



# ECAMA

## FRAMEWORK FOR INTERNAL AND EXTERNAL STABILIZATION

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13<sup>TH</sup> NOVEMBER, 2024

# Outline

**1. The Problem**

**2. In search of a better framework**

**. Unresolved Debate**

**. Currency Boards Arrangements (CBA)**

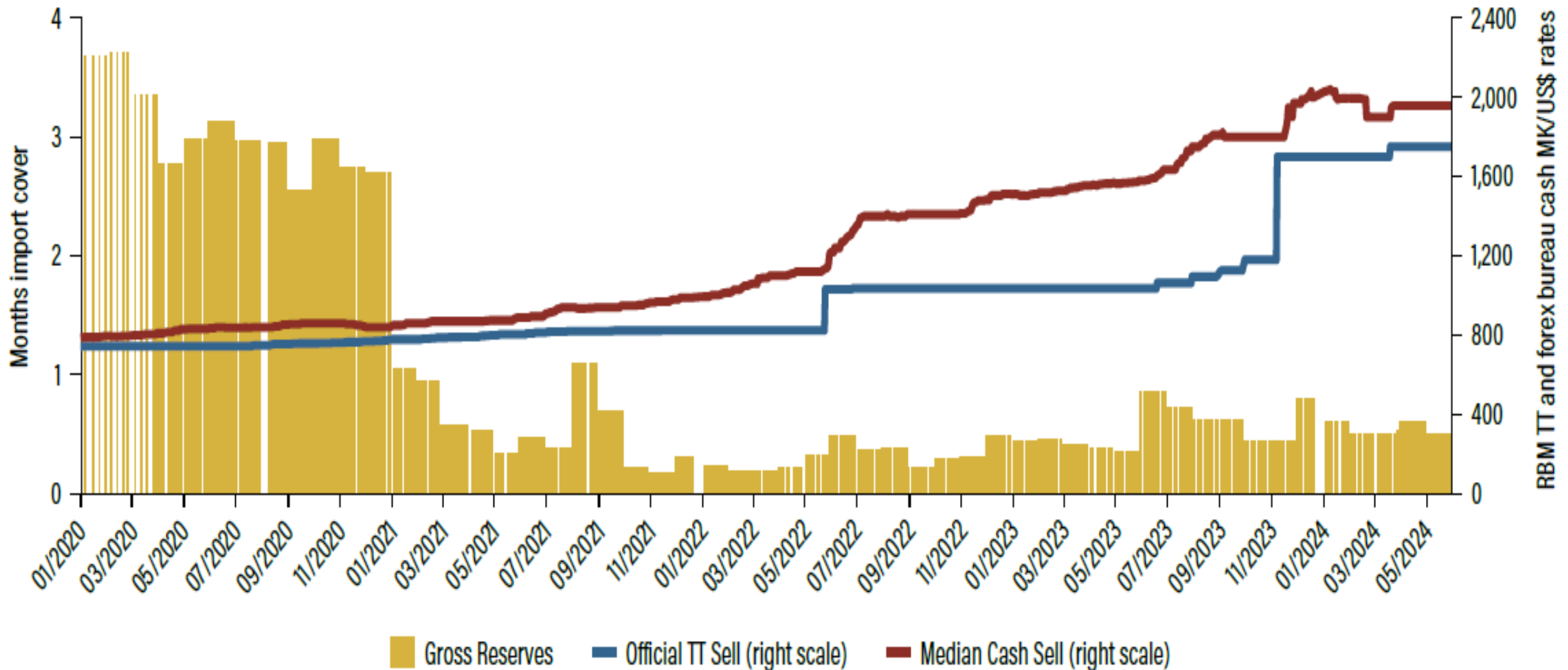
**. Case Studies of CBA**

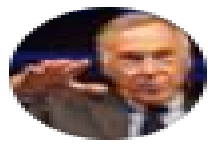
**3. Implications for Malawi**

# THE PROBLEM

# Devaluations have not stabilized the exchange rate

Telegraphic transfer and forex bureau cash MK/US\$ rates and spreads through May 31 and gross official reserves in months of import coverage



