the domestic variable v and v^* is the corresponding foreign variable that was altered.

will moderate the movement in the exchange rate.[20] If, on the other hand, a change in the exchange rate is permanent, resulting from a change in "*real*" conditions,[21] speculation will lead to a rapid adjustment of the exchange rate to its new equilibrium position. Therefore, assuming developed and integrated foreign exchange markets, under the asset market approach, this regime will not adversely effect the microeconomic efficiency or internal and external balances.[22]

Similarly, Black (1976) shows that the impact of a fall in the world price of tradable goods decreases their domestic price under a fixed exchange rate regime. This will result in a departure from the initial equilibrium and to money market disequilibrium. Under a system of flexible exchange rates this disequilibrium will be avoided as the exchange rate will adjust to maintain equilibrium.

Krueger (1985, p.128), however, argues that the insulation properties of flexible exchange rates are challenged by the Mundell-Fleming model on the basis that capital flows respond to interest differentials. Within the framework of this model a foreign monetary shock would have an effect on the domestic economy because a change in the foreign interest rate would induce capital flows. This in turn would induce a change in the exchange rate in order to cause the current account to move in the direction opposite to the capital account movement.

Fischer (1977), using a monetary model of the balance of payments, reaches a different conclusion to that of the Mundell-Fleming model. He argues that a foreign monetary shock, affecting foreign prices, does not affect domestic price levels. It only affects the exchange rate. On the other hand he found that under fixed exchange rates the domestic price level

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[20]If the domestic currency appreciates as a result of temporary changes, speculators will sell some of their domestic currency and buy foreign currency in order to make a profit. By doing so they in fact provide the additional domestic currency to meet some of the excess demand responsible for the initial depreciation in the exchange rate.

[21]He refers to real conditions determining international trade as weather, technical conditions of production, and consumer tastes.

[22]Sections 3.2.2 and 3.2.6 will deal with real shocks further.

as well as the level of real consumption were affected. Krueger (1985, p.129) notes, however, that the Fischer model assumes no capital flows which is an important qualification of his results.

Helpman and Razin (1979) argue that a flexible exchange rate is superior to a fixed exchange rate. They use an intertemporal optimisation model which considers the current account balances as a long-term phenomenon (as defined on page 17). This permits a preferred time path of consumption. They conclude that "*...there is a floating exchange rate equilibrium allocation which is preferred to every fixed exchange rate equilibrium allocation. The equilibrium is attained when a country pursues an optimal interest rate policy. In a fixed exchange rate regime countries cannot pursue independent interest rate policies, and a country which pegs its exchange rate ends up importing the monetary inefficiency that exists abroad.*" (Helpman and Razin, 1979, p.405)

(iia) Domestic nominal shocks

The optimality of a flexible exchange regime becomes questionable when the shocks originate in the domestic money market. Black (1976) argues that under such circumstances the optimal exchange rate regime is one of fixed exchange rates since, through the use of reserves, the domestic economy can be better insulated. This will lead to greater microeconomic efficiency since there will not be an undue shift of resources.

A-K&M (1991, p.6) agree with Black (1976) and explain that if the domestic shock originates in the money market a fixed exchange rate is more effective in minimising fluctuations in output. Since domestic money supply is endogenous under this exchange rate regime, disruptions in the money supply will be absorbed by changes in the foreign exchange reserves, leaving the goods market unaffected.

Although there is a clear indication that, in cases of negative nominal shocks, macroeconomic stability is better served under a fixed exchange rate regime this is not the case with regard to microeconomic efficiency. Edwards's (1989) analysis points to the fact that under these conditions the exchange rate becomes overvalued. A domestic monetary shock will lead to

an increase in the price of non-tradable goods. The price of the tradable goods will remain unchanged since the nominal exchange rate is fixed. Therefore, there is an advantage for local agents to shift resources into the more profitable non-tradable goods sector. Microeconomic inefficiency derives from the fact that if the market were allowed to determine the exchange rate, more resources would have been allocated to the tradable goods sector.

In order to fix the exchange rate there is a need for sufficient foreign exchange reserves or access to foreign borrowing. Friedman (1976, p.170) argues that if the shocks are temporary, reserves will probably suffice and the fixed exchange rate is feasible. However, if the shocks are temporary then fixing the exchange rate is unnecessary since, under flexible exchange rates, private speculative transactions will provide the additional domestic or foreign currency demanded with only minor movements in exchange rates. If the shock is a prolonged one the fixed exchange rate will not be feasible as a result of lack of foreign reserves.

(iib) Domestic real shocks

When the shocks originate domestically and are real, A-K&M (1991) argue that the more appropriate exchange rate to follow, in order to minimise the fluctuations in output, is a flexible exchange rate. The exchange rate will adjust to stabilise output by generating or reducing external demand. An exchange rate appreciation will cushion the effect of a positive shock to domestic demand on output by directing part of the additional demand abroad.

Friedman (1976, p.165) argues that changes in internal prices could produce the same effects on trade as changes in exchange rates. For example, a decline of 10 percent in the price level in Germany with an unchanged dollar price of the mark would have the same effects on the relative costs of domestic and foreign goods as a decline of 10 percent in the dollar price of the mark, with all internal prices unchanged. However in reality, internal prices are not as flexible as the exchange rate. Therefore, in order to insulate the economy from such shocks, this is the most desirable exchange rate regime.

What emerges from the above discussion is that there is no clear optimal exchange rate regime in the face of various shocks, as countries usually face more than one type of shock at a given time. Therefore, it is not surprising that some LDCs have adopted an intermediate exchange rate regime in order to combine the advantages of both extremes.[23]

3.2.2 Structural characteristics affecting insulation

Although the general case is as given above, there are structural characteristics of the economy that will affect the insulating properties of the exchange rate. A-K&M (1991, p.6) consider three structural characteristics:

(1) *The degree of openness in the economy* - they argue that the greater the degree of openness the stronger the case for fixing the exchange rate. This is a result of the cost of frequent exchange rate adjustments that may take place due to transitory shocks as well as channelling some of the domestic monetary shocks abroad. Branson and Katseli-Papaefstratiou (1981; henceforth B-K) share this view with A-K&M (1991) but for different reasons. They maintain that an economy can be open to such an extent that if the exchange rate is flexible, domestic citizens would demand contracts effectively denominated in foreign currency. In such a case there will be no demand for the local currency other than for legal requirements.

On the other hand A-K&M (1991) argue that if a country becomes more vulnerable to external shocks as a result of its openness, exchange rate adjustments will be necessary more frequently, thus requiring a flexible exchange rate.

(2) *Capital mobility* - If there is an external increase in demand which is a result of expansionary monetary policy, under fixed exchange rates and capital mobility domestic interest rates will also fall. This will cause destabilisation in the domestic output as a result of increased imports. Therefore, the currency needs to be

[23]Intermediate exchange rate regimes will be discussed in section 3.2.6.

appreciated in order to maintain domestic output stability. If the increase in external demand is a result of expansionary fiscal policy, interest rates will rise countering the destabilising effect of the increased external demand.

It is possible, however, depending on the elasticities of the aggregate demand and supply functions, that the increase in external demand may be more than offset by a decrease in domestic demand thereby necessitating a depreciation of the domestic currency. As for shocks originating domestically, they argue that when the shock is a real one, under a fixed exchange rate, capital mobility intensifies the destabilisation of domestic output (because domestic exchange rates will not change in order to stabilise output). When the shock is nominal, a high degree of capital mobility justifies the use of a fixed exchange rate as it assists in stabilising domestic output by limiting the destabilising movements in domestic interest rates.

(3) *Degree of wage rigidity* - The general argument here is that if there is a devaluation of the domestic currency, its effect on macroeconomic and microeconomic variables will depend on the degree of wage indexation. A devaluation of the domestic currency will translate into a fall in the price of domestically produced goods, in foreign currency terms, improving the external balance through increased exports. However, if local wages are fully indexed the devaluation of the currency will have no real effect. If wage indexation is less than the level of the devaluation, not only will the external balance improve, but a reallocation of resources from the non-tradable goods sector to production in the tradable goods sector will take place.

3.2.3 The feasibility of the different exchange rate regimes

The issue of the feasibility of the exchange rate regime is separate from that of optimality. This is due mainly to the degree of sophistication and integration of the financial market in question. B-K (1981, p.394), using an asset market approach, look at the conditions under which a flexible exchange rate regime is feasible. They find that this exchange rate regime is only feasible if there are asset markets which are integrated into the international system.

If financial markets are integrated then in the short-term the exchange rate of the currency in question will be determined by equilibrium conditions in those markets. Therefore, stable financial markets mean that in the short-term exchange rates will also be stable. If a country does not have financial markets which are integrated into the international markets the exchange rate will be determined by current account flows. The short-term stability conditions are therefore the Marshall-Lerner conditions of trade elasticities. The feasibility problem under these conditions, they argue, results from the generally low short-term price elasticities. In the event that the financial markets are not internationally integrated or that the Marshall-Lerner condition does not provide the necessary stability, the central bank will have to ensure exchange rate stability. This reduces the viability of a flexible exchange rate regime as an option and raises the need for the implementation of a fixed exchange rate regime in most LDCs.

Black (1976) examined the way in which foreign exchange markets and money markets in LDCs differ from the institutional and market structure of developed countries. He found six significant differences:

(a) *"There is a low degree of substitutability between domestic and foreign securities, including a thin market for domestic securities and an absence of a network of securities brokers and dealers.*

(b) *Because of...(a) and much higher uncertainty concerning political and economic developments, speculation is likely to be destabilising.*

(c) *There is no forward market.*

(d) *Interest rates on domestic securities are likely to be pegged at unrealistically low rates, leading to a fragmentation of the securities markets and a multiplicity of interest rates paid in a disorganised market. There may be no market in short-term securities.*

(e) *The government is likely to impose an exchange-control regime involving government monopoly of exchange dealings, often with multiple discriminatory exchange rates. As a result, the domestic network of exchange dealers will be tightly controlled and have a minute capital position.*

(f) *Finally, less developed countries tend to have small financial markets relative to those*

of developed countries." (1976, p.18)

Wickham (1985, p.253) maintains that under the conditions which Black (1976) found it is unreasonable to allow the exchange rate to be determined by the market. He suggests that it would be preferable, under such conditions, to follow a fixed exchange rate regime where government will intervene in the foreign exchange market by setting the price at which payments for foreign trade are made. He argues that the type of financial markets to which Black (1976) refers are usually accompanied by restrictions on capital and current account transactions as well as controls on the yields from available financial instruments. This point corroborates Mckinnon's (1979) argument that fixed exchange rates are associated with currency inconvertibility. Black (1976, p.21) explains that in order for a successful adoption of flexible exchange rates to take place, a country is compelled to abandon exchange controls, stabilise domestic policies, abandon the pegged interest rates in the domestic securities market, and develop a market for securities and foreign exchange. These steps which he describes as necessary for a successful adoption of a flexible exchange rate, are the conditions that will in fact make this type of exchange rate feasible.

Although the differences that Black (1976) finds between financial markets in developed and less developed countries definitely influence the effectiveness of the flexible exchange rate as a stable exchange rate regime, its applicability to an argument opposing flexible exchange rates is questionable. A distinction must be made between the existence of such markets and the potential to develop such markets. Many of the differences in the markets are a result of government policies. The development of financial markets in LDCs is feasible and is picking up momentum. Therefore, he makes the point that the cost of making the necessary changes must be weighed against the benefits emerging from the flexible exchange rate. The argument that the benefits from developed financial markets are substantial, not only for exchange rate considerations, is well accepted and indeed many LDCs are emphasising their development.

Under circumstances of under-developed financial markets it is possible that the optimal choice would be an intermediate exchange rate regime. The determination of the degree of flexibility or fixity will depend on the dominant type of shock that the economy might face

as well as the structural characteristics and the financial market sophistication. Possibly the most important consideration as to the optimal exchange rate regime is the policy goals of the economy concerned.

3.2.4 Macroeconomic policy under different exchange rate regimes[24]

The question that arises now is: to what extent can government manage its own monetary and fiscal policy under a flexible and fixed exchange rate regime? This point is of importance given that most PTA countries have been implementing a fixed exchange rate regime.

The traditional argument for the implementation of a flexible exchange rate regime is that under this system the government can follow an autonomous macroeconomic policy in accordance with its domestic objectives. Governments will be able to influence the price level in the short-run, through fiscal and monetary policies, without being constrained by balance of payments considerations. This is particularly important since many LDCs attempt to follow expansionary macroeconomic policies due to political pressures. These lead to an increase in domestic prices which will be offset by a depreciation of the exchange rate.[25] Therefore there will be no undue constraint on the country's international reserves, and the tradable goods sector will be in equilibrium in both the short-term and long-term. This is in fact consistent with external and internal balances, and microeconomic efficiency.

This traditional view is questionable. Although macroeconomic policy independence is possible under a flexible exchange rate it may have negative results. Assuming that Purchasing Power Parity (PPP) holds an increase in the money supply will have a nominal effect only since the rise in the domestic prices will be exactly offset by a depreciation of the domestic currency, confirming the traditional argument. If, however, PPP does not hold, an increase in the domestic prices will mean that local goods have become more expensive for foreigners, reducing demand for domestic goods. This will adversely affect

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[24]This is closely related to section 3.2.1 (iia).

[25]This regards the change in the degree of international competitiveness. If the domestic price level increases while the exchange rate depreciates in the same proportion there is no impact on international competitiveness.

microeconomic efficiency.

Caves, Frankel, and Jones (henceforth - CF&J) (1993, p.398) find that there is strong evidence to suggest that PPP does not hold in the short-run.[26] This means that the real exchange rate is not constant in the short-run. Commodity prices are in fact sticky (originally the monetary model assumes that prices are flexible). As a result, disturbances in the nominal exchange rate are reflected as disturbances in the real exchange rate, which diminish over time as prices slowly adjust. The fact that prices are sticky in the short-run was the justification for the constant-price assumption made in both the Keynesian and Mundell-Fleming models. CF&G (1993) argue that the assumption of fixed commodity prices is too extreme. At the other extreme is the flexible-price monetary model which assumes that goods prices adjust instantaneously. This, however, is also unrealistic. Therefore, it was necessary to develop the sticky-price monetary version of the monetary model. This model gives the result of the Mundell-Fleming model for the short-run, where real exchange rates diverge from the long-run equilibrium, and the monetary model, where the real exchange rate is in equilibrium in the long-run. This sticky-price monetary model is best known as the overshooting model.[27]

Looking at the five industrialised countries over the period 1973-86 CF&G (1993, p.580) find that national differences in interest rates do not fully reflect differences in expected inflation rates and that real interest differentials did exist. Consequently, the model was extended to include real interest differentials.

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[26]The reasons which they give for this are: (a) tariffs and transport costs; (b) permanent shifts in the terms of trade; (c) CPI measurements disparities; and (d) imperfect information, contracts, inertia in consumer habits.

[27]The model was formalised by Dornbusch (1976).

Maintaining the assumptions made in the monetary model[28] the uncovered interest parity is retained and is expressed as:

$$i-i^{*}=\Delta S^{e} \tag{1}$$

were i and i^{*} are domestic and foreign interest rates respectively and ΔS^{e} is the expected change in the nominal exchange rate. Subtracting the expected inflation differential, $\Delta p^{e}-\Delta p^{*e}$, from both sides yields the interest parity condition in real terms:

$$(i-\Delta p^{e})-(i^{*}-\Delta p^{*e})=\Delta S^{e}-\Delta p^{e}+\Delta p^{*e}$$

or

$$r-r^{*}=(\Delta S_{real})^{e} \tag{2}$$

where r and r^{*} are the domestic and foreign real interest rates respectively, and $(\Delta S_{real})^{e}$ is the expected change of the real exchange rate. Equation (2) indicates that the real interest rate differential is equal to the expected change of the real exchange rate.

When a country's real interest rates are above those of its trading partners', this is a signal that investors expect the local currency to depreciate in the future. They are willing to hold the local currency as long as they are compensated for the future depreciation by high real interest rates. Investors expectations will guide the real exchange rate to its equilibrium position. CF&J (1993) show that the real exchange rate has a tendency to slowly adjust toward PPP, which makes it a good indicator of the long-run, equilibrium real exchange rate.

Investors' expectations lead to the elimination of the divergence between the short-run and the long-run real exchange rate equilibrium which is formulated as:

$$\Delta s^{e}_{real}=-\theta(S-\bar{S})/\bar{S} \tag{3}$$

where S and $\bar{S}$ are the spot exchange rate and the long-run exchange rate respectively, and

[28]These are: (1) expected returns are equalised across countries when expressed in a common currency, (2) there are no barriers to slow down portfolio adjustment, and (3) investors treat foreign bonds as perfect substitutes in their portfolios.

θ is the rate (speed) at which the exchange rate will adjust towards equilibrium. This equation shows that when a currency is thought to be overvalued (undervalued) investors will expect it to depreciate (appreciate) in the future.

In order to determine the effect of real interest rate differentials on the real exchange rate it is necessary to combine equations (2) and (3) and solve for the divergence of the spot from the long-run exchange rate as a function of the real interest rate differentials:

$$(S-\bar{S})/\bar{S}=-(1/\theta)(r-r^*) \qquad (4)$$

which indicates that when domestic real interest rates exceed foreign real interest rates, the local currency is overvalued. The higher the value of θ the faster the adjustment and the lower the degree of instability.

The above shows that the level of exchange rate, S, relative to its long-run equilibrium, $\bar{S}$, is determined by the real interest rate differential which is determined by such factors as monetary policy. Assuming a macroeconomic shock in the form of an increase in the money supply[29] may lead to the real exchange rate diverging from its long-run equilibrium. This results from the differences in speed of adjustment of assets prices and commodity prices. Any "*news*" on the forthcoming "*shock*" induces an instantaneous adjustment in asset prices. This adjustment will lead to an overshooting of the exchange rate[30] while the rate of inflation, adjusting slowly, will gradually bring the real exchange rate to its long-term path as it counters the nominal money supply growth.

Figure 3.1 shows the short-run overshooting and the adjustment towards the long-run equilibrium of the real exchange rate. The exchange rate is shown on the horizontal axis and the price level on the vertical axis. The PPP line is an upward sloping 45^0 line which indicates that when PPP holds the change in domestic prices and the exchange rate are

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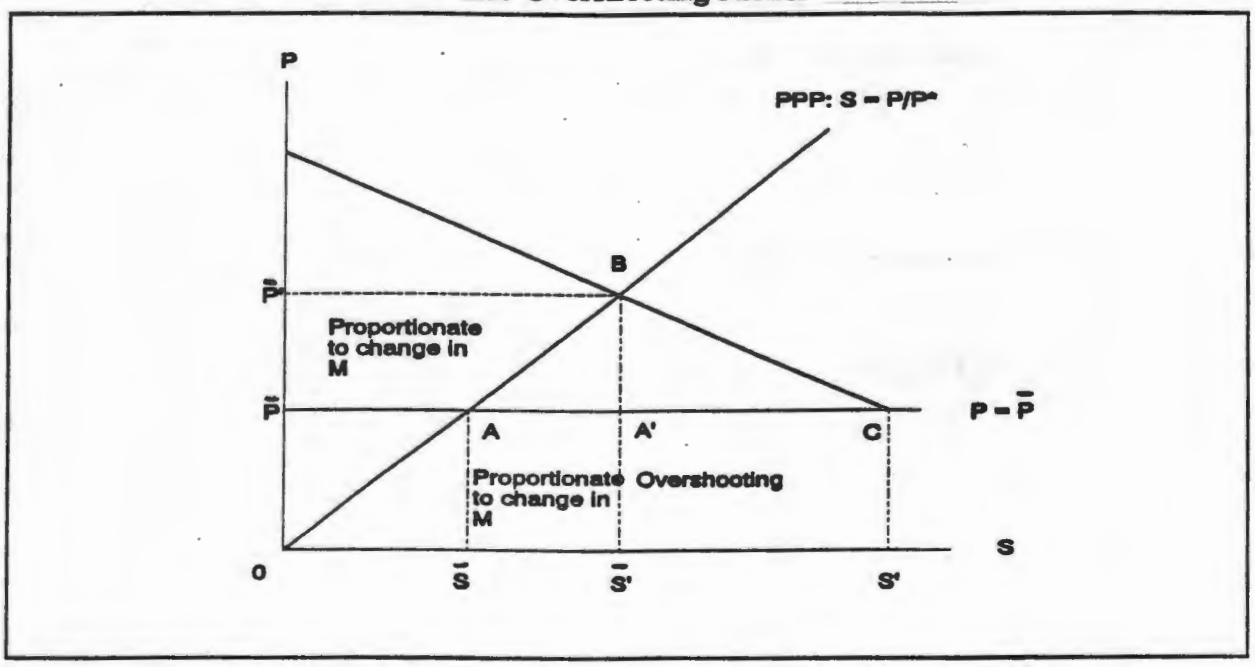
[29]This would be a permanent increase in the money supply. Expansionary fiscal policy will have a similar result but the process is different.

[30]Overshooting of the exchange rate is a term given for the exchange rate depreciating by more than its long-term real exchange rate path.

proportional. Prior to any macroeconomic shock the real exchange rate is at point *A* on the PPP line. An increase in the money supply, *M*, will result in an increase in the real money supply, *M/P*, since prices of goods do not adjust instantaneously. The increase in the real money supply will lead to a fall in the domestic interest rates making domestic assets less attractive for foreign investors. The decline in demand for domestic assets will cause the currency to depreciate and move to its short-run position at point *C*, further than point *A'* - the equilibrium real exchange rate, since the price level has not adjusted.

In the long-run, however, the exchange rate will move back to point *B* since prices of goods will slowly adjust. The fall in interest rates and the value of the currency will increase demand for local goods, putting upwards pressure on prices with the real money supply falling. The process continues for as long as real interest rates and the value of the currency are low. These will increase until such time as the real money supply is the same as before the shock. This process of the adjustment to the real exchange rate equilibrium is shown by the movement along the line from point *C* to point *B*.

FIGURE 3.1
The Overshooting Model



Source: CF&J (1993).

The overshooting model shows evidence of short-run deviations from PPP and long-run equilibrium. Therefore, contrary to the traditional view, microeconomic inefficiency may take place under a flexible exchange rate regime.

The difficulties of implementing a flexible exchange rate regime have led some LDCs to follow a fixed or intermediate regime. The conventional argument here is that a fixed exchange rate acts as a disciplining factor on the authorities. However, in order to have a sustainable macroeconomic equilibrium it is necessary that the monetary and fiscal policies that are implemented are consistent with the exchange rate regime. This means that if the government chooses to implement a fixed exchange rate regime it will have to follow the same macroeconomic policies as those followed by the authorities to which the currency is pegged. Hence, a loss of economic independence results. Failure to do so will lead to a real exchange rate misalignment.

Pegging the currency to another currency necessitates government intervention in the foreign exchange market.[31] Edwards (1989) argues that if the government decides to follow an expansionary macroeconomic policy with a high fiscal deficit it will be inconsistent[32] with a fixed exchange rate regime.[33] In many developing countries fiscal deficits are financed by money creation. The inflation required to finance a fiscal deficit equal to a fraction δ of GDP can be calculated as $\pi=\delta/\lambda$, where π is the rate of inflation required to finance the fiscal deficit, and λ is the ratio of high-powered money to GDP. If the fiscal deficit is high it will necessitate a high level of inflation. This will possibly result in the price of non-tradable goods (P_N) growing faster than the international price of tradable goods (P^*_T) and therefore a real appreciation.[34]

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[31]The degree of government intervention depends on the divergence of macroeconomic policies by the government from those of the government to which the currency is pegged. The larger the divergence, the more intervention will have to take place.

[32]Inconsistent macroeconomic policy refers to a situation where the macroeconomic policy and exchange regime create a long-term balance of payments disequilibrium.

[33]This concerns a case where the other country does not follow a macroeconomic policy which is as expansionary.

[34]The real exchange rate e is defined as: $e=EP_T^*/P_N$, where, E is the nominal exchange rate.

Financing of the fiscal deficit through money creation will lead to an excess supply of money which in turn will be translated into excess demand for tradable goods, non-tradable goods and financial assets. The excess demand for non-tradable goods will lead to an increase in the price of those goods while the excess demand for tradable goods[35] will result in a trade deficit, an increase in foreign borrowing above its long-term sustainable level, and in a loss of international reserves. The combined affect will be an appreciation of the real exchange rate. If there are no changes in the fundamental real determinants of the equilibrium real exchange rate a real exchange rate misalignment will occur.

To describe the effect of inconsistencies between macroeconomic policy and the exchange rate regime on the level of international reserves it is useful to consider Argy's (1982, p.9) "*conventional*" model of exchange rates which uses the interest rate parity framework.[36]

The model:

$$B = C + K \tag{5}$$

$$C = c(Y, (pd \times S)/pf) \qquad C_1 < 0\,;\ C_2 < 0^{37} \tag{6}$$

$$K = k[rd - rf + ((Se - S)/S)] \quad K > 0 \ (assuming,\ F{=}Se) \tag{7}$$

Where:

B = balance of payments

C = current account

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[35]Prices are assumed to be tied up to world prices.

[36]The interest parity framework is defined as:

$$\%\Delta S = F + (\Delta rd - \Delta rf)$$
$$F = \%\Delta S + RP$$

Where: S is the exchange rate;
Se is the expected exchange rate;
F is the forward rate;
rd and rf are domestic and foreign interest rates;
RP is the risk premium; and
$\%\Delta$ is a percentage change.

[37] $C_1 < 0$ and $C_2 < 0$ refer to the current account deficit in the period 1 and period 2.

K = capital account

Y = gross national product

pd= (fixed) domestic price level

pf= (fixed) foreign price level determined in foreign currency.

Substituting equations (6) and (7) into (5) and rearranging we get:

$$\Delta S = -(\frac{1}{C_2 + k})\Delta B - (\frac{C_1}{C_2 + k})\Delta Y + (\frac{k}{C_2 + k})(\Delta rd - \Delta rf + \Delta Se) \quad (8)$$

It is clear from equation (8) that intervention, represented by ΔB will have an effect on the exchange rate. Therefore, when the interest rate differential is given and the expected spot rate is firmly fixed the spot rate must rise sufficiently to create an expected devaluation exactly equal to the new interest differential. However, since in equation (8) ΔSe is in fact zero (because it is fixed) pressure will build up on the foreign reserves which are used for intervention. Therefore, as long as there is a one-sided government intervention in the foreign exchange market the fixed exchange rate will not be sustainable if macroeconomic policy is more expansionary than that of the country to which the currency is pegged.

The irrevocably fixed exchange rate under these circumstances is unsustainable. An important feature of this type of exchange rate regime is the certainty in which foreign trade can take place. If the exchange rate is irrevocably fixed then international trade transactions can take place with little or no foreign exchange risk.[38] This relies on the exchange rate being unchanged, which is the same as saying that the government is credible and will in fact maintain the exchange rate at a predetermined level. However, if the exchange rate regime is inconsistent with macroeconomic policy then an overvaluation (undervaluation) will necessitate a devaluation (revaluation) of the exchange rate in order to both realign the exchange rate and to protect the foreign exchange reserves. This will lead to the loss of government credibility to maintain the exchange rate at the predetermined rate.

[38]Foreign exchange risk is minimised since traders know exactly what the exchange rate will be at the time of payment. This is an important feature when forward exchange markets do not exist, or are unnecessary under an irrevocable fixed exchange rate regime.

The fact that certain macroeconomic policies are inconsistent with an irrevocably fixed exchange rate regime does not mean that it is unattainable in the short-run. Freedman (1991, p.125) maintains that a small country which has perfect asset substitutability, no exchange controls, and a fixed exchange rate has no autonomy in monetary policy. This, however, is seldom the case. In most LDCs asset substitutability is not perfect, and exchange controls are in place. Therefore, there may be some scope for monetary policy autonomy. He gives the example of a country which decides to follow a more expansionary monetary policy than that of its pegged currency. High monetary growth will lead to a decrease in the domestic interest rates. Domestic interest rates will stay lower than foreign interest rates because of imperfect substitutability and exchange controls and domestic prices will rise above the foreign price. Therefore, although these inconsistent macroeconomic policies can be implemented they are in fact unsustainable in the long-run on the basis of both international reserves limitations and credibility. Furthermore, as becomes apparent from Freedman's argument, the anti-inflationary anchor which is supposed to be one of the main features of an irrevocably fixed exchange rate regime is lost under inconsistent macroeconomic policies.

3.2.5 The optimal peg

As noted above, the choice of a government's exchange rate regime will depend to a large extent on its economic goals. Therefore, the choice of a fixed exchange rate rather than a flexible exchange rate is not enough. Rather it is also necessary to decide what is the optimal peg.

Collier and Joshi (1989, p.100) argue that if the government's goal is the stabilisation of the price level then it should fix its currency to a stable trading partner's currency. It is immediately apparent that by doing so it does not necessarily fix its effective exchange rate since the stable partner will most probably have a floating exchange rate regime. It was for this reason that some countries chose to fix their currency to a basket of currencies rather than a single currency. The partner currency should be one which maintains reasonable rates of inflation, and is expected to do so in the future as well. It should have a sound track record as to its macroeconomic policies. Furthermore, as Freedman (1991, p.126) claims,

the country to which the currency is tied should be one which faces similar shocks to that of its own. The anti-inflationary discipline that fixing the exchange rate imposes is the link between the balance of payments and monetary growth as well as the macroeconomic policies that the government is forced to pursue in order to defend the exchange rate and credible expectations.

Williamson (1982, p.50) summarises the literature on the optimal exchange rate peg according to the aim of the macroeconomic policies that the government may pursue as depicted in table 3.1. It shows that there is wide-spread agreement that under most circumstances pegging to a basket of currencies is superior to pegging to a single currency. There is a need however, to keep in mind that pegging to a basket of currencies is more difficult for administrative reasons which may be an obstacle in the case of LDCs.

