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ECONOMIC COMMISSION FOR AFRICA

Fifth Meeting of the Intergovernmental Negotiating Team on the Treaty for the Establishment of a Preferential Trade Area for Eastern and Southern African States

Addis Ababa, Ethiopia, 8-19 October 1979

MEMORANDUM RELATING TO THE DRAFT PROTOCOL ON CLEARING AND PAYMENTS ARRANGEMENTS WITHIN THE PREFERENTIAL TRADE AREA FOR EASTERN AND SOUTHERN AFRICAN STATES

M79-2544

I. INTRODUCTION

It will be recalled that following the adoption of the principle that "Member States should consider appropriate payments arrangements among or between themselves with a view to facilitating trade in goods and services", the inaugural meeting of the Intergovernmental Negotiating Team held in Addis Ababa from 27 to 30 June 1978, agreed that this principle should be supplemented by a "Protocol relating to Clearing and Payments Arrangements". Hence, at its fourth meeting held in Luanda, Angola, from 14 to 16 June 1979, and in accordance with the revised time-table for the negotiations adopted by the second meeting of the Lusaka MULPOC Council of Ministers held in Nairobi from 1 to 2 February 1979, the Intergovernmental Negotiating Team decided that the agenda for its fifth meeting should include "Consideration of Draft Protocol and Memorandum on Clearing and Payments Arrangements".

Accordingly, the purpose of this memorandum is to highlight the existing clearing and payments arrangements among the countries of Eastern and Southern Africa; review some of the existing monetary co-operation arrangements among the developing countries; identify possible clearing and payments arrangements in the context of the proposed Preferential Trade Area arrangements; and introduce the main provisions of the draft protocol itself.

II. EXISTING CLEARING AND PAYMENTS ARRANGEMENTS AMONG THE EASTERN AND SOUTHERN AFRICAN STATES

It has on a number of occasions been pointed out that inadequate or lack of clearing and payments arrangements is one of the major obstacles to trade expansion among the countries of Eastern and Southern Africa. Arising from their historical and institutional backgrounds the countries of Eastern and Southern Africa use different currencies and maintain closer trade and monetary relations with their former colonial powers than they do among themselves. Thus, their currencies are pegged to various key convertible currencies, such as the US dollar, the French franc, the pound sterling, or to the SDR; and one country has pegged its currency to a basket of key currencies of its own choice while another country has fixed the exchange rate of its currency on the basis of a set of economic indicators. Hence, in the majority of cases the exchange rates of their currencies are prone to frequent fluctuations (as shown in Annex I) depending on the economic conditions and policies of the countries to whose key currencies their national currencies are pegged.

Furthermore, the countries of Eastern and Southern Africa, maintain their reserves and working balances in financial centres of the industrialized countries. Settlements of their international trade and other transactions are generally made in the major reserve currencies (chiefly the US dollar, the french franc, the pound sterling, the Deutche mark and the Swiss franc) and their payments are processed by foreign banks situated outside Africa. Thus except where bilateral or other payments arrangements exist, most commercial and other transactions are invoiced in one of the key convertible currencies, and payments generally take place through commercial banks located in the principal financial centres. These arrangements apply not only to transactions with overseas countries, but even to those among neighbouring countries within Eastern and Southern Africa.

III. MAJOR PROBLEMS ARISING FROM THE EXISTING PAYMENTS ARRANGEMENTS WITHIN EASTERN AND SOUTHERN AFRICA

The disadvantages of such payments arrangements as described above cannot be over-emphasized and they include the following:

(a) In the absence of appropriate clearing and payments arrangements, payments are generally made in foreign reserve currencies, thereby reducing still further the countries' meagre foreign exchange reserves.

(b) Since payments are processed by one or more foreign banks situated in overseas countries, there are often delays in the settlement of payments.

(c) The charges for services performed by financial intermediaries for effecting payments are generally high and make the transactions costly.

(d) Furthermore, faced with the above situation, and also due to persistent balance-of-payments problems, many countries are obliged to institute exchange control measures which entail excessively long and costly administrative procedures in monetary transfer operations.

(e) Due to balance-of-payments problems, and in the absence of adequate credit facilities among themsevles, the countries of Eastern and Southern Africa are obliged to trade more with the developed countries which, in some cases, are able to provide them with commercial credits (though an unsatisfactory terms), thus jeopardizing the expansion of trade within the area.