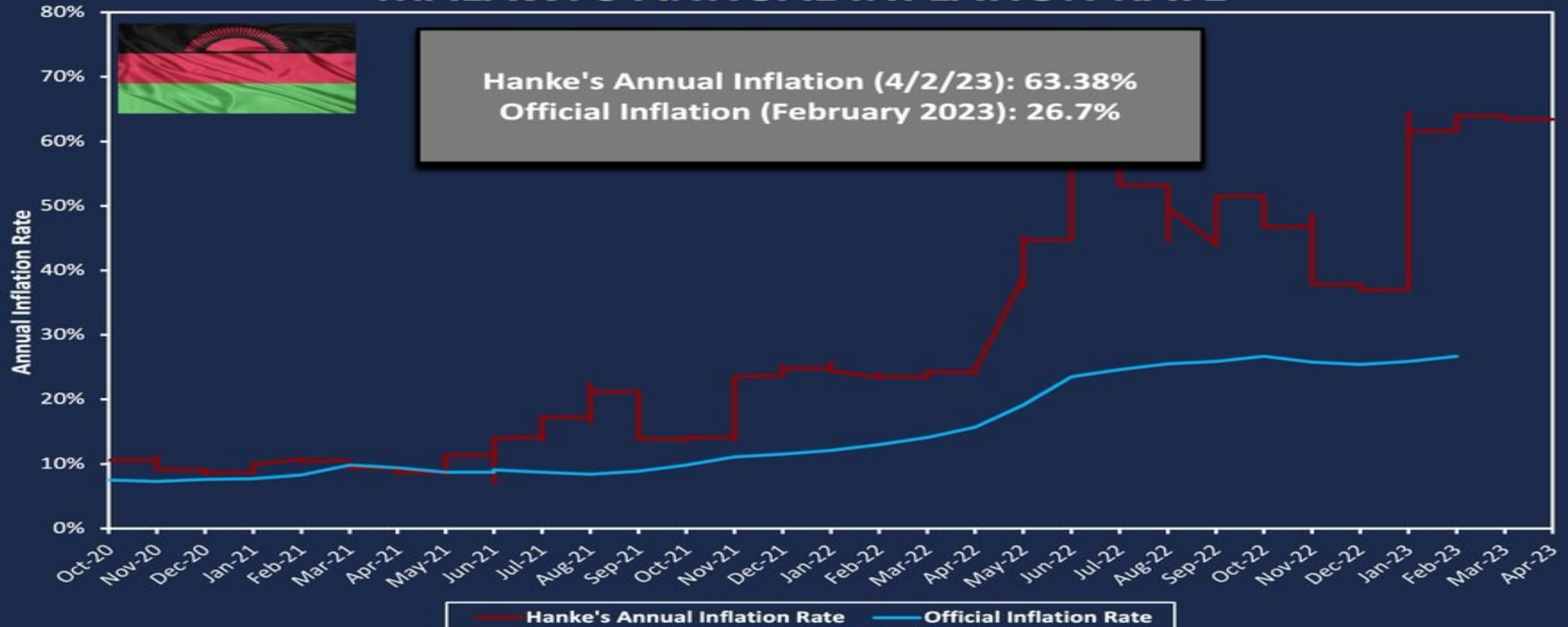


**Steve Hanke**

April 4, 2023 · 🌐

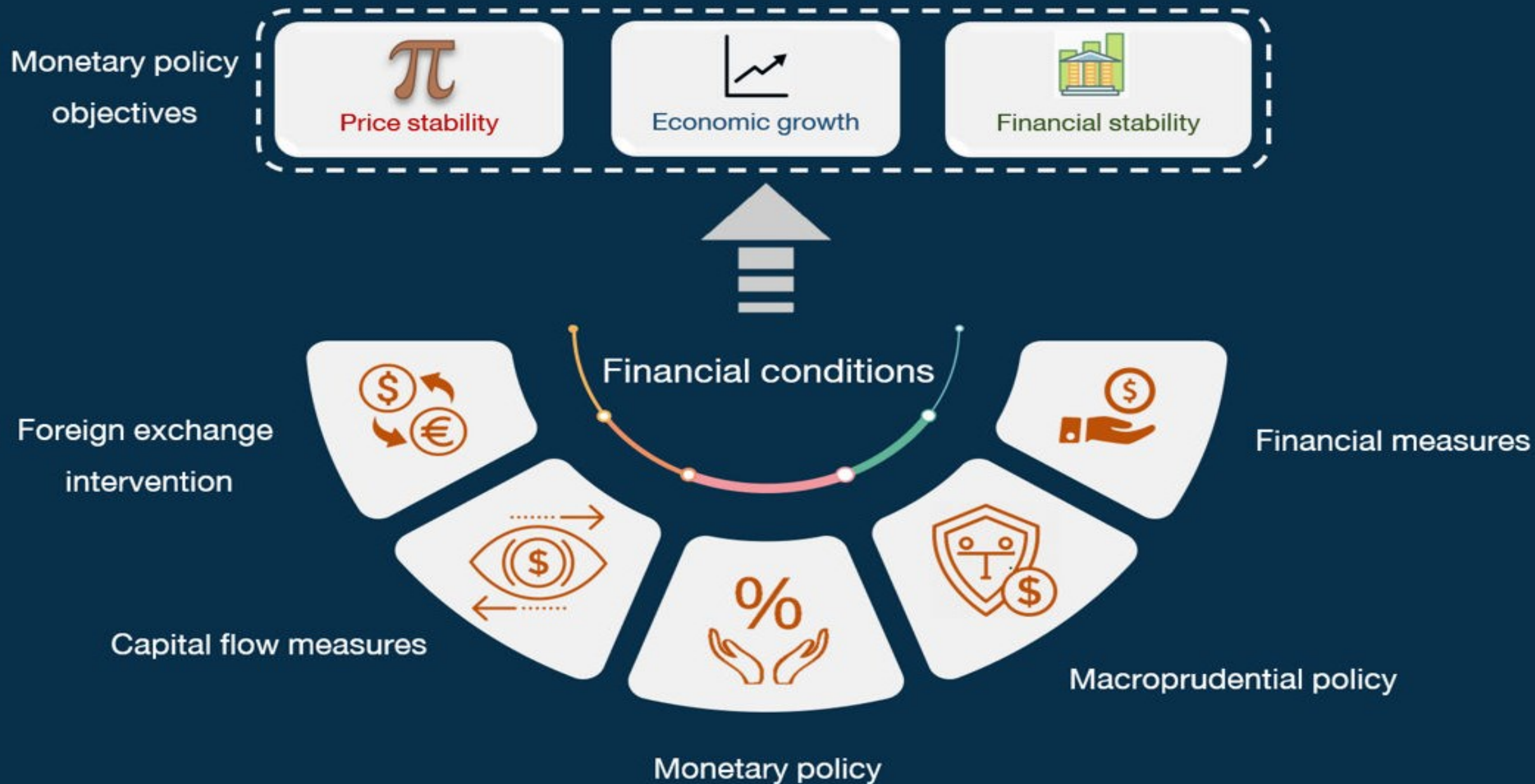
Inflation in [#Malawi](#) continues to race out of control. Today, I measured Malawi's [#inflation](#) at a punishing 63.38%/yr. That's nearly 2.5x the "official" rate of 26.7%/yr. Malawi's INCOMPETENT National Statistics Office continues to publish rubbish.