TABLE 3.1
Aims of Exchange Rate Policy and Recommended Pegs Suggested in the Literature

Suggested Aim	Recommended peg
Minimise variances of relative price of traded goods	Basket with weights based on direction of total trade in goods and services (or elasticity weights for country with market power), provided the benefits of pegging to a basket outweigh the costs of inability to intervene in the unit providing the peg
Stabilise balances of trade and output, by stabilising effective exchange rate	Peg to imported-weighted basket, with consideration as to whether the SDR is a good proxy
Minimise variance of the balance of trade subject to a requirement on its expected level, by stabilising the effective exchange rate with multilateral exchange rate models-type weights	Peg to an elasticity-weighted basket. (Special case with price-inelastic imports and perfectly elastic export demand: export-weighted basket)
Minimise variance of real income subject to a requirement on its expected level	Peg to a basket with large weights for competitors and small or even negative weights for suppliers
Minimise variations in resource allocation and income distribution, by stabilising real effective exchange rate	Peg to a basket, with weights based on currency of denomination of total trade when the export and import-competing sectors are of similar size
Stabilise real effective exchange rate	Peg to elasticity-weighted basket modified by covariance between inflation and depreciation. (Special case with PPP among trading partners: peg to single currency with preferred inflation rate), or consider pegging to a basket
Stabilise terms of trade	Peg to basket with weights reflecting market power in export and import markets
Minimise the level and variability of inflation	Peg to the US dollar, or perhaps to the SDR or a trade-weighted basket

Source: Williamson (1982, P.50)

3.2.6 Intermediate exchange rate regimes

Whatever the optimal peg may be, the argument remains that an irrevocably fixed exchange rate is viable and desirable only if the macroeconomic policies pursued by the government are consistent with it. Since they are seldom so, some countries have opted for an intermediate exchange rate regime allowing them to follow a more independent macroeconomic policy than possible under an irrevocably fixed rate.

The first type of intermediate regimes is the adjustable peg. According to Collier and Joshi (1989, p.104), an adjustable peg regime is accompanied by trade controls as it is still necessary to protect the domestic currency peg, and it loses its anti-inflationary anchor. The trade controls which are imposed in order to assist the fixing of the exchange rate destroy the monetary and expectational links between the domestic and foreign prices. A country which follows an expansionary macroeconomic policy will face increasing domestic prices leading to a loss of international competitiveness. When the real exchange rate becomes grossly overvalued, capital controls lose their effectiveness and capital outflows do occur. When the government does devalue the currency due to balance of payments pressures that have built up, the devaluation is so large that it induces an increase in the wage level and prices. Therefore, the devaluation is ineffective in restoring international competitiveness. Furthermore, due to the necessary continued implementation of trade controls, they are contrary to microeconomic efficiency as they distort the market allocation of resources.

Wickham (1985, p.270) points out that as a result of over-expansionary macroeconomic policies which may take place under the adjustable peg exchange rate, there will be periods of exchange rate misalignment. This may lead to uncertainty surrounding prospective economic developments as well as disruptive speculative fluctuations in the demand and supply of a foreign currency. This is highly detrimental to the tradable goods sector in the economy, as it may find itself in long periods of deteriorating competitiveness. Furthermore, with the absence of forward foreign exchange markets, as is often the case in many LDCs, uncertainty in foreign trade is increased.

Freedman (1991, p.126) adds that such a system does not yield the benefit of full credibility which arises from an irrevocably fixed exchange rate regime. Since economic agents are aware of the need for a devaluation due to the inconsistent macroeconomic policy they may attempt to transfer their capital abroad. Such a scenario is often reduced in LDCs by capital controls. Capital controls, however, do not eliminate this problem since illegal capital outflows do take place. Although there may be a high cost involved in illegal transfer of capital it becomes more profitable the higher the expected devaluation. Therefore, economic agents, facing larger profits the higher expected devaluation, will be willing to incur the

higher cost of illegal transfers.[39]

The second type of intermediate exchange rate regimes is the crawling peg. Here the exchange rate is fixed and allowed to change in order to maintain the real exchange rate as in the adjustable peg. The government can implement a rule-based crawl, in which the nominal exchange rate will adjust sufficiently to maintain the equilibrium real exchange rate. This adjustment should be equal to the difference in the level of inflation between the countries. Or they can implement a discretionary crawl peg in which the adjustments are made by bureaucrats when deemed necessary.

Collier and Joshi (1989, p.105) maintain that the rule-based peg is superior to the adjustable peg as it allows for consistent profit making, it avoids uncertainty, and reduces the need for frequent reallocation of resources. Whereas in the case of adjustable peg there are periods in which the real exchange rate is misaligned, under the rule-based peg this is eliminated since the exchange rate is continuously adjusting to maintain real exchange rate equilibrium. This means that it is possible for the domestic economy to have a different inflation rate from its pegging partner without affecting its level of output. The disadvantage of the rule-based peg is therefore that the anti-inflationary discipline on the government concerned is lost.

A further important difficulty with the crawling peg is that the real exchange rate should not be held constant in the face of a permanent real shock. Changes in real exchange rate fundamentals such as a decrease in the international prices of a country's main export will mean a necessary devaluation greater than that which would take place if only inflation rates are taken into consideration.

This problem can be remedied by the implementation of the discretionary crawling peg. Under this exchange rate regime the monetary authorities will adjust the exchange rate in order to maintain the real exchange rate at its equilibrium level. If real exchange rate fundamentals have changed then the appropriate adjustment would take place. Collier and Joshi (1989, p.105) note that complete discretion may lead to the creation of bureaucracies

[39]These costs would be measured in both monetary terms and in terms of the risk of making an illegal transaction.

which may be influenced by interest groups. They suggest that a modified rule-based peg would be more appropriate since it will limit interest group pressure and maintain real exchange rate equilibrium.

A-K&M's (1991, p.16) analysis suggests that Collier and Joshi's (1989) advocacy of the rule-based peg is questionable on the ground of government's competence to follow such an exchange rate regime.[40] Although there may be a reduction in bureaucracy involvement in the process of exchange rate movements compared with the discretionary peg, it assumes that the government is able to identify and correct for those shocks. They maintain that in practice this exchange rate policy will be difficult to implement as it is difficult to separate the impact on competitiveness of expansionary financial policies from that of exogenous shocks. Furthermore, they argue that in certain circumstances even if the reason for the misalignment is inconsistent macroeconomic policy, a devaluation will be more beneficial than a macroeconomic policy correction. It follows from this that a combination of rule-based peg with a certain amount of discretion should be implemented. It does seem that A&KM (1991) put too much emphasis on governments ability to determine when to allow a change in the exchange rate or not. There should not be any major difficulties for any government to follow such an exchange rate regime.

This leads to the conclusion that the crawling peg is in fact inferior from the anti-inflationary perspective but is advantageous from the microeconomic efficiency perspective. If the government can maintain a moderate monetary policy stance, the irrevocable fixed exchange rate leads to both microeconomic efficiency and macroeconomic stability superiority. If that is not possible, then the rule-based peg is probably preferable because it maintains the microeconomic efficiency advantages and, to some extent, macroeconomic stability.[41] The adjustable peg is similar to the discretionary crawling peg with the difference being that the latter is adjusted on a regular basis. They are both problematic, however, the adjustable peg on microeconomic efficiency and macroeconomic stability considerations and the discretionary crawling peg on the basis of being over-dependent on the discretion of

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[40]Wickham (1985) also has reservations on the ability of LDCs governments to follow this type of exchange rate regime.

[41]Only to some extent because inflation has adverse effects on the economy.

bureaucrats who are susceptible to pressure groups and may lack the necessary expertise.

3.3 Currency Inconvertibility and Fixed Exchange Rates

The above discussion indicates that implementing a fixed exchange rate regime and attempting to follow an independent macroeconomic policy is unsustainable in the long-run. For a country to exercise an independent monetary policy under a fixed exchange rate necessitates sufficient foreign exchange reserves or sustained access to foreign loans. Restrictions on the current account, such as making the domestic currency inconvertible are then an inevitable consequence to help save scarce foreign currency. Currency inconvertibility also operates as a non-tariff trade barrier. Thus, it means that international trade is restricted with the country in question losing out on the potential benefits which it offers.

The restriction on currency convertibility may aggravate the problem of exchange rate misalignment, eventually necessitating an even greater devaluation than would have been the case otherwise. Adding trade barriers to those already in place will lead to further microeconomic inefficiencies. Revenue from exports will be less than if comparative advantage is allowed to function, hence increasing the problem of foreign exchange shortages.[42] If the authorities of a country are unwilling or unable to maintain responsible macroeconomic policies which will coincide with those of the country to which it tied its currency, it will be better off allowing its currency to float. In that way, although not desirable, it can pursue its independent macroeconomic policies with less restrictions on trade. However, the fact that most LDCs do not have the necessary financial infrastructure as well as the adverse effect of exchange rate overshooting makes this regime questionable. This has led some economists to argue for an intermediate exchange rate regime as the most viable for LDCs.

Currency inconvertibility is also possible when the exchange rate is flexible. In the case of

[42]This line of argument holds for the irrevocably fixed exchange rate regime as well as the intermediate exchange rate regimes.

a fixed exchange rate, currency inconvertibility is a consequence of balance of payments constraints. In the case of a flexible exchange rate, balance of payments constraints do not exist in the long-run. Therefore, currency inconvertibility under these conditions is only necessary as a non-tariff barrier for protectionist reasons.

Shortages of international reserves are a severe problem among the PTA members. Therefore, fixing the exchange rate while pursuing independent unsustainable macroeconomic policies is self-defeating. Under these conditions there is no confidence in the domestic currency. Exchange rate misalignment leads to an increased incentive for capital outflows. Although these are restricted by capital controls, these controls become less efficient the greater the misalignment. Microeconomic efficiency is low because of the relatively cheap imports and expensive exports, and macroeconomic stability is not achieved as a result of expectations of a necessary devaluation of the domestic currency. The decision to pursue a fixed exchange rate regime has to be coupled with serious political dedication to follow responsible macroeconomic policies. If this is not possible, using currency inconvertibility as a shield to pursue inconsistent macroeconomic policies is erroneous.

It has been argued that in order for a country to adopt a flexible exchange rate an important pre-requisite is the existence of well developed and integrated financial markets. These conditions are often not fulfilled in developing countries because of the low level financial market sophistication. However, there is a recognition that there are potential benefits from developed financial markets in LDCs which has led to moves to develop these markets in many countries.

The recognition of potential benefits of a flexible exchange rate and the fact that developed financial markets do not exist in most LDCs has led to variants of foreign exchange markets such as the auction market. The problem is that despite this, there are still parallel markets with substantial discounts which indicate that the auction rate is not a true market rate.

CHAPTER 4

LEVELS OF TRADE AND POTENTIAL FOR FUTURE TRADE AMONG SOUTH AFRICA AND THE PTA

4.1 Introduction

Before proceeding to discuss the regional payments arrangements in the Eastern and Southern African region and suggesting an appropriate mechanism for them it is important to consider the past trade levels and whether potential for future trade among South Africa and the PTA exists. If such potential does not exist at all a mechanism for trade payments will not be necessary.[43] South Africa's trade statistics are patchy and incomplete because these were not published between 1985 and late 1992 for "strategic reasons". As economic sanctions against South Africa restricted trade, the South African authorities kept trade statistics secret in order to protect countries that breached the sanctions. Furthermore, most of the trade statistics that were published subsequently include the combined imports and exports of the SACU. Therefore, the exact levels of trade are difficult to determine but a general impression can be obtained by looking at the available trade data.

This chapter first looks at the level of trade among the PTA and South Africa. Then it considers potential for future trade by looking at the structure of South African exports and PTA imports. Whether or not economic integration in the CMA-PTA region is desirable is not the issue considered here.[44] All that will be considered in this chapter is whether the conditions, as they stand at present, indicate that future trade has room for expansion.

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[43]Potential for future trade will almost always exist. If economies are growing trade should grow as well. However, what is considered here is whether the share of CMA-PTA trade as a percentage of total trade can increase.

[44]Therefore, there is no consideration of Viner's (1950) theory of Customs Unions, from which the conventional treatment of economic integration stems. For a survey on the Theory of Economic Integration see Hine (1994).

4.2 Levels of Trade

The first trade data available after the period of concealment was published in the publication Finansies en Tegniek (1991)[45] and are reproduced in tables 4.1 and 4.2 together with trade data that is now published by the Department of Trade and Industry in its monthly abstract of trade statistics. The problem with the 1992 and 1993 data is that it represents imports and exports from the SACU as a whole. Therefore it is necessary to attempt to isolate South Africa's trade with Botswana, Lesotho, Swaziland and Namibia (BLSN) in order to get a better idea of South Africa's trade with the PTA.

TABLE 4.1
South African Imports from PTA Countries (Other than SACU) 1990 (000's of rand)

	1990	1992	1993
Angola	59	728	1,130
Burundi	12		
Comoros	243		
Ethiopia	258		
Kenya	10,875	23,783	30,757
Malawi	81,130	133,953	159,606
Mauritius	14,279	12,326	19,223
Mozambique	30,388	50,978	60,233
Rwanda	891		
Somalia	71		
Sudan	256	357	6,278
Tanzania	2,580	10,290	21,832
Uganda	90	51	1,101
Zambia	6,582	44,565	76,159
Zimbabwe	441,553	762,332	664,292
Total	589,268	1,039,362	1,040,612
Total SA Imports	44,125,000	52,857,600	59,078,694
% of SA Total	1.34	1.97	1.76

Source: Finansies en Tegniek (1991) and Republic of South Africa (1993)

[45]These are not estimates made by the publications but rather data that was made available to them by the authorities.

TABLE 4.2 South African Exports to PTA Countries (Other than SACU) 1990 (000's of rand)			
	1990	1992	1993
Angola	49,551	365,172	263,396
Burundi	5,791	12,003	13,187
Comoros	21,128		
Ethiopia	1,138	743	3,863
Kenya	9,902	151,044	205,433
Malawi	378,309	697,981	593,119
Mauritius	301,220	391,610	470,932
Mozambique	432,151	678,262	964,577
Rwanda	386	8,170	4,810
Somalia	4,606		1,532
Sudan	2,648	21,330	31,037
Tanzania	10,319	27,659	58,563
Uganda	2,150		
Zambia	494,350	1,112,228	1,307,156
Zimbabwe	1,061,801	1,553,369	1,747,723
Total	2,775,452	5,019,577	5,665,328
Total SA Exports	60,928,500	66,774,100	79,480,860
% of SA Total	4.56	7.52	7.13

Source: Finansies en Tegniek (1991) and Republic of South Africa (1993)

Table 4.3 shows the main trading partners of BLSN. It is evident that no significant trade with African countries outside the SACU takes place. Therefore, it seems reasonable to conclude that the trade data available for 1992-1993 represent, to a very large extent, South African trade with the PTA.

TABLE 4.3 Main Trading Partners of BLSN (%of total)						
	Exports			Imports		
	S.Africa	Europe	Other*	S.Africa	Europe	Other*
Botswana	3.0	91.0	6.0	79.0	13.0	8.0
Lesotho	42.1	27.9	30.0	94.1	1.3	4.6
Namibia	25.0	45.0	30.0	90.0	4.0	6.0
Swaziland	46.5	26.5	27.0	91.3	3.3	5.4

Source: Economists Intelligence Unit, BLSN, 1992-93

Note: the figures for Botswana are 1989, Lesotho 1991, Namibia - exports 1991 and imports 1990, and Swaziland 1989.

*The column titled "other" in the case of Botswana represents exports to other Africa. In the case of Swaziland it represents 3.3 percent exported to Mozambique and the rest to outside Africa.

It would appear from tables 4.1 and 4.2 that there has been a significant increase in trade between South Africa and the PTA after 1990. However, since the data that is available does not cover a large enough time series and the fact that the data is not identical, no firm conclusions as to the growth in trade can be reached. What tables 4.1 and 4.2 show is that the levels of trade among South Africa and the PTA are low. South African imports from and exports to the PTA represented less than 2 per cent and 7 percent of South Africa's total imports and exports respectively in 1992. The fact that trade data published in the monthly abstract of trade are given for the SACU as a whole overestimates South Africa's trade levels. However the statistics published do not give the figures for all African countries individually. All African countries for which statistics are not given separately are combined into a category of 'other Africa', underestimating the levels of trade, albeit only slightly.

4.3 The Potential for Future Trade

Although levels of trade between South Africa and PTA countries were low in the past it does not mean that potential for trade expansion in the future does not exist. It is therefore necessary to consider the structure of trade of both the PTA and South Africa. A perquisite for future expanded trade is that trade structures are complementary. In other words that South Africa can offer the PTA what the PTA wishes to import and *visa-versa*.

Considering 55 Standard International Trade Classification (SITC) categories[46] the issue of trade complementarity and potential is confirmed. PTA imports in these selected categories were valued, in 1989, at US$3,568 million while total South African exports of these selected categories were US$2,364 million. The data does not show what proportion of PTA imports come from South Africa. However, since South African exports to the PTA accounted for less than 5 percent (7 percent) of total South African exports in 1990 (1993), it is reasonable to consider that very little of the trade potential with the PTA is fulfilled. Therefore, as Davies *et al* (1993) maintain "there are several niches in the market worth $3.5 billion annually where South African industries could potentially compete". (p.5)

Davies *et al* (1993) show how even fairly small increases in the market share could result in significant growth of trade. For example, Angola's total imports in 1990 were US$1.2 billion. Angola's imports from South Africa in that year amounted to US$19.1 million which accounted for 1.6 percent of Angola's total imports. If Angola's imports from South Africa were to increase to 15 percent of total imports this would have translated into an increase of trade of US$160 million.

Table 4.4 shows the percentage of PTA countries imports that originate from South Africa. In 1990 total PTA (excluding Lesotho and Swaziland) imports amounted to US$12.9 billion of which US$1.1 billion was imported from South Africa making South Africa's share in PTA imports as small as 8.3 percent of total PTA imports. Therefore, if South Africa's exports to the PTA were to increase to 15 percent of total PTA imports, this would translate into an increase in trade of US$866.9 million.

[46]See table B1 in the appendix.

TABLE 4.4 Imports from South Africa as a Percentage of Total Imports of PTA Countries (1990)			
	Total Imports (US$m)	Imports from SA (Value US$m)	Imports from SA (% total)
Angola	1,200	19.1	1.6
Burundi	235	2.2	0.9
Ethiopia	1,081	0.4	0.1
Kenya	2,124	4.0	0.2
Malawi	576	146.1	25.4
Mauritius	1,616	116.3	7.2
Mozambique[1]	680	166.8	24.5
Rwanda	279	0.1	0.1
Somalia	360	1.8	0.5
Sudan	600	1.0	0.2
Tanzania	935	3.9	0.4
Uganda	458	0.8	0.2
Zambia	873	190.8	21.9
Zimbabwe	1,851	410.0	22.1
Total	12,868	1,063	

Source: Davies *et al* (1993)
*1989

It is apparent, therefore, that although past levels of trade have been low there is potential for future expanded trade. Although expecting the removal of all obstacles to trade in the short-term may be over-optimistic, it is evident that even partial removal of trade barriers may increase the level of trade substantially.

CHAPTER 5

MONETARY ARRANGEMENTS BETWEEN SOUTH AFRICA, LESOTHO, AND SWAZILAND

5.1 Introduction

Before the independence of the present PTA and CMA countries, the problem of currency inconvertibility did not exist. There were three important arrangements which dealt with trade payments, making their currencies partially convertible. These were the East African Currency Board, the Southern Rhodesian Currency Board, and the RMA. Under the East African Currency Board, Kenya, Uganda, Tanganyika, Somalia, and Ethiopia (the latter two only for a short period) used the East African shilling which was guaranteed conversion into sterling.

The Southern Rhodesian Currency Board, which under its arrangement included Northern Rhodesia, Southern Rhodesia and Nyasaland, bought and sold Southern Rhodesian currency in exchange for sterling at a fixed rate, thereby guaranteeing convertibility. After the countries belonging to the East African Currency Board and the Southern Rhodesian Currency Board obtained independence these agreements were terminated and their currencies became inconvertible.

This chapter looks at the evolution of the monetary arrangement between Lesotho, South Africa and Swaziland and the conditions which enabled partial currency convertibility among CMA members.[47] It argues that the CMA was instrumental as a transitional currency convertibility arrangement but is no longer necessary for the creation of partial currency convertibility among Lesotho, South Africa and Swaziland. Lesotho and Swaziland have reached the stage where they can achieve partial and even full currency convertibility, as

[47]Once independence was granted to Namibia the agreement, de facto, also included it.

indeed Swaziland has already done.[48]

5.2 The Period Prior to the 1974 Agreement

The RMA originally included South Africa, Lesotho, Swaziland, and Botswana in which the rand was the only currency in circulation. The rand became legal tender in 1960 after the pound sterling (1921) and later the South African pound were taken out of circulation. At independence, which Botswana gained on 30 September 1966, Lesotho on 4 October 1966, and Swaziland on 6 September 1968, there were no formal monetary arrangements between these countries and South Africa. However, these countries and South Africa comprised a de facto unified monetary area with the rand being legal tender in the four territories. Being part of the sterling area, they were not subject to the United Kingdom's exchange controls on capital movements. However, on the fourth of July 1972 these countries were reclassified as non-scheduled territories, resulting in South Africa amending its exchange controls and regulations accordingly.

The reclassification of the four countries as non-scheduled territories by the United Kingdom encouraged negotiations to reach a formal agreement. The South African government imposed, as a result of it becoming a non-scheduled territory, new exchange controls on all countries except Botswana, Lesotho, and Swaziland (BLS). This was made possible by the BLS governments cooperating informally, but closely, with South Africa to enforce the new restrictions. This prevented the BLS territories from being used as loopholes to the South African exchange controls. (PTA, 1990, p.10)

The negotiations were prompted by perceived negative net benefits of the previous informal arrangement. Lesotho and Swaziland believed that in order for them to benefit from the arrangement they should:

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[48]Having partial currency convertibility with a country that has a fully convertible currency does not make that currency fully convertible as well since the balances must arise from trade among the two countries that have a partially convertible currency. For example a Zambian getting paid in maloti cannot convert it to rand at the Lesotho Central Bank and then convert them into dollars at the South African Reserve Bank.

(1) be compensated for the loss of income (by way of interest foregone) that they would have earned on their external reserves if they had their own currency;

(2) have access to capital and money markets in South Africa;

(3) be consulted prior to policy decisions being made by the South African Reserve Bank as to interest, exchange rate and exchange control issues;

(4) have the right to authorise the transfer of capital and profits abroad. (Trade Monitor 1993a, p.19)

5.3 The Monetary Agreement Between the Governments of South Africa, Lesotho and Swaziland.

On the fifth of December 1974 the Governments of South Africa, Lesotho and Swaziland entered into a formal agreement concerning monetary arrangements between them. In this treaty (2/1974) the three countries acknowledged the advantages of maintaining a common monetary area as monetary arrangements should provide for the sustained economic development of the RMA as a whole. The agreement stated that the arrangements should benefit all parties, but a special emphasis was put on encouraging the advancement of the less developed members. It was agreed that each country would be responsible for its own monetary policy and control over financial issues. However, the South African authorities were responsible for the management of the rand currency, gold reserves, and foreign exchange reserves of the RMA.

Using Guma's (1985, p.169) classification, the eleven articles in the agreement are divided into two categories: operational and economic. Articles seven to eleven deal with the operational procedures necessary to make the agreement workable. These articles dealt with the *collection and exchange of monetary statistics; consultations and the RMA commission; settlement of disputes; entry into force, accession, termination and withdrawal; and, notices and requests* respectively. The first six articles deal with economic issues of the agreement.

Article 2 - *Legal tender*, is of central importance as it dealt with the currency to be used in the RMA. Although the rand was the only legal tender, article 2 allowed Lesotho and

Swaziland to issue their own national currencies, pending a further agreement with the South African Government.[49] Any new currency issued would not constitute legal tender outside the issuing country.

Article 3 - *Transfer of funds within the RMA.* Article 3 provides that even when the rand is not the only legal tender in the RMA partial currency convertibility is maintained. It states that "[a] *contracting party shall not apply any restrictions on the transfer of funds whether for current or for capital transactions, to or from the area of any other contracting party...*" (Treaty Series, 2/1974)

Article 4 - *Access to the South African capital and money markets and related markets*, allows Lesotho and Swaziland to participate in the South African financial markets. Of particular importance is the fact that section 4 of article 4 states that in order to preserve monetary stability in the RMA the South African Reserve Bank, in its capacity as lender of last resort, will make available, when the need arises, credit facilities to the monetary authorities of the other countries. This article makes the South African Reserve Bank the RMA's ultimate controlling monetary authority.

Article 5 - *Gold and foreign exchange transactions*, reinforces the role of the South African Reserve Bank as the RMA's central bank. In terms of this article the governments of Lesotho and Swaziland agree to impose the same exchange controls as the South African government does.

Article 6 - *Compensatory Payments*. This article compensates Lesotho and Swaziland for seigniorage loss as a result of the agreement. Since the rand is the legal currency in the RMA, Lesotho and Swaziland incur an opportunity cost in the form of seigniorage foregone. It deals with the amount that the South African government will have to pay the other two members as compensation for opportunity cost. Section 3 of article 6 provides a formula for the calculation of the amount to be paid as compensation to each country. The formula is:

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[49]In fact the need for a further agreement was only in regard to Lesotho. Swaziland had already reached an agreement (1/1974) with South Africa prior to the RMA agreement allowing it to issue a new currency, the emalangeni. In that agreement, Lesotho and Botswana were only observers.

(2/3)XY where: *X* represents the annual yield to redemption of the most recent issue of long - term domestic South African government stock, and *Y* represents the estimated amount of rand notes and coins in circulation in each of the countries. This is in fact *2/3* of what the respective country would earn if all its currency in circulation was invested in long-term South African government stock. (Collings et al, 1978, p.108)

Prior to this trilateral agreement an agreement between South Africa and Swaziland was reached with regard to the issue of notes and coins. That agreement (1/1974) had already raised most of the important issues. However, the importance of this agreement (2/1974) is that it formally established the RMA between the *three* independent states.

On September sixth 1974 Swaziland exercised its right, under article 2 of the 1974 treaty, and issued its new currency, the emalangeni (all conditions of reserves, and convertibility were fulfiled). (Legum, 1975, p.495)

Botswana had been part of the RMA and took part in the negotiations as to the formulation of an agreement on monetary cooperation but withdrew from the negotiations in August 1974. Following its withdrawal from the RMA, the government of Botswana announced that within two years a Central Bank would be established and its own currency would be issued. This currency would replace the rand and become the only legal tender within the country's borders. Although it withdrew from the negotiations it remained part of the RMA for the transition period.

Botswana's break away from the RMA was prompted by the belief that the agreement would not be beneficial to all parties as South African government policy would not be able to accommodate all the members of the monetary area. Furthermore, the excess savings which took place in Botswana at the time were, to a large extent, invested abroad. Breaking away from the RMA would enable the authorities to channel those savings to domestic investment. (Legum, 1975, p.368)

On the twenty third of August 1976 the Bank of Botswana issued its new currency, the pula (notes) and thebe (coins) replacing the rand as legal tender. The exchange rate was fixed at

par until the thirteenth of November 1976 after which a 3 percent commission was charged on the exchange of rand for pula.

The rationale behind Botswana's withdrawal from the RMA can be found in the authorities' desire for greater independence in monetary, financial and exchange rate policies. New exchange controls were implemented, particularly restrictions on the capital account transactions, which necessitated the Bank of Botswana's approval. Foreign exchange for imported goods was made readily available from commercial banks, and interest or exchange allowances applicable to non-resident companies or individuals were unrestricted.

Approximately 50 percent of Botswana's official reserves were held in South African rand and 75 percent of the country's imports were purchased from South Africa. (Legum, 1976-1977, p.B751) The bank kept and continues to keep a rand account in South Africa for payments of creditors of the Botswana government, thus making the rand and the pula convertible.

5.4 The Amendments to the Original Agreement

The original 1974 trilateral agreement stipulated that in order for a new currency to be issued a further agreement between South Africa and the issuing country would be necessary. When the Lesotho government decided to exercise its right to issue its own currency a new agreement was reached on the twelfth of January 1979. This was based on the original agreement with the addition that the new currency would have to be backed 100 percent by the sum of:

(a) *"Rand currency held by the Lesotho monetary authority;*

(b) *a Special Rand Deposit with the SARB; and*

(c) *South African stock provided this does not exceed 10 percent of the backing of the national currency."* (6/1986, Article 2, p.3)[50]

[50]The agreement was signed in 1979 but was published in the treaty series only in 1986.

The amount to be backed in this way is calculated on the average of the Lesotho notes and coins in circulations during the previous 14 days.

Furthermore, the agreement stated that the South African government will pay, on the Special Rand Deposit, an annual interest of 2 percent below the yield to redemption at which the most recent long-term domestic South African government stock was offered. This payment was to be paid quarterly and calculated on a daily average of the Special Rand Deposit. This agreement enabled the government of Lesotho to introduce the new currency, the maloti, on the nineteenth of January 1980, when the Lesotho Monetary Authority was launched. The motivation for issuing the maloti was that it would allow the Lesotho authorities to exercise increased control over its monetary and fiscal policy, although it would continue to be a member of the RMA. (Legum, 1979-80, p.B713)

On the first of June 1985 the governments of South Africa and Swaziland amended the original agreement. They added to article 2 the provision that the government of Swaziland can, on special request, have the Special Rand Deposit invested in short-term stock issued by the South African government or the Corporation of Public Deposits. This allowed, potentially, a better return than that in the original agreement. Later in that year (1 April 1986, 30/1986) the bilateral agreement between South Africa and Lesotho was altered to allow Lesotho the same conditions as those available to Swaziland.

The government of Swaziland decided to terminate the rand as legal tender in its territory as of the first of April 1986. This was executed in an agreement between the parties (31/1986) which also discontinued the compensatory payments to Swaziland. The rand and the emalangeni did, however, remain convertible by the respective monetary authorities. This convertibility is achieved by the stipulation that Swaziland must hold an account in the South African Reserve Bank in order to maintain convertibility. It is important to note, however, that Swaziland has not as yet, more than eight years after the agreement was reached, de-linked the emalangeni from the rand.

The RMA was renamed the CMA on the first of April 1986 (32/1986). This change was due to the fact that there were three currencies in the area and the rand was not the only currency

in circulation as was the case in the past. The important difference is the fact that this title means that it is an area in which exchange arrangements are coordinated regardless of the currency.

An important aspect of the CMA agreement is that of gold and foreign exchange reserves. These are held and managed by the respective monetary authorities of each country. However, both Lesotho and Swaziland have access to the foreign exchange market in South Africa. In the case of Swaziland it is stipulated that this will be allowed "*on the understanding that the net foreign exchange requirements of Swaziland are in the first instance met from the foreign exchange reserves of Swaziland*". (Treaty Series, 31/1986, p.5) In the case of Lesotho this stipulation is not made, implying that there is free access to South African reserves. In order to enable the South African authorities to manage the gold and foreign exchange reserves, and monitor the exchange control of the CMA, the monetary authorities provide the South African Reserve Bank with a monthly statement of gold and foreign exchange holdings, and transactions that have taken place during the period. (Treaty Series, 31/1986 article 4.2, and 4/1989 article 9.2)

On the twentieth of March 1990 Namibia was granted its independence from South Africa. Prior to its independence, Namibia was part of the RMA and later the CMA as it was part of South Africa. The Namibian constitution stated that Namibia would have its own currency. (Article 128(1)) Once independence was granted the Namibian authorities established the Bank of Namibia on the second of July 1992.

