Common Market for
Eastern and Southern Africa

COMESA

Progress and Challenges
of the COMESA Monetary Integration Program

Special Report

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This paper analyzes the progress that has been made in COMESA Monetary Integration programme and identify challenges that are faced and provides the generic roadmap for achieving monetary union

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Background

The mandate to set up a Monetary Union in COMESA is derived from Article 4(4) of the COMESA Treaty signed in Kampala, Uganda on 5 November 1993 which states: COMESA Member states shall' in the field of monetary affairs and finance, cooperate in monetary and financial matters and gradually establish convertibility of their currencies, irrevocable fixing of conversion rates as a basis for the eventual establishment of a Monetary Union.

The COMESA Monetary cooperation programme considers fiscal and monetary discipline as the overriding principle for achieving macroeconomic convergence by requiring member countries to fulfil a set of macroeconomic convergence criteria, categorized as ***Primary criteria*** and ***Secondary criteria.*** The roadmap for implementation of the new stages for achieving the Programme, which will culminate in Monetary Union by 2035 is categorized based on the following three key pillars:

Pillar I: Achieving macroeconomic convergence: This include statistical harmonization and implementation of the COMESA Multilateral Macroeconomic Surveillance Framework. This is aimed at ensuring the viability and sustainability of the COMESA Monetary Integration Agenda.

Pillar II. Implementation of the COMESA Financial System Development and Stability Plan: The main objective of this pillar is to achieve Regional Financial Integration (RFI), which is needed to facilitate the financing of larger real transactions at a regional level. This is key to enhance the implementation of the COMESA's long-term objective of creating a single market in financial services to support regional integration This will also significantly help to enhance the implementation of African Continental Free Trade Area.

Pillar III. Institutional, administrative, and legal preparations for the creation of the COMESA Monetary Union.

The objective of this paper is to analyze the progress that has been made in the COMESA Monetary Integration programme and identify challenges that are faced. The first part of the paper briefly provides the generic roadmap for achieving monetary union. The second part then proceeds to assess the progress made by COMESA in evaluating the implementation status of the following:

I. Convergence and harmonization of macroeconomic policies and implementation of COMESA Multilateral Macroeconomic Surveillance Framework;
II. Implementation of the COMESA Financial System Development and Stability Plan;

III. Harmonisation of concepts, definitions of macroeconomic data; and
IV. Developments in trade integration.

The paper also summarizes key challenges and provides recommendations on the way forward in section (III) and section (IV).

I. Generic Roadmap for Achieving Monetary Union[1]

The generic roadmap for achieving monetary union, envisage the following five hybrid stages:

(a) **Preparatory stage:** This stage includes modernizing the domestic financial system including the payment system;

(b) **Harmonisation stage:** Modernization of the financial sector in individual countries would be further extended by the introduction of and compliance with various international standards and practices in the financial sector that would ensure regional harmonization.

(c) **Cooperation stage:** Member countries cooperate in effectively implementing agreed convergence criteria that are monitored and evaluated by a regional Convergence Council. They also complete the full harmonization process relating to regulatory, supervisory, and accounting procedures which began under stage II, and cooperate in cross border regulations and supervisory activities.

(d) **Integration stage:** In this stage, the focus will be shifted to a regional level. This will be characterized by an effective integration of various financial institutions to achieve Regional Financial Integration, and of the exercise of regulatory and supervisory functions, including single bank licensing, a single regulatory agency, and increased cross-border presence of financial institutions originating in member countries.

(e) **Unification/Monetary Union stage:** Integration would be characterized by common currency and a common central bank. A roadmap towards a monetary union will be a fusion of the real economic integration and regional financial integration processes. This includes policy and institutional steps that need to be taken in both the real and financial sector in moving towards establishing monetary union. Almost all regional cooperation arrangements aiming at the formation of monetary union have followed sequential process. between Regional Economic Integration and Regional Financial

1 AfDB &COMESA “Facilitating Multilateral Fiscal Surveillance: In Monetary Union Context: With Focus on COMESA Region, pp 6-9.

Integration. Economic and Monetary Union (EMU) started with sectoral real integration (coal and steel) and gradually progressed towards economic community and the economic and monetary union. The two CFA currency unions in Africa began with the establishment of a currency union and then proceeded to establish monetary union (WAEMU and CEMAC) by setting up customs union and other elements of economic community among their member countries. COMESA follows EMU precedent, establishing FTA, Customs Union and Economic Union in sequential order to achieve monetary union.

