



**EAST AFRICAN COMMUNITY
EAST AFRICAN LEGISLATIVE ASSEMBLY**

**REPORT OF THE COMMITTEE ON
COMMUNICATIONS, TRADE AND INVESTMENTS
ON THE CONSULTATIVE WORKSHOP ON EAST AFRICAN
MONETARY UNION (EAMU)**

September 9th - 11th 2013, Kampala - UGANDA

**Clerk's Chambers
EALA Wing
EAC Headquarters
Arusha, Tanzania**

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1.0 BACKGROUND

Under Article 49 of the Treaty for the Establishment of the East African Community, East African Legislative Assembly is mandated to exercise both legislative and oversight functions on all matters within the scope of the EAC through meetings, studies, workshops; tours, on spot assessment activities, to mention but a few.

Article 82 of the Treaty provides that EAC Partner States undertake to cooperate in monetary and fiscal matters in accordance with the approved macro-economic policies, harmonisation programmes and convergence framework of the Community in order to establish monetary stability within the Community aimed at facilitating economic integration efforts and the attainment of sustainable economic development of the Community.

In view of the above, the EAC Partner States have been engaged in the negotiations of the East African Monetary Union (EAMU) Protocol since 2011, and the negotiations are currently in advanced stages targeting the protocol to be signed by the Summit of EAC Heads of States by the end 2013. It is against this background therefore that a consultative workshop was organized to acquaint Members with the state of play of the negotiations, opportunities and challenges involved.

1.1 OBJECTIVES OF THE WORKSHOP

The overall objective of the interactive workshop was to sensitize and build the capacity of the Members of the Committee on Communications, Trade and Investment on various issues pertaining EAMU. The specific objectives included:-

- i) To update Members on the current status of EAMU Negotiations and how they impact the EAC Integration;
- ii) To inform Members on Opportunities and Challenges associated with EAMU;
- iii) Come up with recommendations on the way forward for EAMU Negotiations.

1.2 ATTENDANCE AND METHODOLOGY

The workshop was attended by CTI Committee Members,, Members of Parliament from EAC National Assemblies, representatives from the East African Community Secretariat, Government Ministries agencies, Private Sector, Academia, Civil Society and the Media. The meeting was organized in form of Paper presentations, interactions and plenary discussions between participants and Experts.

2.0 FINDINGS

From the presentations and discussions at the workshop, the committee took stock of the following findings:-

2.1 An Overview of the Proposed East African Community Monetary Union

2.1.1 Definition of a Monetary Union

A Monetary Union is where two or more countries with a single currency or different currencies having a fixed mutual exchange rate monitored and controlled by one central bank. A Monetary Union entails attainment of macro-economic convergence, establishment of a legal and institutional framework, and attainment of integrated financial market and use of a single currency.

2.1.2 History of EAMU

The entry point of the EAC integration process is the Customs Union, with subsequent stages of Common Market, Monetary Union and ultimately a Political Federation as provided for in Article 5 of the Treaty establishing the East African Community. The integration milestones in Article 5(2) of the Treaty constitute the foundation upon which the projects and programmes of the Community are developed.

Following the directive of the 6th Extraordinary Summit to expedite the establishment of an EAC Monetary Union by 2012, the process for the establishment of the EAC Monetary Union started. The 11th Ordinary Summit held on 20th November 2009 directed that upon the coming into operation of the Common Market, the preparations for the establishment of the Monetary Union should be moved into higher gear.

In this regard, a comprehensive study on the level of preparedness on the establishment of the EAC Monetary Union was undertaken by the European Central Bank (ECB) at the instance of Monetary Affairs Committee (MAC).

The study was validated through a consultative process by all stakeholders and was adopted by the Council. Subsequently Council established a High Level Task Force (HLTF) composed of key players in the financial sector to negotiate the EAMU Protocol. A Sectoral Council on Monetary Union was established by the Council to drive the process and technical negotiations for the Monetary Union commenced in January 2011 and ended in June 2013.

The 14th Ordinary Summit held on 30th November 2012 directed that the High Level Task Force concludes the negotiations of EAMU protocol and report progress during the 11th Extra-ordinary Summit with the view of signing the protocol during the 15th Ordinary meeting of the Summit.

The 11th Extra-ordinary Summit held on 28th April, 2013 directed that the roadmap to the conclusion of the EAMU protocol will include: the third meeting of Sectoral Council on EAMU to finalize the technical negotiations; the Extra-ordinary Council of Ministers to clear the EAMU Protocol and refer it to the Sectoral Council on Legal and Judicial Affairs for legal inputs.