On the fifteenth of September 1993 Namibia introduced its own currency (the Namibian dollar) making both the rand and the Namibian dollar legal tender in Namibia and convertible at par by the banking system. It was made clear by the Namibian authorities that this would continue as long as the latter's value does not fall sharply: the decision to fix the dollar to the rand stems from the close trade relations between the two countries.

5.5 Achieving Currency Convertibility Through the CMA Agreement

The most important aspect of this agreement, for the purpose of this study, is the achievement of currency convertibility. Article 6 of treaties 31/86 and 4/89 provides that "*...the contracting parties shall permit notes and coins issued by them to be repatriated...*". Thus currency (maloti and emalangeni) repatriated from South Africa to the Central Banks are convertible into rand. Any rand currency surplus held by the smaller members may be placed in the South African money and capital markets or may be used to purchase foreign exchange in that market. Therefore, the currencies are partially convertible but this does not mean that the holding of rand leads to a loss of income by way of interest foregone.

As a result of the maloti and emalangeni being convertible within the CMA, payments for trade are unrestricted for imports from other members. It is worth noting that although Botswana is not a member of the CMA the pula is convertible within the CMA. Settlement of trade transaction between Botswana and South Africa are identical to those between the CMA members. Commercial banks in these countries will finance trade and enable payments as they are assured that the foreign currency which they receive can be exchanged for the local currency. This is different from the situation where the currencies are inconvertible.[51]

5.6 Currency Convertibility among South Africa, Lesotho and Swaziland if the CMA Agreement is Terminated

The advantages that Lesotho and Swaziland derive from the CMA are access to the South African foreign exchange and capital markets. The allowance made in the CMA agreement for access by Lesotho and Swaziland to South Africa's foreign exchange markets (and hence reserves) does not mean unrestricted access to reserves. In order for the smaller members to acquire foreign exchange on the South African market they will have to draw down their rand deposits in South African banks. Since these are limited so is their ability to draw on

[51]Payments for trade among countries with and without convertible currencies will be discussed in chapter 7.

South Africa's foreign exchange reserve. Furthermore, as table 5.1 shows, Lesotho and Swaziland have a relatively superior capital account and reserve position than that of South Africa.

TABLE 5.1
Balance of Payments: Lesotho, South Africa and Swaziland (US$m)

	1985	1986	1987	1988	1989	1990	1991	1992
Current A/C:								
Lesotho	-12	-3	24	-25	10	65	83	38
South Africa	2622	3153	2936	1218	1579	2253	2664	1388
Swaziland	-39	10	62	65	4	45	3	25
Basic Balance:								
Lesotho	17	14	64	34	56	126	126	81
South Africa	1987	1850	1628	831	1089	1549	1691	866
Swaziland	-17	42	89	96	71	21	43	71
L\T capital:								
Lesotho	29	17	40	59	46	61	43	43
South Africa	-636	-1303	-1308	-387	-490	-704	-973	-522
Swaziland	22	32	27	31	67	24	40	46
Reserves:								
Lesotho	44	60	68	56	49	72	115	157
South Africa	315	370	641	780	960	1008	899	992
Swaziland	83	97	127	140	181	217	172	309

Source: IMF, (International Financial Statistics, 1994).

The preconditions for a convertible currency are fulfilled by both Lesotho and Swaziland. Their exchange rates can continue to be fixed to the rand at par or, if such a decision reached, be fixed to a basket of currencies as in the case of Botswana. In fact a strong argument can be made for Lesotho breaking away from pegging to the rand only. Looking at table 5.2 it is evident that Lesotho's trade with South Africa has lessened (in relative terms) since 1979. In the case of Swaziland, however, trade has increased (in relative terms) since 1970.

TABLE 5.2
Percentage Trade of BLS with South Africa and the Rest of the World - 1970, 1979, 1984, and 1989-1991

Country	1970		1979		1984		1989-1991*	
	S.A	R.o.W	S.A	R.o.W	S.A	R.o.W	S.A	R.o.W
Botswana	52.5	36.4	48.2	44.2	44.3	49.3	41.0[a]	52.0
Lesotho	90.2	9.8	91.4	8.6	72.4	27.4	68.1[b]	29.0
Swaziland	51.1	46.0	54.9	43.6	66.9	32.3	68.9[a]	21.4
South Africa	-	88.0	-	90.3	-	93.5	-	-

Source: Maasdorp and Whiteside, 1992, p.3.
* The EIU, (2nd quarter 1993).
[a] 1989,
[b] 1991.

The current account position of both Lesotho and Swaziland is such that there is no indication that the exchange rate is overvalued to the extent that available reserves will not be sufficient to continue guaranteeing partial currency convertibility with South Africa. Also, there is no indication that macroeconomic policies implemented by the Lesotho and Swaziland authorities will be such as to create an unsustainable current account position.

The remaining issue then is that of access to the South African capital market. If the CMA agreement is terminated South Africa will probably impose the same restrictions on capital account transactions with Lesotho and Swaziland as those imposed on other countries. The impact of such an action on the economies of Lesotho and Swaziland is difficult to determine. However, the long-term capital account position of both Lesotho and Swaziland, as shown in table 5.1, indicates that the impact may only be marginal.

It is apparent therefore that the CMA agreement was instrumental in establishing partial currency convertibility among South Africa, Lesotho and Swaziland. However, as it stands today, partial currency convertibility can be maintained without the CMA agreement.

CHAPTER 6

PAYMENTS ARRANGEMENTS WITHIN THE PREFERENTIAL TRADE AREA FOR EASTERN AND SOUTHERN AFRICAN STATES

6.1 Introduction

Chapter 2 has shown that most countries in the PTA have a currency which is not fully convertible. However, partial currency convertibility among the PTA members does exist. The trade payments mechanism that facilitates partial currency convertibility is the PTA Clearing House. In the CMA all current account transactions are guaranteed convertibility by the respective monetary authorities whereas in the PTA only trade payments which are channelled through the Clearing House are guaranteed convertibility. Therefore, although there is partial currency convertibility, not all transactions among PTA members are convertible.

As the PTA Clearing House is the most important tool facilitating partial currency convertibility within the PTA, this chapter, after looking at the general objectives of the PTA agreement, takes a close look at it. Because the Clearing House is not fully utilised, indicating that partial currency convertibility is only partially obtained, the reasons for low Clearing House utilisation are considered.

The chapter then considers whether the PTA countries can and should move immediately to full currency convertibility in terms of the criteria set out in chapter 2. This requires looking at the profile of individual countries' exchange rate, international liquidity and macroeconomic policies.

6.2 The Preferential Trade Area and its Objectives

The treaty establishing the PTA was signed in Abuja, Nigeria on 21 December 1981 within the Framework of the Lagos Plan of Action and the Final Act of Lagos. It entered into force on 30 September 1982 and became operational on 1 January 1984. (Kumar, 1989) It established the objectives and institutional framework for the PTA region.

The objectives of the PTA were defined in the 12 protocols of the treaty and can be summarised as follows:

(a) *"to promote co-operation and integration covering all the fields of economic activity, particularly trade, customs, industry, transport, communications, agriculture, natural resources and monetary affairs;*

(b) *to raise the standard of living of the people by fostering closer relations among member states;*

(c) *to create a Common Market by the year 2000 in order to allow free movement of goods, capital and labour within the subregion; and*

(d) *to contribute to the progress and development of the other African countries".* (PTA, 1991, p.1)

In order to facilitate achieving the objective of cooperation in monetary affairs, Protocol 6 - *Protocol on Clearing and Payment Arrangements*, was introduced. The committee in charge of the monetary harmonisation of the treaty is the Clearing Payments Committee which has the governors of the Central Banks as its members. It determines the maximum debit and credit limits in relation to the Clearing House and daily interest rate for outstanding debit balances, as well as dealing with all issues on monetary and financial cooperation.

6.3 The PTA Clearing House

As discussed in chapter 2 the problem of currency inconvertibility is a hindrance to trade. The administrative complexities involved in trade payments as well as waste of resources makes it highly desirable to have a convertible currency. Since the currencies of the PTA members were not convertible, the PTA Clearing House was introduced and is instrumental in creating partial currency convertibility.

6.3.1 The PTA Clearing House objectives

The PTA Clearing House was established on the 1st of February 1984. The objectives of the Clearing House (Article 22) indicate that the Clearing House will assist:

(a) *"to promote the use of national currencies in the settlement of all transactions between the member states;*

(b) *to establish adequate machinery for the settlement of payments among the member states;*

(c) *to economise on the use of foreign exchange by member states in their inter-state transactions;*

(d) *to encourage the member states to promote and liberalise trade among their countries;*

(e) *to promote monetary co-operation among the member states and closer relations among the banks in member states so as to contribute to the expansion of trade and economic activity among the member states".* (PTA, 1992d, p.1)

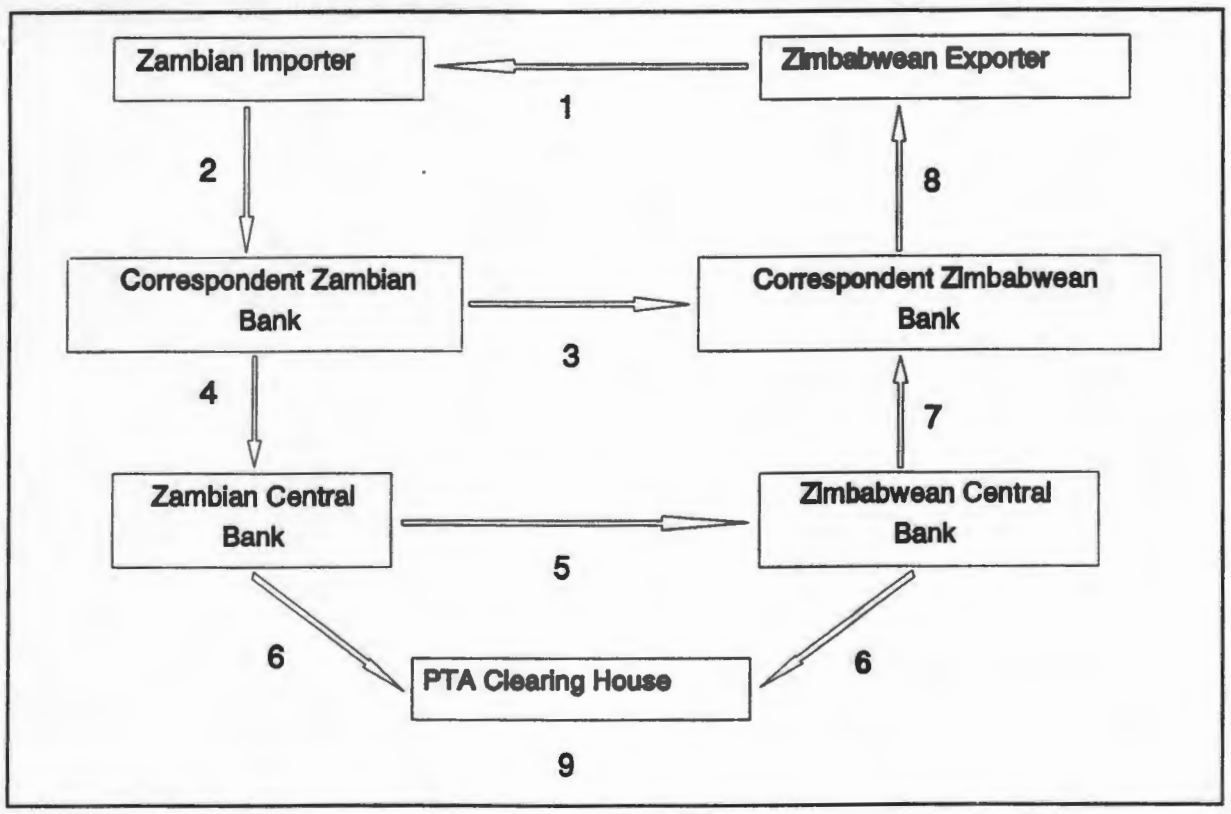
(i) Workings of the PTA Clearing House - Objectives (a and b)

The workings of the PTA Clearing House are best demonstrated with the aid of an example. Consider a Zambian importing commodities from Zimbabwe. The Zimbabwean exporter will not accept payment in kwacha as it would be worthless to her/him since (1) s/he is forbidden by the authorities to hold foreign currency; and (2) the Central Bank of Zambia will not guarantee exchanging the kwacha for a convertible currency or Zimbabwean dollars (unless

settlement takes place through the Clearing House). This is a result of a shortage of convertible currencies and the fact that Zambia has a significant trade deficit with Zimbabwe (shortage in Zimbabwean dollars). Therefore, the Zambian importer will be invoiced by the Zimbabwean, usually in Zimbabwean dollars. The Zambian importer will have her/his commercial bank issue a letter of credit on her/his behalf after the equivalent amount of kwacha is deposited in the bank. The Zambian commercial bank will then advise its correspondent bank in Zimbabwe of the terms of the letter of credit.

Once trade has taken place, on the presentation of the necessary documents, the Zimbabwean commercial bank will pay the Zimbabwean exporter from the Zambian bank account which is held at that bank. The account is replenished using the Clearing House facility. The Zambian commercial bank then transfers the necessary amount to the Zambian Central Bank. The Zambian Central Bank is debited by the Zimbabwean dollar amount [in Unit of Account PTA (UAPTA)] at the Clearing House, and the Zimbabwean account is credited. This clearing procedure can be summarised in a flow chart as illustrated figure in 6.1.

FIGURE 6.1
Flow Chart of the Operations of the PTA Clearing House



Source: Adapted from PTA (1992d, p.5).

The numbers in the figure correspond to the following stages:

1. The Zimbabwean exporter invoices goods and/or services in Zimbabwean dollars or in UAPTA.
2. The Zambian importer pays her/his commercial bank in kwacha for the imports.
3. The Zambian importer's commercial bank opens a letter of credit in favour of the Zimbabwean exporter which would be advised through the Zimbabwean exporter's commercial bank in Zimbabwe.
4. The Zambian importers's commercial bank in Zambia approaches the monetary authority to buy Zimbabwean dollars, and instructs that the commercial bank in Zimbabwe be credited accordingly.
5. The monetary authority in Zambia requests the monetary authority in Zimbabwe to credit the specified commercial bank in Zimbabwe, against credit through the Clearing House.
6. The monetary authority in Zambia, at the same time, advises the Clearing House of the transactions, requesting that its account be debited and the account of the monetary authority in Zimbabwe be credited. The monetary authority in Zimbabwe also advises the Clearing House as to the expected receipt of cover from the monetary authority in Zambia.
7. The Zimbabwe monetary authority then pays (on the due date) the exporter's commercial bank the amount due for the goods and/or services.
8. The Zimbabwean exporter's commercial bank then pays the exporter.
9. Clearing House records transactions and arranges settlement at the end of the transactions period.

(ii) Saving Foreign Currency - Objective (c)

All trade transactions which are channelled through the PTA Clearing House are settled every two months. The PTA Clearing House calculates the values of the transactions in UAPTA which is fixed in hard currency terms at one UAPTA per SDR. Fifteen days after each settlement date the net debtor countries are required to deposit hard currency (usually US

dollars) in the Federal Reserve Bank of New York. Net creditors receive the amount owed to them in their accounts at the same bank. In this way the PTA Clearing House provides member states the opportunity to pay for trade transactions, within the region, in their own currency. The way in which the Clearing House reduces the use of foreign currencies for payments for trade within the region is explained in table 6.1.

It is assumed that there are four countries, Malawi, Mozambique, Tanzania, and Zambia which are engaged in trade and use the PTA Clearing House for settlement of payments. Mozambique and Tanzania are net debtors, at the date of settlement. If payments for trade would not have taken place through the PTA Clearing House but rather through a foreign bank, US$38.52 million would have to be used. However, when using the PTA Clearing House, only the net debtors, being Mozambique US$12.11 million (imports of US$13.34 million less exports of US$1.23 million) and Tanzania US$6.6 million (imports of US$9.1 million less exports of US$2.5 million), would have to make payments in US dollars. Therefore, only US$18.71 million would have to be used, saving US$19.81 million in foreign exchange.

TABLE 6.1
Saving Foreign Currency (US$m)

	Imports				Total Exports
	Malawi	Mozambique	Tanzania	Zambia	
Exports: Malawi	-	11.44	0.60	7.25	19.29
Mozambique	0.83	-	0.40	0	1.23
Tanzania	0.30	1.6	-	0.60	2.5
Zambia	7.1	0.3	8.1	-	15.5
Total Imports	8.23	13.34	9.1	7.85	38.52

It is important to clarify that Mozambique and Tanzania still have to come up with the net balances in convertible currencies. Therefore, *"foreign exchange might be saved only to the extent that:*

a) *"Commissions arising out of foreign trade financing are appropriated by member country commercial banks and not by banks outside the region;*

b) *Interest incomes from short term foreign trade credit financing is earned by member*

country commercial banks". (Musokotwane, 1991, p.137)

(iii) Encourage and Promote Regional Trade - objective (d)

Trade transactions which are settled through the PTA Clearing House are guaranteed payment in a usable currency.[52] Therefore, the PTA Clearing House eliminates the preference of trading outside the PTA on grounds of currency inconvertibility.

The PTA agreement stipulates a 25 percent credit limit and a 20 percent debit limit that participating countries are allowed in respect to others. The existence of persistent deficits of some countries puts pressure on net creditor countries to import more from the net debtor countries. By importing from the net debtor they will be saving foreign exchange that would otherwise have to be used for imports from a non-PTA member.

Musokotwane (1991, p.138) points out that the emergence of persistent net debtors has led to complaints by those countries as to the low level of imports by the net creditors from them. As a result some countries, such as Burundi, Ethiopia, Kenya, Malawi, Rwanda, Swaziland and Zimbabwe,[53] have entered into bilateral agreements which stipulate that credit balances can be utilised in the debtor country only.

(iv) A form of Finance - Objective (e)

The fact that the settlement period is two months plus 15 days to deposit the foreign currency by the net debtor countries means that the net creditor countries are providing interest free loans to net debtor countries. This constitutes a form of cooperation and benefits both the net debtor and net creditor countries. It is an interest free loan for the net debtors and will create a greater incentive for them to trade with PTA members as imports from net creditors become relatively cheaper.

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[52]This would either be a convertible currency or the local currency.

[53]In fact two-thirds of PTA member states have bilateral payments arrangements.(Kumar, 1989, p.108)

6.3.2 Utilisation of the PTA Clearing House

The PTA Clearing House has proved itself as a well functioning facility for trade payments which has the potential for saving foreign exchange. Table 6.2 shows that net settlement in convertible currencies as a percentage of total settlements has decreased from 74.6 percent in 1984 to 33.1 percent in 1992 implying that objective (c) in 6.3.1 above is being fulfilled. It has also proved to be a smoothly operating mechanism with participating countries fulfilling their obligations for payments. To date no country has defaulted although some countries have been late with payment.[54] This, however, has been made possible by a deliberate policy to limit imports through the Clearing House to avoid accumulation of excessively large net debit balances to settle in hard currency at the end of the transaction period.

TABLE 6.2
Utilisation of the PTA Clearing House

YEAR	Volume of Business (UAPTA million)	Percent Increase	Utilisation level (% of Intra PTA Trade)	Net Settlement in Forex as % Total
1984	74.6	-	8.7	74.6
1985	98.1	31.5	11.8	85.7
1986	118.8	37.2	17.2	51.7
1987	175.8	48.0	24.9	54.8
1988	283.1	61.0	32.3	50.1
1989	441.0	55.8	55.7	46.9
1990	389.0	-11.8	45.7	42.3
1991	348.0	-15.2	32.8	33.7
1992	272.4	-21.7	25.1	33.1
1993	197.8	-27.4	-	-

Source: Calculated from the PTA Annual Report (1994).

Criticism has been directed at the appropriateness of the PTA Clearing House on the grounds that total PTA trade has increased at an annual average rate of 11.53 percent while intra-regional trade has increased at a rate of only 5.82 percent between 1984 and 1992. Garner *et al* (1992, p.6/140) make the point that criticising the PTA Clearing House on the basis of such analysis, using US dollars to establish trends in trade, is unjustified. This is because the rapid depreciation of the region's currencies lead to a reduction in the value of trade, in

[54]Late payments carry an interest charge at the SDR rate plus one percent for every week overdue.

US dollar terms. In other words, even if the volume of intra-PTA trade is unchanged or increases by less than the depreciation of the currency, in terms of US dollars it will have decreased. Therefore, the correct way to evaluate intra-PTA trade is by using the total volume of trade in inflation - adjusted local currency terms. The difficulty with their argument is that most PTA currencies, as will be shown in section 6.4.1, have not experienced real exchange rate depreciation. Therefore, measuring trade trends in local currencies or in US dollars will have the same result.

The issue of the low degree of utilisation of the PTA Clearing House for intra-PTA trade payments settlement is an important one. Although the level of utilisation has increased during the 80's, the PTA Clearing House was only used to settle 25.1 percent of intra-PTA trade in 1992.[55] This relatively low level of utilisation means that there is still great potential for foreign exchange savings on current intra-PTA trade. It further indicates that there are still substantial barriers for it to realise its full potential.

Although the PTA Clearing House is not utilised for settlement of all intra-regional trade it is not obvious that this is undesirable. It must be remembered that the issue is the creation of convertible currencies. Therefore, does low utilisation actually indicate a move away from convertible currencies? In order to establish if this is the case, it is necessary to consider some of the reasons for low PTA Clearing House utilisation.

6.3.3 Reasons for the low utilisation of the PTA Clearing House

The reasons for under-utilisation of the PTA Clearing House are closely related to the low level of intra-PTA trade as a percentage of total PTA trade. The larger the intra-regional trade imbalances the larger the amount of trade transactions that will not be channelled through the PTA Clearing House in order to avoid payment default. The main reasons for the under-utilisation do not derive from the PTA Clearing House itself. Some of the barriers to full utilisation are unique to individual countries resulting from government policies and

[55]This trend seems to only be getting worse. From private correspondence it appears that intra-regional exporters are increasingly demanding payments in hard currency.

regulations, while others result from PTA policies and regulations.

Export Incentive Schemes

(i) As a result of balance of payments constraints some countries have implemented schemes to increase the volume of exports. One of these schemes allows exporters to retain part of the export earnings in foreign currency. This, although an incentive for increasing of exports, is a disincentive to the utilisation of the PTA Clearing House. The Ugandan authorities, for example, allow exporters to retain 100 percent of their export earnings. It is not surprising, therefore, that in 1988, 1989, and 1990 the proportion transacted through hard currencies was 94 percent, 83 percent and 89 percent respectively. (African Development Bank (Uganda), 1992, p.13)

(ii) A similar problem to that of individual countries incentive schemes is that of the Open General Import License (OGIL) which has been adopted in Mozambique, Zambia, and Zimbabwe. Under this scheme, which eliminates the need for import licenses on particular goods that originate in the PTA, part of the export receipts can be retained by the exporter in foreign currency (hard currency). Therefore, many exporters refuse to use the Clearing House since they demand payment for intra-PTA exports in hard currency. This means that the Clearing House's potential for foreign exchange savings is not fulfilled. In some cases (eg. Zambia), the utilisation of the PTA Clearing House is limited because most of the metal trade within the region is not processed through the Clearing House for OGIL related reasons. (African Development Bank (Zambia) 1992, p.12)

Foreign exchange retention schemes and the OGIL can be seen as an attempt to encourage currency convertibility and improve the allocation of foreign exchange. Foreign exchange retention schemes are an incentive for exporters. This in turn should increase foreign exchange earnings and alleviate balance of payments constraints, one of the reasons for currency inconvertibility.

OGIL is aimed at reducing the costs involved in import licences and improving the allocation

of foreign exchange by allowing exporters to retain some of the foreign currency they have earned. Although it reduces the utilisation of the PTA Clearing House it does not necessarily create currency inconvertibility. In fact if export retention schemes and OGIL increase exports then current account deficits may be reduced allowing currency convertibility without the use of the PTA Clearing House. Therefore it is apparent that low utilisation is not necessarily negative, as long as it does not discourage moves towards currency convertibility.

Private Sector Resistance

(iii) There is an entrenched lack of faith in the region's currencies by the private sector leading to some members still insisting on payments with hard currencies, particularly US dollars. This is, to a large extent, a result of lack of knowledge by the private sector as to the services the PTA Clearing House provides and the advantages it represents for the PTA member states. The demand for hard currencies is not surprising when the exported goods have a high import content. In many cases the exporters are forced to import machinery from outside the PTA necessitating the use of foreign currency. Because of foreign exchange shortages the authorities allocate foreign exchange to importers. Therefore, they get around the foreign exchange allocation by insisting on payment in hard currency for their intra-PTA exports.

Discouragement by Commercial Banks

(iv) In many cases commercial banks discourage the use of the PTA Clearing House. In Uganda, for example, a 1 percent commission on UAPTA travellers cheques is shared by three agencies and commercial banks obtain only 0.3 percent of it. Therefore banks prefer customers to buy US dollar denominated travellers' cheques rather than the UAPTA travellers cheques. (African Development Bank (Uganda), 1992)

(v) An even more severe case of commercial banks discouraging the use of the PTA Clearing House, is as a result of the delayed export payments. As a result of the settlement period of the Clearing House, the exporters themselves are those who extend credit to importers. This can often be detrimental to an exporter who imports

from outside the PTA. Because of the inadequacy of forward markets (see appendix A) for foreign exchange the time delay of export receipts increases the uncertainty of the exporter as to his ability to pay for imports particularly when exchange rates are volatile. (African Development Bank (Kenya), 1992, p.18)

In order to alleviate this problem, commercial banks should be allowed to pay exporters with the guaranteed reimbursement from the Central Banks. There is little risk in the Central Banks extending such a facility since payment to them is assured. Furthermore, this will lead to a situation where net creditor countries extend credit to net debtor countries rather than individual exporters doing so.

Intra-Regional Trade Imbalances

(vi) Intra-PTA trade is small in absolute terms and is of limited importance to most of the countries in the region. In 1980, total intra-PTA trade (exports plus imports) amounted to US$1,281 million or 6.3 percent of total PTA trade. The corresponding figures for 1991 (in 1980 prices) were US$801.55 million and 5.4 percent. (PTA, 1993a) While the percentage of intra-PTA trade as a share of total PTA trade has decreased by 0.9 percent, total PTA trade in 1980 prices has fallen by approximately 37 percent over the period.

The major trading partners in the PTA are Kenya, Zimbabwe, Uganda and Zambia. Together, in 1992, they accounted for more than half of trade within the region.[56] This indicates the very skewed trade relationship which is found in the PTA. Kenya's intra-PTA trade over the period has been more than a quarter of total intra-PTA trade. This figure, although large, has declined since the 1973-1980 period when it amounted to about one third of trade. (Anjaria *et al.* 1982, p.4)

The significance of intra-PTA trade varies substantially and does not necessarily follow the value of trade. The best indication of the importance of intra-PTA trade

[56]See table B2 in the appendix.

is its share of total trade as can be seen in table 6.3. Although Djibouti ranks ninth according to its value of intra-PTA trade, intra-PTA trade accounted for 16.3 percent of total PTA trade between 1980 and 1991, making it the second most dependent country on intra-PTA trade (Uganda being the first). Countries like Djibouti, Kenya and Malawi are highly dependent on the PTA markets for their exports, while the majority (e.g. Uganda) are more dependent on the PTA for their imports. The fact that there are a substantial number of net debtors and net creditors is a serious impediment to the effectiveness of the PTA Clearing House. This means that there is only limited potential for foreign exchange savings. In order for the PTA Clearing House to be effective, it is necessary that multilateral intra-regional trade by countries in the region be as balanced as possible. If this is not the case a situation could arise where net debtors will not be able to honour their payments commitments as they have to be settled in convertible currencies.[57]

[57]Regional net creditors in 1992 were: Djibouti (1991), Ethiopia, Kenya, Swaziland (1991), Tanzania, and Zimbabwe. The regional net debtor countries in 1992 were: Angola, Burundi, Comoros, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia (1991), Sudan (1991), Uganda, and Zambia. Only Angola, Swaziland and Zimbabwe were overall net creditors during the period analysed.

TABLE 6.3
Intra-PTA Trade, Annual Average 1980-1992

	Value of Intra-PTA Trade in US$m	Rank[1]	Rank[2]	Share of Intra-PTA Trade in Own Total Trade		
				Exports %	Imports %	Total %
Angola	5.77	16	17	0.00	0.46	0.17
Burundi	35.25	12	3	4.38	17.54	12.71
Comoros	4.45	17	11	1.68	8.08	5.62
Djibouti*	46.92	9	2	41.95	11.38	16.32
Ethiopia	39.39	10	14	8.34	1.12	3.11
Kenya	271.21	1	4	21.37	1.64	9.52
Lesotho	3.23	18	12	1.69	6.26	4.78
Malawi	58.28	6	5	9.93	8.55	8.98
Mauritius	15.79	14	16	0.55	1.59	1.01
Mozambique	66.30	5	7	4.96	8.02	7.33
Rwanda	48.71	8	3	4.43	17.16	12.71
Somalia*	24.18	13	8	1.52	7.56	6.10
Sudan*	37.16	11	15	0.13	3.24	2.39
Swaziland*	14.37	15	10	4.45	4.96	5.67
Tanzania	55.09	7	13	5.75	3.50	4.20
Uganda	113.81	3	1	1.61	30.76	16.90
Zambia	104.84	4	9	5.14	7.38	6.07
Zimbabwe	167.85	2	6	9.82	7.49	7.87

Source: Calculated from table B2 in the appendix.
[1]Rank according to total value.
[2]Rank according to share of intra-PTA trade in own total trade.
*The share of intra-PTA trade in own total trade, annual average 1980-1991.

6.4 The Preconditions for Transformation to Currency Convertibility and the PTA Currencies.

Given the advantages of having a convertible currency, as were described in chapter 2, it is worthwhile considering whether transformation to full currency convertibility by PTA members is possible at present. Therefore a closer look is taken at the key economic factors.