It is therefore not surprising that under the above circumstances and coupled with other problems, the level of intra-area trade among the countries of Eastern and Southern Africa has remained very low. Annex II shows that between 1973 and 1975 the level of intra-area trade among the thirteen countries of Eastern and Southern Africa (in respect of which data are readily available) averaged about 5.9 per cent, 5.9 per cent and 4.9 of their total world exports, and 6.9 per cent, 6.5 per cent and 5.8 per cent of their total imports for the years 1973, 1974 and 1975, respectively.

IV. MONETARY CO-OPERATION ARRANGEMENTS AMONG THE DEVELOPING COUNTRIES

Concious of the need for monetary co-operation in order to achieve closer trade and financial relations, a number of developing countries in Latin America, Asia and Africa have established various forms of monetary co-opertion with positive results. Among such co-operation arrangements are the following:

(a) The Central American Monetary Agreement (signed in 1974) covers Costs Rica, El Salvador, Guatemala Honduras and Nicaragua. The main objective of this Agreement is to facilitate the use of national currencies and to provide short and medium-term financing of balance-of-payments deficits to the member countries. It provides for a Clearing House for full multilateral clearing and settlement of payments relating to all current and capital transactions within the Central American Common Market. Only net balances after clearing are settled in US dollars.

(b) The Asian Clearing Union (established in 1975) covers Bengladesh, India, Iran, Nepal, Pakistan and Sri Lanka. The main objective of the Asian Clearing Union is to facilitate the use of national currencies and expand trade among the member countries. Like the Central American Monetary Agreement, it provides for full multilateral clearing and settlement of payments arising from specific current transactions agreed upon by the member countries.

(c) The West African Clearing House (established in 1975) covers Benin, Gambia, Ghana, Guinea, Ivory Coast, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo and Upper Volta. Like the Asian Clearing Union the main objective of the West African Clearing House is to facilitate the use of national currencies and liberalize trade among the member countries. It provides for full multilateral clearing and settlement of payments arising from all current transactions (with certain exceptions, including re-exports originating from third countries) among the member countries.

(d) More recently, this year, the Banque des Etats de l'Afrique Centrale (the Central Bank for Cameroon, Central African Empire, Congo, Gabon and Chad) and the Bank of Zaire have signed an agreement providing for the establishment of a Central African Clearing and Payments Union for the respective countries. The agreement provides for multilateral clearing and settlement on similar lines to those of the West African Clearing House, and a working group has been set up to work out the necessary arrangements for the implementation of the agreement.

Within Eastern and Southern Africa, in the absence of monetary co-operation arrangements of the types sited above, a number of major trading partners have established bilateral payments arrangements (as part of their respective trade agreements) to minimize the frequent use of foreign exchange in the settlement of their trade transactions. Besides the bilateral payments arrangements of the defunct East African Community such arrangements now exist between Angola and Mozambique, Kenya and Zambia, Mozambique and Tanzania, and Tanzania and Zambia. These arrangements in most cases provide for fixed ceilings of swing credits expressed in convertible currencies, for the volume of transactions to be undertaken, and for the amounts exceeding the agreed limits to be settled in agreed convertible currencies. There are also "agency arrangements" between Mozambique and Zambia, and Mozambique and Malawi.

No doubt such payments arrangements as exist between some of the countries of Eastern and Southern Africa are inadequate for alleviating the problems experienced in international settlements or liberalizing and promoting trade within the proposed Preferential Trade Area. Positive measures should therefore be taken to establish appropriate monetary co-operation arrangements among the countries if the objectives of the Preferential Trade Area have to be achieved.

V. OBJECTIVES AND SCOPE OF CLEARING AND PAYMENTS ARRANGEMENTS FOR THE PREFERENTIAL TRADE AREA FOR EASTERN AND SOUTHERN AFRICAN STATES

It will be observed that it is mainly due to concern with the state of their balance-of-payments that many countries in the area resort to trade and payments restrictions among themselves. Hence, and also taking into account the problems experienced in the settlement of transactions among the countries, the clearing and payments arrangements envisaged for the Preferential Trade Area should be aimed at:

(a) liberalizing and promoting trade in goods and services among the member countries;

(b) providing a clearing mechanism for the settlement of payments among the member countries;

(c) facilitating the use of national currencies in the settlement of payments among the member countries and thus effecting economies in the use of their foreign exchange reserves;

(d) facilitating the efficient and quick transfer of payments among the member countries;

(e) reducing the cost of monetary transfers among the member countries; and

(f) generally promoting monetary co-operation and consultations among the member countries.