## MALAWI'S ANNUAL INFLATION RATE



# FRAMEWORK FOR ECONOMIC MANAGEMENT

# A Typical Central Bank's Integrated Policy Framework



# The Unresolved Debate in Economic Governance

## Rules versus Discretion

- Should economic governance be based on a well-defined code of conduct, or should it depend on how those in authority judge and interpret events?
- Is monetary policy best conducted under a **regime based on rules** or, alternately, in a framework where **discretion** prevails.

## Or is there a middle ground?

- What, if anything, in the monetary policy sphere should be decided by rule and what, if anything, should be left to the discretion of the policymaker?

# Rationale for Rules-based Regime

**Objective:** *Policy Predictability* in an *uncertain world*.

**Thesis:** The *predictability of policy* should help offset *unpredictability of the environment*.

**Logic:** In a setting in which economies are subject to unpredictable shocks, the best approach is to prevent monetary policy from adding to the uncertainties.

# Rationale for Discretion

**Objective:** *Policy adaptability* in *an uncertain world*

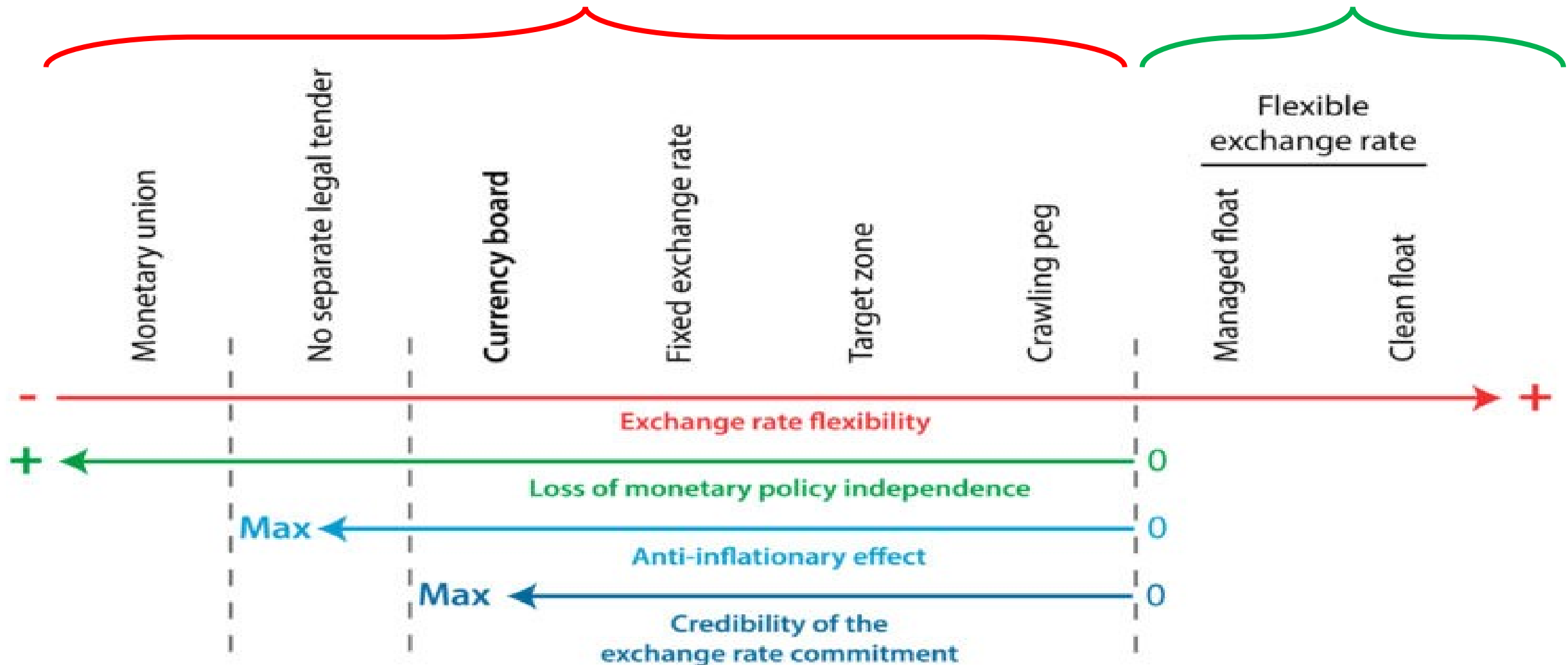
**Thesis:** The economy is subject to uncertain shocks. Since the effects of monetary policy depend on the nature of the disturbance identified, policy needs to be **responsive** and **adaptable**.

**Logic:** Policymakers should be free to ascertain the nature of the shocks, identify the factors that cause them, and implement appropriate response.