II. Assessment of progress made by COMESA on the Implementation of the COMESA Monetary Integration Programme

(a) Assessment of the Status on the Convergence scale and the Implementation of the COMESA Multilateral Macroeconomic Surveillance Framework

The assessment of primary and secondary criteria generally indicates the following:

- Fiscal deficit, Inflation and external reserves (in months of imports) criteria remained the most challenging for member countries.
- Member States performance was not satisfactory on achieving stable exchange rates.
- Monetary policy stance varied depending on the individual circumstances in the member countries but generally remained focused on controlling inflation.
- A number of Member States responded to higher inflation and currency depreciation by raising policy interest rates.
- Significant depreciation of currencies was observed in a number of member countries in recent years, primarily owing to high public sector demand for foreign exchange to finance big public investment projects, a strong dollar and high demand for foreign exchange from the local corporate sector and other importing enterprises

As per the requirements of the COMESA Multilateral Macroeconomic Surveillance Framework, key achievements include the following:

- Regarding, fiscal transparency and accountability, most countries currently have Public Finance Management Act (PFM);

- Many member countries prepare Medium Term Financial Frameworks – many countries have also national fiscal rules;
- There is significant improvement in revenue administration, cash flow planning and procurement.

(b) **Assessment of Member Countries in the Implementation of the COMESA Financial System Development and Stability Plan**

The Financial system in most member countries had undergone significant reforms with progress recorded in banking and insurance. The following are some of the achievements:

- To modernise payment systems many member countries have introduced RTGS electronic payment system.
- COMESA has a Regional Payment and Settlement System which is fully operational.
- COMESA Member States have also seen an increase in the number and operations of microfinance institutions (MFIs). Banks have also started to focus more on broadening access to retail banking through introduction of mobile banking operations. Some banks for example, Equity Bank in Kenya have their business model on low-end customers. Many banks are also broadening their branch network.
- There is high degree of compliance by many member countries to the core principles of bank supervision and regulation that are applicable to them. Some are in partial compliance to the principles.
- Most countries are implementing Basel I, and some Basel II, although there are challenges.
- Quoting and trading in the COMESA national currencies by deposit money banks is highly limited in most countries except to some extent in member countries which are also members of EAC.
- Regulatory framework for insurance and pension schemes is less developed in most member countries of the COMESA region.
- While most countries require the use of International Financial Reporting Standards (IFRS) for financial sector enterprises, they are deficient in application, in part because of lack of sufficiently trained personnel and the absence of enforcement mechanism.
- COMESA regional financial institutions such as Trade and Development Bank, PTA Reinsurance Company and African Trade Insurance Company are making great contributions in enhancing the COMESA regional integration agenda.

The following are achievements towards assuring financial stability in the region:

- Most member Central Banks established the financial stability unit;
- Many member Central Banks publish financial stability reports
- Some countries established Credit Reference Bureaus.
- All member Central Banks produce data on Financial Soundness Indicators.
- Some countries are undertaking systemic risk assessment using bank stability index, financial stress index, heat map and cobweb. Some also are undertaking micro and macro stress testing.

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COMESA Monetary Institute (CMI) has provided and is providing capacity building and research activities that are related to improving macroeconomic management and financial stability with the aim of enhancing the COMESA Monetary Cooperation Programme, focusing mainly on the implementation of the COMESA Multilateral Macroeconomic Surveillance Framework and the COMESA Financial System Development and Stability Plan. CMI has also developed a number of User's Guides which will assist member countries for undertaking macroeconomic analysis and for assessing stability of the financial system.

(c) Assessment of Member Countries on Harmonisation of Statistics

- Most Member States are making progress towards implementing SNA 93.
- COMESA has operationalized a Consumer Price Index harmonization Project (HCPI) with the support of African Development Bank.
- Member countries are quite advanced in the use of the Customs Declaration Information System software (ASYCUDA) and in the use of EUROTRACE for external trade statistics.
- The compilation of monetary statistics in most member countries is in accordance with the IMF's Monetary and Financial Statistics Manual.
- The periodicity and timeliness of the monetary survey broadly follow the General Data Dissemination Standards (GDDS) recommendations.
- The main areas where measurement problems still exist are with inflation, the fiscal out turn and the determination of central bank financing of fiscal deficit.