In determining the scope of the clearing and payments arrangements to be adopted by the countries of Eastern and Southern Africa, it should be borne in mind that the proposed Preferential Trade Area is only a first step towards the creation of more advanced economic integration arrangements. Consideration should also be given to the different levels of economic development among the member countries, and the current trade relations not only among the countries themselves, but also between them and the industrialized countries, which can only be changed gradually. Furthermore, note should be taken of the views expressed by the Association of African Central Banks at their fifth regular meeting held in August 1977, that there is need for a network of payments systems at subregional and regional levels for the promotion of trade in Africa to pave the way for common payments arrangements for the whole of Africa.

It should be noted that the Central American Common Market whose Monetary Co-operation arrangements provide for not only multilateral clearing and payments but also financial assistance schemes, is a more advanced form of economic integration than the proposed Preferential Trade Area for Eastern and Southern African States. Thus, while it would be ideal for the countries of Eastern and Southern Africa to adopt monetary co-operation arrangements similar to those of the Central American Common Market, the scope of co-operation envisaged under the proposed Preferential Trade Area arrangements and the different levels of economic development within the area, would oblige the member countries to opt, at least initially, for a simpler form of monetary and financial co-operation arrangements.

As stated earlier, the bilateral payments arrangements which exist in some of the countries are inadequate for liberalizing or promoting trade within the Preferential Trade Area. While it is true that bilateral trade and payments arrangements may enable each pair of participating countries to exchange products for which they would otherwise not be able to spare foreign exchange, they are characterized by serious limitations including the following:

(a) Since very often provisions of the bilateral agreements are confined to trade in a limited range commodities with pre-determined small credit ceilings for specified periods, trade expansion under such arrangements is rather limited.

(b) The creditor and debtor situations arising from bilateral trade and payments arrangements may lead to frozen balances which the creditor countries cannot put to immediate use.

(c) Due to balance-of-payments problems, and in order to avoid payments in convertible currencies beyond the limits of their swing credits, debtor countries are encouraged to curtail imports from the creditor countries, while the credtor countries are discouraged from increasing their exports to the debtor countries, thus jeopardizing trade expansion among the countries concerned, with tendencies to balance trade at the level of the country which has the smallest trade share.

In contrast with bilateral trade and payments arrangements, multilateral clearing and payments arrangements like those established by the Central American Monetary Agreement, the Asian Clearing Union and the West African Clearing House, provide for each country extending an agreed limit of swing credit in its national currency to all other participating countries, and for a central mechanism through which transactions among the member countries are cleared on a multilateral basis. Under such arrangements, credit balances arising from bilateral accounts are used to offset debit balances among all the countries, and only net debits resulting from multilateral clearing after a specified period are settled by debtor countries in agreed currencies. Since transactions do not have to be balanced bilaterally, and in view of the fact that only net balances are paid in foreign exchange, the member countries are encouraged to trade more among themselves, thus facilitating the expansion of trade.

It would therefore be appropriate for the countries of Eastern and Southern Africa to establish a Clearing House for multilateral clearing of transactions among themselves in order to promote the objectives of the Preferential Trade Area. However, since the proposed Preferntial Trade Area is neither a free trade area nor an economic community, the types of transactions which may be channelled through the Clearing House should initially be limited to those relating to trade in goods and services which are covered by the provisions of the Treaty establishing the Preferential Trade Area and its related protocols.

VI. THE MAIN PROVISIONS OF THE DRAFT PROTOCOL

Taking into account the problems experienced by the member countries in effecting payments among themselves, the Draft Protocol generally provides for the establishment and promotion of monetary co-operation arrangements for the purpose of liberalizing and promoting trade in goods and services within the Preferential Trade Area.