# Implication for Monetary Policy Frameworks

Rules based frameworks

Discretionary frameworks



# CURRENCY BOARD ARRANGEMENT

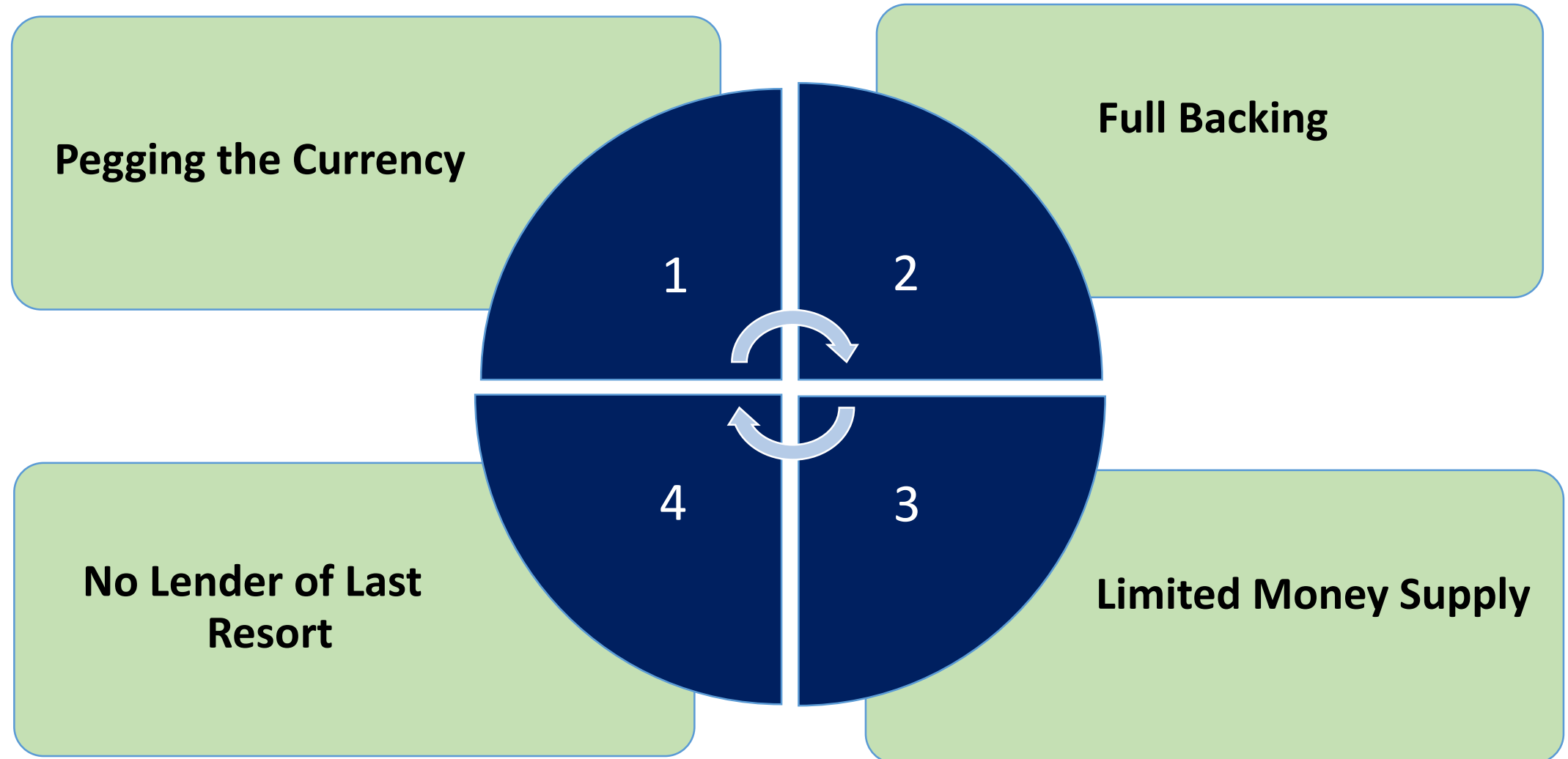
**A Monetary Arrangement for Colonies**

# Understanding Currency Board Arrangements

**Currency Board - is a monetary authority that issues a local currency that is fully backed by a foreign reserve currency, and which is freely convertible with the foreign reserve currency at a fixed exchange rate.**

- The first currency boards appeared during the nineteenth century in British and French colonies.
- The monetary unit of the Imperial power was a **master currency** for the colonies.
- Currencies of colonial territories issued by CBs (**servile currencies**) were chained to the master currency.
- The servile currencies were on an **exchange standard** (i.e. they were tied to the master currency which itself was fixed value in gold)

# How Currency Boards Operate



# Benefits of Currency Board Arrangement

**1**

**Reduced  
Inflation**

**Increased Foreign  
Investment**

**2**

**Improved  
Fiscal  
Discipline**

**3**

**Increased  
Trade**

**4**

**Reduced Currency  
Speculation**

**5**

# The Demise of Colonial CBAs

## ...Nationalistic Argument

In 1957, Ghana's new finance minister declared that

***“a currency board is the financial hallmark of colonialism”.***

Basu (1967) observed that

*To newly independent former colonies “the central bank was an appropriate symbol of financial independence that was the counterpart of political freedom. **The possession of a central bank of its own was as much a question of prestige and status as operating a national airline, constructing a parliamentary building and establishing an embassy”***

# The Demise of Colonial CBAs

## ... *Economic Arguments*

A. Post WWI, the League of Nations' International Financial Conference (1920) recommended that

***“in countries where there is no central bank of issue, one should be established”.***

B. Post WWII as colonies demanded independence, CBAs were targeted because

1. They were seen as anti-developmental – they directed savings abroad
2. They were undemocratic- prevented “fine-tuning” of macroeconomic policies.