6.4.1 An appropriate exchange rate

An overvalued exchange rate is detrimental to both trade and transformation to a convertible currency. It is therefore necessary to consider whether PTA countries have misaligned exchange rates. Ghura and Grennes (1993) have constructed a "*Real Exchange Rate Misalignment Index*" (*RERMIS*) to measure the level of overvaluation or undervaluation of the exchange rate. The *RERMIS* is measured as:

$$RERMIS_{it} = \left(\frac{ERER_{it}}{RER_{it}} - 1\right) \tag{1}$$

where *RER* is the real exchange rate and *ERER* is the equilibrium real exchange rate, t is time index, and i is a country index.

The RER is defined as:

$$RER_{it} = \frac{E_{it} * P_t^*}{P_{it}} \tag{2}$$

where E is the official nominal exchange rate measured as the amount of domestic currency per unit of U.S. dollars, and P and P^* are the local price index of tradables and the foreign currency price of tradables respectively. The U.S. consumer price index (*CPIUS*) is used as proxy for P^* and the domestic CPI as the proxy for P.

$$RER_{it} = \frac{E_{it} * CPIUS_t}{CPI_{it}} \tag{3}$$

Hence,

A positive value for the index indicates an exchange rate overvaluation while a negative value indicates an exchange rate undervaluation. Using a PPP approach the exchange rate misalignment is measured as the deviation of the real exchange rate from the base year where

the real exchange rate was at equilibrium. Following Cottani *et al* (1990), this thesis uses the average of the three highest values of the *RER* over the period as a proxy for equilibrium *RER*.[58] Hence the PPP measure of misalignment is

$$RERMIS_{it} = \left(\frac{\Sigma_j \max RER_{ij}/3}{RER_{it}} - 1\right) \qquad (4)$$

where $[(\Sigma_j \max RER_{ij})/3]; (j=1,2,3)$

The results of the PPP measure are shown in the first two columns of table 6.4. The first column shows Ghura and Gernnes's results for the period 1972-1987 while the second column shows the results calculated here for the period 1980-1993.

The weakness of the PPP measure, however, is that it does not allow for changes in the ERER that may occur as a result of sustainable changes in economic fundamentals. Therefore, they use a second measure of RER misalignment which is based on a formal model of ERER determination. This model-based measure of misalignment is superior to the PPP measure as it allows for the ERER to change continuously. The results of this model are given in column three of table 6.4.

A third measure of RER misalignment is that of the black market premium. When a local currency is believed to be more expensive (in foreign currency terms) in the official market than what the market rate is, an informal market for it emerges - the black market. The exchange rate in the black market therefore gives an indication as to the degree which the exchange rate is overvalued. The black market proxy for RER misalignment is calculated as: *(black market exchange rate/official exchange rate)-1*. The result will always be positive because a negative figure would mean a RER undervaluation. Under such conditions then the black market would not emerge. The results of the black market proxy are shown in the fourth column of table 6.4.

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[58]They assumed that these years correspond to those where the real exchange rates were closest to the equilibrium rates.

It is important to note that Ghura and Grennes (1993, p.167) find that the correlation coefficients with the model-based measure of misalignment for the PPP and black market measures are high.

TABLE 6.4
Real Exchange Rate Misalignment in the PTA

Country	PPP Measure of RER Misalignment (%)[a]		Model Measure of RER Misalignment(%) (72-87)	Black Market Proxy for RER Misalignment (%)[b] (1993)
	72-87	80-93		
Angola	-	-	-	1316
Burundi	17.4	27.0	23.8	26.0
Ethiopia	29.5	44.6	19.5	48.7
Kenya	13.6	21.8	18.8	14.0
Lesotho	38.9	29.1	25.7	-
Malawi	23.6	16.7	25.3	53.2
Mauritius	21.0	15.8	22.6	-
Mozambique	-	76.6	-	11.2
Rwanda	47.3	23.2	30.3	-
Somalia	50.2	51.7	49.1	72.2
Sudan	25.5	91.2	39.8	130.1
Swaziland	-	26.6	-	-
Tanzania	34.4	155.3	56.2	6.9
Uganda	115.9	-	145.6	-
Zambia	103.0	78.4	32.8	47.0
Zimbabwe	26.4	32.4	15.1	19.0
Average	42.1	49.4	36.5	

Source: Ghura and Grennes (1993, p.166).
[a]The 1980-1993 figures were calculated in the thesis.
[b]Rates from Africa Analysis (1993, December).

Table 6.4 shows the results of different measures of real exchange rate misalignment. All these measures show that over the period measured the exchange rate of all these countries were overvalued, on average, irrespective of the measure used. However, the first three measures give the average exchange rate overvaluation. According to these measures it is possible that there were certain years in which the exchange rate was not overvalued. Only the black market proxy for 1993, in the fourth column, gives an indication of the level of misalignment for a particular year. It may, therefore, be helpful to identify the direction in which the RER of the PTA currencies are moving.

To find the direction of RER movement a 'traditional' real exchange rate measure which relies on the PPP approach is used.[59] The nominal exchange rates and consumer price indices, as published in the International Financial Statistics, for the relevant countries were used. The RER was calculated using equation (3) in section 6.4.1 above. The results of the measurement are shown in figures 6.2 to 6.14. These show RER trends over the period considered. A segment of the graph with a positive slope indicates a real exchange rate depreciation. A segment of the graph with a negative slope indicates real exchange rate appreciation.

Figures 6.2 to 6.14 show a mixed trend of real exchange rates of PTA members.[60] The Ethiopian birr, Mozambique metical, Tanzanian shilling, and the Zimbabwean dollar have followed a depreciating trend. Nonetheless, according to the 1993 black market proxy for real exchange rate misalignment these currencies were overvalued. The currencies of Lesotho, Malawi, Mauritius, Rwanda, Swaziland and Zambia have either maintained a stable exchange rate or experienced a currency appreciation. Here too the 1993 black market proxy establishes that the Malawi kwacha and the Zambian kwacha are overvalued. It is apparent therefore that in certain cases the exchange rate policy pursued had good intention, that of depreciating the currency, attempting to bring it in line with its equilibrium rate. However, other accompanying policies were not complementary to these attempts.

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[59]This is the same RER measure as discussed above but does not take into consideration the ERER. The reason for this is the fact that the three years with the highest RER may be the closest to ERER, but are not exactly the ERER (because they are an average). Therefore, using the PPP measure of misalignment for the presentation of the RER trends may imply that in the year that the RER is highest it was undervalued.

[60]Once again unavailability of data has restricted the analysis. Sufficient data was only available for thirteen countries.

Figure 6.2

BURUNDI – REAL EXCHANGE RATE TREND

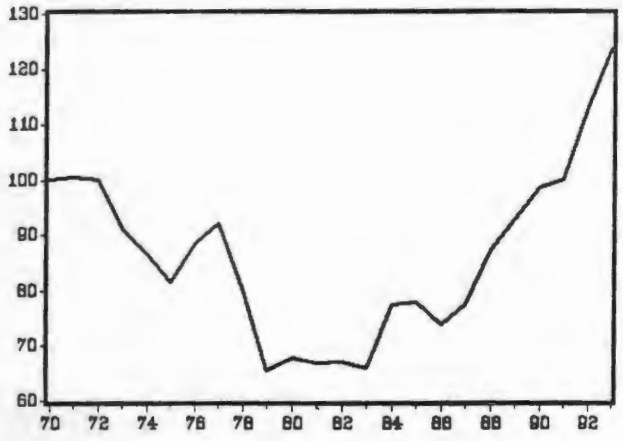


Figure 6.3

ETHIOPIA – REAL EXCHANGE RATE TREND

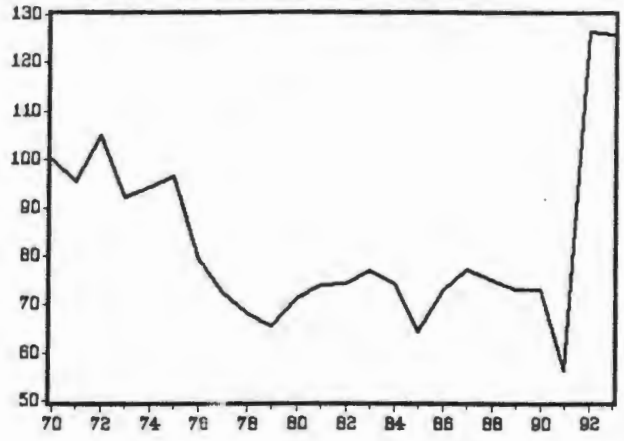


Figure 6.4

KENYA – REAL EXCHANGE RATE TREND

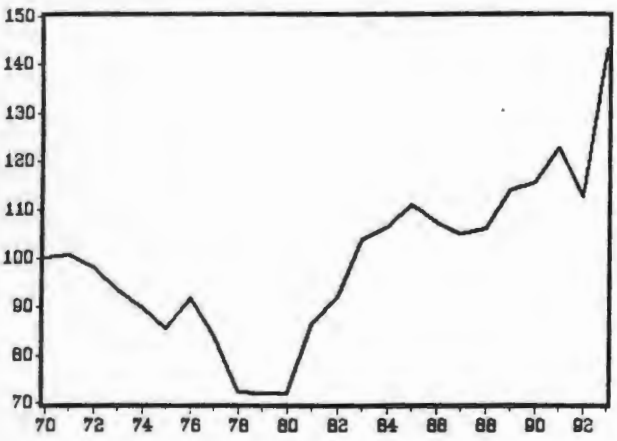
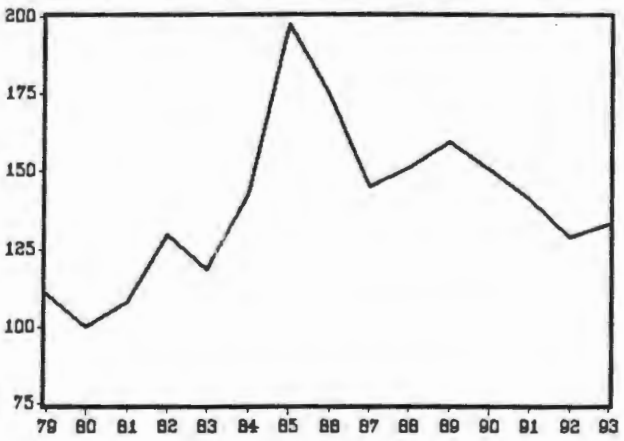


Figure 6.5

LESOTHO – REAL EXCHANGE RATE TREND



ure 6.6

MALAWI – REAL EXCHANE RATE TREND

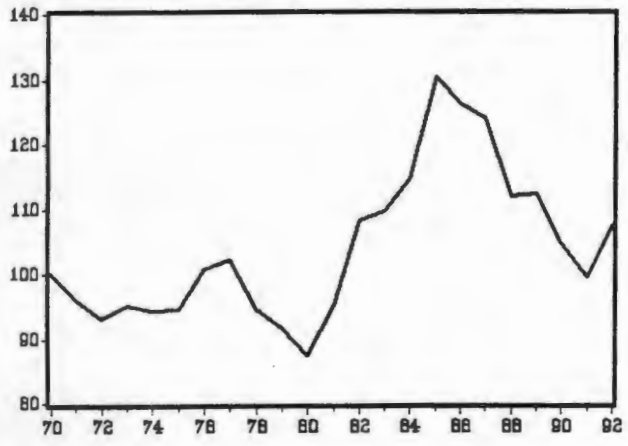
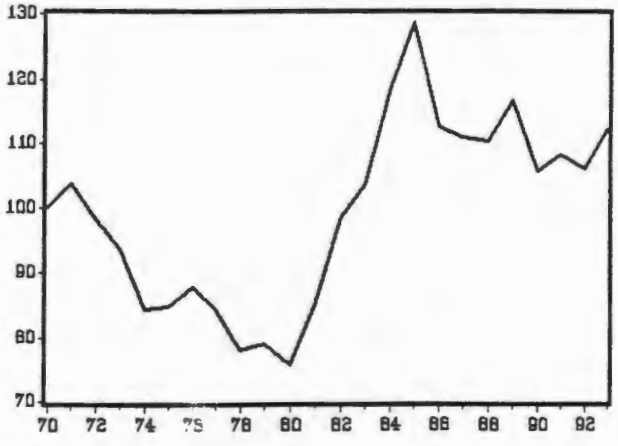


Figure 6.7

MAURITIUS – REAL EXCHANGE RATE TREND



ure 6.8

MOZAMBIQUE – REAL EXCHANGE RATE TREND

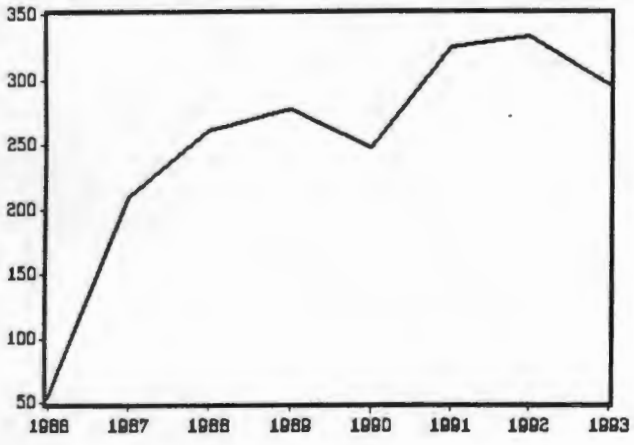


Figure 6.9

RWANDA – REAL EXCHANGE RATE TREND

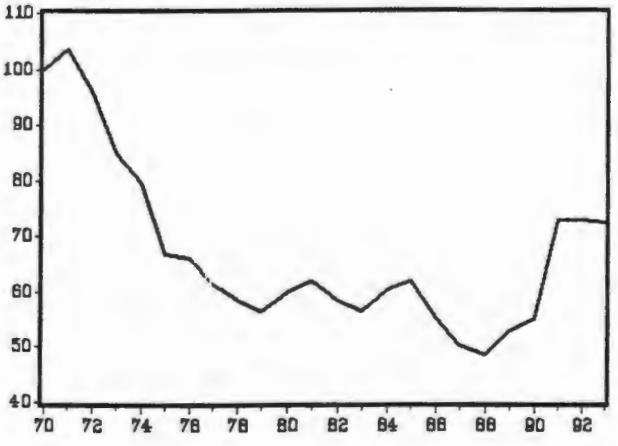


Figure 6.10

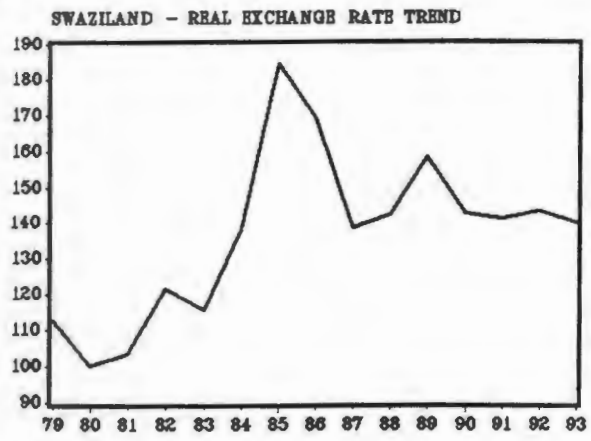


Figure 6.11

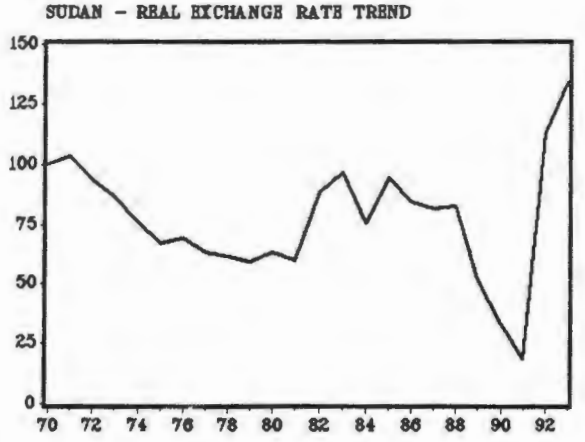


Figure 6.12

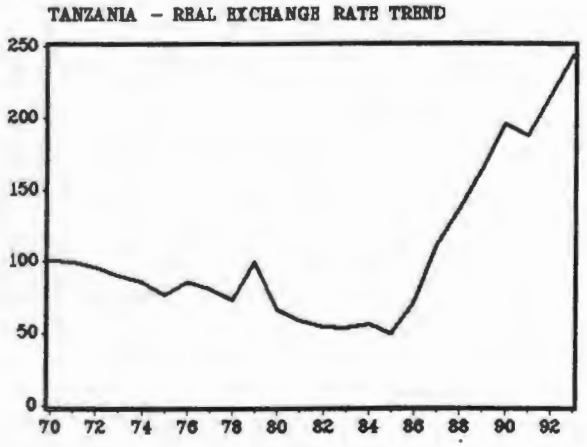


Figure 6.13

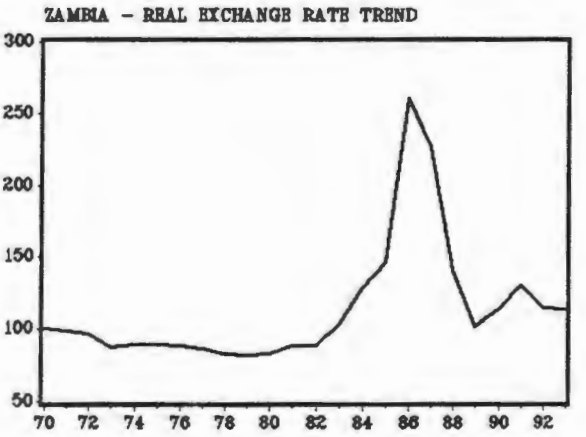
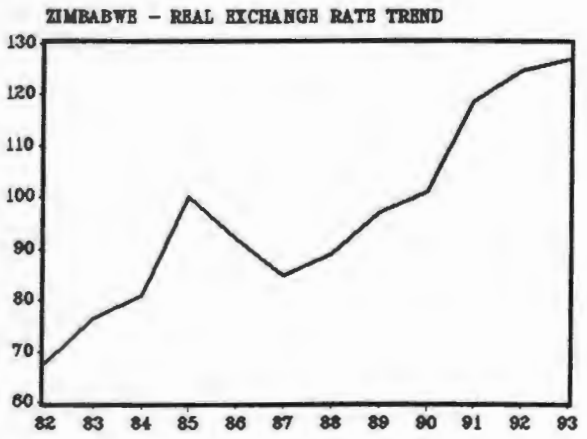


Figure 6.14



The trends that are apparent in the PTA currencies in recent years may seem encouraging as RER depreciation is taking place in some cases. However, since the PPP measure does not allow for ERER changes, a depreciation of the RER does not necessarily indicate a movement towards equilibrium.[61] Therefore, to get a better approximation of the currencies' position with regard the ERER it is necessary to look at each country's current account, international reserves, and the level of international debt.

A persistent current account deficit would indicate that the exchange rate is in fact overvalued since imports are cheaper than they would have been if the real exchange rate was at equilibrium. However, looking at the current account on its own is not sufficient since consideration must also be made as to the level of international reserves. If international reserves are positive then a current account deficit could indicate a healthy economy with an appreciating equilibrium real exchange rate as economic growth occurs and economic fundamentals improve. Thus under these conditions the appreciation of the real exchange rate may not mean that the real exchange rate is moving away from equilibrium.

Table 6.5 shows the current account position of PTA countries since 1985 and table 6.6 shows the reserve position of these countries in terms of months of import cover. The only PTA countries that have not had a persistent current account deficit since 1985 are Lesotho and Swaziland.[62] International reserves of most PTA members do not show particular strength to indicate that the persistent current account deficits are not problematic with the possible exception of Burundi, Djibouti, and Mauritius.

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[61]This could of been established if the black market rates were available for all PTA countries. For the countries that it is available, as was shown, the currencies are overvalued.

[62]South Africa's debt standstill has, no doubt, a hand in this.

TABLE 6.5 PTA Members Current Account position (US$m)								
	1985	1986	1987	1988	1989	1990	1991	1992
Angola	-	-303	447	-469	-132	-236	-580	-511
Burundi	-42.2	-37.6	-96.5	-70.6	-12.1	-66.2	-31.3	-54.0
Comoros	-14.3	-15.6	-21.4	-6.5	5.4	-9.3	-8.9	-9.0
Djibouti	-	-	-	-	-	-		-
Ethiopia	105.9	-327.3	-217.5	-227.9	137.1	-284.1	174.0	-120.0
Kenya	-112.9	-38.1	-497.7	-460.4	-579.6	502.1	-230.9	-98.0
Lesotho	-12.1	-2.8	23.6	-24.6	10.4	65.0	83.0	38.0
Malawi	-124.7	-89.9	-55.3	-53.1	-130.0	-78.0	-156.0	-
Mauritius	-29.5	94.1	63.0	-63.6	-104.4	-119.9	-18.0	-2.0
Mozambique	-301.0	-409.0	-389.0	-359.0	-460.0	-415.0	-344.0	-381.0
Rwanda	-64.1	-69.2	-134.3	-144.5	-122.6	-108.8	-34.1	-85.0
Somalia	-102.8	-125.7	-114.0	-98.5	-156.7	-	-	-
Sudan	148.4	-17.4	-231.7	-358.0	-150.3	-369.2	-957.8	-506.0
Swaziland	-39.0	11.0	62.0	65.0	4.0	45.0	3.0	25.0
Tanzania	-37.5	-321.8	-446.0	-375.8	-358.8	-426.0	-	-
Uganda	4.6	-3.8	-112.0	-195.2	-259.5	-263.3	-170.0	-100.0
Zambia	-398.0	-350.0	-248.0	-295.0	-222.0	-597.0	-307.0	-
Zimbabwe	-75.7	6.8	48.0	116.6	-3.0	-172.0	-489.0	-

Source: World Development Report (World Bank, 1993) and International Financial Statistics (IMF,1994).

TABLE 6.6 PTA Countries Import Cover in Months (1992)	
Angola	-
Burundi	6.3
Comoros	-
Djibouti	6.0*
Ethiopia[a]	2.8
Kenya	0.4
Lesotho	1.8
Malawi	0.7
Mauritius	4.8
Mozambique	2.2
Rwanda	2.5
Somalia	-
Sudan	0.3
Swaziland	3.0*
Tanzania	2.1
Uganda	1.5
Zambia	1.3
Zimbabwe	1.8

Source: World Development Report (World Bank, 1994)
* 1991

Furthermore, looking at table 6.7 which shows the PTA member countries debt to the IMF, it is evident that most PTA countries have drawn on IMF credit and loans[63] in the form of the General Resource Account (GRA), Structural Adjustment Facility (SAF), and the Enhanced SAF (ESAF) to a large degree. Since some of the reserves would be used to pay back for credit and loans outstanding the level of reserves is even less favourable than that which is given by the months of import cover.

[63]Looking at the capital account would be of little help here since a positive capital account balance may be a result of IMF credit and loans. This would in fact distort the result since these do not necessarily mean an improvement of economic fundamentals.

TABLE 6.7 Total IMF Credit and Loans Outstanding (1993) US$m[1]	
Angola	-
Burundi	44.4
Comoros	0.9
Djibouti	-
Ethiopia	35.3
Kenya	264.3
Lesotho	24.9
Malawi	62.62
Mauritius	-
Mozambique	137.9
Rwanda	8.8
Somalia	112.0
Sudan	671.6
Swaziland	-
Tanzania	156.2
Uganda	243.0
Zambia	565.8
Zimbabwe	205.0

Source: International Financial Statistics (IMF, 1994)
[1]This includes outstanding use of Fund's credit within GRA, SAF, ESAF, and Trust fund loans.

The above analysis therefore indicates that the problem of exchange rate overvaluation is still prevalent in most PTA countries. Since there is no indication of an improvement in the real exchange rate fundamentals coupled with the 1993 black market proxy of real exchange rate misalignment which shows exchange rate overvaluation, it can be concluded that the PTA currencies are overvalued. It is important to note, however, that there are different degrees of overvaluation among PTA currencies.

6.4.2 Adequate International Liquidity

International reserves and access to foreign financing, are necessary for transformation to full currency convertibility. The sufficient level of international reserves cannot be accurately quantified as the exact pressure on them can not be predicted. However, it can be argued that the level of international reserves of countries about to transform to full currency convertibility should be higher than those of countries that have already got a convertible currency.

The first indicator is that of months of imports covered. Here, as has been discussed, the situation is anything but promising. Seeing that the generally accepted necessary level of reserves under normal circumstances is three months of import cover, in most PTA countries this is not the case. The second indicator is that of access to international loans. Table 6. 8 shows that both official development assistance and total external debt as a percentage of GNP are high. This indicates that these countries may find it difficult to get any additional assistance from outside sources. This means that PTA members will have difficulty in accessing international financial markets. [64]

[64]The related issue of credit ratings is discussed in more detail in chapter 7.

TABLE 6.8 Access to International Loans and External Debt		
	Official development assistance as a % of GNP (1991)	Total external debt as a % of GNP (1991)
Angola		81[a]
Burundi	21.8	83.8
Comoros		72
Djibouti		42.1
Ethiopia	16.5	53.4
Kenya	10.6	89.6
Lesotho	18.9	39.2
Malawi	22.6	78.5
Mauritius	2.5	37.0
Mozambique	69.2	426.0
Rwanda	22.2	53.7
Somalia		283.4[a]
Sudan	-	221.7
Swaziland		28.7
Tanzania	39.2	250.8
Uganda	19.5	109.2
Zambia	-	262.6[a]
Zimbabwe	6.2	57.0

Source: World Development Report (World Bank, 1993)
[a]1990

6.4.3 Sound macroeconomic policies

Establishing whether PTA countries pursue sound macroeconomic policies is a difficult task due to the unavailability of necessary data. Time series reflecting levels of taxation, money supply growth, and government consumption expenditure, but to mention a few, are incomplete. The only data available that may assist in evaluating macroeconomic policies is that of the external debt as a percentage of GNP shown in table 6.8 and inflation shown in table 6.9. Both of these measures are indicating that macroeconomic policies pursued are not sound.

TABLE 6.9 PTA Inflation Rates									
	85	86	87	88	89	90	91	92	93
Angola	-	-	-	-	-	-	-	-	-
Burundi	3.6	1.9	7.0	4.7	11.6	7.0	8.8	4.5	9.7
Comoros	-	-	-	-	-	-	-	-	-
Djibouti	-	-	-	-	-	-	-	-	-
Ethiopia	19.1	-9.8	-2.4	7.1	7.8	5.2	35.7	10.5	3.5
Kenya	13.1	3.9	7.6	11.2	12.9	15.6	19.8	29.5	45.8
Lesotho		18.1	11.8	11.4	14.7	11.6	17.7	17.2	13.9
Malawi	10.5	14.0	25.2	33.9	12.5	11.8	12.6	22.7	-
Mauritius	6.7	1.6	0.5	9.2	12.7	13.5	7.0	4.6	10.5
Mozambique			91.0	50.1	40.1	47.0	33.3	45.2	76.2
Rwanda	1.7	-1.1	4.1	3.0	1.0	4.2	19.6	9.6	12.4
Somalia	37.8	35.8	28.2	81.9	-	-	-	-	-
Sudan	45.4	24.5	-	64.7	66.7	65.2	123.6	117.6	101.4
Swaziland	20.5	13.7	13.4	12.5	8.3	11.0	10.8	8.2	17.0
Tanzania	33.3	32.4	30.0	31.2	25.8	19.7	22.3	22.1	23.5
Uganda	158	161	200	196	61.4	33.1	28.1	52.4	6.1
Zambia	37.3	54.0	45.6	54.7	129	111	92.6	197.4	189.0
Zimbabwe	8.5	14.3	12.5	7.4	12.9	17.4	23.3	42.1	27.6

Source: International Financial Statistics, (IMF, 1994)

The above analysis indicates that transformation to full currency convertibility cannot take place as yet in most cases. Rather a gradual attempt to correct the problems that are standing in the way of full currency convertibility are necessary. There are strong signs, however, that PTA members are attempting to achieve the prerequisites to transformation to full currency convertibility. The most notable cases of exchange rate reforms that have taken place recently are those in Angola, Ethiopia, Kenya, Malawi, Tanzania, and Zimbabwe. The new Angolan kwanza has been devalued repeatedly by the authorities during 1994 in an attempt to bring the official exchange rate to "...a point of macroeconomic equilibrium". (Africa Research Bulletin, 5/1994) Ethiopia has introduced a fourthnightly foreign exchange

auction. The Kenyan shilling's exchange rate has been floating since early 1993 and regulations on foreign exchange transactions were abolished in early 1994. This means that foreign visitors are now able to use Kenyan shillings instead of hard currency and that restrictions on local borrowing by foreign - controlled companies are removed. Malawi and Tanzania have both introduced a weekly foreign exchange auction sale. At the beginning of 1994 the Zimbabwean authorities made it clear that they will attempt to bring the official and black market exchange rates closer together, clearing the way for the abolition of the remaining exchange controls. The Zimbabwean dollar was devalued by 17 percent in January 1994 which led to the official exchange rate being 4 percent to 5 percent below the black market rate, down from 19 percent at the end of 1993. (Africa Research Bulletin, 3/1994) In July 1994 the Zimbabwean Reserve Bank announced that the gap was almost eliminated.[65] (EIU, 4th quarter, 1994)

Although these are positive moves there are already signs that some of these reforms are problematic and may be reversed as has happened often in the past. One example is that of Malawi where the auctions are dominated by a small cartel of bidders. Furthermore, companies which are part of an international conglomerate can buy foreign currency from sister companies at lower rates than those in the auction market, giving them an unfair advantage. (EIU, 3rd quarter, 1994) In the case of Tanzania the authorities fix the price of the foreign exchange that is offered for sale with the result being that demand is almost three times greater than supply, a clear indication that the exchange rate is overvalued. (Africa Research Bulletin, 7/1994)

[65]This seems to be a rather optimistic view of the Zimbabwean Reserve Bank. There are indications that the gap has indeed narrowed but not to that extent.

CHAPTER 7

PAYMENTS FACILITIES AND PRACTICES

7.1 Introduction

When currencies are convertible, international trade payments are settled primarily through commercial banks as any arising balances will be guaranteed currency convertibility. However, when currencies are inconvertible commercial banks would be very cautious of dealing in such currencies as arising balances may not be converted into usable currencies.[66] Take for example a UK bank having a debit balance with a US bank. If the UK has not got sufficient US dollars to make payment, it can pay the US bank with sterling.[67] The US bank can then go to the Bank of England and convert those pounds into US dollars. However, if for example, a Malawian bank has a debit balance with a US bank and cannot come up with the necessary amount of dollars, payment in Malawian kwacha will be useless to the US bank because the Malawian Central Bank will not guarantee convertibility of the Malawian kwacha to a convertible currency such as US dollar.