Basically, it provides for the establishment of a Clearing House for facilitating multilateral settlement of net balances arising from eligible transactions among themselves. To effect savings in the use of foreign exchange reserves and to minimize transfer costs in effecting payments, the protocol stipulates the exchange of swing credits among the member States in national currencies, and provides for net debit balances arising from multilateral clearing to be settled in convertible currencies within a specified period of time. Provision is also made for payment of interest on outstanding debit balances after the settlement date, and for defaulters being subjected to certain conditions and sanctions to be determined by the Council.

Since there is a number of currencies in Eastern and Southern Africa, each with a different exchange rate, the Draft Protocol provides for the creation of a common Unit of Account for the Preferential Trade Area (UAPTA), not only for facilitating common valuation of clearing operations and outstanding balances, but also for guaranteeing the maintainance of value of creditors' claims.

While providing for the reduction and progressive elimination of restrictions on the making of payments and transfers among the member States, the Protocol concedes that under preferential trade arrangements, certain exchange control measures may be applied under certain conditions to alleviate accute balance-of-payments problems. Hence, the Protocol stipulates the co-operation of member States in the effective implementation of each other's exchange control measures, provided such measures are not inconsistent with the objectives of the Preferential Trade Area arrangements.

Noting also that the clearing and payments arrangements envisaged cannot alleviate payments problems relating to trade exchanges and other transactions with third countries, the Protocol permits the Clearing House and the member States to establish appropriate monetary co-operation arrangements with third parties; provided such arrangements do not prejudice or conflict with the objectives of the protocol.

For the effective implementation of its provisions, the Protocol provides for the establishment of a Clearing and Payments Committee, composed of representatives from the Monetary Authorities of member States, to advise the member States on the steps to be taken in order to achieve the objective of the monetary co-operation arrangements. The Committee is also assigned, among the things, the function of drawing up the rules and regulations for governing the operations of the clearing operations, supervising the activities of the Clearing House, and keeping under constant review the co-operation arrangements with a view to recommending appropriate measures for progressively achieving a more advanced form of clearing and payments arrangements for the Preferential Trade Area.

VII. IMPLEMENTATION OF THE CLEARING AND PAYMENTS ARRANGEMENTS

It will be noted that while the proposed clearing and payments arrangements hinge on the Clearing House, the draft Protocol only provides for its establishment and does not actually establish it. Hence, for the implementation of the proposed clearing and payments arrangements, measures should be taken immediately after the signing of the protocol to appoint the Clearing and Payments Committee which should recommend on the necessary steps to be taken to launch the Clearing House, and agree on the rules and regulations for governing its operations. In the meantime the ECA Secretariat could be requested to draft the agreement establishing the Clearing House, and draw-up the necessary rules and regulations for consideration by the Committee when established.

No doubt the effectiveness of the proposed clearing and payments arrangements will depend not only on the continuing co-operation among the member States, but also on the volume of trade and rapid and reliable means of communications among themselves.

ANNEX I

ESA NATIONAL CURRENCIES AND FLUCTUATIONS IN THEIR EXCHANGE

RATES PER SDR AS OF 31 MAY 1979

Country	National currency	Currency pegged to	Average exchange rate for the year 1975	1976	1977	1978	Exchange rate at end of quarter (1978) I	II	III	IV
Angola 3/	Kwanza	Other 1/	...	...	...	...	...	...	...	...
Botswana	Pula	US Dollar	...	...	...	...	...	...	...	...
Comoros	Franc (Com)	Fr. Franc	...	...	...	...	...	...	...	...
Djibouti	Franc (Djib)	US Dollar	...	...	...	...	...	...	...	...
Ethiopia	Birr	US Dollar	2.4233	2.4050	2.5145	2.6968	2.5599	2.5658	2.6518	2.6968
Kenya	Shilling (K)	SDR	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600
Lesotho	Rand	S.A. Rand	.9824	.9898	.9467	.8827	.9299	.9278	.8977	.8827
Madagascar	Franc (Mad.)	Fr. Franc	262.5400	288.7006	285.7600	272.2800	283.2300	278.9900	277.4200	272.2800
Malawi	Kwacha (Mal.)	SDR	1.0541	1.0541	1.0541	1.0541	1.0541	1.0541	1.0541	1.0541
Mauritius	Rupee (Mau.)	SDR	7.7138	7.7138	7.7138	7.7138	7.7138	7.7138	7.7138	7.7138
Mozambique 3/	Escudo (Moz.)	Port Escudo	...	...	...	...	...	...	...	...
Seychelles	Rupee (Sey)	Pound Sterling	...	...	...	...	...	...	...	...
Somalia	Shilling (Som.)	US Dollar	7.3693	7.3137	7.6466	8.2011	7.7848	7.802[illegible]	8.0643	8.2011
Swaziland	Emalangeni	S.A. Rand	.9824	.9898	.9467	.8327	.9299	.9278	.8977	.8827
Tanzania	Shilling (Tanz.)	Other 2/	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600
Uganda 4/	Shilling (Ug.)	SDR	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600	9.6600
Zambia 4/	Kwacha (Zam.)	SDR	1.3275	1.0848	1.0848	.9763	.9763	.9763	.9763	.9763