# British Sterling Zone

<b>Sterling Zone</b>	<b>Countries</b>	<b>Monetary Unit /Issuer</b>
West African Currency Board Zone	Ghana, Nigeria, Sierra Leone and the Gambia.	West African Pound, WACB
Central African Currency Board zone:1954	Zambia, Malawi and Zimbabwe.	Central African Pound, CACB
East African Currency Board Zone: 1919	Tanzania, Uganda and Kenya (1942-43 Ethiopia, Eritrea, Somalia)	East African Shilling, EACB
Southern African Currency Zone (The Rand Zone)	South Africa, Namibia, Botswana, Lesotho and Swaziland.	South African Rand, South African Reserve Bank

**Except for Rand Zone, all British Sterling Zones and CBAs were died with independence.**

# French Franc Zone

Franc Zone	Countries	Currency, Issuer
Union Monétaire Ouest Africaine (UMOA)	Benin, Guinea, Ivory Coast, Mali, Mauritania, Niger, Senegal, Togo and Burkina Faso	CFA-franc issued by Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO).
Currency Union of Equatorial Africa	Chad, the Central African Empire, Congo (Brazzaville), Gabon and Cameroun.	CFA-franc issued by Banque Centrale des Etats de l'Afrique Equatoriale et du Cameroun (BCEAEC)
Maghreb Region	Morocco	Morocan Franc issued by d'Etat du Maroc
	Algeria, Tunisia	Algerian Franc & Tunisian franc Banque de l'Algérie et de la Tunisie

# MODERN DAY CURRENCY BOARD ARRANGEMENTS

# Modern day currency boards, early 2000s

	<b>Bosnia</b>	<b>Bulgaria</b>	<b>Estonia</b>	<b>Hong Kong</b>	<b>Lithuania</b>	<b>Argentina (until 2002)</b>
Currency	Convertible marka	lev	kroon	HK dollar	litas	peso
Anchor currency	euro <sup>1</sup>	euro <sup>1</sup>	euro <sup>1</sup>	US dollar	euro <sup>2</sup>	US dollar
Link rate	1.95583 <sup>1</sup>	1.95583 <sup>1</sup>	15.6466 <sup>1</sup>	7.8	3.4528 <sup>2</sup>	1
Inception	1997	1997	1992	1983	1994	1991
Liabilities backed	Monetary base	Monetary base	Currency	Monetary base	Currency	Monetary base
Minimum backing ratio	100%	100%	100%	100%	100%	67%?
Lender of last resort	No	Yes	Yes	Yes	Yes	Yes

# Successful CBA – Hong Kong

Hong Kong has both a Central Bank & CBA - the Hong Kong Monetary Authority (HKMA) est 1983

- HKMA maintains a fixed exchange rate between the HK\$ and the US\$ ever since.
- **Except for the financial crisis years the HKMA has been successful in controlling inflation**
- **The HKMA has reserves around US\$440 billion, equivalent to seven times the amount of the Hong Kong dollar in circulation.**



# Successful CBA - Estonia

Estonian Central Bank (ECB) was established in 1992

The Estonian kroon was pegged to the Euro as Estonia wanted to join the Eurozone

- It has been successful in maintaining a stable exchange rate and reducing inflation
- Has accumulated **US\$2 billion in forex reserves** - twice the amount of the Estonian kroon in circulation.



# Unsuccessful CBAs – The Argentine Convertibility Plan

Implemented in 1991 to **stabilize the Argentine peso** and **reduce inflation**.

- It established a CBA that pegged the peso to the US dollar at a 1-1 exchange rate.
- The CBA worked well for ten years, but in 2001 the CBA was abandoned due to its inability to deal with a severe economic crisis
  - The currency peg that was too strong
  - Argentina had high levels of debt
  - There was a lack of investor confidence.



# CBA's generally out perform other frameworks

	Sample	Inflation		Money Growth		GDP Growth	
		Mean	Median	Mean	Median	Output	Per capita
Full Sample	1915	29	8.4	32.7	14.3	3.2	1.3
CBA	112	5.6	3.9	12.1	11.1	4	3.1
<i>Other Pegged</i>	1089	22.3	8.4	25.1	13.7	3.3	0.9
<i>Float</i>	714	43.1	9.2	47.4	16	3.1	1.7
Full Sample	814	22.9	6.0	28.3	11.4	3.1	2
CBA	44	4.7	4.0	14.3	12.9	5.7	4.6
<i>Other Pegged</i>	317	8.3	6.1	14.1	11.6	3.3	1.8
<i>Float</i>	453	35	6.2	39.6	11.1	2.8	1.9
Full Sample	1101	33.6	9.9	35.9	17.1	3.3	0.8
CBA	68	6.2	3.9	10.7	8.6	2.9	2.2
<i>Other Pegged</i>	772	28	9.4	29.7	15.6	3.3	0.5
<i>Float</i>	261	57.1	15.2	61	25.4	3.6	1.4

**So what are we saying?**

SHOULD MALAWI CONSIDER ESTABLISHING CBA?