When currencies are partially convertible the commercial banks are able to function within the partially convertible area in a similar manner to the US and UK banks discussed above. They will not be concerned about the availability of a usable currency because this is guaranteed. Therefore, the instruments for short-term trade finance are similar when currencies are convertible or partially convertible and the risk involved is lower than when currencies are inconvertible.

This chapter discusses the different types of risks that originate from international trade and how these are reduced when currency convertibility or partial currency convertibility are

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[66]Usable currencies are either convertible currencies or the domestic currency.

[67]It would probably just buy the dollars in the foreign exchange market, but for the sake of illustration this option is disregarded here.

established. It considers the different methods of short-term trade finance which are used considering first the actual instruments which are available and their use in the region, followed by those which would be used if the level of risk was lower. Finally it determines the importance of correspondent banking in the region and its role in intra-regional trade due to its credit risk reduction.

7.2 Types of Risks Involved in International Trade

When an exporter decides on the most appropriate way in which payment should take place the main considerations are the risk and the transactions cost. The precautions which will be taken in order to be protected from default of payment will depend not only on the financial standing of the potential trading partner but also the country in question. The greater the chance of default the more precaution is necessary and hence the higher the cost of insuring against it. The important risk categories which have to be considered when deciding on the appropriate payment method are the credit (commercial) risk, country (sovereign) risk, and currency (transaction) risk.[68]

7.2.1 Credit risk

When a bank considers granting an exporter a loan in order to finance trade it will, as in the case of any other type of loan, appraise the ability of the exporter to repay. The risk of the borrower being unable to repay the loan when it becomes due is known as *credit risk*. (Blake, 1990, p.5) The ability of the exporter to repay the loan will also depend on the ability of the importer to pay for the exported goods. Furthermore, the bank will have to consider the standing of the importer's bank, and of the confirming bank. Therefore, the assessment of the credit risk involved in the financing of trade is not the normal domestic credit risk assessment but must include the importer's, importer's bank and the confirming bank's

[68]The definition of currency risk often includes credit and country risk. However, here currency risk is used in its narrowest sense of transaction risk which is the risk of fluctuations of the exchange rate.

financial standings.[69]

The assessment of credit risk requires information collection which becomes more difficult once the information required is abroad. This leads to difficulties in distinguishing between good-quality debt and bad-quality debt resulting in costs to both the bank and the exporter since bad-quality debt may force out good-quality debt.[70]

7.2.2 Country risk

Country risk is best expressed as the risk which arises from the possibility of the exporter not receiving payment due to the fact that they are sold abroad. It arises from the possibility of payments default as a consequence of economic, social, and political events which take place in a foreign country. These do not include the credit risk which was discussed above. Although the political factors in the CMA-PTA region are particularly important, only the economic factors will be considered. These are:

i) *Balance of payments prospects* - A country's ability to repay loans (short-term and long-term) depends on its foreign currency earnings. In the case of a country facing a current account deficit it may borrow from abroad in order to finance imports. However, these loans have to be repaid and a persistent deficit will decrease the ability to pay for trade. The factors which will influence the ability to repay loans are those which affect the level of exports and imports.

ii) *Prospects for long-term growth* - A current account deficit is not always undesirable. If loans from abroad are taken in order to finance imports of goods and services which will be instrumental for future economic growth these are desirable. Therefore, country risk arises

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[69]This will become more clear in section 7.4 where there is a discussion of the finance instruments.

[70]Banks will often limit the amount of trade finance that they grant for trade with certain countries. Therefore, if a bank helps finance exports which are not paid for (bad-quality debt) reaching the limit for trade finance with a country, then exporters which would have been paid for (good-quality debt), would not be able to get the finance required for trade.

only if these loans are taken in order to finance current consumption or failing industries. (Williams, 1982)

Indices of country risk are used by banks in order to determine exposure limits and charges on loans to different countries. The ranking of countries according to the degree of risk that is involved in dealing with them is published in several publications such as *Institutional Investor* and *Euromoney*. In 1993, PTA members fared very poorly in the Euromoney country risk rankings. Out of 170 countries in the survey the PTA members which were included were ranked as follows: Mauritius (67), Zimbabwe (69), Kenya (81), Lesotho (88), Djibouti (98), Malawi (105), Burundi (121), Rwanda (123), Tanzania (135), Zambia (136), Uganda (140), Ethiopia (141), Angola (143), Mozambique (158), Sudan (168), and Somalia (169).[71] (Euromoney, 1993)

The above data shows how poorly most PTA countries are regarded by the international banking community. The Euromoney country risk method considers ten separate categories and gives each one a different weight.[72] The political risk, for example, holds a 25 percent weighting in the calculations. Therefore, although currency convertibility may reduce country risk due to the guarantee that foreign exchange will be available, it will not eliminate it.

7.2.3 Currency (transaction) risk

Where a financial transaction involves a foreign currency and there is a time gap between the agreement and actual payment, currency risk will occur. Currency risk, for the purpose of trade payments, can be defined as the prospect of loss as a result of fluctuations in the exchange rate of the currencies involved in the transactions. Currency risk can be eliminated

[71]South Africa was ranked 49th.

[72]Economic data (25 percent), political risk (25 percent), debt indicators (10 percent), debt in default or rescheduled (10 percent), credit ratings (10 percent), access to bank finance (5 percent), access to short-term finance (5 percent), access to international bonds and syndicated markets (5 percent), access to and discount on forfeiting (5 percent).

by buying or selling currency forward. This however, may become more costly the less developed the forward market is. In ten of the eighteen PTA members there are no forward exchange facilities offered for trade transactions at all. In the other countries the available forward cover is underdeveloped and not widely used. In all cases the cost of forward cover is high.[73]

7.3 Currency Convertibility and Risk Reduction

A significant non-tariff trade barrier is that of various categories of risk involved in international trade. The higher the risk involved the higher the cost of insuring against loss. The increased cost translates into higher prices for the importer or lower profits margins for the exporter. Therefore, the removal or decrease of export risk becomes beneficial to both parties. Establishing partial currency convertibility will reduce country risk because it will guarantee that foreign currency will be made available for all debit balances that have arisen from trade with certain countries. Furthermore, it will assist in reducing the credit risk because of an overall change in the commercial environment. For example, commercial links which may follow will assist in evaluating credit risk and hence reduce it. As a result of the lower costs involved in intra-regional trade[74] exporters can lower their prices giving importers an incentive to buy from them. Consequently, achieving partial currency convertibility will assist in reducing the risk exposure which is associated with regional trade and will encourage intra-regional trade.[75]

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[73]See appendix A for foward cover availability.

[74]That is the region for which partial currency convertibility is established.

[75]There is the risk of overemphasising the importance of partial currency convertibility on improved trade relations. However, from private correspondence it seems that this risk is significant. It is apparent that finding new reliable trade partners is extremely difficult as there is doubt as to their ability to pay. Even with available trade finance instruments which reduce the risk, trade is constrained due to scepticism.

7.4 Trade Financing by Commercial Banks

There are numerous instruments of short-term trade finance available from commercial banks. These include open accounts, revolving credit, back to back credits, and standby credits amongst others. Most of these instruments are not offered by South African banks for short-term finance for regional trade. Although non-documentary credits are not often used in the PTA it is worth explaining briefly what they are since once partial currency convertibility is established they may become useful. However, it is necessary to first discuss the frequently used methods of payments, namely documentary credit instruments.

It is important to note that although the same type of documentary credit facilities are available for trade among developed countries and LDCs they have different characteristics.[76] In order to demonstrate this difference the general case will be discussed followed by the differences which occur when used for LDCs.

7.4.1 Types of documentary credits

The agreement on the method of payment for trade is negotiated by the trading parties and is embodied in the contract of sale. The decision on the method of payment and the currency in which the payment will be made will depend on the risk involved. As to the decision in which currency the payment will be made, there is an advantage to the party whose currency is used for quotation in the sale documents since foreign exchange fluctuations do not affect the amount that it will receive.[77] In this way the foreign exchange risk is reduced. The agreement as to what currency will be used for the transaction will be determined according to the scarcity of the good traded and the currency in question. If the good is widely available, quotation of the price will be made in the currency that the importer will choose. However, if the currency of both parties to the agreement is unstable, and forward cover does not exist, as is the case with most PTA countries, the quotation could be made in a third

[76]Developed countries are regarded here as low risk countries while LDCs are high risk countries.

[77]The advantage is a result of certainty of the amount paid if forward cover is not used or unavailable.

currency. Under these conditions both parties face a currency risk, with a possible advantage to one of the sides.[78]

The first and most popular documentary credit is the *Export Letter of Credit*[79] which provides a high level of protection to the exporter. Take the example of a UK company importing telecommunication equipment from a South African company. The UK company wants to pay for the equipment once it arrives in the UK while the South African company wants payment to be made at the time it is shipped from South Africa. It is assumed that the parties to the contract have agreed that payment will be made in sterling. The UK company then arranges with its bank to provide an irrevocable Letter of Credit[80] to cover the cost, insurance and freight of the equipment. The letter of credit is issued in favour of the South African company (see figure 7.1).

If the UK company is not able to cover the costs at the time the Letter of Credit is requested, the bank will consider the company's credit worthiness. In this case the UK bank will have the equipment as collateral for the credit line. The UK bank will inform a South African bank of the opening of the credit and the reimbursement instructions,[81] which will then inform the South African company. The South African bank may also be requested to confirm (guarantee) the letter of credit although this is not common when a first class international bank is involved.

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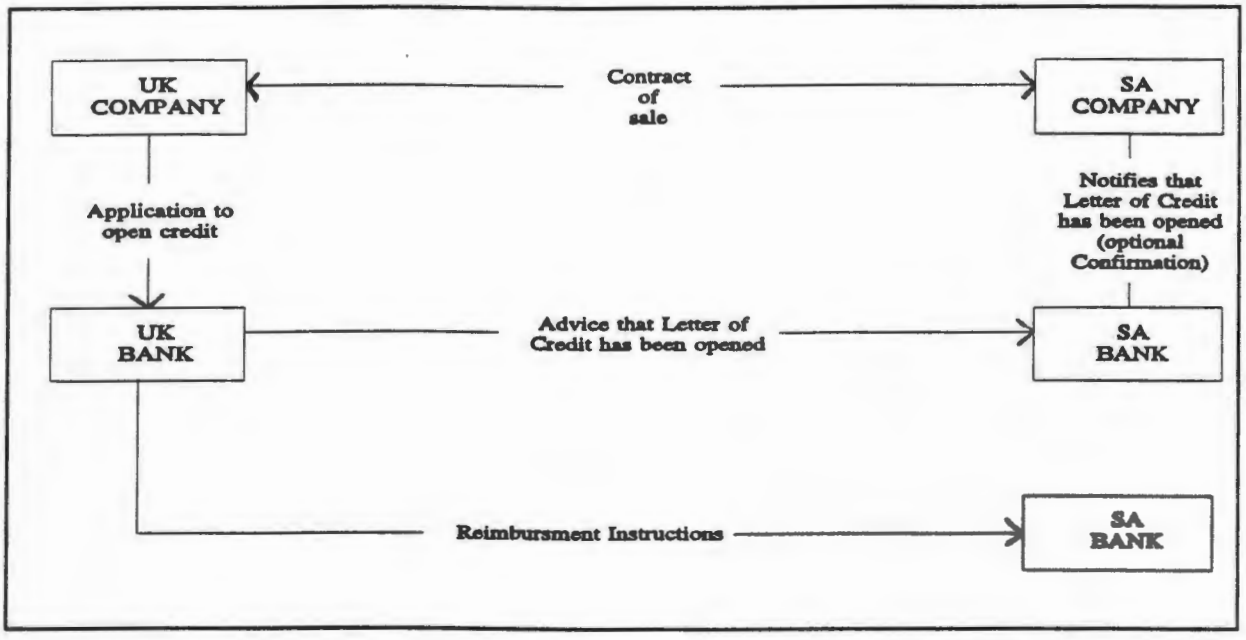
[78]If the price is quoted in US dollars and the exporter's currency depreciates s/he will end up receiving more of the domestic currency than what s/he would have if the quotation was made in her/his currency. This does not necessarily mean that s/he would gain in real terms, but rather in nominal terms compared to her/his trading partner. There are obviously other possible outcomes but probably the more relevant one is that mentioned above.

[79]An Import Letter of Credit is the mirror image of the Export Letter of Credit, but for purposes of clarification only the more common one will be explained.

[80]Although they can use a revocable letter of credit this is disregarded as it does not constitute a legally binding undertaking of the banks concerned and may be modified or cancelled at any time.

[81]It is assumed here, for the sake of simplicity, that the reimbursing bank is the same as the advising bank. This means that one South African bank may advise, reimburse and confirm the letter of credit.

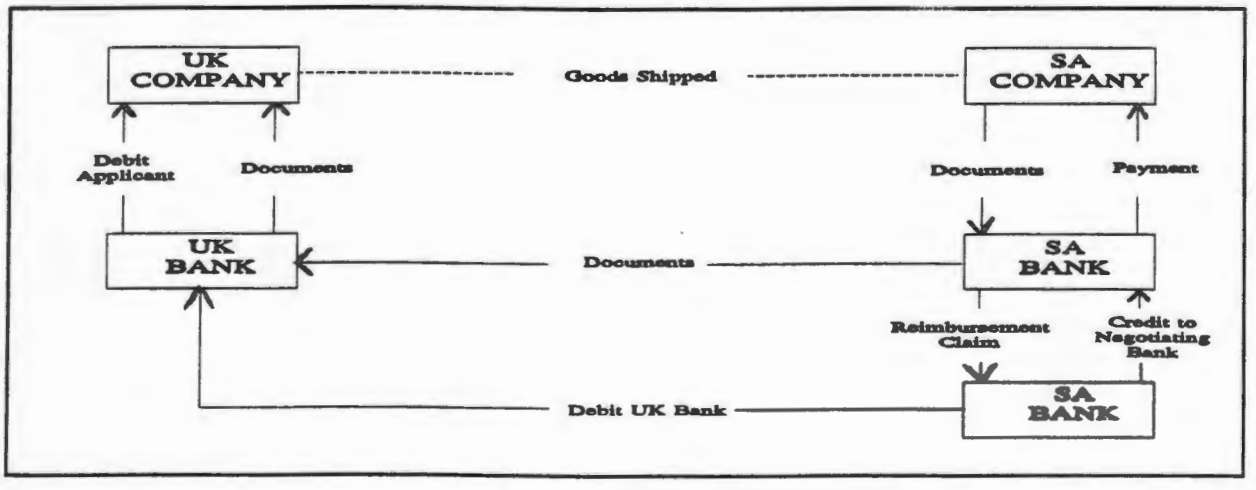
FIGURE 7.1
Establishing a Documentary Letter of Credit



Source: Adapted from Standard Bank SA, (1993a).

Figure 7.2 shows how payments actually take place. The South African company has the equipment shipped and prepares and presents the documents to the South African bank which checks the documents against the Letter of Credit. It then effects payment to the South African company in terms of the Letter of Credit.

FIGURE 7.2
Presentation of Documents



Source: Adapted from Standard Bank SA, (1993a).

The South African bank will then claim reimbursement from the UK bank which will receive the documents and check them against the credit. If the documents conform, the UK bank will release the documents to the UK company and claim payment from it. If the documents do not conform, the UK company may refuse to pay and the UK bank will request a refund from the South African bank (if it did guarantee the Letter of Credit). The South African bank then in turn will demand repayment from the South African company. If the documents do conform, the final transaction will be that the South African bank's account will be credited in the books of the UK bank.

7.4.2 Cost of trade payments with LDCs inconvertible currencies

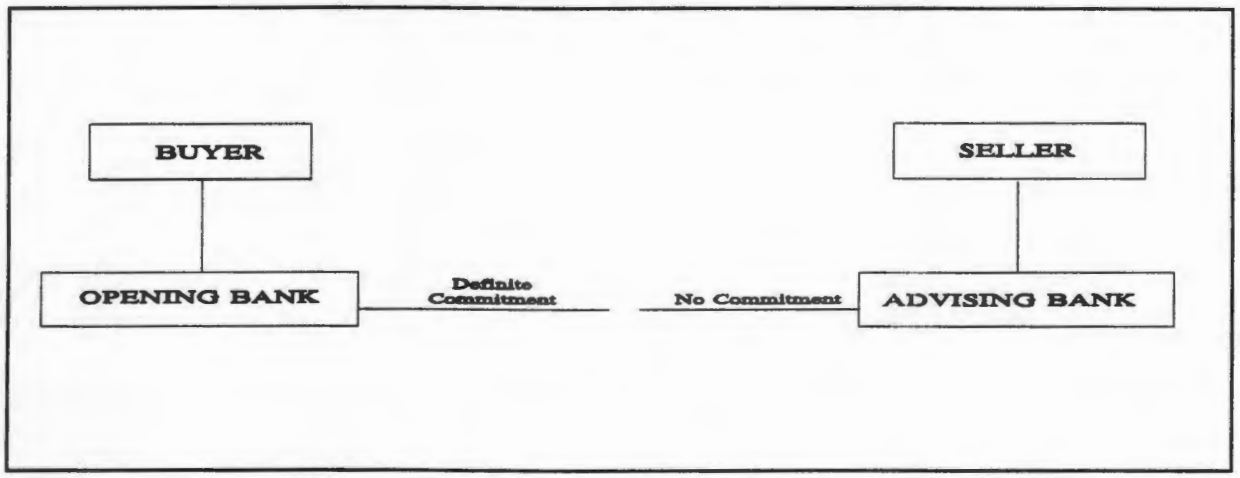
The main difference between the use of documentary credits among developed and developing countries involves the establishment of the ability to pay. If there is a risk for the exporter that the importer's bank will not be able to honour the Letter of Credit then it will demand that it is confirmed by its bank, thus reducing its own risk. The bank, also facing the risk, will turn to a third bank, usually a first class international bank, to confirm the Letter of Credit. The third bank will guarantee the Letter of Credit on deposit in its account of the necessary amount by the importing country's bank.

This scenario is pertinent to the South African-PTA situation as can be seen from tables B3.1 and B3.2 in the appendix. Standard Bank of South Africa requires that a Letter of Credit be confirmed in the case of all (Kenya, Malawi, Tanzania, Uganda, and Zambia) but one (Zimbabwe) of the PTA members for which it offers a country profile. First National Bank of South Africa also requires confirmation for letters of credit for all (Angola, Kenya, Malawi, Mozambique, and Zambia) but one (Zimbabwe for which it recommends confirmation) of the PTA members for which it offers a country profile.

The difference between a confirmed Letter of Credit and one which is not confirmed, is explained in figures 7.3 and 7.4. In figure 7.3 the seller's (exporter) bank does not guarantee payment to the seller (exporter). Under such circumstances the seller (exporter) may face payment default. Since the buyer's (importer) bank is committed to make payment

the only difficulty which may be encountered is that the buyer's bank will not have sufficient foreign exchange to pay with. If the currency is inconvertible the seller (exporter) would have incurred a loss. In figure 7.4 the seller's (exporter) bank confirms the Letter of Credit and therefore is assured that payment will be made. In certain cases a further step is taken by the bank. It may ask for confirmation from a first class international bank, in order to safeguard itself from possible default.[82] This eliminates the exporter's risk as her/his bank commits to pay her/him and s/he will have knowledge of her/his bank's ability to pay.

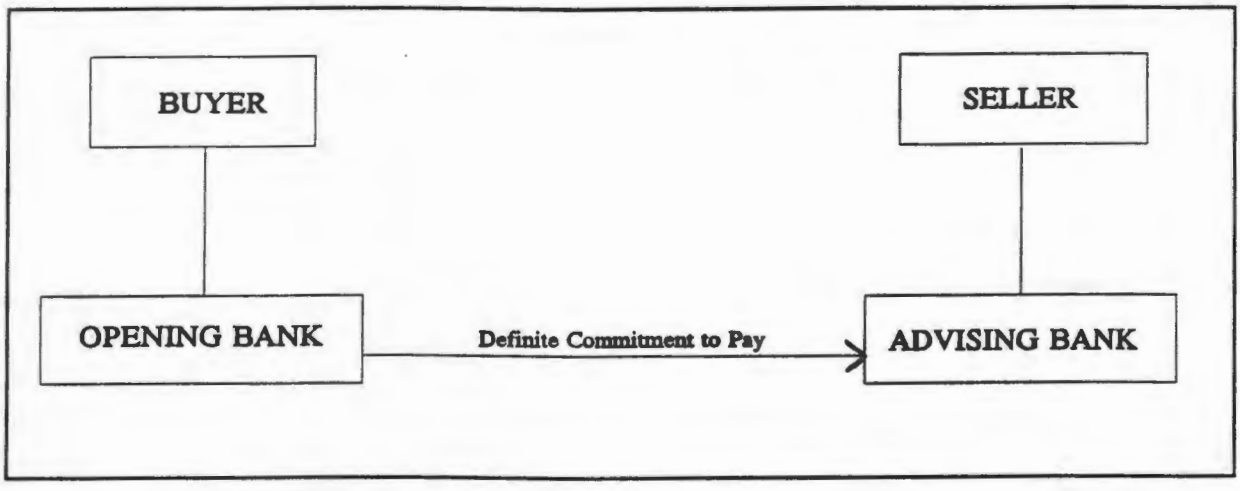
FIGURE 7.3
Irrevocable Letter of Credit (not confirmed)



Source: Potgieter *et al*, (1991).

[82] A confirmation by a first class international bank is used mainly in order to eliminate the exposure to the country risk by the local bank.

FIGURE 7.4
Irrevocable Letter of Credit (Confirmed)



Source: Potgieter *et al*, (1991).

Another source of protection available to South African exporters derives from the Credit Guarantee Insurance Corporation.[83] Using this method of protection can eliminate the danger of all type of risks. However, this type of cover is costly. The cost of obtaining such insurance depends on the type of instrument used for payment. The more protective the instrument, the lower the cost of insurance.

Using the export shipment policy offered by the Credit Guarantee Insurance Corporation for trade with the PTA (other than CMA members) is at least twice as expensive as insuring for trade with Botswana, Lesotho and Swaziland. Table B4 in the appendix shows the costs of insuring exports from South Africa to another country. The costs vary according to the method of payments used and the country of destination. The premium rate varies from 0.06 percent of the value of shipment when using a method of an irrevocable Letter of Credit in the case of exports to Japan[84] to 2.23 percent when open credit is used and the destination

[83]Zimbabwe is the only other country in the region that offers viable export credit insurance (Zimbabwe Credit Insurance Corporation).

[84]The premium rates to Botswana, Lesotho, and Swaziland are similar to that charged on exports to Japan. Japan is used as an example of a country with low country risk as indicated in the Euromoney (1993) country ratings.

of exports is to Mozambique.[85]

The costs for confirmation of Letters of Credit are closely related to the premium rate charged by the Credit Guarantee Insurance Corporation. This is a result of the banks themselves seeking guarantee from the Credit Guarantee Insurance Corporation. In most cases exports to PTA countries are accompanied by very high confirmation costs.[86] By establishing partial currency convertibility between CMA and PTA the risk involved in financing trade will be reduced as discussed in section 7.3, and therefore it can be expected that Credit Guarantee Insurance Corporation charges will become lower.

7.4.3 Non-Documentary methods of payments

Non-Documentary methods of payment are more common among developed countries. They are available and viable only where risk exposure is low as they offer little protection for the exporter. Therefore, although not popular in the PTA, it is possible that once partial currency convertibility is achieved along with an improvement in the correspondent banking, they will become a cheaper option in the region.

The important[87] non-documentary payments include:

i) *Open Account* - The exporter will send the shipping documents to the importer directly and will require that payment be made to her/his bank's correspondent bank in the importer's country.

ii) *Consignment* - The exporter will ship the equipment which will be released by her/his agent in the importers country where it will be stored. When payment is effected by the importer to the exporter the equipment will be handed over.

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[85]Mozambique is the lowest ranked PTA country to which the Credit Guarantee Insurance Corporation offers insurance for. No insurance is offered for trade with Somalia and Sudan which are ranked lower than Mozambique.

[86]See Table B3.1 and B3.2 in the appendix.

[87]These are the most used by South African exporters to outside the PTA.

iii) *Foreign Bill of Collection* - The importer's bank will receive the shipping documents from the exporter and will act as her/his agent. Once payment has been made the goods will be released by the bank. This method requires a relationship with a bank in the importer's country.

Non-documentary credits are very simple and cheap. However it exposes the exporter and the commercial bank which finances the exporter to a high risk. The open account is the most risky method of payment as it exposes the exporter to both a country and commercial risk. Consignment reduces credit risk as does a guaranteed foreign bill for collection.[88]

7.5 Common Methods of Payments between South Africa and the PTA

The fact that most PTA countries have an inconvertible currency and the poor credit ratings that are given to them is an indication that trading with the PTA members is risky. Appendix B3 gives a good indication as to the most common method used for trade finance between South Africa and PTA countries. Botswana, Lesotho, Namibia and Swaziland all have a convertible currency *vis-à-vis* South Africa. Therefore, exports to these countries have a low cost of confirmation with finance instruments available across the board.[89] On the other hand PTA countries such as Malawi, Mozambique, Kenya and Zambia should be exported to only with the use of a confirmed Letter of Credit. These are associated with high or very high costs of confirmation as there is often a need for confirmation by a first class international bank in order to eliminate country risk.

An important issue to note is that trade finance instruments which are used for trade between South Africa and the PTA, and within the PTA are similar. The differences are the cost associated with trade finance and the instruments which are offered by the commercial banks.

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[88]They reduce credit risk, but there is still the danger that the importer will not be able to pay after the goods have already been shipped. Therefore, although the exporter still has the goods s/he has incurred production, transport, and storage costs.

[89]Partial currency convertibility reduces country risk and therefore the cost of insurance.

7.6 Correspondent Banking in Southern Africa

The importance of correspondent banking is that of economic relations normalisation. This emerges at two levels. First, without correspondent banking relations, it becomes very difficult and costly to arrange risk-free payments for trade. Correspondent banking means that the risk of the foreign bank not fulfilling its obligation to pay the local bank, is avoided. The second issue is that of enhancing general economic relations among countries. A correspondent foreign bank will assist the local bank in determining the credit-worthiness of an importer. In fact having correspondent banking will increase the available types of payments arrangements. For example, the non-documentary instruments mentioned in section 7.4.3 will become more viable once there are correspondent banking relations.

At both levels correspondent banking can lead to increased competitiveness via risk reduction. Runge (1993, p.2) points out that the lack of correspondent banking is a problem that is pertinent in South Africa's case. He argues that:

> *"South African banks do not have direct correspondent relationships and credit lines with many African countries. In using foreign intermediary banks and institutions, substantial delays and costs are incurred; (eg. opening and confirmation charges)".*

Bucknor (1993, p.12) finds it curious that African banks have neglected the development of correspondent banking, an area where, he believes, they have a natural advantage, in an effort to promote the financing of intra-regional trade. He finds that the financial performance of African banks has weakened in recent years. As a result overseas banks have reduced credit lines and other forms of technical support to African banks in order to reduce their exposure to this risky market. Furthermore, the adoption by the Bank of International Settlements of *international risk-based capital adequacy standards*[90] has meant that many international banks are withdrawing from developing countries in order to reduce their

[90]The risk weighting system applied by the Bank of International Settlements has become more restrictive under this standard. Therefore, in order to achieve the minimum capital adequacy requirements banks are increasing their retained earnings while emphasising credit and cost control. This comes at the expense of LDCs.

exposure. Therefore, credit facilities for intra-regional trade have become prohibitive and as a result very costly.

One of the reasons that necessitate the usage of third banks[91] is the fact that there is minimal information interchanged among banks in the region about their activities and their clients. The lack of technological sophistication is another obstacle to correspondent banking. For example the fact that many banks are not members of SWIFT[92] means that banks are constrained to handle their international banking operations using outdated systems. These difficulties lead to substantial delays and costs of trade.

Standard Bank of South Africa has already been increasing its correspondent banking with PTA and other African countries[93] recognising the potential market and assisting in regional development. The bank has acquired the African operations of ANZ Grindlays Bank which gives the Standard Bank representation in Zimbabwe, Zambia, Kenya, Uganda, Zaire, Ghana, and Nigeria. A substantial portion of its operations is in providing Letters of Credit, foreign exchange and trade related financial services. (African Connexion International, 1993)

[91]This would be the first class international bank.

[92]Society for Worldwide Interbank Financial Transmission.

[93]First National Bank and Nedbank declined to give out information on their regional activities since it is "confidential".

CHAPTER 8

ALTERNATIVE INSTITUTIONAL PAYMENTS ARRANGEMENTS FOR THE CMA-PTA REGION

8.1 Introduction

The mechanisms for trade payments used by the CMA and the PTA bear no resemblance. The CMA has an advanced monetary arrangement which allows for partial currency convertibility for all type of transactions. The PTA, on the other hand, uses the most elementary form of arrangement, allowing for partial currency convertibility for trade payments only through the PTA Clearing House.

The type of institutional payments arrangements are determined by the objectives of the agreements and the degree of integration which they are supposed to create. The objectives of the arrangements range from achieving partial currency convertibility to the achievement of a full currency union. It will depend on the level of present integration, exchange rate practices, the degree of financial market sophistication, balance of payments position, the level of intra-regional trade as well as the potential for future trade among the countries involved.

This chapter looks at transitional arrangements for transformation to currency convertibility which are available and are being implemented in other regions. First, non-monetary institutional arrangements which are either based on foreign exchange allocation restrictions or import protection are considered. This is followed by a discussion of institutional payments arrangements or monetary arrangements, which allow for partial currency convertibility. The experience of existing arrangements may assist in determining the type of payments arrangement that is most suitable for the CMA-PTA region.

It is seldom the case that countries move from having an inconvertible currency to a convertible currency in one step. Postwar Europe, the newly industrialised Asian economies and the formerly centrally planed economies in Eastern Europe[94] have all taken a step-wise approach to establishing currency convertiblity. As chapter 2 argued, transformation to full currency convertibility when the preconditions have not been met may have negative results. Even when these preconditions have been met, some countries may wish to retain certain restrictions on the current account due to fears that allowing for currency convertibility without limiting the level of imports will lead to large current account imbalances, exchange rate fluctuations, and cause large declines in the level of output. (Green and Isard, 1991)

Non-Monetary Transitional Arrangements

Green and Isard (1991) suggest two kinds of transitional arrangements in order to mitigate the risks of allowing for full currency convertibility. The first type of arrangements is exchange restrictions which allows for free access to foreign exchange while enabling the authorities control over the level of imports. Foreign exchange, import licences, or foreign exchange licenses could be offered for sale by the authorities. The amount of these that will be offered for sale by the authorities will depend on the availability of foreign exchange to the authorities. This will, however, necessitate foreign exchange surrender by exporters. The advantage of this type of arrangement over one where foreign exchange is allocated and granted by the administration is that price signals will determine where the limited foreign exchange will be allocated.