(d) Assessment of Member Countries in Trade Integration

The following are key achievements in trade integration

a) COMESA formed a Free Trade Area (FTA) in October 2000 in which 16 member countries out of 21 are currently participating.
b) COMESA also launched a Customs Union in 2009.
c) The top priority for implementation of Customs Union by member states is to finalize domestication of the COMESA Common Tariff Nomenclature/Common External Tariff (CTN/CET) to HS 2012 version and migrate to COMESA Customs regulations (CMRs.)
d) There is a great effort to resolve non-tariff barriers through various avenues which included bilateral meetings held in the margins of the Regional NTBs as well trade and customs meetings.
e) COMESA is implementing the Standards and Quality Assurance (SQA) and Sanitary and Phyto-Sanitary (SPS) programmes.
f) COMESA Secretariat is implementing programmes to improve the transport and communications systems of the region as well as improve information available to businessmen wishing to trade both within the region and beyond. They include among others the following:

    - Harmonised Road Transit Charges;
    - COMESA Carrier's License;
    - Harmonised Axle Loading and Maximum Vehicle Dimensions;
    - The Regional Customs Transit Guarantee Scheme, and
    - The Yellow Card.

➢ The Member States of COMESA, the EAC and SADC agreed in October 2008 to negotiate a Tripartite Free Trade Area (TFTA) in Kampala, Uganda. The Heads of State and Government of the COMESA, EAC and SADC also met again on 10 June 2015 in Sharm El Sheikh, Egypt at the Third Tripartite Summit to officially launch the COMESA-EAC-SADC Tripartite Free Trade Area (TFTA). The harmonization and coordinating of regional programmes in the three RECs will play a pivotal role in not only boosting intra-African trade but also in rationalizing use of resources and cooperation among the Regional Economic Communities (RECs). The TFTA stands as part of a much more ambitious agenda to establish a continental FTA (or AfCFTA) covering the whole of Africa.

iII. Key Challenges for Achieving COMESA Monetary Integration Programme

- Achievement of the convergence criteria on a sustainable basis continued to pose a serious challenge for most countries. The fiscal deficit and inflation criteria remained the most challenging.
- In some Member States fiscal and monetary policy coordination remained weak leading to high interest rates, exchange rate pressures and rapid inflation.
- The COMESA Macroeconomic Multilateral Surveillance Framework is not yet fully implemented.
- The level of intra-COMESA trade remained low, partly on account of poor transport network, unstable power and water supply, as well as the existence of some non-tariff barriers.
- Quoting and trading in the COMESA national currencies by deposit money banks remained limited, partly due to the absence of stable exchange rates and the lack of a mechanism for clearing and settling of accumulated long positions of banks.
- Although the financial sector remained stable and sound in many member countries, the financial markets are characterized by; low savings rates, underdeveloped bond markets, limited investor base, lack of modernised payment system in some countries, lack of cross-border supervision of financial markets etc.
- COMESA economies are prone to relatively large and asymmetric shocks, including terms of trade and exchange rate shocks, with implications for the real economy. The existence of asymmetric shock would pose a challenge for the effective implementation of monetary policy in the zone.
- Some countries were heavily dependent on unpredictable aid inflows to finance a substantial portion of government expenditure. Reliance on such aid inflows for budgetary support constrains the attainment of the fiscal deficit to GDP (excluding grants) criterion on a sustainable basis.
- In order to facilitate better assessment of the integration process and for purposes of comparison of convergence indicators across member countries, reliable, timely and harmonised statistical information is required. This can be mitigated by encouraging member countries to adopt best international standards of compiling macroeconomic data.
- Lack of sufficiently trained manpower to implement internationally accepted standards.

IV. Recommendations on the Way Forward

The following are key recommendations on the way forward:

- There is need for the implementation of macroeconomic surveillance framework that oversees compliance and is endowed with appropriate instruments to enforce compliance.
- The surveillance mechanism should be supported by an effective legal framework, which could serve as a commitment technology for macroeconomic stability and policy credibility.
- The role of the surveillance framework should be that of "promoter" (assisting member countries to fulfil their obligations and a crisis manager. Assistance should be more prominent during earlier stages of monetary cooperation, followed by gradually assigning growing importance to sanctions as integration intensifies.
- Surveillance mechanism should pay special attention to Public Finance Management (PFM) systems in member countries. It is necessary to ensure that member countries of monetary union possess a minimum standard of efficient PFM system in the interest of convergence and sustainability of the union.
- Encouraging member countries to formulate their budgetary policies within a comprehensive Medium Term Financial Framework, comprising a set of four separate frameworks: Medium Term Macroeconomic Framework, a Medium-Term Fiscal Framework, a Medium-Term Budget Framework, and a Medium-Term Expenditure Framework
- Since monetary union is a fusion of two integration processes, namely real and financial, it is necessary that trade integration its formulation and implementation be embedded as a parallel, if not an integral part of macroeconomic surveillance framework.

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