# *Malawi has experimented with all exchange rate regimes*

- 1954-64: Malawi operated within Sterling zone as a member of the British Central African Currency Board using Central African £.
- 1964 -71: Malawi operated within the **Sterling zone** with the Malawi £ pegged at par to the British £.
- 1971 - 73: The MW Kwacha was introduced and pegged at MKW2 = British £ 1.
- 1973 – 75: MWK was pegged to a weighted average of the £ and the US \$.
- 1975 - 80: The MWK pegged to the IMF's SDR.
- Post 1980, Malawi has been forced into regimes as part of stabilization and structural adjustment

# Well, may be ...

1. CBA will guarantee a **stable exchange rate**, which can help to promote trade and investment.
2. CBA will help to control inflation by limiting RBM ability to create money
3. CBA will provide **policy transparency** and **credibility**, as the exchange rate will be fixed and fully backed by foreign currency reserves.
4. CBA will inoculate monetary policy from political economy considerations



# May be not

## Economic Realities

- 1. Dependence on Foreign Reserves:** Maintenance of CBA is premised on existence of forex to back the currency and defend the fixed exchange rate. **But Malawi does NOT have the forex in the first place**
- 2. Limited Monetary Policy Flexibility:** The RBM will be required to maintain a fixed exchange rate with another currency or a commodity.
- 3. Vulnerability to External Shocks:** Since the exchange rates will be fixed, Malawi may not be able to adjust to changes in global economic conditions that can impact its economy.
- 4. Potential for Speculative Attacks:** The fixed exchange rate will be more vulnerable to speculative attacks if people suspect that Malawi is low on forex reserves

# May be not ...

## 2. Political economy considerations

1. What about nationalism and the symbolism of having our own Central Bank?
2. What about the appearance of a surrender of political autonomy?



# Or, is there a middle way?

- Short of abolishing the RBM, can Malawi hive off certain RBM functions into a currency board ?
- If Yes which functions?
- How does it get credibility?