The problem with this arrangement is that even though foreign exchange or import licences are offered and sold on the free market, the initial sale is done by the administration. There is the inherent danger that this type of administrative allocation will result in corruption and pressure groups receiving special treatment. Even under such a system there is no question that the preconditions for transformation must be either fully or at least partially obtained. Zambia is an example of a country in which such an arrangement was attempted. The sale

[94]These have not established full currency convertibility as of yet.

of a fixed amount of foreign exchange by the authorities on the open market proved unsuccessful. As a result of the overvaluation of the kwacha, the Zambian authorities introduced an auction market for the sale of foreign exchange in October 1985. This resulted in a very significant depreciation of the Kwacha with the authorities withdrawing the auction market and fixing the Kwacha to the dollar in June 1987. (African Development bank (Zambia), 1992)

The second arrangement, first suggested by McKinnon (in Green and Isard, 1991), involves imposing temporary import tariffs on goods in order to dampen the potential high increase in imports. Here full currency convertibility will be established immediately and all quantitative trade restrictions will be removed. Temporary tariffs which will initially be set at high levels to protect local industries will be introduced in order to limit imports in the short-term. Gradually the rates at which the tariffs are set will be reduced until such time that they will be abolished.

The advantage of this system is that there will be limited administrative involvement. Industries would not be "targeted" but rather a blanket rate of tariffs will be introduced. The problem with this arrangement is similar to that of *infant industry protection*. The imposition of tariffs may reduce the exposure of local industries to international competition. If industries are "targeted" and differential tariffs are imposed the result is that local prices do not adjust to international prices,[95] causing distortions of domestic production and investment decisions. Furthermore, it is often the case that domestic industries, once under protection of high tariffs, will resist the reduction of tariffs because it will reduce their profit margin and they may never become competitive enough (due to protection) to compete. (Green and Isard, 1991, p.15)

[95]Imposing differential tariffs (protecting an industry) will affect "untargeted" industries. For example, imposition of tariffs on motor vehicle electronic equipment raises the price of electronic devises that the South African motor vehicle manufacturers have to pay, making it more difficult for them to compete against foreign motor car industries which buy the electronic equipment more cheaply.

Monetary Transitional Arrangements

Institutional payments arrangements are either part of a broader type of economic cooperation, in which case there are further arrangements, or exist for the sole purpose of supporting payments for trade. Some agreements only have a clearing arrangement while others may have a financing facility to aid members with balance of payments difficulties. Regional cooperation agreements which use clearing arrangements include the Latin American Integration Association (ALADI),[96] the Central American Clearing House,[97] the Clearing Facility of the Caribbean Common Market,[98] the West African Clearing House,[99] the Clearing Arrangement of the Economic Community of Great Lake States,[100] the PTA, the Asian Clearing Union,[101] and the Regional Cooperation for Development Group.[102] Other Regional cooperation agreements which do not use a clearing arrangement include the Arab Monetary Fund[103] and the Andean Reserve Fund.[104]

Agreements on monetary cooperation can be categorised into three different groups according to the degree of integration which they entail (Michalopolous, 1973). These are:

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[96]The participating members are Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. The ALADI system involves the multilateral agreement coupled with bilateral agreements between each pair of countries that specify eligible transactions and interim credit arrangements. The central bank of Peru acts as the clearing house of the system.

[97]Participating members are El-Salvador, Guatemala, Honduras, Nicaragua, and Costa Rica.

[98]This is the Caribbean Community Multilateral Clearing Facility. The countries belonging to the agreement are Barbados, Belize, Guyana, Jamaica, Trinidad and Tobago, and the East Caribbean.

[99]The participating members are Benin, Gambia, Ghana, Ivory Coast, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo, Upper Volta, Guinea, Guinea-Bissau, and Mauritania.

[100]The participating members are Burundi, Rwanda, and Mauritania.

[101]The participating countries are Bangladesh, Burma, India, Iran Nepal, Pakistan and Sri Lanka.

[102]The members of the Regional Cooperation for Development are Iran, Pakistan, and Turkey.

[103]The participating countries are Algeria, Bahrain, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, Yemen Arab Republic, and People's Democratic Republic of Yemen.

[104]The participating countries are Bolivia, Colombia, Ecuador, Peru, and Venezuela.

1) a Clearing Arrangement with a relatively short interval between settlement dates which provides only interim credit;
2) a Payments Union which has an additional mechanism which provides medium-term credit facilities to the members of the arrangement; and
3) a Reserve-Pooling arrangement which can range from the simple agreements to pool a portion of total reserves and extend medium term credit to members to a full monetary union.

8.2 Clearing Arrangements

The clearing arrangement provides an alternative to the existing payments network, which involves denominating transactions in a convertible currency. There is a mutually compensated settlement for intra-regional trade using an agreed upon unit of account. The net debts are settled at an agreed interval of time using a convertible currency. The advantage of this simple arrangement is that it necessitates only limited cooperation between the participating countries. Furthermore, policy coordination is not a requirement, an advantageous element in the context of LDCs, particularly for political reasons.

An important feature of clearing arrangements is that although it necessitates only limited cooperation it has the potential of promoting consultations and cooperation among Central Banks and monetary authorities within a region. This feature makes it a stepping block towards economic cooperation or even integration. Michalopolus (1973, p.10) found that in areas where the clearing arrangement was instituted it followed or accompanied decisions to undertake important integration decisions. Where political and economic circumstances do not allow for an advanced type of economic cooperation in the mould of the EC this type of arrangement is important.

The main problem with the clearing arrangement is the fact that many LDCs have a severe shortage of foreign exchange. This may lead to default in payment to the intra-regional net creditor countries on the date of settlement. The potential for default may result in the arrangement being under-utilised and inconsequential. Therefore, the inadequacy of the

clearing arrangements to guarantee currency convertibility is apparent. Currency convertibility is attained through the commitment of member Central Banks to discharge their respective foreign currency obligations as notified by the Clearing House. However, this commitment cannot always be guaranteed since:

(1) *"for some member countries, this effort at convertibility cannot be maintained if their exchange rates remain far from the equilibrium and if regional trade remains indefinitely unbalanced.*

(2) *in the frequent situations when their import programmes are undermined by short-term balance of payments problems, some countries may have problems discharging their payments obligations.*

(3) *the non-availability of credit in the clearing system could induce a diversion to non-regional sources that are able to offer credit".* (PTA, 1993a, p.7)

Although the clearing Arrangement has in it a built-in credit facility in the form of settlements being made periodically, this may not be enough. Therefore, in the event of a member country not being able to honour its obligation to settle its debit balance it may arrange for a credit-line swap and receive assistance from one or more net creditor countries. Such credit could be provided by a net creditor country extending credit to the net debtor member over and above the credit limit for settlement of deficits in the Clearing House. The net debtor country will have to repay the credit extending country with interest over a certain period established under the agreement. (PTA, 1993a)

The difficulty with this is that the credit is short-term and usually very limited. Furthermore the credit-line swap is arranged only when inability to pay arises. Therefore there is no guarantee that the creditor country will accept such an arrangement. Thus, in order to guarantee partial currency convertibility, an arrangement that will allow for assistance to a country that will not be able to honour its obligation is necessary.

8.2.1 A clearing arrangement for the CMA-PTA region

In chapter 6 it was shown that the PTA Clearing House has been under-utilised mainly as a result of intra-regional trade imbalances. It is necessary at this stage to explain the concept of *Theoretical Compensable and Uncompensable Trade*. (PTA, 1993a) That is how much hard currency would be required to settle debt arising from intra-PTA trade if it was all settled through the Clearing House.[105] The more balanced intra-regional trade is the greater the compensable trade will be. Table 8.1 shows that in 1992 only 41.7 percent of intra-regional trade was compensable.

TABLE 8.1
Theoretical Compensable and Uncompensable Trade (percentage)

	Compensable Trade	Uncompensable Trade
1984	36.6	63.4
1985	31.5	68.5
1986	32.3	67.7
1987	39.9	60.1
1988	38.7	61.3
1989	44.0	56.0
1990	43.9	56.1
1991	43.0	57.0
1992	41.7	58.3
1990 (including SA)	35.2	64.8
1992 (including SA)	42.2	57.8

Source: For 1984-1991 (PTA, 1993a). For 1992 calculated from PTA (1994) and Republic of South Africa (1993). See Appendix B5 and B6 for details.

The inclusion of the CMA[106] into the PTA Clearing House in 1992 would have improved the level of compensable trade slightly from 41.7 percent to 42.2 percent. However, the problem with having unbalanced trade will increase, reducing the utilisation of the PTA Clearing House further. The PTA Clearing House is being under-utilised because net debtor countries prefer to use convertible currencies for intra-regional trade to avoid payment

[105]If table 6.1 was to include all PTA countries compensable and uncompensable trade would be arrived at.

[106]This is in fact the inclusion of South Africa since other CMA mambers are participants in the PTA.

default. Furthermore, intra-regional net creditors are showing growing signs of reluctance to use the PTA Clearing House since they are concerned about net debtor countries accumulating debit balances that they will not be able to honour. The inclusion of the CMA will increase this problem because South Africa, potentially a substantial net creditor, will be wary of using the PTA Clearing House.

Therefore, unless there is some sort of guarantee for South African exporters that the clearing arrangement will be default free, intra-regional trade will continue to be unattractive. The cost of insuring trade payments will influence both exporter and importer and the incentive of lower costs of trade finance will be lost. As long as this is the case the clearing arrangement will be inconsequential.

8.3 Payments Union

In order to overcome the problem of default in payment by intra-regional net debtor countries and to make it more instrumental in increasing intra-regional trade, a provision of medium-term credit can be made. The provision can take one of two forms:

a) a direct extension of credit by the net creditor countries, as mentioned above; or
b) a direct extension of credit with the assistance of non-participating countries.

The rationale behind the establishment of a payments union rests on the assumption that it will provide the participating countries with the necessary security with respect to balance of payments to enable them to liberalise intra-regional trade. It is often the case that LDCs governments are motivated to erect trade controls in order to combat short-term balance of payments disequilibria and as a basic policy of industrial promotion. The implementation of a payments union can be valuable in increasing trade liberalisation among member countries for purposes of balance of payments equilibrium and industrial promotion.

The most successful payments union to date is the European Payments Union (EPU) which was established in 1950 and followed by the European Monetary Agreement (EMA) in 1958.

In addition to the clearing arrangements the most important features of the EPU were:

(i) *"The allocation to each member country of a quota (proportionate to its relative importance in intra-European trade), representing the limits within which the net surpluses or deficits would be settled - in varying proportions dependent on their cumulative position - by means of credits or in gold or dollars.*

(ii) *The provision by the USA of the initial working capital of $350,000,000".* (Fraser, 1987, p.16)

Whether a country's balances were to be settled by credit or gold depended on its balance for the current month and its cumulative position (which was its balance in the EPU from the first month). When a country had a cumulative deficit, it received or made gold payments, depending on whether it had a surplus or deficit for the current month according to column 1 in table 8.2.[107] When a country had a cumulative surplus, it received or made gold payments, depending on whether it had a surplus or deficit for the current month according to the right hand schedule in table 8.2.

TABLE 8.2
Initial Schedule of Settlements in the EPU
(Percent of current deficit or surplus)

Cumulative Surplus or Deficit (percent of EPU quota)	Country with Cumulative Deficit		Country with Cumulative Surplus	
	Gold	Credit	Gold	Credit
From 0 to 20 percent	0	100	0	100
From 20 to 40 percent	20	80	50	50
From 40 to 60 percent	40	60	50	50
From 60 to 80 percent	60	40	50	50
From 80 to 100 percent	80	20	50	50
Overall percentage	40	60	40	60

Source: Kenen (1991,p.256)

[107]In 1954 the EPU adopted a formula where 50 percent of each member's surplus or deficit was settled by credit and the other 50 percent in convertible currencies.

The higher the cumulative deficit which a country ran with the EPU the greater the gold payment it had to make and the less credit it received. Once it reached its credit quota all payments had to be made in gold. Countries with a cumulative surplus the size of their quota or greater did not earn gold in an amount equal to their subsequent surplus, because they were asked to extend the credit to the EPU. If the countries having a deficit in the current month were to be in the low end (top) of the schedule for cumulative deficit balances the gold payments into the EPU would be smaller than the payments it would have to make to corresponding surplus countries. (Kenen, 1991) It was this which necessitated the provision by the USA of $350 million, enabling greater credit extensions as payment was guaranteed.

There is little doubt that the direct extension of credit has to be made by governments themselves and should not be expected to be extended by individual firms. If individual firms have to bear the burden of the credit extension this will act as a disincentive for intra-regional trade for cost and risk reasons. Under such conditions they will prefer to look for markets, outside the region, where payment is assured immediately.

8.3.1 A payments union for the CMA-PTA region

A 1992 PTA (1993a) study on the "*Establishment of a Clearing and Support Facility in the PTA Clearing House*" suggested a possible EPU-type arrangement for the PTA to reduce the risk of payments default and encourage intra-regional trade. This arrangement too, as in the case of the EPU, will necessitate the provision of initial working capital to enable payment guarantee. The PTA study (1993a) suggests a settlement structure which is given in table 8.3.

A net debtor country with a deficit of 25 percent of its debit limit would settle its debt entirely by credit,[108] deficits between 25 percent and 50 percent would be settled half in credit and half in convertible currencies; deficits between 50 percent and 75 percent will be settled 25 percent in credit and 75 percent in convertible currencies; deficits above 75 percent

[108]Settlement by credit means that the net creditor country extends a credit to the net debtor country. It can be regarded as a revolving credit arrangement. Obviously, the amount of credit is still owed in hard currency.

would be settled entirely in convertible currencies.

A net creditor country with a surplus of less than 25 percent will have its account settled 100 percent in convertible currencies; surpluses between 25 percent and 50 percent will be settled 75 percent in convertible currencies and 25 percent in credit; surpluses of between 50 percent and 75 percent would be settled 50 percent in convertible currencies and 50 percent in credit; surpluses of above 75 percent will be settled 25 percent in convertible currencies and 75 percent in credit.

TABLE 8.3
Proposed Schedule of Dollar and Credit Settlements in the PTA Clearing House (in % of Surplus and Deficit)

Deficit/Surplus Range as % of Debit/Credit Limit	Deficits		Surplus	
	Dollars	Credit	Dollars	Credit
From 0-25	0	100	100	0
From 25-50	50	50	75	25
From 50-75	75	25	50	50
From 75-100	100	0	25	75

Source: PTA (1993a, p.49).

This structure of settlements accommodates, with some flexibility, the ability of countries to settle timeously. It encourages member countries to increase intra-regional trade and maintain a more balanced intra-regional trade by virtue of favouring lower imbalances. It may be suggested that this could have the opposite effect and encourage lower intra-regional trade since intra-regional net creditors will prefer to trade with outside the region and receive payment in convertible currencies. However, conditions of partial currency convertibility favour intra-regional trade rather than trade outside the region. Therefore, locals will be inclined to take the route of increasing intra-regional trade. However, in the case where

there are structural intra-regional net creditors[109] the payments union may fail to encourage intra-regional trade sufficiently.

It appears that no structural intra-regional net creditors exist in the PTA. From table B2.1 and B2.2 (in the appendix) it is clear that during the period of 1980 to 1992 Djibouti, and Zimbabwe have reversed their position from intra-regional net debtor to intra-regional net creditor countries while Malawi, Mozambique, and Zambia have reversed their position in the other direction. Some countries which have not experienced a reversal of their trade balance have shown substantial change in the magnitude of their debit or credit balances. For example, in 1992 Kenya had a substantially lower net credit balance than was the case in 1980.

Introducing South Africa into a payments union may have a significant effect on the size of the necessary initial working capital, and will introduce the problem of having an intra-regional structural net creditor. The question is how big must the initial working capital of the payments union be in order for it to be able to honour its obligations fully? For this two payments unions will be considered. The first will include PTA members only - a small PTA Payments Union (PTAPU), and the second will include PTA members and South Africa - a large PTAPU.

To establish the size of the payments union capitalisation, it is necessary to consider the quotas that will be introduced. Following Kenen's (1991) study it is assumed here that quotas are set at 20 percent of each member's total intra-regional trade (that is imports plus exports).[110] The quotas for a small PTAPU and a large PTAPU are shown in table 8.4.

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[109]These are net creditors that maintain that position over a prolonged period of time and there is no indication that their net credit position is either about to be reversed or declining.

[110]It may be more correct to use the credit and debit limits that are used in the PTA Clearing House. However, since they are not identical it will be simpler to assume a 20 quota with the result being approximately the same.

TABLE 8.4
Hypothetical Quotas for a Payments Union (US$m)

Country	Small PTAPU		Large PTAPU	
	1990	1992	1990	1992
Angola	1.30	2.15	5.02	26.05
Burundi	6.94	8.24	5.43	8.24
Comoros	0.83	0.53	2.10	0.53
Djibouti	8.54	10.50	8.72	10.50
Ethiopia	5.42	8.65	6.96	8.65
Kenya	41.93	62.46	59.68	73.92
Lesotho	1.36	0.49	0.46	0.49
Malawi	13.35	17.88	48.34	64.09
Mauritius	5.28	6.41	29.55	41.16
Mozambique	15.86	15.93	52.60	63.71
Rwanda	9.14	10.04	8.74	10.56
Somalia	6.16	7.37	7.02	7.37
Sudan	0.64	7.99	7.39	9.41
Swaziland	4.29	6.61	5.86	6.71
Tanzania	9.33	19.45	11.05	21.95
Uganda	19.24	22.38	18.74	40.72
Zambia	33.73	23.65	61.15	99.43
Zimbabwe	48.54	48.99	162.66	200.69
S. Africa	-	-	262.55	396.10
Total	231.87	279.71	764.04	1090.27

Source: calculated from tables B2 in the appendix and 4.1 and 4.2.

The size of the initial capitalisation can then be calculated by taking the most extreme scenario where the member with the largest quota ran a long sequence of deficits, and the country with the smallest quota ran a long sequence of surpluses, while all other members have balanced intra-regional trade.[111] This extreme position would minimise the convertible currencies receipts of the PTAPU and maximise its payments. A small PTAPU with the structure suggested in table 8.3 will necessitate initial capitalisation of US$46.45 million[112] (30.83) in order to insure against payment default. A large PTAPU will

[111]This is based on the unrealistic premise that South Africa would be a net debtor rather than net creditor to the payments union. In the more realistic position of South Africa being a net creditor the payments union will gain convertible currencies from it rather than have to make payments to it.

[112]This is the difference between Kenya's quota (the highest) and Comoros's quota (the lowest). If Kenya cannot honour its payment the PTAPU will pay Comoros 75 percent of the balance owing to it and the extra 25 percent will be granted as credit.

necessitate initial capitalisation of US$296.68 million (193.14).[113] The initial capitalisation of the small PTAPU and the large PTAPU amount to 16.3 (20.5) and 27.2 (25.3)[114] percent of total quotas. This compares to 9 percent of total quotas of the EPU initial capitalisation and 18 percent of a possible East European Payments Union. (Kenen, 1991, p.263)

Currencies of CMA-PTA members have different degrees of convertibility. The introduction of a PTAPU (small or large), although having a positive effect on intra-regional trade liberalisation, may have a detrimental effect on the move towards full currency convertibility. The creation of a PTAPU may disrupt the lifting of exchange controls. A country participating in a payments union is compelled to centralise its payments to the other members. However, since some PTA countries have moved away from a system of centralised payments (e.g. countries that are using the export retention schemes) the PTAPU may be a step backwards. (Kenen, 1991)

A large PTAPU will depend on South Africa's willingness to provide credit to the PTAPU as it will be a structural net creditor.[115] The advantage to South Africa in doing so is the potential market that exists for South African exports of approximately US$3.5 billion annually. The decision as to whether it is to South Africa's benefit to provide the PTAPU credit, therefore, hinges on whether the cost of such credit will be smaller than the benefits in increased exports. Given that South Africa's trade balance with the PTA in 1992 (1990) was US$1303.4 million (853.18) and its quota in a PTAPU would have been US$396.10 million (262.55) South Africa would have extended the PTAPU credit of 75 percent of its credit limit or US$297.1[116] million (196.9). It is questionable whether South Africa can afford to forgo US$297.1 million of convertible currency earnings in the short-run. There

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[113]The figures are for 1992 and those in brackets are for 1990. The calculations are:
For a small PTAPU (62.46 - 0.53) = 61.93 * 0.75 = 46.45 payment to Comoros.
For a large PTAPU (396.10- 0.53) = 395.57 * 0.75 = 296.68 payment to Comoros.

[114]This may be a slight overestimation since South Africa's trade with Lesotho and Swaziland is not included in this measure.

[115]A net creditor is getting payed 25 percent in convertible currencies and the rest is credit.

[116]Credit and Debit limits are given in table 8.6.

is little doubt, therefore, that South Africa would be apprehensive about extending credit to its neighbours to this extent.

It must be remembered, in this regard, that the initial capitalisation of the PTAPU does not have to be made by member countries only. Rather, as was the case of the EPU, assistance of foreign countires and institutions will most probably be required.

8.4 Reserve Pooling

The rationale for reserve pooling arrangements is to provide some sort of defence for balance of payments fluctuations experienced by LDCs in a region. The pooling of reserves enables members to deal with *occasional* balance of payments disturbances. The main benefits from this type of arrangement are best explained by the proposals for creating an Asian Reserve Bank:

a) *"facilitating members' participation in proposals for trade liberalization and expansion, either individually, regionally, or worldwide;*

b) *reducing the likelihood that members losing reserves will adopt income, an exchange rate, and trade policies that would reduce regional and world economic welfare;*

c) *directly economizing on the reserves held by members and so freeing some portion of these reserves to be used for investment in development projects in the region, raising regional growth rates and expanding regional markets;*

d) *providing, at low or zero marginal cost, reserve "insurance" for the cooperating nations and so reducing risk, when payments problems arise, of trade distorting and income reducing speculative movements in capital and commodities".* (Michalopoulos, 1973, p.16)

In accordance with the objectives of the institutional arrangements different types of reserve pooling have been instituted.

i) Currency Union

A currency union is defined here as the use of a single currency in countries belonging to a monetary arrangement. Under a currency union all foreign exchange reserves are pooled and there is a Central Bank which is in charge of the monetary policy of the area.

The best example of a currency union is that of the franc area countries of Central and West Africa. It comprises of two currency unions,[117] the West African Monetary Union and the Equatorial and Central African Monetary Union,[118] each using its own Central Bank. (Honohan, 1992, p.398) Members of the agreement are required to maintain uniform rules on external exchange controls while interest rates and banking regulations are harmonised. (Edwards, 1985, p.314)

The reserves of the participating countries are pooled and deposited in the French treasury which guarantees the convertibility of the CFA franc into French francs, as well as unlimited overdraft facilities. If a participating country's reserves become negative, the country pays a charge on the debit balance.

ii) Monetary Union

The second type of reserve pooling is a monetary union which can be regarded as a less advanced version of reserve pooling than that of a currency union. Under this type of arrangement the participating countries issue their own legal tender but manage their monetary policy jointly. Country members to the agreement follow a uniform exchange rate regime while pooling part of their reserves.

An arrangement which follows this method of reserve pooling is the Central American

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[117]The two currency areas have currencies with slightly different names (franc de la Communité Financière Africane and Franc de la Cooperation Financière en Afrique Centrale), but are both fixed at parity of 0.02 to the French franc.

[118]The West African Monetary Union countries are Benin, Burkino Faso, Cote d'Ivoire, Mali, Niger, Senegal, and Togo. The Equatorial and Central African Monetary Union countries are Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, and Gabon. (Fraser, 1987, p.353)

Monetary Arrangement (CAMA). The Central Banks of the signatory countries undertake to follow a uniform exchange rate regime with the basic characteristic of stability and convertibility of the currencies for transactions and payments among the countries to the arrangement.

Another arrangement which has some of the monetary union characteristics is the CMA. The countries in the arrangement hold their currencies at par with each other and follow the same exchange control policies. However, it cannot be regarded as a pure monetary union since although consultations do take place between the monetary authorities, there is no indication that the management of monetary policy is joint.

iii) Monetary Fund

The currency union and monetary union emphasise the importance of joint monetary policy management. A third type of reserve pooling is one which puts most of its emphasis on balance of payments finance.

The monetary fund can either be part of the monetary union as in the case of the CAMA, or it can stand alone where a monetary union does not exist, as in the case of the Arab Monetary Fund and the Andean Reserve Fund. (Edwards, 1985)

The CAMA has a stabilisation fund as part of its monetary union . This mechanism has as its purpose the provision of financial assistance for countries which are in a position of temporary disequilibria in the balance of payments. In order to achieve this, each member state has to deposit a fraction of its international reserves in the fund. (Fraser, 1987, p.359)

While both currency unions and monetary unions make use of a Clearing House for the clearance of intra-union trade payments, the Arab Monetary Fund and the Andean Reserve Fund do not. Although the exact details may differ from one monetary fund to another they have similar characteristics. The objective of such funds is to assist countries who subscribe

to it at times of global balance of payments difficulties.[119] The assistance takes place by granting loans to the countries in need. A loan is made available only when a country does not have sufficient reserves and is limited by a formula which takes into consideration the country's balance of payments deficit, its contribution to the fund's capital, and the level of its intra-fund trade.

8.4.1 A reserve pooling arrangement for the CMA-PTA region

Table B7 summarises the necessary relationship and characteristics of a currency and monetary union with regard to the relationship among its members. Both arrangements require partial currency convertibility.

Both the currency union and the monetary union require that all members fix their currency to each other or to that of another currency. As a starting point this is a highly unlikely condition in the CMA-PTA region as attempts by countries in the PTA to follow a fixed exchange rate regime have been mostly unsuccessful. There is insufficient evidence, at this stage, that there is adequate political conviction to follow macroeconomic policies which are necessary for such an exchange rate regime. It is not surprising then that some PTA members have turned to pursue more flexible exchange rate regimes, a trend that can be expected to continue. This indicates that currency union or monetary union are rather unlikely in the PTA for some time. The inclusion of South Africa into the PTA will do little to change this situation in the short-term. Looking at trade relationships between South Africa and the PTA there is no case for most members to fix their currency to the rand. Therefore, a more viable agreement to consider is one which may assist PTA members to guarantee partial currency convertibility.

The study commissioned by the PTA to consider the appropriate credit scheme in support of intra-regional trade expansion (PTA, 1993a) suggests possible reserve fund arrangements. These will be considered and then if potentially appropriate adapted to the circumstances of

[119]As opposed to intra-regional balance of payments difficulties.

South Africa joining them.

i) Contribution commitments of Central Banks

The Contribution commitments of Central Banks arrangement suggests that when one of the member countries cannot settle its debt on the day of settlement all the other participants will lend it the necessary amount of foreign currency. The study (PTA, 1993a) suggests that the amount that each country will contribute in such an event should be in proportion to the ratio of each Central Bank's credit limit to the total of all credit limits. Therefore, if for example Angola runs an intra-regional deficit of US$10 million which it cannot settle in hard currency Burundi, whose credit limit in the PTA Clearing House is 2.54 percent of all credit limits, will have to contribute US$2.54 million towards the total.

The total contribution to such a fund, the study (PTA, 1993a) suggests, should be approximately 20 percent of the trade which will be settled in convertible currencies (uncompensable trade). In 1992 (1990) the uncompensable trade amounted to US$407.8 million (325.16) which was 58.3 percent (56.1 percent) of total settlements.[120] This translates to a fund of US$81.6 million (65).

In order to enhance the credibility and functionality of the fund it would be necessary for outside funding, in the form of loans and grants, to be arranged. However, in order to establish the credibility of participants to the fund it is essential that they contribute more than outside donors. The study (PTA, 1993a) therefore suggests that 60 percent of the fund which was in 1992 terms US$49 million (39) be financed by PTA members. The individual members contributions are shown in table 8.5.

[120]See table in appendix B5.

TABLE 8.5
Resource Contribution Commitments (US$m) 1992

	Debit Limit[1]	Credit Limit[1]	% of Limits[2]	Commitment[3]
Angola	1.39	1.73	0.57	0.279
Burundi	6.16	7.70	2.54	1.245
Comoros	0.72	0.90	0.30	0.147
Djibouti	8.95	11.19	3.69	1.808
Ethiopia	6.54	8.17	2.69	1.318
Kenya	52.04	65.05	21.43	10.501
Lesotho	1.21	1.51	0.50	0.245
Malawi	13.17	16.46	5.42	2.656
Mauritius	4.35	5.44	1.79	0.877
Mozambique	17.02	21.28	7.01	3.435
Rwanda	10.59	13.23	4.36	2.136
Somalia	6.34	7.92	2.61	1.279
Sudan	5.21	6.51	2.15	1.053
Swaziland	4.77	5.96	1.96	0.960
Tanzania	9.24	11.56	3.81	1.867
Uganda	20.35	25.44	8.38	4.106
Zambia	28.40	35.50	11.70	5.733
Zimbabwe	46.38	57.98	19.10	9.356
Total	242.83	303.54	100.00	49

Source: Adapted from PTA (1993a, p.51).

[1]Debit and Credit limits are calculated as 20 and 25 percent respectively of average intra-regional trade of each country.

[2]Individual country's limit/total limit

[3]60 percent of total contribution (49,000,000) * percent of total limit

Contribution commitments of Central Banks poses a simillar difficulty to that suggested for Credit-Line swaps. It only comes into effect once a country is unable to pay its debt on the settlement date. Therefore, there is no guarantee that contributions will be made when they become necessary.

ii) A reserve fund

This facility is based on the monetary fund arrangement that was discussed in section 8.4(iii). It is a variant of the reserve pooling arrangement that can be used for short-term finance (which is a type of credit guarantee against country risk) or in its more advanced form as a balance of payments stabilisation fund as well.

