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Free Movement of Capital in the EAC

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Editorial

Dear Reader,

This month's Digital Symposium draws on the proposed East African Monetary Union, whose bedrock is free movement of capital and a single currency. As part of the four freedoms for successful integration, it is important to highlight the value of free movement of capital towards a successful monetary union which is a necessary step towards a more stable and sustainable economic community.

Free movement of capital and the monetary union have already been emphasized in EAC legislation. The Treaty for Establishment of the East African Community has instructed partner states to permit free movement of capital through ensuring unimpeded capital flow and other measures. This therefore presents a unique opportunity for the citizens of the Partner States in the EAC to take advantage of this.

The first article discusses the core structure and aspects of monetary integration, proposing a re-energized agenda for an East African Monetary Union.

The second article explores the concept of free movement of capital in the EAC, concentrating on the aspect of capital markets and suggesting a regional capital markets authority.

This 10-minute read is essential for anyone interested in East Africa's future financial outlook.

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ASSESSING THE PROPOSED EAST AFRICAN MONETARY UNION

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1. Introduction

The EAC is a Regional Economic Community in Eastern Africa composed of six Partner States – Kenya, Uganda, Tanzania, Rwanda, Burundi and South Sudan. The EAC was 're-established' in 1999 (following the collapse of the first EAC of 1967-1977 composed of Kenya, Uganda and Tanzania) by the Treaty for the Establishment of the East African Community (EAC Treaty). That Treaty was originally signed between Kenya, Uganda and Tanzania, with Rwanda and Burundi acceding to it in 2007 and South Sudan in 2016.

Article 5 of the EAC Treaty lays out the East African integration road map in very simple terms: first, a customs union – which has now been established by the EAC Customs Union Protocol 2005; second, a common market – also subsequently established by the EAC Common Market Protocol 2010; third, a monetary union – more recently set up by the EAC Monetary Union Protocol 2013; and, finally, a political federation – currently in the pipeline.

In view of this timeline, and mindful of the fact that the customs union and common market stages have been implemented with relative success (although not to perfection), the next stage of East African integration is a monetary union – a fiscal and economic union underpinned by a single currency, single banking system, common central bank as well as common fiscal and economic policies.

2. Rationale of EAC Monetary Integration

Trade being the backbone of modern society and, in turn, it flourishing in the absence of barriers to movement of people, goods, services and capital, it might be that the greatest rationale of EAC monetary integration is the attainment of borderless and barrier-free trade within the region. One of the major impediments to inter-State trade and inter-State movement of people or capital is the burden of currency exchange with all the transactional costs and monetary value loss that comes with it. People will be keener to move and spend within the region, investors will be more comfortable to spread their capital across the region and traders will be able to sell their goods or services more cheaply and conveniently when there is a single currency controlled by a common central bank in a harmonized regional economic environment.

There are other benefits including improved and increased access to finance as all financial institutions across the region can lend and be repaid in one currency, increased foreign direct investment by investors attracted by the economic prospects and financial certainty that a monetary union presents, improved bargaining power for the EAC when negotiating trade deals and enhanced currency stability.

3. Current Issues in the EAC Monetary Integration Agenda

Although the Protocol establishing the EAC monetary union was signed in 2013, full ratification by the Partner States was only achieved in late 2015 and implementation – according to the Protocol's timeline –should take eight years. Thus, the EAC single currency and all the other aspects of a monetary union including a single banking system, single capital markets area and single financial services area, can in theory be expected in 2024. In reality however, there have been delays both on a structural and technical level.

On the structural level, the requisite institutions – in particular an institution to carry out the preparatory work of the monetary union, an institution responsible for surveillance, compliance and enforcement, an institution responsible for statistics and an institution responsible for financial services – have all not yet been set up despite an original timeline of 2015 for the preparatory institution and 2018 for the others. So far, and way beyond the 2015 delivery date, only the preparatory institute has been legislated for via the East African Monetary Institute Act 2019 although its host Partner State, the concomitant host-country agreements and the institute itself, have not been established.