Consequently, Sectoral Council on East African Monetary Union and 27th Extraordinary Meeting of Council were held in June 2013 in which technical negotiations were concluded. EAMU negotiations process was informed by the ongoing developments, lessons and experiences in the Euro zone and the West African Monetary Union among others.

2.1.3 The Legal Basis

The following articles provide a legal basis for EAMU; - Article 5(2) of the Treaty provides for the establishment of monetary union; and Article 82 of the Treaty provides for a scope of cooperation in monetary and financial cooperation. Chapter 14 of the Treaty provides for broad monetary and financial cooperation to achieve objectives in Article 5 of the Treaty. While Article 151 of the Treaty

provides that Partner States are enabled to conclude Protocols in areas of cooperation and it's on this basis that, EAMU Protocol was proposed.

2.1.4 Objectives of the EAMU

The broad objective of EAMU is to promote and maintain a zone of sound monetary policy and prudent fiscal policies and financial stability to facilitate the achievement of sustainable growth and development of the community. Specific objectives include:-

1. To strengthen the internal markets by removing exchange rate fluctuations and the costs inherent in exchange transactions, as well as the costs of hedging against currency fluctuation risks;
2. To ensure comparability of costs and prices within the EAC, which would help consumers to stimulate intra-EAC trade and facilitate business;
3. To reinforce EAC's monetary stability by ending any possibility of speculation between the EAC countries' currencies, and ensuring that the EAC currency is largely invulnerable to international speculation and enabling it to become a major payment currency.

2.1.5 Scope of EAMU

1. Introduction of single currency;
2. implementation of single monetary and exchange rate policy and harmonised fiscal policies;
- 2 Integrated financial markets;
- 3 Common principles in regulation and prudential supervision;
- 4 Harmonised statistics frameworks;
- 5 Common framework for ensuring financial stability;
- 6 Policies to ensure sustainable economic convergence;
- 7 Surveillance, compliance and enforcement mechanism;
- 8 Harmonised accounting principles and standards;
- 9 Attainment of prerequisite for admission and entry into EAMU.

2.1.6 Aspects of the EAMU Protocol

1. Article 2 of the draft EAMU Protocol provides for the establishment of a Monetary Union which will be established in a progressive manner following the roadmap;
2. Roadmap provides for implementation of the EAMU Protocol over a period of 10 years when single currency will be realized and this roadmap has timelines which is now a schedule in the Protocol;
3. The macroeconomic framework involves the following:-
 - i) Monetary policy framework which highlights that the primary objective shall be price stability;
 - ii) Monetary and Exchange rate policies will be formulated by the East African Central (EACB) Bank and be implemented by the National Central Banks (NCBs);
 - iii) Exchange rate policy shall have a convergence phase and conversion of exchange rates will be irrevocably fixed by the Council;
4. Determination of conversion rates and Partner States currencies will be converted to EAC currency on a date to be determined by the Council and will be within 6 months from date of starting a single currency.
5. Coordination and harmonisation of fiscal policies shall include coordination of Budget processes, joint project planning and financing, public procurement, public debt management;
6. Coordination of monetary and fiscal policies;
7. Restriction on central bank lending to public entities;
8. No provision for bail outs;
9. Framework for resilience and managing economic shocks;
10. Foreign reserves management whereby part of it will be transferred to the East African Central Bank;
11. Legal instruments to be redenominated and bank notes and coins only will only be legal tender;
12. Financial stability will be done through development and harmonisation of the financial sector which includes banking, capital and Money Markets, Insurance, Pensions and Microfinance;

13. Harmonised payment and settlement system, statistical frameworks, compilation and dissemination.
14. The conduct of foreign exchange operations is an important function of the conduct of monetary policy and will be assigned to the East Africa System of Central Bank to ensure that foreign exchange operations remain consistent with the aims of monetary policy.
15. Specific supervisory tasks related to the financial stability of all banks in the EAC will be surrendered at the supranational level, though national supervisors that will continue to play an important role in day-to-day supervision and in preparing and implementing East African Central Bank decisions.
16. East African Central Bank will monitor compliance by the National Central Banks with the prohibition of monetary financing and privileged access to financial institutions for the public sector. At the country level monetary policy will be transferred to the East African Central Bank after EAMU formation and fiscal policies will have key roles to play in achieving the appropriate policy mix.
17. The fiscal rules will ensure that priority expenditures such as those for social safety nets and infrastructure investment be preserved to avoid exacerbating the economic and social effects of shocks.
18. The EAC countries will ensure that national procedures in the budgetary processes enable them to meet their obligations and the EAC member states will report their planned and actual deficits and debt levels promptly and regularly to the Council.