This arrangement has the advantage of increasing foreign exchange savings. This results from the advantage to be gained from the variability in the prevailing time pattern of international payments of the member countries with the rest of the world arising from cyclical, seasonal or other factors. Since foreign exchange reserves are held primarily in order to pay for international transactions, if reserves are pooled less reserves have to be held by each member. The reserves that are saved can then be used as a source of intra-regional development and trade finance or invested in higher yielding markets outside the region. (PTA, 1993a, p.53)

Of specific relevance is the fact that a reserve fund has not only the potential of assisting the guarantee for partial currency convertibility. It also has the potential, through assistance in overall balance of payments difficulties, of evolving into a full currency convertibility facilitator. In addition this arrangement has the advantage of substantial indirect benefits. These originate from the pooling of information, the exchange of ideas that are necessary for closer future monetary cooperation as well as greater inflow of borrowed capital from international sources which will be possible because of the greater security that the arrangement creates. The study (PTA, 1993a) suggests that successful implementation of such a fund may be a step towards the creation of a monetary union or even a currency union. Therefore, it suggests a reserve fund as the most appropriate facility to be adopted for the PTA.

The contribution of each country will be identical to that in table 8.5 which is arrived at on the basis of the net credit and debit limits that the participating countries are allowed to have in the PTA Clearing House. These limits are calculated annually on the basis of the best available information on trade flows between participating countries during the previous three years. For instance, average annual intra-regional trade of Djibouti for 1989, 1990, and 1991 amounted to US$44.76 million. This translates to a US$8.95 million debit limit and a US$11.19 million credit limit. In order not to put excessive pressure on the members of the arrangement, the contribution could be made over a period of time.

Certain problems occur once South Africa is admitted to a regional reserve fund. South Africa's credit and debit limits cannot be calculated using the previous (to 1992) three years of trade data as those are not available. Therefore, the average trade levels of 1990 and 1992 were used to estimate the contribution commitments once South Africa is admitted to a reserve fund. According to this South Africa's debit and credit limits would be US$396.1 million and US$495.13 million respectively.[121]

To accommodate South Africa's membership in the PTA Clearing House it will be necessary to increase the size of the suggested facility considerably. Therefore it would be necessary to increase the size of the suggested reserve fund to US$314 million (247).[122] We maintain the assumption that 40 percent of the fund will be contributed by outside bodies such as the EC and the World Bank while the remaining 60 percent will be contributed by the participating countries. The schedule of resource contribution once South Africa is added to the arrangement is shown in table 8.6.

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[121]Table 4.1 is in rand. The exchange rate used to calculate the dollar value is R/$1.3568 which is the periods average (line sb) in the IMF International Financial Statistics (IMF)

[122]This is 20 percent of uncompensable trade (exports or imports).

TABLE 8.6
Resource Contribution Commitments PTA and South Africa (US$m) 1993

	Debit Limit[1]	Credit Limit[1]	% of Limits[2]	Commitment[3]
Angola	15.54	19.42	1.68	3.157
Burundi	6.83	8.54	0.74	1.389
Comoros	1.31	1.64	0.14	0.267
Djibouti	9.61	12.01	1.04	1.953
Ethiopia	7.81	9.76	0.84	1.586
Kenya	66.80	83.50	7.20	13.574
Lesotho	0.48	0.60	0.05	0.097
Malawi	56.21	70.27	6.06	11.423
Mauritius	35.36	44.20	3.81	7.185
Mozambique	58.15	72.69	6.27	11.817
Rwanda	9.65	12.07	1.04	1.961
Somalia	7.20	9.00	0.78	1.463
Sudan	8.40	10.50	0.91	1.707
Swaziland	6.29	7.86	0.68	1.277
Tanzania	16.50	20.62	1.78	3.353
Uganda	29.73	37.16	3.21	6.041
Zambia	80.29	100.36	8.66	16.315
Zimbabwe	181.67	227.09	19.59	36.917
S.Africa	329.33	411.66	35.52	66.920
Total	927.16	1158.95	100.00	188.4

Source: Calculated from tables 4.1 and 4.2 and PTA (1994).

[1]Debit and Credit limits are calculated as 20 and 25 percent respectively of average intra-regional trade.

[2]Individual county's limit/total limit

[3]60 percent of total contribution (188,400,000) * percent of total limit

It appears that, with the addition of South Africa to the arrangement, substantial changes to the contribution commitments to the fund will be necessary. Zimbabwe and South Africa's joint contribution to the fund will amount to approximately 55 percent (56 percent) of the total fund. Uncompensable trade as indicated in tables B5 and B6 (in the appendix) will drop from 58.37 percent (56.1 percent) to 57.8 percent (55.3 percent) which may marginally contribute to the success of such an arrangement. However the fact that intra-regional trade is so unbalanced and significantly skewed restricts the potential of a reserve fund.

As South Africa will become the biggest contributor to a reserve fund, the fund should possibly start off in its basic capacity as partial currency convertibility guarantor and not as a balance of payments stabilisation fund. This is because a distinct possibility exists that South Africa, being such a large regional net creditor, will become a financier of members extra-regional balance of payments deficits. Only once this arrangement has proven successful, can it be considered as a balance of payments stabilisation fund. However, in favour of such an arrangement, it must be stressed that South Africa would still receive interest payable on its reserves.

The decision as to whether to implement a reserve fund or payments union is difficult. Seeing that the objective of creating a payments arrangements is to improve intra-regional trade relations, the PTAPU may seem more appropriate as it could enhance intra-regional trade due to its structure. There is, however, the threat that continued unbalanced trade, with South Africa remaining a structural intra-regional net creditor, will lead to South Africa's non-willingness to participate in the PTAPU as it will have to forego substantial convertible currency earnings, at least, in the short-run. The cost to South Africa of participating in a PTAPU would be much higher than participation in a PTA reserve fund as suggested here. Furthermore, there is the danger that bias towards intra-regional trade and tightening foreign exchange restrictions will impede the ultimate goal of full currency convertibility. Therefore, the reserve fund would be a more appropriate mechanism since it would enhance intra-regional trade due to lower risk involved and assist in balance of payments difficulties (only if these are not permanent) which could be a step towards full currency convertibility. Another advantage is that whereas in the case of a PTAPU there has to be a clearing house this is not the case with a reserve fund. Although it may be necessary

at the outset it could be phased away at a later stage, liberalising payments further. However, the reserve fund would be a viable alternative only if South Africa does not emerge as a long-term net financier of other members permanent balance of payment imbalances. Therefore it is of the outmost importance that the arrangement is a transitional one. There will be a need for regional governments under a reserve fund to follow policies which will lead to the accomplishment of the prerequisites for transformation to full currency convertibility.

CHAPTER 9
CONCLUSION

Attempts to improve economic conditions in Southern and Eastern Africa have so far had limited success. Recently part of the strategy to improve economic growth has included moves towards opening up of economies and liberalising international trade. A significant step in this direction would be to guarantee full currency convertibility. Most countries in the region do not have a fully convertible currency and have not met the preconditions for transformation to full currency convertibility. A one step move towards full currency convertibility may have negative effects which will make it unsustainable. Therefore transformation to full currency convertibility should rather be gradual.

Achieving the preconditions for transformation to full currency convertibility - an appropriate exchange rate, adequate international liquidity, and sound macroeconomic policies - will require governments to adopt policies directed at this goal and most importantly to follow an exchange rate regime with a market related exchange rate.

In most cases currency inconvertibility is a result of balance of payments pressures which come about as a consequence of implementing a fixed exchange rate regime while attempting to follow independent macroeconomic policies. Fixing the exchange rate while following unsustainable macroeconomic policies puts pressure on international reserves and ultimately results in (or sustains) currency inconvertibility. It is apparent that the economic characteristics of most countries in the region are such that the most appropriate exchange rate regime to follow under the criteria of micro and macro economic efficiency is an intermediate exchange rate regime. This type of exchange rate regime will allow the exchange rate to be closer to its market determined level even where developed financial markets do not exist.

As a transitional measure partial currency convertibility may be implemented. In this way a non-tariff trade barrier among the countries in the region would be lifted and intra-regional trade enhanced while saving on convertible currencies. With South Africa being incorporated into an arrangement which creates partial currency convertibility, PTA members stand to gain

closer economic relations and cheaper imports from South Africa than those from countries outside the partial currency convertibility arrangement. At the same time South Africa can benefit from a larger export market since potential for future extended trade does exist.

An example of a successful monetary arrangement which has served to create partial currency convertibility is that of the CMA. It is apparent that close economic relations with South Africa and partial currency convertibility have led Lesotho and Swaziland to a point where no official arrangement is necessary in order to maintain partial currency convertibility. The CMA agreement as it stands today is not needed for the creation of partial currency convertibility and probably full currency convertibility as well. However, without the CMA arrangement in the past, there is little doubt that Lesotho and Swaziland would be in the same position as most other PTA members.

The PTA Clearing House is another arrangement which creates partial currency convertibility in the region but does not incorporate South Africa. The PTA Clearing House is a rudimentary arrangement which although functioning well is substantially under-utilised. The main reasons for the PTA Clearing House being under-utilised is that it does not address problems of balance of payments disequilibrium and international reserve shortages as well as the unbalanced regional trade.

Most PTA members do not meet the preconditions for transformation to full currency convertibility. The most indicative factor of this is the fact that all PTA currencies are overvalued. Furthermore, there is no indication that they have adequate international liquidity in order to transform to full currency convertibility at present.

Currency inconvertibility increases the risks which are involved in international trade. In order to reduce these risks it is necessary to use trade finance methods which reduce these risks. The more risky international trade transactions are, the greater the costs of reducing the risk. Most PTA members are regarded as very risky countries to trade with. Therefore, trade finance instruments which are offered for trade with PTA members are restricted and accompanied by high costs. This is also the case with trade between South Africa and PTA members which are not CMA members. Furthermore, due to the poor economic prospects

in the region, correspondent banking is undeveloped. The improvement of correspondent banking in the region could enable banks to offer less costly trade finance instruments if partial currency convertibility is achieved. In other words the poor credit ratings can be improved and resulting high costs of trade financing can be significantly reduced if partial currency convertibility is achieved.

Since the PTA Clearing House was found to be under-utilised, the incorporation of South Africa would not improve this position and might even worsen it. Therefore, it is found that a more advanced arrangement that will address the problem of the lack of short-term trade finance is necessary. To this end two arrangements are possible. First, a payments union which has a built-in mechanism that encourages intra-regional trade and allows for trade finance which guarantees against payment default. There is a considerable difference when considering a small PTAPU and a large PTAPU. The incorporation of South Africa into a PTAPU becomes problematic since, as it is a structural intra-regional net creditor, it will be granting the PTAPU credit of 75 percent of its net balance at a cost of approximately US$297.1 million in convertible currencies, using 1992 data. Furthermore, since the PTAPU would use a clearing house the arrangement may be under-utilised since export incentive schemes may undermine it. Therefore a PTAPU may act as a deterrent to trade liberalisation. The second arrangement, a reserve fund, requires each participating member to contribute to a fund that will be used as guarantee of trade payments. The problem, here too, is that the incorporation of South Africa will mean a contribution of approximately US$67 million or 35.5 percent of total resource contribution commitments of all members, using 1992 data. This has the danger of making South Africa a financier of other countries balance of payments difficulties. However, this is significantly less than in the case of the PTAPU and South Africa will still earn interest from its reserve. Before agreeing to join a reserve fund South Africa will have to be sure that this is a transitional arrangement only. A proof of this will be the undertaking of policies which will be directed at achieving the preconditions for transformation to full currency convertibility.

Introducing a reserve fund in a vacuum is doomed to fail as balance of payments disequilibrium may persist. It is of paramount importance that foreign exchange be made available to producers for the importation of machinery and raw materials. If this is not the

case, although partial currency convertibility will exist, regional currencies will continue to be useless for trade payments and this arrangement will be ineffective.

For a successful payments arrangement which will enhance intra-regional trade, economise on foreign exchange, and act as a step towards full currency convertibility, assurance must be given to participants as to the availability of foreign exchange. In effect under a reserve fund it may be advisable not to have a clearing house so as to eliminate the problem of having centralised payments. Removing the clearing arrangement but guaranteeing convertibility of all balances that arise from regional trade may be preferable.

There is little question that achieving partial currency convertibility between South Africa and the PTA will not, on its own, achieve all the potential of regional economic cooperation and increased trade. Therefore further studies are required to consider how best economic cooperation in the fields of communications, customs, industry and transport can be achieved.

It must be emphasised that PTA members should aspire to full currency convertibility as this is one of the more important and basic moves they can take to indicate to the rest of the world their willingness to open their markets and pursue economic policies which are consistent with the goals of future growth. This would be an important element in the reforms that are required to attract foreign investment and encourage sustainable domestic investment.

APPENDIX A
EXCHANGE ARRANGEMENTS AND CURRENT ACCOUNT RESTRICTIONS IN THE PTA-CMA REGION

Angola

a. Exchange arrangements - The currency of Angola is the New Kwanza. The exchange rate system consists of two rates - the official rate, which is pegged to the US dollar, and the free market rate, which is market-determined. The official rate applies to public sector transactions and to traditional exports (oil and diamonds).

The free market rate applies to purchases of foreign exchange, checks, traveller's checks, payment orders, and other instruments used in international transactions by individuals, organizations, firms and tourist operators, and to sales of foreign exchange for travel and special expenses or transfers abroad.

There are no taxes or subsidies on the purchases or sales of foreign exchange. There are no arrangements for forward cover against exchange rate risk operating in the official or the commercial banking sector.

b. Administration of Control - The NBA has delegated authority to banks to licence and execute permitted foreign exchange invisible transactions.

Commercial banks and foreign exchange dealers licensed by the NBA are authorised to deal in foreign exchange at the floating exchange rate. The NBA operates in the floating rate foreign exchange market only in its dealings with financial institutions. All imports and exports are subject to licensing.

c. Prescription of Currency - The NBA prescribes the currencies to be used for imports, depending upon the country with which the transactions are to be carried out. The currencies are usually those of the exporting countries or the US dollar.

d. Imports and Import Payments - All imports are subject to licensing, with limits pre-established in the import plan, and are subject to the availability of foreign exchange, except imports of spare parts, accessories or similar goods, medicines, equipment, and raw materials, up to a quarterly maximum of $50,000 (or its equivalent) an importer; licences are expeditiously issued by the NBA.

Licences are granted only to registered enterprises of proven technical, commercial and financial capacity and are issued on the basis of a foreign exchange allocation and restricted to imports of goods for which the enterprise is registered. A myriad of administrative regulation applies.

e. Exports and Export Proceeds - Exports of certain goods are prohibited. Restrictions apply to the exportation of products that are in short domestic supply. All other exports are subject to prior licensing. Licences may be obtained by registered enterprises, and proceeds must be collected within 30 days of shipment and surrendered to the NBA.

Burundi

a. Exchange arrangements - The currency of Burundi is the Burundi franc, the external value of which is pegged to a basket of currencies that reflects the pattern of Burundi's international trade. Commercial banks are authorized to buy and sell foreign exchange on their own account and on behalf of their customers at rates within 1% of either side of the middle rate established by the central bank. Commercial banks are allowed to borrow foreign exchange to hedge against exchange rate risk.

b. Administration and control - Control over foreign exchange transactions and foreign trade is vested in the central bank; authority to carry out some transactions is delegated to five authorized banks.

c. Prescription of currency - Outgoing payments may be made and may be obtained in any convertible currency.

d. Imports and Import Payments - Imports are fully liberalized, except for a limited number of goods the importation of which is restricted mainly for security reasons. Foreign exchange is made available either at the time of shipment of the goods on the basis of the shipping documents or following importation of the goods.

e. Exports and Export Proceeds - All exports are fully liberalized. All proceeds from traditional exports must be surrendered to an authorized banks. Exporters of nontraditional products may retain 30 percent of the proceeds. Exports of mineral products, coffee, hide, and all exports that are not authorised by ministerial order are subject to export duties.

Comoros

a. Exchange Arrangement - The currency of the Comoros is the Comorian Franc, which is pegged to the French franc, the intervention currency, at the fixed rate of CF1 per F0.02.

With the exception of those relating to gold, the exchange control measures of the Comoros do not

apply to (1) France and Monaco; and (2) all other countries whose bank of issue is linked with the French Treasury by an Operations Account. Hence, all payments to these countries may be made freely. All other countries are considered foreign countries. Forward cover against exchange rate risk is authorised by the Central Bank of the Comoros and is provided to traders by the commercial bank for up to three months.

b. Administration of Control - Import and export licences are issued by the Directorate-General of Economic Affairs in the Ministry of Economy and Trade.

c. Prescription of Currency - Settlements with all countries other than defined above are usually made through correspondent banks in France in any of the currencies of those countries or in French francs through foreign accounts in francs.

d. Imports and Import Payments - Importation of certain other goods is prohibited from all countries. The importation of other goods, except those originating from member countries of the European Community, Monaco and the Operations Account countries, is subject to individual licensing. All import transactions relating to foreign countries must be domiciled with the authorised bank if the value is CF 500,000 or more.

e. Exports and Export Proceeds - With a few exceptions, exports to any destination are free of licensing requirements. Proceeds from exports to foreign countries must normally be collected; the receipts must be repatriated within 30 days of the expiration of the commercial contract and sold immediately to the authorised bank.

Djibouti

a. Exchange Arrangement - The currency of Djibouti is the Djibouti Franc, which is freely convertible into US dollars, the intervention currency. Commercial enterprises are free to negotiate forward exchange contracts for commercial and financial transactions through local banks or banks abroad. All transactions are negotiated at free market rates. There are no arrangements for forward cover against exchange rate risk operating in the official or the commercial banking sector.

b. Administration of Control - There is no exchange control. The Djibouti franc is issued in notes and coins by the National Bank of Djibouti, which issues and redeems the currency against US dollars. Deposits in US dollars constitute the cover for the notes issued.

c. Prescription of Currency - No prescription of currency requirements are in force.

d. Imports and Import Payments - Formally, customs duties are not charged on imports, but, in practice, fiscal duties are levied by means of the general consumption tax, at the rate of 30 percent on luxury goods and 20 percent on all other goods.

e. Exports and Export Proceeds - There are virtually no restrictions. Export proceeds may be retained.

Ethiopia

a. Exchange Arrangement - The currency of Ethiopia is the Ethiopian Birr, which is pegged to the US dollar, the intervention currency. Authorised dealers must have the approval of the National Bank to undertake forward exchange transactions. There are no arrangements for forward cover against exchange rate risk operating in the official or commercial banking sector.

b. Prescription of Currency - Outgoing payments are normally made in convertible foreign exchange appropriate to the country of the recipient or in US dollars. The net proceeds of exports must be received in a freely convertible foreign currency or in any other acceptable foreign currency.

c. Administration of Control - All transactions in foreign exchange must be carried out through authorized dealers under the control of the National Bank. All payments abroad require licences. All exports are licensed to insure the surrender of foreign exchange proceeds.

d. Imports and Import Payments - All imports from South Africa are prohibited, and all imports from other sources require a licence. Payments abroad for imports require exchange licences, which can be obtained when a valid importer's licence is presented. Applications for exchange licences are conditional upon the provision of satisfactory information on costs and payment terms and the submission of evidence that adequate insurance has been arranged with the Ethiopian Insurance Corporation, particularly for goods imported under letters of credit.

e. Exports and Export Proceeds - All commodity exports require permits from the Exchange Controller and some require, in addition, the approval of specified public bodies. Foreign exchange receipts are surrendered to the National Bank, generally within three months.

Lesotho

a. Exchange Arrangement - The currency of Lesotho is the Loti (plural Maloti), which is pegged to the South African rand at M1 per R1. Authorised dealers are permitted to conduct forward exchange operations through their correspondent banks abroad at rates quoted by the

latter. Forward exchange cover is not, however, common in Lesotho.

b. Exchange Control Territory - In its relations with countries outside the CMA, Lesotho applies exchange controls that are largely similar to those of South Africa and Swaziland.

c. Administration of Control - The Central Bank of Lesotho controls external currency transactions and delegates to commercial banks the authority to approve certain types of current payments up to established limits.

d. Imports and Import Payments - Imports from countries outside the Customs Union are usually licensed in conformity with South Africa's import regulations; Lesotho reserves the right to restrict certain imports.

e. Exports and Export Proceeds - Unless otherwise permitted, all export proceeds must be remitted to Lesotho and surrendered within six months of the date of the export transaction.

Mauritius

a. Exchange Arrangement - The currency of Mauritius is the Mauritian Rupee, the external value of which is determined on the basis of its relationship to a weighted basket of currencies of Mauritius's major trading partners.

Forward exchange facilities in pounds sterling, French francs, and US dollars are made available by the Bank of Mauritius for industries operating in the export processing zone (EPZ) and for banks engaged in foreign borrowing for on lending to the sugar sector. The maximum period for forward cover is six months; the forward rates are based on a uniform margin of 3 percent a year. In addition, companies operating in the EPZ and other Mauritian exporters and traders dealing in priority imports are authorised to engage in forward cover transactions in foreign exchange markets abroad through their banks in Mauritius.

b. Administration of Control - Exchange control is administered by the Bank of Mauritius under powers delegated by the Financial Secretary. Commercial banks, as agents of the Bank of Mauritius, are authorised to approve and effect payments for current transactions.

c. Prescription of Currency - Payments to nonresidents may be made in Mauritian rupees from a nonresident account or in any convertible foreign currency. Similarly, payments from nonresidents may be received in Mauritian rupees from a nonresident account or in any convertible foreign currency. Mauritius maintains a bilateral payments agreement with Madagascar.

d. Imports and Import Payments - Importers must be licensed under the Licences Ordinance. All imports other than exempt or prohibited goods require import permits from the Ministry of Trade and Shipping; the permits are essentially for statistical and tax purposes. Commercial banks are authorised to approve and transfer funds for import payments without limit.

e. Exports and Export Proceeds - All export proceeds in any currency other than Mauritian rupees must be repatriated within six months of shipment and offered for sale to an authorised dealer.

Mozambique

a. Exchange Arrangement - The currency of Mozambique is the Metical. Exchange rates are determined by supply and demand conditions, and authorised operators are free to set buying and selling rates.

There are no arrangements for forward cover against exchange rate risk operating in the official or the commercial banking sector.

b. Administration of Control - Imports and exports are authorized through licences, issued by the Ministry of Commerce for statistical purposes.

c. Imports and Import Payments - All imports exceeding the equivalent of $500 are subject to licensing by the Ministry of Commerce; licenses are provided routinely.

d. Exports and Export Proceeds - All exports are subject to a license. All export proceeds must be collected through the Bank of Mozambique (BM) and sold in the secondary exchange market.

Rwanda

a. Exchange Arrangement - The currency of Rwanda is the Rwanda Franc which is pegged to the SDR at RF 201.39 per SDR 1. There are no arrangements for forward cover against exchange rate risk.

b. Administration of Control - Control over foreign exchange transactions is vested in the central bank; authority to carry out some of these transactions is delegated to authorised banks. Arrears are maintained with respect to external payments.

c. Prescription of Currency - To facilitate trade and other external transactions, the central bank maintains agreements with the central banks of the Economic Community of the Great Lakes Countries (CEPGL), Burundi, Rwanda and Zaire. Under these arrangements, settlements are made through reciprocal accounts in convertible domestic currency; balances on such accounts are periodically transferable. Payments to and from the member countries of the Preferential Trade Area for Eastern and Southern African States (PTA) (Burundi, Comoros, Djibouti, Ethiopia,

Kenya, Lesotho, Malawi, Mauritius, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe) are made through the PTA's clearinghouse. Otherwise, payments for imports must be made in the currency quoted by the central bank, which, in principle, is the currency of the country of origin.

d. Imports and Import Payments - Imports of all (with some exceptions) goods have been permitted under an open licence (OGL) system and foreign exchange is provided upon request.

e. Exports and Export Proceeds - All exchange proceeds from exports must be surrendered to an authorised bank within eight days of their collection.

Somalia

a. Exchange Arrangement - The currency of Somalia is the Somali Shilling, which is pegged to a basket of currencies of Somalia's main trading partners. The official exchange rate is adjusted weekly to reflect weekly to reflect changes in the cross rates of currencies in the basket and the relative changes in the cross rates of currencies in the basket and the relative rates of inflation in Somalia and its trading partners.

There are no arrangements for forward cover against exchange risk operating in the official sector. The commercial banks also do not conduct forward exchange transactions on behalf of the public, although they are not prohibited from doing so.

b. Administration of Control - Exchange controls are administered by the Central Bank.

c. Prescription of Currency - Settlements with all other countries must be made in Somali shillings or in specified currencies.

d. Imports and Import Payments - All items, with the exception of items prohibited for reasons of public safety and social policy, may be imported freely.

All payments for private imports must be effected through letters of credit. Private importers may open letters of credit for imports at a commercial bank on the basis of foreign exchange made available for that purpose through a foreign currency account with the commercial bank; in such a case, the foreign exchange involved is kept in a suspense account until the time of settlement of the letter of credit. A non-interest-bearing cash advance deposit of 100 percent is required to open letters of credit for private sector imports; the deposit is retained until the letters of credit are settled.

e. Exports and Export Proceeds - All export proceeds must be repatriated. Exporters of bananas and livestock may retain 40 percent of their foreign exchange receipts in export/import accounts and must surrender the remainder to the Central Bank or to authorised dealers. Exporters of nontraditional goods may retain 70 percent of their export earnings. For exports other than those made under letter-of-credit arrangements, an advance payment deposit of 100 percent of the value of exports is required.

Sudan

a. Exchange Arrangement - The currency of Sudan is the Sudanese Pound. The official exchange rate of the Sudanese pound is determined under an exchange market arrangement in which the rate is determined by the Committee for the Fixing of the Exchange Rate of the Union of Banks (Bankers' Association) and is quoted uniformly by all commercial banks.

In principle, commercial banks are authorized by the Bank of Sudan to sell foreign exchange to be transferred abroad for all purposes. In practice, commercial banks conduct informal rationing by making foreign exchange available according to the priorities established by each bank manager. In the case of payments for imports, commercial banks are authorised to sell foreign exchange to licensed traders. Under a central bank regulation, the commercial banks are obligated to require 100 percent cash cover before agreeing to the sale of foreign exchange. Commercial banks do not bear any exchange risk for any foreign exchange transaction.

There are no arrangements for forward cover against exchange rate risk operating in the official of the commercial banking sector.

b. Administration of Control - Exchange control is administered by the Bank of Sudan, with the assistance of the authorised banks and specialised banks acting as exchange houses.

c. Prescription of Currency - Payments to all countries and all monetary areas (the "convertible area") may be made in foreign currency from any free foreign currency account or special foreign currency account, while receipts from the convertible area may be accepted in any convertible currency.

d. Imports and Import Payments - In principle, commercial banks are authorised to sell foreign exchange to finance all imports (except those on the negative list) irrespective of their final use.

Insurance for imports must normally be taken out with local companies. Imports financed at the free unified rate, including those financed through the opening of letters of credit, could be subject to an advance deposit of up to the full c.i.f. value.

e. Exports and Export Proceeds - Export licences are not required for any category of exports. However, all exporters must submit export contracts and the "EX" export form to commercial or specialised banks for approval.

All export proceeds, except those permitted to be retained under the Export Enhancement Scheme, must be repatriated to the domestic banking system at the official exchange rate.

Swaziland

a. Exchange Arrangement - The currency of Swaziland is the Lilangeni (plural Emalangeni), which is pegged to the South African rand at E1 per R1.

The Central Bank of Swaziland (CBS) permits authorised dealers to engage in forward exchange operations. Commercial banks are generally able to meet demands for forward sales of foreign currency against emalangeni. The forward exchange rates are market determined.

b. Exchange Control Territory - In relations with countries outside the CMA, Swaziland applies exchange controls that are generally similar to those of South Africa but has not adopted the dual exchange rate system that was reintroduced in that country in September 1985. Financial rand may not be acquired by, or held for account of, any resident of Lesotho, South Africa, or Swaziland.

c. Administration of Control - The Central Bank of Swaziland, on behalf of the Ministry of Finance, controls all external currency transactions.

d. Imports and Import Payments - Imports from countries outside the customs union are licensed in conformity with specific import regulations. Import licences granted in Swaziland entitle the holder to buy the foreign exchange required to make the import payment.

e. Exports and Export Proceeds - All exports are subject to licensing. For goods shipped to countries outside the customs area, licensing is administered to ensure that export proceeds are repatriated in the prescribed manner and within the stipulated period.

Tanzania

a. Exchange Arrangements - The currency of Tanzania is the Tanzania Shilling, which is pegged to a basket of currencies of Tanzania's main trading partners.

The Bank of Tanzania does not offer forward cover against exchange rate risk. However, authorized dealers may enter into forward contracts for purchases and sales of foreign currencies.

b. Administration of Control - With the exception with transactions made through foreign exchange bureaus all outward payments must be approved by the Bank of Tanzania.

c. Prescription Currency - Settlements between residents of Tanzania and nonresidents must be made either in convertible currencies or in Tanzania Shilling by debit or credit to a convertible nonresident account.

d. Imports and Imports Payments - All goods with a value exceeding $5,000 require licence before they can be imported.

The importation of certain categories of goods is permitted under an open general licence (OGL) system based on a negative list. Under the OGL system, the minimum value for each import licence is set at $5,000.

e. Exports and Export Proceeds - Export proceeds most be repatriated in convertible currencies within two months of the date of exportation. Exporters of traditional products may retain up to 10 percent of foreign exchange earnings, and exporters of nontraditional products may retain up to 50 percent.

Uganda

a. Exchange Arrangements - The currency of Uganda is the Uganda Shilling. The exchange rate system consists of three rates; the foreign exchange bureau rate, the official rate, and the auction rate. The exchange rate in the foreign exchange bureau market is determined by supply and demand conditions. The official rate is determined as the average of the foreign exchange bureau exchange rate and is applied to proceeds for coffee exports, some government imports, and debt service payments.

Authorized banks may deal forward with customers, in pounds sterling, U.S dollars, and certain other convertible currencies, provided that there is an underlying approved import or export contract.

b. Administration and control - Import and export control regulations are administered by the Ministry of commerce, which has powers to prohibit imports and exports.

c. Prescription of currency - The Bank of Uganda settles accounts in U.S. dollars with PTA members through the PTA Clearing House. Authorized payments by residents of Uganda may be made in Uganda shilling to the credit of an external account in Uganda, or in any other currency.

d. Imports and Import Payments - Most imports are controlled through the import-licensing system. Foreign exchange allocation to various ministries and departments must be backed by documents showing the approval of the Central Tender Board.

e. Exports and Export Proceeds - Exporters may retain proceeds from exports other than coffee and

sell them in the foreign exchange bureaus.