On the technical level, the Protocol's roadmap to the EAC monetary union requires that by 2018 the Partner States should have completed the coordination and harmonization of their fiscal policies, coordination and harmonization of their monetary and exchange rate polices, harmonization of their payments and settlements systems, integration of their financial systems and adoption of a common regulatory framework for their financial systems. Although some measures have been taken to satisfy these technical steps, there is none solid enough to comprehensively tick any of the boxes even when the 2018 delivery date has passed.

The limited progress thus far foreshadows even more unfulfilled deadlines. In particular, by 2021 each Partner States is expected to have phased out any outstanding central bank lending to public entities and, importantly, each Partner State must have attained the four-layered macroeconomic convergence criteria, that is: (a) headline inflation of no more than 8%; (b) a fiscal deficit ceiling of 3% of GDP; (c) a gross public debt ceiling of 50% of GDP in Net Present Value terms; and (d) foreign reserves of at least the value of 4.5 months' worth of imports. In addition, by 2022, the Partner States should have established a stabilization facility and implemented a common exchange rate mechanism. And by 2024, the Partner States should have established the East African Central Bank and introduced a single currency. That said, given what we have seen so far and in view of the looming delivery date, unless serious remedial action is taken, the hopes of having an EAC monetary union by 2024 seem to be fading away. Can they be re-ignited?

4. Risks of EAC Monetary Integration

Like all positive economic shifts, transitioning into a monetary union can bear some economic risks. One of the more common risks is the potential spillover of fiscal and economic shocks from one Partner State to another given the absence of fiscal and economic barriers between States. There is also the risk of potential manipulation of the macroeconomic convergence criteria by some Partner States with dire financial consequences for the currency itself. There is the risk of potential inability of a Partner State's economy to adjust quickly to the single currency and the risk of potential inability of a Partner State's population to adjust quickly to the single currency given the low literacy and education levels in some Partner States or in some territories of different Partner States.

Above all, the potential for ineffective or poor implementation caused mostly by lack of political (and sometimes administrative) will coupled with the reluctance to be exceedingly technical remains the biggest risk of East Af-

rican monetary integration. For such a significant economic shift requires utmost attention to detail, careful planning and non-politicized implementation of policies, each of which have occasionally ben absent in the previous stages of East African integration (that is, the customs union and common market stages).

However, these are not unmitigable risks as measures can be taken to avert or control them. Indeed, the EAC Monetary Union Protocol installs a robust structural framework composed of a preparatory institution, an institution for surveillance, compliance and enforcement, an institution for statistics and an institution for stabilization to be endowed with a fund to intervene in struggling economies. These institutions working meticulously and with technical support from development partners like the World Bank and International Monetary Fund may well be able to facilitate a flawless East African monetary union.

5. Conclusion

Full economic integration, and not the EAC monetary union alone, can make the EAC compete more favourably with larger African economies, such as Nigeria, South Africa and Egypt.

That said, the Economic Community of West African States (ECOWAS), of which Nigeria is part, is also advancing its goal of establishing a single currency by 2020 among its fifteen Member States (that is, Benin, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo, Burkina Faso and Cape Verde). We must also bear in mind the CFA Franc currently used (although amidst significant drawbacks and criticism for being pegged to the Euro) in eight West African States (that is, Benin, Burkina Faso, Guinea-Bissau, Ivory Coast, Mali, Niger, Senegal and Togo) and in six Central African States (that is, Cameroon, Central African Republic, Chad, Congo-Brazzaville, Equatorial Guinea and Gabon). Add to this the Southern African Common Monetary Area (CMA) made up of four Member States and anchored by South Africa whose currency is legal tender in all four (that is, South Africa, Namibia, Lesotho and Eswatini).

Accordingly, monetary integration in Africa is not a preserve for the EAC as the trend has caught on across the continent. This must put the EAC on notice not only to fire up its drive towards monetary integration but also consolidate its achievements at the customs union and common market levels.