2.1.7 Prerequisites for transition to EAMU

1. Implementation of customs union and common market;
2. Coordination and harmonization of monetary and exchange rate policies;
3. Introduction of bands and gradually fixing exchange rates;
4. integration of financial systems;
5. Harmonization and integration of payment and settlement systems;
6. Harmonization and coordination of statistics and macroeconomic policy;

7. Phasing out of outstanding central bank lending to public entities;
8. Establish a mechanism for surveillance, compliance and enforcement;
9. Meet the macroeconomic convergence criteria. Below are major aspects in adhering and maintaining the macroeconomic convergence criteria;
 - (i) Performance criteria, this includes:-
 - Headline Inflation ceiling of 8%;
 - Fiscal deficit (excluding grants) ceiling of 3% of Gross Domestic Product (GDP);
 - Public debt to GDP of 50% ceiling in Net Present Value;
 - Reserve cover of 4.5 months of imports;
 - (ii) Indicative criteria:-
 - Core inflation ceiling of 5%;
 - Fiscal deficit (excluding grants) ceiling of 6% of GDP;
 - Tax to GDP ratio of 25%;
 - Partner States will develop a medium, term convergence program, where they will be required to fulfill the prerequisites and consistently satisfy the macroeconomic convergence criteria for at least 3 consecutive years with economic fundamentals indicating sustainability.
10. Summit shall pronounce the commencement of Monetary Union if there is a minimum of three Partner States ready while others will be continuously working towards meeting the conditions as provided for under the principle of Variable Geometry in Article 7(e) of the Treaty establishing the East African Community.

2.1.8 Proposed institutional framework under EAMU

For purposes of effective implementation of EAMU, the following institutions will be established:-

1. East African Monetary Institute (EAMI) – this will be a transition institution and will be a precursor to other institutions;
2. The East African Central Bank (EACB);
3. Institution responsible for financial services;

4. Institution responsible for Statistics;
5. Institution responsible for surveillance, compliance and enforcement.

2.1.9 Decision making and governance in the Monetary Union

1. Decision making will be by all the Partner States however most of the decisions shall be delegated to the East African Central Bank;
2. East African Central Bank shall be independent with no influence from Partner States;
3. There shall be a Governing Council of the East African Central Bank comprising of representative of all the Partner States.
4. In EAMU, the members of the Governing Council representing the Partner States that will have not surrendered their monetary and exchange rate policy shall not have decision making powers.

2.2 EAMU Transition

After ratification of the EAMU protocol, a transition phase of 10 years will follow before the realization of the single currency and the implementation roadmap with timelines is now a schedule in the Protocol. Several activities that support the transition to EAMU are ongoing through different Sectoral Committees as mentioned below. These Committees have tremendously advanced on a number of aspects and they include the following:-

1. ***The Committee on fiscal Affairs;*** This committee among other things covers Public Financial Management and Reporting, Fiscal convergence, Fiscal deficit and debt management, Tax harmonisation, Public Private Partnerships and other financing mechanisms.
2. ***Capital Markets, Insurance and Pensions Committee;*** This Committee follows up on the creation of a single financial market.
3. ***The Committee on Statistics;*** This is responsible for production of robust statistics and the harmonisation programs with focus on harmonisation of Government Finance Statistics, Consumer Price Index, Balance of payments, Monetary and Financial Statistics and national accounts.

4. ***The Monetary Affairs Committee***; This covers Monetary and exchange rate policies, Financial Markets, Banking and Supervision, Payment and Settlement Systems, Currency, Accounting and Financial Standards among others.

2.3 Benefits of a Monetary Union

1. A monetary union will lead to reduction in transaction costs, consolidation of the Single Market, price convergence and stability. This is important because it will increase efficiency in production as a result of increased specialization and economies of scale, thus increasing the EAC's level of total GDP.
2. Monetary Union will lead to a stable EAC currency which will increase certainty to business and this ultimately will attract foreign multinationals to invest in the EAC.
3. A monetary union will also lead to more stable and predictable monetary policy which will be managed independently by the future East African Central Bank, and ultimately lower and less volatile inflation, exchange and interest rates.
4. A monetary union will generally have clear long-term benefits in form of lower transaction costs, increased trade and greater macroeconomic and monetary stability.
5. A monetary union will give the EAC increased bargaining power in the emerging free trade negotiations.

2.4 Challenges of a Monetary Union

Some of the challenges of a Monetary Union include;-

1. The strongest economic argument against monetary union is the obvious diversity of the economies involved. Problems will emerge when economies with different fundamental economic structures, levels of efficiency, productivity and inflation are integrated under a single currency.
2. The economic convergence will lead to loss of sovereign monetary policies. Economic policy would become very rigid within EAMU as governments lose the option of devaluation, and monetary policy would be set by a

supranational East African System of Central Banks (EASCBs).