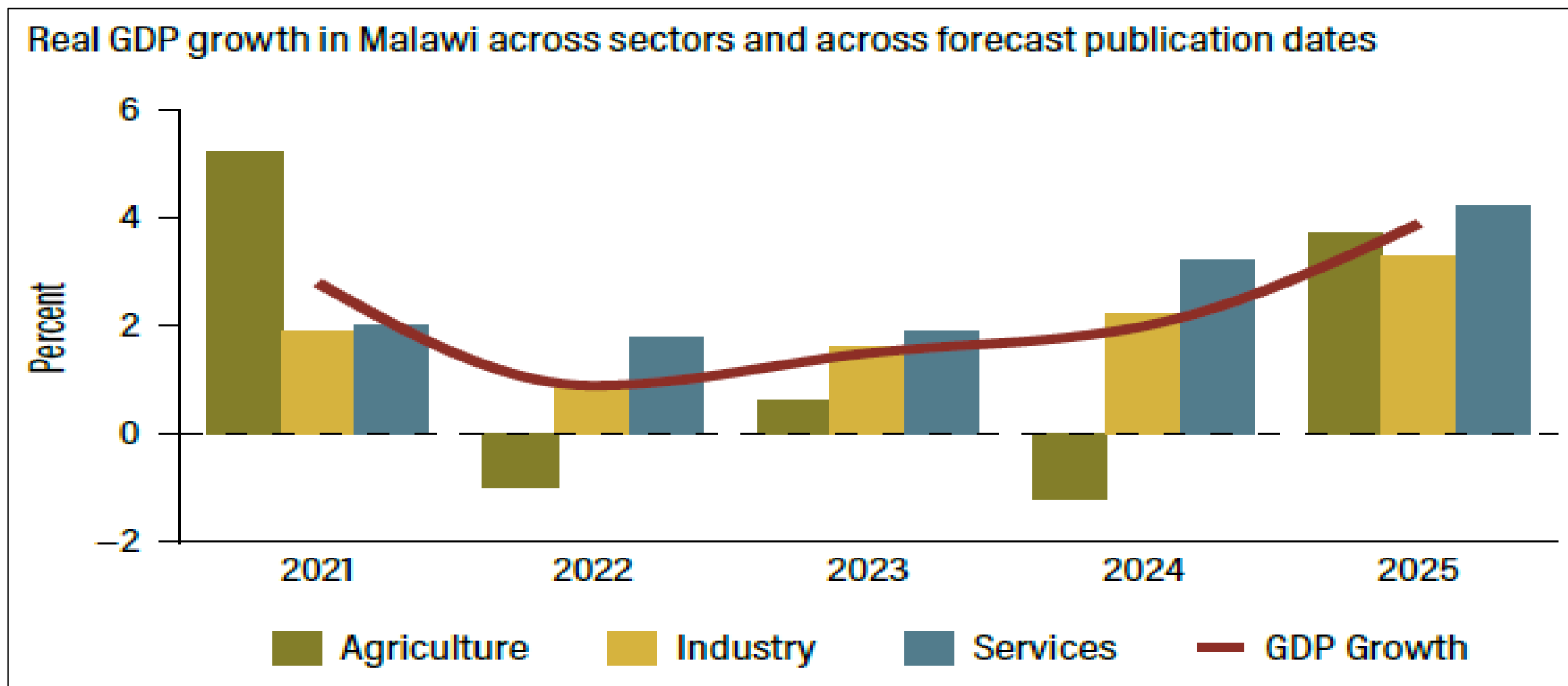


THE END

# ANNEXES

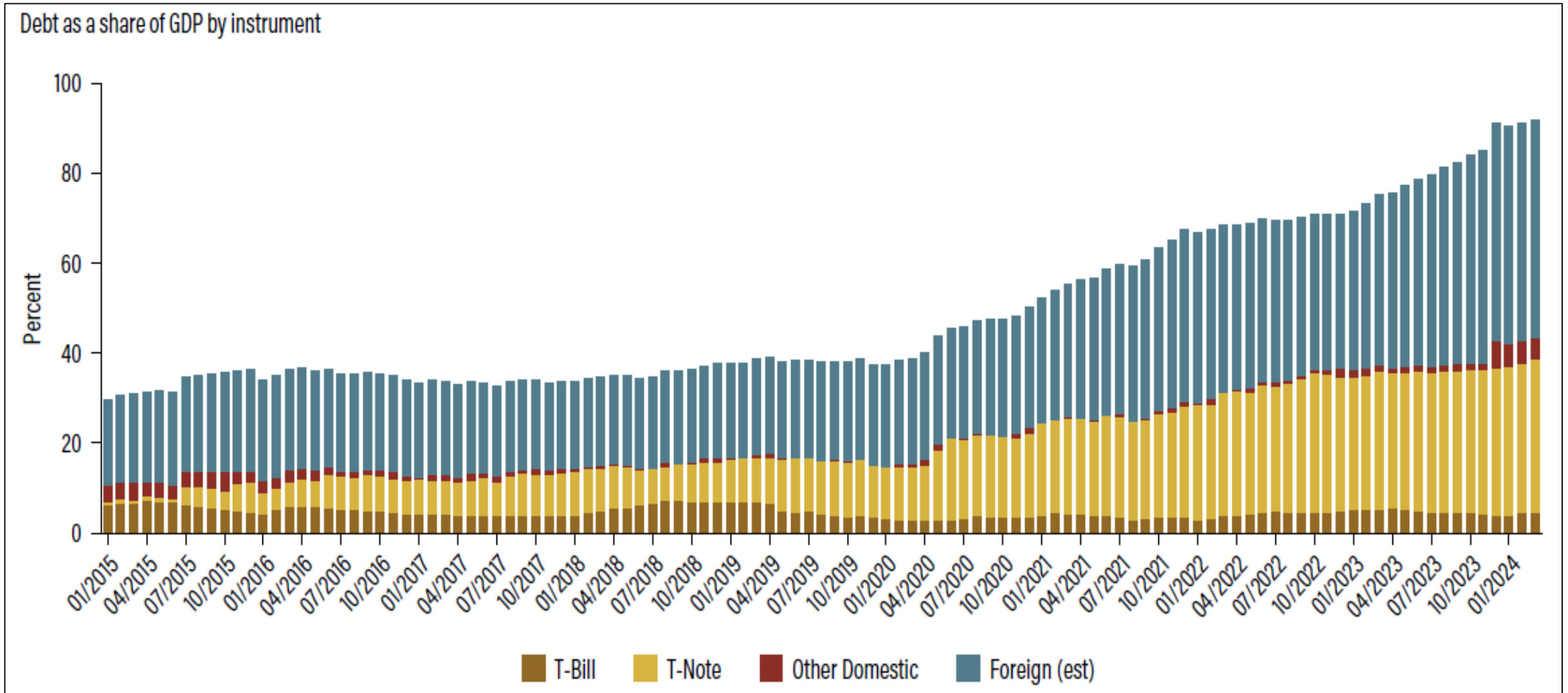
# 1. The Real Sector has a Growth crisis...

The real sector has not recovered from COVID and other external shocks <sup>34</sup>



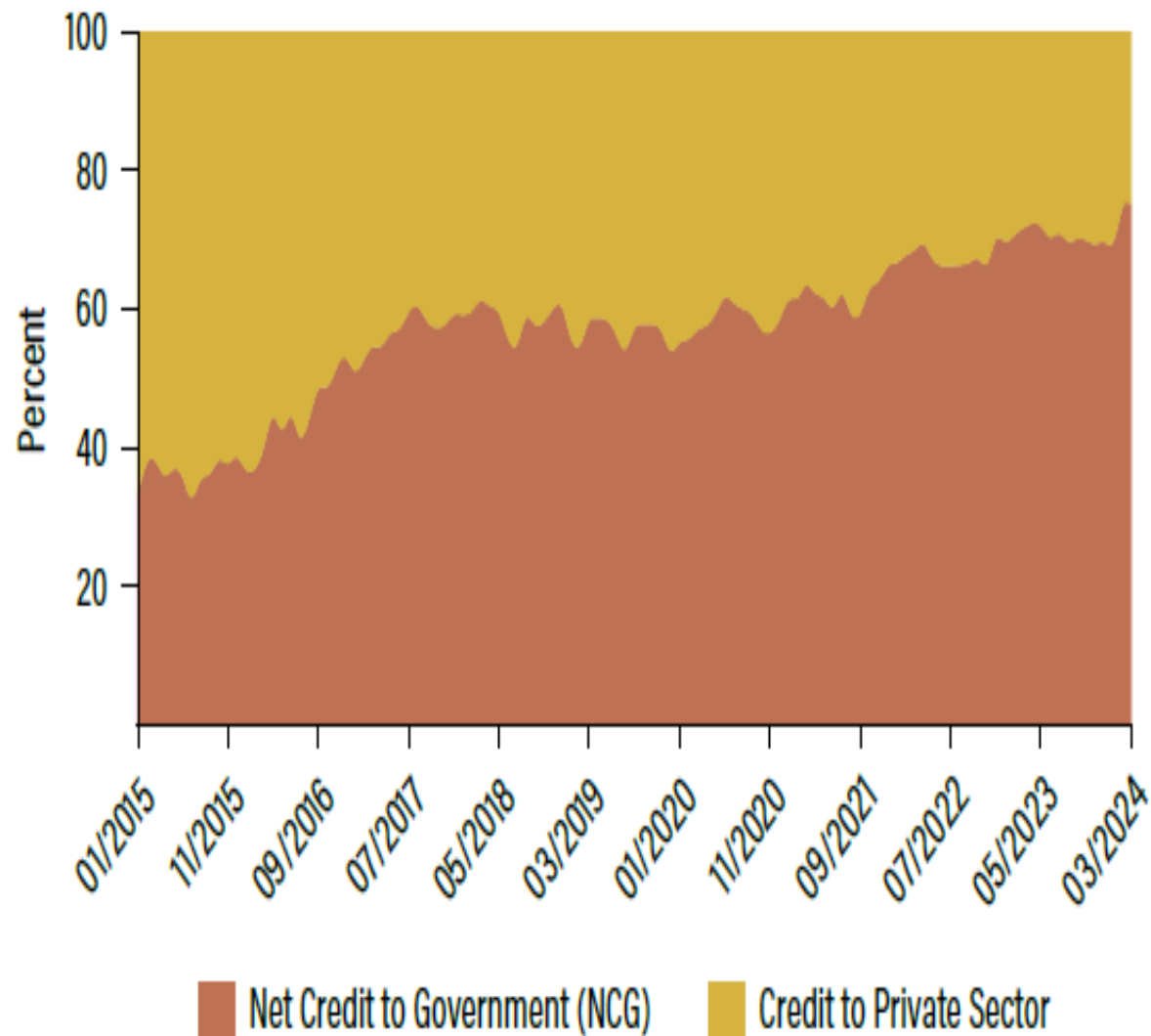
Source: World Bank (2024)