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CAPITAL MARKETS: A CASE FOR A SINGLE EAST AFRICAN CAPITAL MARKETS AUTHORITY

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1. Introduction

With the rising globalization, the push towards an integrated, greatly grounded and supported East African Community economic market is imperative considering the East African bloc has some landlocked countries and there is an increasing connectivity between the Partner States due to the growing international trade conducted by the Partner States with unique products although, ultimately, they depend on each other in one way or another for their business and economic efficiency. Notably, the growth of the capital markets shall not necessarily be segmented for a long time. The recognizable number of cross listings present on the East African market demonstrates that the growth is also geared towards and has been geared towards integration in the last decade.

The stock exchanges in East Africa include the Uganda Stock Exchange, Nairobi Stock Exchange (Kenya), Tanzania Stock Exchange and Khartoum Stock Exchange.

2. Structure of Capital Markets

Globally, the capital markets are a three-layered structure with primary capital markets being markets for new capital investments that are not only private but considerate and inclusive of government institutions. Secondary markets make up the second layer wherein, the market is specifically dealing with exchange of existing securities. In addition, the derivative market, being the third layer of the structure of capital markets is one which facilitates the exchange of securities primarily created from the secondary market whose value is derived from the underlying security.

In light of the above, the economic market in East Africa needs to be greatly unified, and in particular the capital markets sector of the economies ought to be collaborated uniformly and comprehensively considering that there are numerous cross listings and a growing concession of cross border transactions purposed towards crowd funding in one Partner State that directly or indirectly affect assets and business operations in another.
It is arguable that the stock market is an indication of the growth in the business cycle and a predictor of the economic activities in a state or region. With the varied levels of economic market and business strengths in addition to the stock market trade in the different countries, it is argued that there could be challenges in agreeing on a uniform capital market authority, rules and procedure.
To that extent, there ought to be great consideration of the element of complementarity between capital markets and financial institutions. In the foregoing, it is further arguable that the increased active stock markets in the East African bloc shall exponentially result in increased volumes of business for financial intermediaries such as equity markets and financial intermediaries.

3. Need for an East African Capital Markets Authority

It is to that aforesaid baseline and consideration that an East African Capital Markets Authority be adopted sooner rather than later so as to aid and circumnavigate rule, policy and procedure hurdles. Notably, the implementation of such a union shall raise questions of Community taxation rules that are particularly purposed to addressing and clothing the capital markets in the Partner States.

The presence of an aggressive and stern macroeconomic policy environment is imperative for the growth of the performance of the capital markets. Notably, such an aggressive approach, such as a centralized capital markets authority managing the Partner States' capital markets shall include revitalizing the stock markets as well as taking into consideration financial liberalization policies and programmes with a further regard of interest rate and exchange rate liberalization.

Therefore, it is suggested that in the absence of an amalgamated or equivalent currency and exchange rate value between the Partner States, the need of a Community capital markets authority is immeasurable.
On the other hand, considering that the East African bloc consists of mainly developing markets, the current relatively relaxed capital controls have definitely assisted the upsurge of capital inflows especially in the Kenyan Market.

While the forward movement and regard of a capital markets union is pending, there is a need to consider the varying economic systems which have produced diverse economic environments across the Partner States and different levels of political stability, industrial growth and visions as well as taxation and monetary policies. These differences can unarguably distort and affect equal or reasonable growth of the capital markets in the individual Partner States because of the risk of uncertainty of the political climate, annual change of tax policies in different Partner States that could be geared towards the respective Partner State's industrial growth strategy and the uncertainty of the business climate which can all, simultaneously or otherwise, strain the workability of the Community's capital markets authority.

Furthermore, in the absence of a single supervisory banking system, the potential East African Capital Markets Authority could face capital inadequacy and inefficiencies in addition to potential spillovers from the insurance sector and any performance problems that banks in one Partner State could be experiencing that might cripple that State's economy and business market to ably participate in the capital markets.

4. Conclusion

An integrated capital markets authority is an undisputed necessity for the East African Community, not only for ensuring increased growth within the Community as to its capital adequacies and business climate, but also to create the best foot forward for crowd funding by private and public investors in East Africa.

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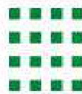

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