Zambia

a. Exchange Arrangements - The currency of Zambia is the Zambian kwacha. Most transactions, except for imports under the OGL system, take place at the exchange rate determined by supply and demand conditions in the foreign exchange bureau market. for some foreign transactions, foreign exchange is allocated by the Bank of Zambia, which fixes its buying and selling rates on the basis of the exchange rate quoted by the foreign exchange bureaus, with appropriate spreads to reflect the bank's exchange margin.

Authorized banks and foreign exchange bureaus are free to deal in the currencies of neighbouring countries, subject to approval by the Bank of Zambia.

There are no arrangements for forward cover against exchange rate risk operating in the official or the commercial banking sector.

Zimbabwe

a. Exchange Arrangements- The currency of Zimbabwe is the Zimbabwe dollar. The exchange rate of the Zimbawean dollar is determined on a basis of a trade-weighted basket of currencies. The U.S. dollar is the intervention currency.

Forward exchange rate contracts are permitted only for trade transactions. There is no limit on the size of such contracts, but they must be limited to periods of six to eight months, depending on the currency involved and the type of coverage.

b. Administration and control - Exchange control is administered by the Reserve Bank of Zimbabwe.

c. Prescription Currency - All payments by nonresidence must be effected in denominated currencies.

d. Imports and Imports Payments - With the exception of imports covered by the OGIL and Export Retention Scheme, all imports are subject to licensing requirements.

Allocation for local markets are assessed on the basis of priority and foreign exchange availability, whereas those for export markets take the form of initial allocations based on past performance.

e. Exports and Exports Proceeds - Export-licensing requirements are imposed for reasons of health and social welfare, as well as ensure an adequate domestic supply of essential products.

Export receipts must be sold to authorized dealers.

IMF (Annual Report on Exchange Arrangements and Exchange Restrictions, 1993)

APPENDIX B - REGIONAL TRADE DATA

TABLE B1

Comparison of SA Exports and PTA Imports for 1989 (in US dollars '000)

SITC	SA	PTA	SITC	SA	PTA
251	325.201	13.906	711	4.315	10.614
335	37.014	13.595	721	15.044	42.954
515	24.077	16.965	723	32.108	77.578
522	316.013	27.778	728	36.440	35.541
533	11.483	30.890	736	10.796	40.659
541	23.741	181.278	741	113.426	64.011
554	13.483	37.942	742	13.499	60.721
562	58.735	88.591	743	13.219	62.813
591	25.252	95.858	744	12.276	95.424
598	28.866	69.847	745	16.164	20.917
625	15.513	74.642	749	31.614	83.534
628	5.203	16.914	764	16.640	222.226
635	13.627	18.524	772	24.448	106.786
641	224.692	83.266	773	10.782	72.344
642	29.000	25.672	775	10.337	23.344
651	42.337	13.919	778	22.386	78.330
652	34.631	78.898	781	55.656	323.057
657	11.110	17.719	782	23.330	321.491
658	7.468	17.885	784	68.332	223.856
662	12.350	31.998	786	51.729	28.643
665	10.588	11.524	821	35.422	29.021
682	392.820	10.780	872	8.995	30.760
684	166.700	21.418	874	18.254	67.094
691	17.876	79.600	892	6.622	38.528
692	19.401	20.177	893	18.103	56.736
693	17.464	14.502	897	28.892	14.724
694	46.772	11.238			
695	51.573	58.249			
699	52.657	52.359			
Total				2.634.485	3.567.669

Source: Davis *et al*, (1993).

TABLE B2.1 Intra-PTA Exports (in millions of US dollars)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
ANGOLA	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10
BURUNDI	0.99	2.57	6.15	7.50	8.49	3.29	4.33	2.18	2.08	6.70	8.40
COMOROS	0.00	0.20	0.40	0.40	0.50	1.40	0.40	0.00	0.00	0.04	0.04
DJIBOUTI	14.40	10.00	8.21	6.10	14.50	18.90	20.90	22.60	24.10	25.80	28.80
ETHIOPIA	38.72	33.56	35.64	20.05	26.25	21.47	24.49	25.06	18.35	29.27	32.32
KENYA	241.56	236.25	221.85	197.04	247.40	202.80	221.12	218.10	189.50	251.40	264.30
LESOTHO	0.01	0.61	0.00	0.00	0.10	0.10	0.10	0.10	0.12	0.32	0.93
MALAWI	19.87	27.58	29.22	26.52	23.21	27.24	31.74	28.22	31.81	34.71	30.09
MAURITIUS	1.8	1.53	3.33	2.18	2.21	2.68	3.47	4.36	6.84	7.54	12.24
MOZAMBIQUE	42.47	18.84	5.49	1.30	2.50	3.08	3.13	3.31	4.12	5.79	10.04
RWANDA	2.12	0.68	3.23	3.71	4.37	3.55	4.12	23.82	4.73	13.77	0.25
SOMALIA	3.49	0.44	5.14	0.41	1.16	0.84	1.08	1.20	1.31	0.67	0.69
SUDAN	0.95	1.15	0.60	0.20	0.45	0.31	0.30	0.30	0.60	0.70	0.70
SWAZILAND	9.11	5.08	2.71	6.94	6.51	11.86	13.35	15.17	18.01	27.13	30.78
TANZANIA	22.97	20.12	23.43	12.50	14.40	11.60	12.60	9.40	17.50	17.95	51.20
UGANDA	2.96	6.02	13.49	3.91	3.74	3.66	3.98	3.51	4.30	2.14	2.42
ZAMBIA	47.73	41.52	25.22	27.13	29.71	47.81	67.70	69.30	71.90	40.82	37.82
ZIMBABWE	104.90	72.12	74.80	87.90	96.70	131.00	145.30	152.60	184.40	197.60	188.15
TOTAL	554.05	478.27	458.91	403.79	482.20	491.59	558.11	579.23	579.67	662.35	699.27

Source: PTA (1994)

TABLE B2.2 Intra-PTA Imports (in millions of US dollars)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
ANGOLA	4.04	0.60	10.10	7.50	3.10	5.30	6.90	7.90	6.49	6.40	10.63
BURUNDI	34.66	28.15	27.44	25.57	28.49	28.48	34.18	24.76	32.61	24.09	32.82
COMOROS	4.55	2.51	4.98	3.41	3.88	3.67	3.64	4.18	4.16	2.43	2.61
DJIBOUTI	46.45	35.48	36.38	14.71	20.01	16.03	19.1	21.47	18.59	21.73	23.70
ETHIOPIA	8.87	9.99	10.87	9.23	11.95	10.14	6.93	6.94	8.74	9.72	10.91
KENYA	25.50	7.52	17.69	14.32	21.52	18.72	20.84	35.86	20.14	65.58	48.02
LESOTHO	0.30	0.90	0.30	1.80	1.80	5.90	7.5	8.7	6.70	2.22	1.52
MALAWI	36.74	31.39	18.44	16.78	17.13	24.41	31.96	31.23	34.93	36.66	59.29
MAURITIUS	9.35	6.08	7.75	7.33	7.92	9.08	8.85	7.32	19.54	19.62	19.82
MOZAMBIQUE	28.08	32.58	20.58	23.56	49.83	63.46	74.7	81.94	75.17	85.01	69.59
RWANDA	41.69	39.13	42.61	39.59	50.98	41.65	44.69	41.77	40.97	33.75	49.93
SOMALIA	21.73	11.23	10.81	7.91	17.16	19.15	23.41	26.34	29.49	36.03	36.18
SUDAN	40.28	44.82	41.78	36.06	44.51	37.75	39.74	35.73	2.58	38.26	39.24
SWAZILAND	2.40	1.70	0.50	0.71	0.20	2.10	1.52	1.72	3.44	6.08	2.27
TANZANIA	43.56	23.24	37.45	27.64	27.79	30.58	35.39	27.37	29.15	37.30	46.06
UGANDA	102.42	105.53	98.19	86.59	111.58	88.75	96.42	103.32	91.91	100.08	109.48
ZAMBIA	48.03	42.79	47.05	60.40	41.60	47.75	54.47	60.58	96.77	86.63	80.41
ZIMBABWE	55.39	54.64	25.98	20.68	22.75	38.68	47.87	52.1	58.29	50.76	56.79
TOTAL	554.04	478.28	458.90	403.79	482.20	491.60	558.11	579.23	579.67	662.35	699.27

Source: PTA (1994)

TABLE B2.3 Total PTA Exports (millions of US dollars)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
ANGOLA	1558	1510	1916	2051	1597	2258	2664	3036	3696	3091	3788
BURUNDI	88	77	99	112	169	87	154	78	81	101	72
COMOROS	20	18	10	15	16	19	28	26	23	28	22
DJIBOUTI	26	31	33	24	33	42	51	53	46	54	-
ETHIOPIA	406	404	417	338	455	373	429	499	366	307	169
KENYA	997	976	1084	958	1200	961	1071	1157	1096	1324	1339
LESOTHO	7	4	4	5	4	9	29	30	38	58	65
MALAWI	235	229	308	227	222	277	289	267	314	443	383
MAURITIUS	365	366	372	433	662	882	1001	986	1204	1120	1297
MOZAMBIQUE	311	223	125	121	106	216	303	359	372	390	139
RWANDA	102	120	143	130	173	129	101	121	147	203	66
SOMALIA	199	108	64	109	80	127	157	170	139	106	-
SUDAN	507	624	685	399	335	543	510	652	555	358	-
SWAZILAND	238	143	173	155	198	215	248	230	336	327	-
TANZANIA	446	371	377	284	360	266	317	312	423	385	419
UGANDA	357	326	382	378	429	311	306	270	179	171	142
ZAMBIA	958	836	650	471	517	877	1179	1322	1353	1061	756
ZIMBABWE	1073	1023	1011	956	1001	1137	1293	1451	1411	1541	-
TOTAL	7893	7389	7853	7166	7557	8729	10130	11019	11779	11068	8657

Source: PTA (1993a) and IMF (International Financial Statistics, 1994)
Note: - not available

TABLE B2.4 Total PTA Imports (in millions of US dollars)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
ANGOLA	900	721	911	1192	890	1068	1247	1299	1544	1774	-
BURUNDI	193	169	167	171	185	197	184	163	215	222	193
COMOROS	36	36	43	38	51	70	60	69	85	108	68
DJIBOUTI	258	259	266	278	255	275	279	284	302	338	-
ETHIOPIA	689	791	836	890	992	1104	1016	1121	982	1003	719
KENYA	1443	1241	1351	1292	1452	1580	1778	2312	2131	2006	1569
LESOTHO	28	28	35	27	27	42	68	59	60	93	104
MALAWI	262	281	244	253	222	266	365	453	477	491	646
MAURITIUS	417	396	425	470	608	894	1169	1192	1458	1301	1467
MOZAMBIQUE	726	565	430	361	412	626	700	702	757	809	769
RWANDA	252	244	250	268	322	320	331	280	272	192	185
SOMALIA	297	319	230	215	256	416	293	386	356	177	-
SUDAN	1148	1220	1181	842	845	1047	1048	1308	1094	1277	-
SWAZILAND	36	31	23	25	27	40	56	50	61	69	89
TANZANIA	1018	717	762	925	837	827	804	645	1035	981	1284
UGANDA	290	277	278	264	311	459	426	440	433	418	461
ZAMBIA	1079	835	611	676	583	726	752	960	750	959	922
ZIMBABWE	1472	1099	988	925	1022	1084	904	1076	1209	1339	1271
TOTAL	10544	9229	9032	9113	9297	11039	11479	12800	13222	13557	9747

Source: PTA (1993a) and IMF (International Financial Statistics, 1994)
Note: - not available

TABLE B2.5 Intra-PTA Exports as a Percentage of Total PTA Exports (percentage)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
ANGOLA	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BURUNDI	2.20	2.10	1.13	3.34	6.21	6.70	5.02	3.78	2.81	2.79	2.57	6.63	11.67
COMOROS	1.82	0.03	0.00	1.11	4.00	2.67	3.13	7.37	1.43	0.00	0.00	0.14	0.19
DJIBOUTI	41.78	50.94	55.38	32.26	24.88	25.42	43.94	45.00	40.98	42.64	52.39	47.78	0.00
ETHIOPIA	14.38	5.74	9.54	8.31	8.55	5.93	5.77	5.76	5.71	5.02	5.01	9.53	19.12
KENYA	24.46	26.63	24.23	24.21	20.47	20.57	20.62	21.10	20.65	18.85	17.29	18.99	19.74
LESOTHO	0.00	0.00	0.14	15.25	0.00	0.00	2.50	1.11	0.34	0.33	0.32	0.55	1.43
MALAWI	8.73	11.00	8.46	12.04	9.49	11.68	10.45	9.83	10.98	10.57	10.13	7.84	7.86
MAURITIUS	0.70	0.59	0.49	0.42	0.90	0.50	0.33	0.30	0.35	0.44	0.57	0.67	0.94
MOZAMBIQUE	10.80	10.55	13.66	8.45	4.39	1.07	2.36	1.43	1.03	0.92	1.11	1.48	7.22
RWANDA	8.92	1.56	2.08	0.57	2.26	2.85	2.53	2.75	4.08	19.69	3.22	6.78	0.37
SOMALIA	1.14	1.43	1.75	0.41	8.03	0.38	1.45	0.66	0.69	0.71	0.94	0.63	0.00
SUDAN	0.11	0.37	0.19	0.18	0.09	0.05	0.13	0.06	0.06	0.05	0.11	0.20	0.00
SWAZILAND	1.31	4.20	3.83	3.55	1.57	4.48	3.29	5.52	5.38	6.60	5.36	8.30	0.00
TANZANIA	11.00	6.25	5.15	5.42	6.21	4.40	4.00	4.36	3.97	3.01	4.14	4.66	12.22
UGANDA	1.39	2.35	0.83	1.85	3.53	1.03	0.87	1.18	1.30	1.30	2.40	1.25	1.70
ZAMBIA	2.77	8.18	4.98	4.97	3.88	5.76	5.75	5.45	5.74	5.24	5.31	3.85	5.00
ZIMBABWE	7.46	8.19	9.78	7.05	7.40	9.19	9.66	11.52	11.24	10.52	13.07	12.82	0.00
TOTAL	7.72	7.78	7.87	7.19	6.21	5.70	6.77	7.07	6.49	7.15	6.89	7.34	8.08

TABLE B2.6 Intra-PTA Imports as a Percentage of Total PTA Imports (percentage)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
ANGOLA	0.05	0.37	0.45	0.08	1.11	0.63	0.35	0.50	0.55	0.61	0.42	0.36	0.00
BURUNDI	22.34	33.05	17.96	16.66	16.39	14.95	15.44	14.45	18.62	15.20	15.16	10.84	17.01
DJIBOUTI	16.83	12.25	12.64	6.97	11.53	9.02	7.56	5.23	6.04	6.03	4.92	2.25	3.84
ETHIOPIA	26.74	18.49	18.00	13.70	13.70	5.29	7.86	5.84	6.85	7.55	6.15	6.42	0.00
KENYA	1.89	1.01	1.29	1.26	1.30	1.04	1.20	0.92	0.68	0.62	0.89	0.97	1.52
LESOTHO	2.80	1.10	1.77	0.61	1.31	1.11	1.48	1.19	1.17	1.55	0.95	3.27	3.06
MALAWI	0.48	7.83	1.07	3.21	0.85	6.67	6.67	13.95	11.11	14.65	11.11	2.39	1.46
MAURITIUS	5.71	9.50	14.02	11.17	7.56	6.64	7.71	9.19	8.75	6.90	7.32	7.47	9.18
MOZAMBIQUE	2.50	3.13	2.24	1.54	1.82	1.56	1.30	1.02	0.76	0.61	1.34	1.51	1.35
RWANDA	3.55	5.78	3.87	5.77	4.78	6.53	12.09	10.13	10.67	11.67	9.93	10.51	9.05
SOMALIA	18.23	23.48	16.54	16.04	17.03	14.76	15.82	13.04	13.49	14.92	15.07	17.61	26.99
SUDAN	11.56	5.20	7.32	3.52	4.69	3.68	6.71	4.61	7.98	6.82	8.27	20.32	0.00
SWAZILAND	2.45	2.74	3.51	3.67	3.54	4.28	5.27	3.61	3.79	2.73	0.24	3.00	0.00
TANZANIA	8.75	6.90	6.67	5.48	2.22	2.82	0.74	5.30	2.72	3.47	5.62	8.77	2.55
UGANDA	1.90	2.30	4.28	3.24	4.91	2.99	3.32	3.70	4.40	4.24	2.82	3.80	3.59
ZAMBIA	44.96	43.08	35.32	38.10	35.31	32.84	35.83	19.34	22.65	23.48	21.23	23.97	23.75
ZIMBABWE	4.80	7.02	4.45	5.12	7.70	8.94	7.13	6.57	7.25	6.31	12.91	9.03	8.72
TOTAL	9.75	10.18	8.41	7.56	7.54	6.87	7.58	6.59	7.08	7.08	6.91	7.36	4.47

TABLE B3.1
Trading Profile - Standard Bank of South Africa

Country	Export Credit and Collection Details			Available Risk Cover	SA Exports Recommended Terms
	Defaults	Exchange delays	Collection Experience		
Botswana	None	Negligible	Acceptable	CGIC[1] - case by case	1) Irrevocable Letter of Credit 2) Placement of cash cover in a bank designated by SBSA 3) Avalised Bills of Exchange
Kenya	In 1992 the central bank failed to honour L/C's	3 to 4 month delays in payment	Fair	CGIC	1) Confirmed Irrevocable Letter of Credit 2) Cash cover with SBSA
Malawi	Exchange delays due to shortage of foreign exchange	5 months and more	Poor to Fair	CGIC - case by case	1) Confirmed Irrevocable Letter of Credit indicating that Forex has been allocated 2) Avalised bill of exchange
Namibia	Negligible	None	Good	CGIC	1) Irrevocable Letter of Credit 2) Placement of cash cover in a bank designated by SBSA 3) Avalised bill of exchange
Tanzania	-	3 month delay of payment	Fair/Poor	CGIC does not provide export cover	1) Irrevocable Letter of Credit confirmed by a first class international bank 2) Placement of cash cover in a bank designated by SBSA 3) Bills of Exchange avalised by a first class international bank

Trading Profile - Standard Bank of South Africa (continued)					
Country	**Export Credit and Collection Details**			**Available Risk Cover**	**SA Exports Recommended Terms**
	Defaults	**Exchange delays**	**Collection Experience**		
Uganda	None (due to limited trade)	5 months	Guaranteed by first class international bank	CGIC does not provide export cover	1) Irrevocable Letter of Credit confirmed by a first class international bank 2) Placement of cash cover in a bank designated by SBSA 3) Bills of Exchange avalised by a first class international bank
Zambia	-	4 months	Guaranteed	CGIG - very limited	1) Irrevocable Letter of Credit confirmed by a first class international bank 2) Avalised bill of exchange
Zimbabwe	-	3 months	Good	CGIC	1) Irrevocable Letter of Credit 2) Placement of cash cover in a bank designated by SBSA 3) Avalised bill of exchange

Source: Standard Bank of South Africa International Division Trade and Financial Institutions Department - Country Trading Profiles (1993)

1. Credit Guarantee Insurance Cooperation

TABLE B3.2
Trading Profile - First National Bank

Country	Banks	Trade Instrument	Confirmation Required	FNB Confirms	Max. Period	Cost
Angola	Various Considered Case by Case	L/C's	Essential	On Application Requests will be evaluated	90	Very High
Botswana	FNB of Botswana, Barclays Bank of Botswana, Standard Charted of Botswana	L/C's, FBC's and open a/c	Not Essential	Yes	180	Low
Kenya	Barclays Bank Kenya, Commercial Bank	L/C's	Essential	Case by Case	90	Very High
Lesotho	Barclays Bank PLC, Standard Charted Bank	L/C's, FBC's and open a/c	Not essential	Yes	180	Low
Malawi	Indebank LTD, National Bank of Malawi, Commercial Bank of Malawi	L/C's	Essential	Yes	90	High
Mozambique	Banco Commercial De Mozambique, Standard Totta De Mozambique	L/C's	Essential	Yes	90	High
Namibia	Standard Bank of Namibia, Bank Windhoek Ltd, SWA Building Society, Commercial Bank Namibia, FNB Namibia, Namibian Banking Cooperation	L/C's, FBC's and open a/c	Not Essential	Yes	180	Low

Trading Profile - First National Bank (continued)						
Country	**Banks**	**Trade Instrument**	**Confirmation Required**	**FNB Confirms**	**Maximu m Period**	**Cost**
Swaziland	Barclays Bank of Swaziland, Standard Bank of Swaziland, Union Bank of Swaziland	L/C's, FBC's and open account	Not Essential	Yes	180	Low
Zambia	Barclays Bank of Zambia	L/C's	Essential	Yes	180	High
Zimbabwe	Grindlays BK, Merchant Bank of Central Africa, First Merchant Bank Ltd, Standard Charted Merchant, Barclays Bank Zimbabwe, Standard Charted Bank	L/C's, FBC's and open account	Recommended	Yes	180	Low

Source: First National Bank of Southern Africa Limited - Africa Brief (March 1993)

TABLE B4

COUNTRY GROUP CLASSIFICATION - Credit Guarantee Insurance Corporation

COUNTRY	GROUP
Botswana	1B
Burundi	2B
Comores	2B
Djibuti	2B
Kenya	2B
Lesotho	1A
Malawi	2A
Mauritius	2A
Mozambique	2B
Namibia	1B
Rwanda	2B
Swaziland	1A
Zambia	2B
Germany	1A

PREMIUM RATE PERCENTAGE TABLE		
COUNTRY GROUP CLASSIFICATION	TERMS OF PAYMENT	PRIVATE BUYERS
1A	cadLC	0.06
	cad	0.28
	1-3mLC	0.19
	1-3m	0.66
	4-6mLC	0.35
	4-6m	1.07
	TT7d	0.15
1B	cadLC	0.09
	cad	0.35
	1-3mLC	0.27
	1-3m	0.93
	4-6mLC	0.50
	4-6m	1.40
	TT7d	0.19
2A	cadLC	0.23
	cad	0.50
	1-3mLC	0.61
	1-3m	1.08
	4-6mLC	1.18
	4-6m	1.90
	TT7d	0.32
2B	cadLC	0.26
	cad	0.57
	1-3mLC	0.69
	1-3m	1.35
	4-6mLC	1.33
	4-6m	2.23
	TT7d	0.36

Terms of Payment

cadlC - Cash against presentation of shipping documents from an irrevocable Letter of Credit opened and/or confirmed before Shipment of Goods by a bank in the buyer's country and not confirmed by a bank in South Africa. Payment under the Letter of Credit may not be upon any action or discretion of the buyer.

cad - Cash against presentation of shipping documents through a bank in the buyer's country.

1-3m - Open Credit - including accepted bills of exchange - payment to be made latter than 3 months but not latter than 6 months after date of shipment or month-end statement or delivery or arrival of the goods.

1-3mLC - Payment from an irrevocable Letter of Credit opened and/or confirmed before shipment of the goods by a bank in the buyer's country and not confirmed by a bank in South Africa and payable after, but not later than 3 months from the date of presentation of the shipping documents. Payment under the Letter of Credit may not be conditional upon any action or discretion of the buyer.

4-6mLC - Payment from an irrevocable Letter of Credit opened and/or confirmed before shipment of the goods by a bank in the buyer's country and not confirmed by a bank in South Africa and payable after 3 months but not later than 6 months from the date of presentation of the shipping documents. Payment under the Letter of Credit may not be conditional upon any action or discretion of the buyer.

TT7d - Telegraphic Transfer within 7 days from the date of shipment. Rate will only apply provided the insured actually receives payment in South Africa within 7 days from the date of Bill of Landing. Otherwise the cad rate or, where documents are released before payment, the open credit premium rates apply.

Source: Credit Guarantee Insurance Corporation.

TABLE B5a
Compensable and Uncompensable Trade and Foreign Exchange Requirements for Settlements of Net Balances in US$ million (1990) PTA

	Imports (1)	Exports (2)	Total (3)	Compensable Trade = The lower of (1) and (2) times 2 (4)	Uncompensable Trade = (3) - (4) (5)
Angola	6.49	0.00	6.49	0.00	6.49
Burundi	32.61	2.08	34.69	4.16	30.53
Comoros	4.16	0.00	4.16	0.00	4.16
Djibouti	18.59	24.10	42.69	37.18	5.51
Ethiopia	8.74	18.35	27.09	17.48	9.61
Kenya	20.14	189.50	209.64	40.28	169.36
Lesotho	6.70	0.12	6.82	0.24	6.58
Malawi	34.93	31.81	66.74	63.62	3.12
Mauritius	19.54	6.84	26.38	13.68	12.70
Mozambique	75.17	4.12	79.29	8.24	71.05
Rwanda	40.97	4.73	45.70	9.46	36.24
Somalia	29.49	1.31	30.80	2.62	28.18
Sudan	2.58	0.60	3.18	1.20	1.98
Swaziland	3.44	18.01	21.45	6.88	14.57
Tanzania	29.15	17.50	46.65	35.00	11.65
Uganda	91.91	4.30	96.21	8.60	87.61
Zambia	96.77	71.90	168.67	143.80	24.87
Zimbabwe	58.29	184.40	242.69	116.58	126.11
Total	579.67	579.67	1159.34	509.02	650.32
Percentage				43.9%	56.1%

TABLE B5b
Compensable and Uncompensable Trade and Foreign Exchange Requirements for Settlements of Net Balances in US$ million (1992) PTA

	Imports (1)	Exports (2)	Total (3)	Compensable Trade = The lower of (1) and (2) times 2 (4)	Uncompensable Trade = (3) - (4) (5)
Angola	10.63	0.10	10.73	0.20	10.53
Burundi	32.82	8.40	41.22	16.80	24.42
Comoros	2.61	0.04	2.65	0.08	2.57
Djibouti	23.70	28.80	52.50	47.40	5.10
Ethiopia	10.91	32.32	43.23	21.82	21.41
Kenya	48.02	264.30	312.32	96.04	216.28
Lesotho	1.52	0.93	2.45	1.86	0.59
Malawi	59.29	30.09	89.38	60.18	29.20
Mauritius	19.82	12.24	32.06	24.48	7.58
Mozambique	69.59	10.04	79.63	20.08	59.55
Rwanda	49.93	0.25	50.18	0.49	49.68
Somalia	36.18	0.69	36.87	1.38	35.49
Sudan	39.24	0.70	39.94	1.40	38.54
Swaziland	2.27	30.78	33.05	4.54	28.51
Tanzania	46.06	51.20	97.26	92.12	5.14
Uganda	109.48	2.42	111.90	4.84	107.06
Zambia	80.41	37.82	118.23	75.64	42.59
Zimbabwe	56.79	188.15	244.94	113.58	131.36
Total	699.27	699.27	1398.54	582.93	815.60
Percentage				41.7%	58.3%

TABLE B6a
Compensable and Uncompensable Trade and Foreign Exchange Requirements for Settlements of Net Balances in US$ million (1990) PTA including South Africa

	Imports (1)	Exports (2)	Total (3)	Compensable Trade = The lower of (1) and (2) times 2 (4)	Uncompensable Trade = (3) - (4) (5)
Angola	25.09	0.02	25.11	0.05	25.07
Burundi	21.04	6.11	27.15	3.06	24.09
Comoros	10.36	0.13	10.49	0.12	10.37
Djibouti	19.8	23.80	43.60	27.40	16.20
Ethiopia	8.22	26.60	34.82	13.50	21.32
Kenya	63.65	234.74	298.39	35.10	263.29
Lesotho	2	0.32	2.32	0.18	2.14
Malawi	180.93	60.76	241.69	91.36	150.33
Mauritius	135.35	12.42	147.77	17.90	129.87
Mozambique	245.87	17.12	262.99	22.72	240.27
Rwanda	31	12.71	43.71	7.46	36.25
Somalia	34.49	0.63	35.12	1.94	33.18
Sudan	36.15	0.80	36.95	1.02	35.93
Swaziland	4.74	24.57	29.31	5.08	24.23
Tanzania	38.46	16.81	55.27	27.20	28.07
Uganda	91.72	1.98	93.70	6.38	87.32
Zambia	271.69	34.07	305.76	109.58	196.18
Zimbabwe	459.59	353.71	813.30	513.78	299.52
South Africa	229.96	1082.80	1312.76	459.92	852.84
Total	1910.11	1910.11	3820.22	1343.74	2476.47
Percentage				35.2%	64.8%

TABLE B6b
Compensable and Uncompensable Trade and Foreign Exchange Requirements for Settlements of Net Balances in US$ million (1992) PTA including South Africa

	Imports (1)	Exports (2)	Total (3)	Compensable Trade = The lower of (1) and (2) times 2 (4)	Uncompensable Trade = (3) - (4) (5)
Angola	129.91	0.34	130.25	0.68	129.57
Burundi	32.78	8.40	41.18	16.80	24.38
Comoros	2.61	0.04	2.65	0.08	2.57
Djibouti	23.7	28.80	52.50	47.40	5.10
Ethiopia	10.91	32.32	43.23	21.82	21.41
Kenya	97.52	272.09	369.61	195.04	174.57
Lesotho	1.52	0.93	2.45	1.86	0.59
Malawi	246.48	73.97	320.45	147.93	172.51
Mauritius	189.53	16.28	205.81	32.55	173.25
Mozambique	291.79	26.77	318.56	53.54	265.02
Rwanda	52.57	0.25	52.82	0.50	52.32
Somalia	36.18	0.69	36.87	1.38	35.49
Sudan	46.22	0.82	47.04	1.63	45.40
Swaziland	2.76	30.78	33.54	5.52	28.02
Tanzania	55.16	54.57	109.73	109.14	0.59
Uganda	201.16	2.44	203.60	4.87	198.72
Zambia	444.71	52.42	497.13	104.83	392.29
Zimbabwe	565.59	437.85	1003.44	875.70	127.74
South Africa	340.44	1640.08	1980.52	680.89	1299.64
Total	2771.54	2679.82	5451.37	2302.17	3149.19
Percentage				42.2%	57.8%

TABLE B7
Charactaristics of Diffrent Types of Monetary Arrangements

Type of Arrangement	Between Members			Currencies	Central Banks	Reserve Pooling
	Partial Currency Convertibility	Capital Account Convertibility	Exchange Rate Fixity			
Currency Union	yes	yes	yes (no margin)	single	multiple, independent	yes
Monetary Union	yes	yes	yes (no margin)	seperate	multiple, coordinated	yes
Monetary Fund	yes	no	no	seperate	single	yes

Source: Adapted from Cobham and Robson (1994).

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