4th Specialized Technical Committee on Finance, Monetary Affairs, Economic Planning and Integration Experts Meeting
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COMMENTS OF REGIONAL ECONOMIC COMMUNITIES (RECs) ON THE TIMELINES FOR THE ESTABLISHMENT OF THE AFRICAN CENTRAL BANK (ACB) AND AMCP MACROECONOMIC CONVERGENCE CRITERIA

January, 2020
I. Introduction

The 3rd Specialized Technical Committee (STC) on Finance, Monetary Affairs, Economic Planning and Integration meeting in Yaoundé, Cameroon, from 4 to 8 March 2019, requested the African Union Commission (AUC) and the Association of African Central Banks (AACB) to work together to revise the timelines for the establishment of the African Central Bank (ACB) using the AACB report on the refinement of the macroeconomic convergence criteria of the African Monetary Cooperation Programme (AMCP) as the reference document. The STC further requested the AUC to ensure that the AMCP convergence programme is aligned with that of the RECs.

Accordingly, the AUC and AACB revised the timelines and organized a consultative meeting with RECs from 1 to 3 July 2019, in Niamey, Niger, on the margins of the African Union Summit. However, the meeting did not reach its intended objective due to low participation of RECs as a result of conflicting schedules of the Summit. In an effort to collect comments from RECs, the AUC sent the reports to RECs for comments and conducted working visits to some of the RECs, due to resource constraints. The AUC obtained comments from Common Market for East and Southern Africa (COMESA); Economic Commission of West African States (ECOWAS); East African Community (EAC); Southern Africa Development Cooperation (SADC), Community of Sahel-Saharan States CEN-SAD, and Economic Community of Central African States (ECCAS). Only the Intergovernmental Authority on Development (IGAD) and Union Maghreb Arab (UMA) were not able to provide comments.

CEN-SAD and COMESA provided their comments during the meeting in Niamey, where they noted that there was divergence in the criteria for the RECs and variances in the establishment of regional single currencies. For purposes of having a single currency, it was emphasized that the threshold in all RECs must be aligned. As such, RECs must adhere to the criteria as set by the AACB to achieve the same monetary integration goal. For instance, it was reported that the Central African Economic and Monetary Community (CEMAC) has set convergence criteria for the six Member countries, while the other members of ECCAS all have their own currencies, with some members belonging to other regional groupings such as SADC and EAC.

II. Convergence criteria for the AMCP and timeline for the establishment of the African Central Bank

The RECs were requested to provide comments on the proposals for the primary and secondary criteria that have been selected, as well as their thresholds, definitions and measurements. The compliance with the convergence criteria by Member States is critical to reduce the pressure on the common central bank to grant monetary financing to States.

II.1. Harmonization of the primary criteria

The following table summarizes the proposals for the primary criteria that have been selected, as well as their thresholds, definitions and measurements.
Table 1: Selected Primary Criteria

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Threshold</th>
<th>Definition</th>
<th>Measurement</th>
<th>Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation rate</td>
<td>Inflation ≤7%</td>
<td>Change in Consumer Price Index during the year (12 months year-on-year)</td>
<td>Average Annual Inflation Rate (Headline Inflation)</td>
<td>Historical inflation on the continent averages 11% - Threshold studies indicate level of about 12% - High budget deficit - High debt/GDP ratio - Need to stimulate growth in the forecast horizon</td>
</tr>
<tr>
<td>Overall Budget Deficit</td>
<td>≤5% (target ≤3%)</td>
<td>The difference between General Govt. revenue (+grants) and expenditure on commitment basis as a percentage of nominal GDP - Measured using the fiscal year</td>
<td>- Difference between revenue (+grants) and expenditure of less than 5% of GDP</td>
<td>Using the European Monetary Union Framework where d=g*b d=budget deficit / GDP g=projected nominal GDP growth rate b=government debt / GDP In Africa; g=8%, b=65%</td>
</tr>
<tr>
<td>Central Bank credit to Government</td>
<td>≤ 5% (target 0%)</td>
<td>Central Bank advances to government including purchase of government debt instruments in the current year</td>
<td>≤ 5% of the previous year’s government’s tax revenue</td>
<td>Given the current state of Government finances - Governments are encouraged to move towards financing from the market - Progressively towards elimination</td>
</tr>
<tr>
<td>External Reserves/Imports of Goods and Services</td>
<td>≥ 3 months (target ≥ 6 months)</td>
<td>The ratio of stock of gross external reserves to current imports of goods and services</td>
<td>Number of months of imports based on moving average of the last six months</td>
<td>To address macroeconomic shock - To create confidence in the economy - Smooth functioning of the foreign exchange market</td>
</tr>
</tbody>
</table>