3. In the event of a detrimental asymmetric shock that puts the economy in recession, the government would be very limited in its policy response options in EAMU.
4. EAMU will reduce flexibility as direct control over exchange rate and monetary policy lies in the hands of East African Central Bank and not the Central Banks of Partner States.
5. Financial constraints in establishing and funding key institutions may be a challenge due to donor dependence.
6. Partner States may struggle complying with the macroeconomic convergence criteria due to different economic structures with unequal capabilities.

3.0 EMERGING ISSUES

1. The Sectoral Council on Monetary Union approved and referred the Draft Protocol on EAMU to the Sectoral Council on Legal and Judicial Affairs for its legal input; However there are concerns that some key elements have since been removed by the Sectoral Council on Legal and Judicial Affairs;
2. The Committee was informed that the name of the single currency shall be determined by the summit at a later stage;
3. All countries have agreed on the entire protocol including the proposed roadmap of 10 years for transition. This time frame was proposed due to all preparatory works involved including full implementation of the Customs Union, common market, macroeconomic convergence criteria and other prerequisites;
4. It was proposed that the funding of East African Central Bank is based on the equal contribution model by all Partner States as they will have equal rights and obligations;
5. There are concerns about Exit from EAC Monetary Union by a Partner State. The meeting was informed that once a Partner State entered the EAC Monetary Union, it cannot withdraw from the EAC Monetary Union.

The only possibility is to fully withdraw from the EAC as per Article 145 of the EAC Treaty.

6. EAMU will be robust since it is drawing lessons from the challenges of the existing currency unions such as euro zone and others on the African continent;
7. Currently, each EAC country conducts its monetary policy independently and Monetary Policy frameworks and policy goals differ among the EAC countries. However, Central Banks have made tremendous progress in harmonizing the conduct of monetary policy and other areas/operations that fall under the realm of central banking and efforts to harmonize and eventually converge remain on track.
8. Despite the harmonization, the EAC partner states will continue to exercise considerable sovereignty in several economic areas. In particular, spending and taxing powers will continue to be vested in the hands of national authorities.
9. Fiscal deficits financing remain the biggest challenge to the realisation of EAMU. This is because most of the EAC partner states have rapid expanding fiscal deficits and debts and the methods of deficits financing, i.e. pressure for monetary accommodation. Therefore, the potential threat of budget deficits and their financing to monetary stability requires prohibitive laws.

4.0 RECOMMENDATIONS

1. Partner States should fully implement the EAC Customs and Common Market Protocols as they are critical for the success of the East African Monetary Union;
2. The EAC Council of Ministers should harmonise the two versions of EAMU Protocol approved by the Sectoral Council on Monetary Union and the one of the Sectoral Council on Legal and Judicial Affairs of to void discrepancies between them.

3. EALA should facilitate the passing of bills and other implementing regulations for EAMU to avoid stagnation as it was the case in common market protocol.
4. Partner States should develop medium term convergence programs early enough to work towards complying with convergence criteria and maintain fiscal discipline;
5. EALA should take part in the advocacy on EAMU among the EAC populace;
6. There should be active involvement by all organs, the private sector and civil society to play their respective roles and ensure that East Africa Monetary Union benefits reach all stakeholders;
7. Surveillance and enforcement mechanisms should be put in place to ensure that all member states abide by the rules in the EAMU;
8. The harmonization of capital markets laws & integration of capital markets infrastructure should be fast tracked;
9. A robust Regional Capital Markets Institutional and Supervisory Framework should be developed;
10. A Financial Sector and Economic Stabilization Mechanism should be established.

5.0 CONCLUSION

EAMU is a great opportunity to accelerate the process of integration in East African Community because the benefits are credible despite the challenges. However, Partner States should exercise financial discipline for a successful Monetary Union. EAC Council of Ministers and EALA should also initiate and expedite the necessary and required legislations under EAMU including expediting all aspects under East African Community Customs Union and Common Market to ensure effective implementation of EAMU.

6.0 ACKNOWLEDGEMENTS

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2. Special thanks go to the office of the Clerk of EALA for the tireless efforts

portrayed in all logistical arrangements to make this workshop a reality.

3. The committee is also indebted to the Governor of Bank of Uganda and the Minister of Finance, Planning and Economic Development Uganda for officiating the opening and closing ceremonies of this workshop respectively despite their busy schedules.
4. We thank the Resource Persons for the paper presentations and all participants for having spared their precious time to participate in this workshop.

MEMBERS OF THE COMMITTEE ON COMMUNICATIONS, TRADE AND INVESTMENT

(Report on Consultative Workshop on the East African Monetary Union)

September 9th – 11th 2013 - Kampala, Uganda

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