1/ Not pegged to any currency, exchange rate fixed on the basis of certain economic indicators.

2/ Pegged to a basket of currencies of its own choice.

3/ Angola and Mozambique are not members of the IMF.

4/ Exchange rate for Zambia is expressed in SDRs per Kwacha.

... Exchange rates not readily available.

Source: International Financial Statistics - Volume XXXII No. 7 of July, 1979

ANNEX II

INTRA-AREA TRADE WITHIN ESA, 1973-1975

(in '000 US$)

Country		Trade balance with ESA 1/	Exports to ESA 1/		Imports from ESA 1/	
			Value	% of world trade	Value	% of world trade
Angola	1973	-452	8,500	1.1	8,952	1.6
	1974	-1,801	7,600	0.5	9.401	1.3
	1975	-8,500	7,500	0.8	16,000	3.3
Botswana	1973	1,908	2,808	1.7	900	0.5
	1974	3,441	4,903	4.1	1,462	0.7
	1975	830	1,775	1.2	945	0.4
Ethiopia	1973	-2,637	2,783	1.2	5,420	2.5
	1974	-2,941	3,569	1.4	6,510	2.3
	1975	-3,944	1,222	0.6	5,166	1.8
Kenya	1973	109,544	148,420	32.3	38,876	6.2
	1974	145,966	186,375	31.5	40,409	4.0
	1975	146,708	178,084	30.4	31,376	3.3
Madagascar	1973	965	3,970	2.0	3,005	1.5
	1974	4,699	7,950	3.3	3,251	1.2
	1975	2,910	5,030	1.8	2,120	0.7
Malawi	1973	-1,351	9,966	10.0	11,317	7.9
	1974	-4,109	8,725	7.3	12,834	6.8
	1975	-3,681	4,607	3.4	8,288	3.3
Mauritius	1973	-4,891	852	0.6	5,743	3.4
	1974	1,250	7,409	2.4	6,159	2.0
	1975	-2,300	7,140	2.1	9,440	2.9
Mozambique	1973	1,109	11,230	5.0	10,121	2.2
	1974	6,919	12,230	6.1	11,311	2.4
	1975	8,250	16,300	5.5	8,050	2.0
Somalia	1973	-6,188	884	1.6	7,072	6.6
	1974	-13,678	463	0.9	14,141	10.0
	1975	-12,760	1,070	1.4	13,830	6.7
Swaziland	1973	1,876	3,493	4.2	1,617	1.6
	1974	3,234	4,865	3.5	1,631	1.5
	1975	-	-	-	- -	-
Tanzania	1973	-10,537	39,301	11.5	49,888	10.0
	1974	-22,024	41,846	10.9	63,870	7.8
	1975	-27,068	36,370	9.5	63,438	8.0
Uganda	1973	-50,229	15,058	4.8	65,287	40.0
	1974	-74,238	11,732	3.6	85,970	39.0
	1975	-66,390	4,906	1.8	71,296	35.0
Zambia	1973	-17,911	13,637	1.1	31,548	5.9
	1974	-13,727	26,657	1.9	40,384	5.0
	1975	-17,578	6,237	1.0	23,815	2.0
Total ESA	1973	21,206	260,902	5.9 2/	239,696	6.9 2/
	1974	32,991	330,324	5.9 2/	297,333	6.5 2/
	1975	16,477	270,241	4.9 2/	253,764	5.8 2/

1/ All ESA countries except Djibouti.

2/ Average for the ESA countries.

Source: Document ECA/MULPOC/Lusaka/53 of 27 September, 1977