These convergence criteria aim at reinforcing the homogeneity and stability of the main macroeconomic indicators of the countries before joining a monetary union, in order to allow countries to better absorb the idiosyncratic economic shocks after the adoption of a common monetary policy. The four proposed primary criteria are the ones mostly used in the AACB sub-regions and the RECs. They are related to the inflation rate, the level of the budget deficit, the financing of the budget deficit by the Central Bank and the adequate level of external reserves.

II.2. Harmonization of the secondary criteria

The table 2 below shows the selected secondary criteria. They are generally linked to the primary ones and are also justified by the strengthening of monetary stability and fiscal discipline. The criterion Public debt / GDP is used for its relevance in the assessment of the level of indebtedness of a given country. Moreover, public debt is one of the relevant criteria for judging the financial solvency of a state and is a result of all financial policy decisions. Total tax revenues / GDP is maintained to assess the fiscal pressure and the efforts made by governments to collect taxes. In a monetary union, it is necessary to pool the main monetary policy instruments, in particular the exchange rate variable, so that they are stabilized in the pre-monetary union phase. Moreover, information on nominal exchange rate is considered to be easier to collect than computing real exchange rate or real effective exchange rate. An adequate level of Government capital investment / tax revenue is maintained in to encourage tax revenue collection and investment in capital expenditure.
<table>
<thead>
<tr>
<th>Criteria</th>
<th>Threshold</th>
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<th>Measurement</th>
<th>Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Government Debt / GDP</td>
<td>&lt;65%</td>
<td>Total stock of outstanding General Government debt as a ratio of nominal GDP</td>
<td>Ratio of General Government debt to GDP</td>
<td>Available data indicates that the current average is 56%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>End period data</td>
<td></td>
<td>- Infrastructure needs of member States</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>- 65% will give us a budget deficit to GDP</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>ratio of 5%, with a projected nominal GDP growth rate of 8%.</td>
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<tr>
<td>Total Tax Revenue / GDP</td>
<td>≥ 20%</td>
<td>Total tax revenue as a ratio of nominal GDP</td>
<td>Total tax revenue divided by nominal GDP</td>
<td>- Grants average 3%</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>- Total tax revenue to GDP ratio currently at 18%</td>
</tr>
<tr>
<td>Nominal Exchange Rate</td>
<td>Variability ±10% (Target ±5%)</td>
<td>The average official exchange rate of the country during the year</td>
<td>Depreciation/Appreciation in the nominal exchange rate not exceeding 10%</td>
<td>Concerns raised by Bureau members on the need for flexibility - Provide room for macroeconomic adjustment</td>
</tr>
<tr>
<td>Government Capital Investment / Tax Revenue</td>
<td>≥ 30%</td>
<td>Capital expenditure by Central Govt. as a ratio of tax revenue (Govt. to invest in projects that generate more tax revenue)</td>
<td>Ratio of capital expenditure to tax revenue</td>
<td>To encourage tax revenue collection - To encourage investment in capital expenditure</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>- The high growth rate has to be supported by high investment spending by Governments to encourage tax revenue</td>
</tr>
</tbody>
</table>

II.3. The revised timelines for the establishment of the African Central Bank

The revised timelines for the establishment of the African Central Bank and the common currency by 2045 were divided into the following stages: **First (1st) Stage January 2017 - December 2027**: Policy and Institutional Decision, Creation of African Monetary Institute (AMI) and Strengthening Macroeconomic Convergence and Financial Integration - this stages include the establishment of the Pan-African Stock Exchange; **Second (2nd) Stage January 2028 – December 2032**: Strengthening of Macroeconomic and Trade Policies and Creation of REC Central Banks; **Third (3rd) Stage January 2033-December 2042**: Introduction of Regional Currencies; **Fourth (4th) Stage January 2038-December 2037**: Transitional period during which the Regional Central Banks/Monetary Institutions would converge into the African Central Bank and; **Fifth (5th) Stage January 2043 – December 2045**: Establishment of the African Central Bank (ACB).
III. Comments of RECs on the timelines and the AMCP macroeconomic convergence criteria

III.1. Community of Sahel-Saharan States CEN-SAD

CEN-SAD indicated that establishing a monetary union was part of the agenda of the region within the larger framework of the integration of the community. It is also in support of the continental macroeconomic convergence criteria as this is part of their objective. However, the region has not been successful in achieving this objective. However several Member States are advancing and implementing the criteria of the West African Economic and Monetary Union and the Central African Economic and Monetary Community.

III.2. Common Market for East and Southern Africa (COMESA)

COMESA informed that its experts’ group on Finance and Monetary Affairs had recommended convergence criteria to be implemented in three stages from 2019 to 2035 leading to the creation of a single currency. The criteria were approved by the Bureau of the COMESA Committee of Central Bank Governors and would be submitted to the Convergence Council comprising Ministers of Finance, Trade, and Industry, and Central Bank Governors for approval before they could be considered to be binding on Member countries. It was emphasized that the buy-in of the fiscal authorities was necessary to move the process forward. COMESA was largely in compliance with the AMCP criteria.

III.3. Economic Community of Central African States (ECCAS)

Monetary union is an integral part of ECCAS and the macroeconomic convergence is also addressed in the region. The Central African Economic and Monetary Community (CEMAC) is promoting the macroeconomic convergence policy. In the ongoing rationalization process of RECs in Central Africa, the CEMAC macro-economic convergence program has been extended to DR Congo and Sao Tome Principe. The convergence criteria will be gradually extended to the other member countries of ECCAS.

ECCAS, in their comments, indicated that CEMAC convergence criteria were amended in January 2017 to take into account the specificities of the oil and natural resource rich countries in the sub-region. The main amendment of the convergence mechanism in the area has focused on the definition of a new reference budget balance. The reference budget balance is calculated from the overall balance, and incorporates a financial savings rule for oil resources. Also, the reference budget balance is equal to the overall budget balance from which financial savings on oil resources are subtracted.

In addition to the above criteria, CEMAC follows a criterion that addresses non accumulation of arrears over the current period. This criterion is used to track and assess the solvency of states in each fiscal year with respect to commitments made and services received.

General Government Debt/GDP: it should be noted that this is indeed the total public debt (domestic and external).

CEEAC identifies the AMCP criteria as relevant, however, they are uncertain on the timetable for implementation, in particular, the convergence towards the optimal thresholds.
of the various criteria. Convergence has been applied in CEMAC and the WAEMU countries for more than 20 years already. But the observation that is made is that of the fragile economies making the external shocks. On compliance with the criteria, it is at the country level.

III.4. **East Africa Community (EAC)**

The delegation of the African Union Commission conducted a working visit to EAC in Arusha, Tanzania, on 11 November 2019 on the margins of the African Regional Integration Index.

**a) Timelines for establishment of ACB**

The representatives of the EAC indicated that they appreciated the approach of migrating from regional currencies in 2028 to an African single currency in 2034. However, there would be a requirement for extensive preparations by the RECs in terms of harmonization of financial, fiscal and monetary policies; harmonization of statistics (compilation methodologies), harmonization of regulatory frameworks; and attainment of macroeconomic convergence criteria. The EAC noted that gains from a monetary union would be much higher if there was significant movement of goods and services, and labour and capital across countries. As such, it would be prudent to promote a customs unions and a common market as we pursue a monetary union.

**b) AMCP macroeconomic convergence criteria**

The EAC representatives indicated that they were comfortable with the proposed targets of the AMCP. It was noted that the fiscal criteria, i.e. the budget deficit and debt, sounded more realistic compared to those of EAC which were considered rather restrictive. For example, the overall budget deficit of 3% for EAC with huge infrastructure deficit has recently been questioned by most of their development partners. The proposed 5% moving progressively towards 3% was considered a better approach. However, the debt to GDP was considered a primary criterion for the EAC. The EAC also have core inflation as one of their secondary criteria, which is not a criterion in the AMCP. Rather, the AMCP criteria include two additional targets, being nominal exchange rate and capital investment/tax revenue which are not EAC criteria. Based on the foregoing, the EAC representatives emphasised the need to explain the implication of this variation for the RECS and whether they would be required to amend their protocols to include these targets.

The EAC underscored the need to put in place mechanisms aimed at ensuring compliance with the convergence criteria, especially when the monetary union has been established, to avoid negative repercussions for complying countries.

III.5. **Economic Community of the West African States (ECOWAS)**

The delegation of the African Union Commission (AUC), met with the Economic Community of West African States (ECOWAS) Commission’s Department of Macroeconomic Policy and Research on 28 October 2019 at the Headquarters of the ECOWAS Commission in Abuja, Nigeria.
a) Timelines for the establishment of ACB

The ECOWAS noted that there was still room for considerable work toward meeting the convergence criteria. They stated that they were generally comfortable with the revised timelines despite the divergence on the continental and the ECOWAS criteria. However, they recommended that implementation at the RECs level should be accelerated, with short deadlines given for RECs to achieve some of the targets. In addition, they mentioned that engagement should not only be at the technical level, but should be elevated to the level of Heads of State and Government to facilitate progress. Also, there should be parallel implementation of certain programmes at the regional and continental levels to fast-track implementation.

b) AMCP Macroeconomic convergence criteria

**Primary criteria**

- On specific criteria, they explained that ECOWAS had included grants in the calculation of the budget deficit to cater for their constituency which had substantial amounts of grants, save for Nigeria.

- On inflation, the ECOWAS representative sought clarity on deflationary situations because the criteria excluded those. It was explained that in the case of ECOWAS, the inflation target was set at the regional average ± 2 percent as per the European Union (EU) criterion.

- Further on inflation, it was noted that there were challenges in the ECOWAS region on the calculation of the inflation rate. All Francophone countries calculate inflation for capital cities, while other countries calculate the rural/urban inflation rate. In addition, some countries restrict the calculation of the inflation rate to national households, while others take into account all resident households. The ECOWAS representatives recommended that the formula for calculating inflation should be agreed upon at the continental level to avoid disparities in reporting.

- On the primary criteria, the budget balance should be properly defined, and the calendar year should be used in place of the fiscal year to avoid different formulas.

**Secondary criteria**

- On the general government debt, the suggestion was to involve the fiscal authorities to agree on the final threshold to be applied.

- On the nominal exchange rate, the recommendation was to specify that the effective exchange rate would be used. Also, a suggestion was made to use the International Monetary Fund’s Special Drawing Rights (SDR) or any other Unit of Account (UA) or the United States Dollar.
• The secondary criterion on the government capital investment as a proportion of tax revenue was deemed to be vague. Clarity on the definition would be useful for better reporting, with emphasis on fixed investment rather than capital investment.

III.6. Southern African Development Community (SADC)

The meeting with the SADC region was held on 21 August 2019 on the margins of the African Multidimensional Regional Integration Index (AMRII) Training Workshop in Lusaka, Zambia.

The representative of the SADC Secretariat acknowledged that the Secretariat was in receipt of the communication from the AUC regarding the revision of the macroeconomic convergence framework and the timelines for the establishment of the ACB. They indicated that macroeconomic convergence framework exists within the SADC region and there are some differences between the regional and continental frameworks in terms of the definition of the indicators. In order to make any revisions to the regional framework, there was need for consultations with the various regional structures responsible for macroeconomic convergence, including the Committee of Central Bank Governors (CCBG), the SADC Macroeconomic Committee (MEC), which consists of representatives from the Sub-Committee of Treasury, Central Banks, and Planning Officials, and the Senior Treasury Officials comprising Finance and Central Bank Senior Officials.

Conclusion

Based on the above-mentioned comments from RECs on the macroeconomic convergence criteria, an emerging consensus has to be reached by all parties on the criteria to be used on the continental macroeconomic convergence framework as well as the timeline and monitoring mechanism. All the RECs are in support of the AMCP macroeconomic convergence criteria and on operationalization of the African Monetary Institute to take the lead in the establishment of the ACB.

Recommendation

As a way forward, it should be recommended that the AUC, AACB and RECs continue to work closely together in order to ensure the harmonisation and alignment of the RECs macroeconomic convergence criteria to the AMCP convergence programme and timeline, as some criteria do not exist in other RECs and some are different in terms of definition, measurement and threshold. Therefore, harmonisation of the definition, threshold and measurement has to be agreed upon by all the parties. It is also critical to involve RECs in monitoring framework and a peer review mechanism for macroeconomic convergence at the regional level and put in place mechanisms for reporting in countries where do not exist. The AMI should be set up as soon as possible to coordinate the monitoring process and report to the STC on Finance, Monetary Affairs, Economic Planning, and Integration every year.