## 2. There is a Fiscal Crisis exemplified by Debt Stress

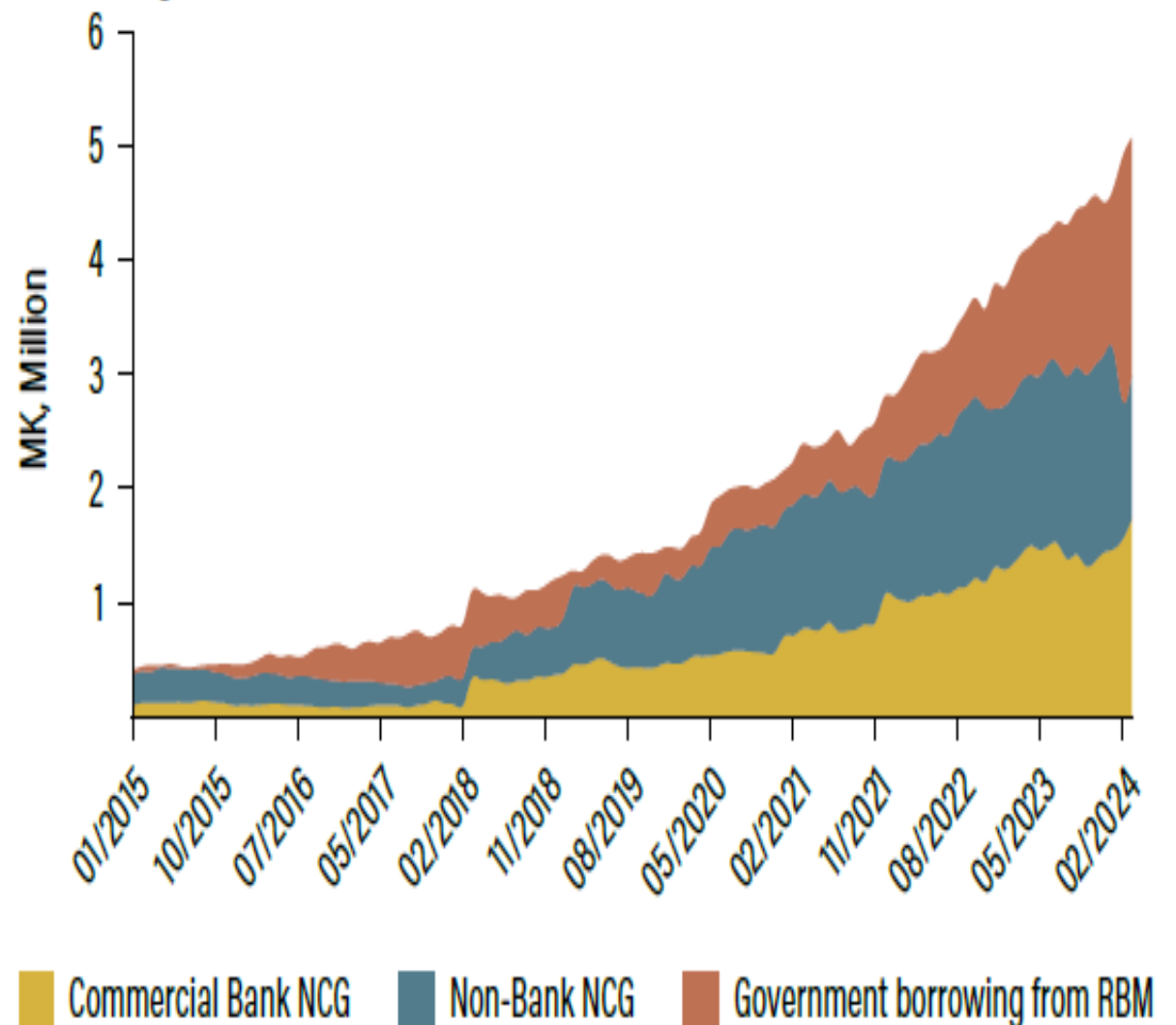


# 3. The Fiscal Crisis has led to a Monetary Crisis

### Shares of the public and private sectors in total credit

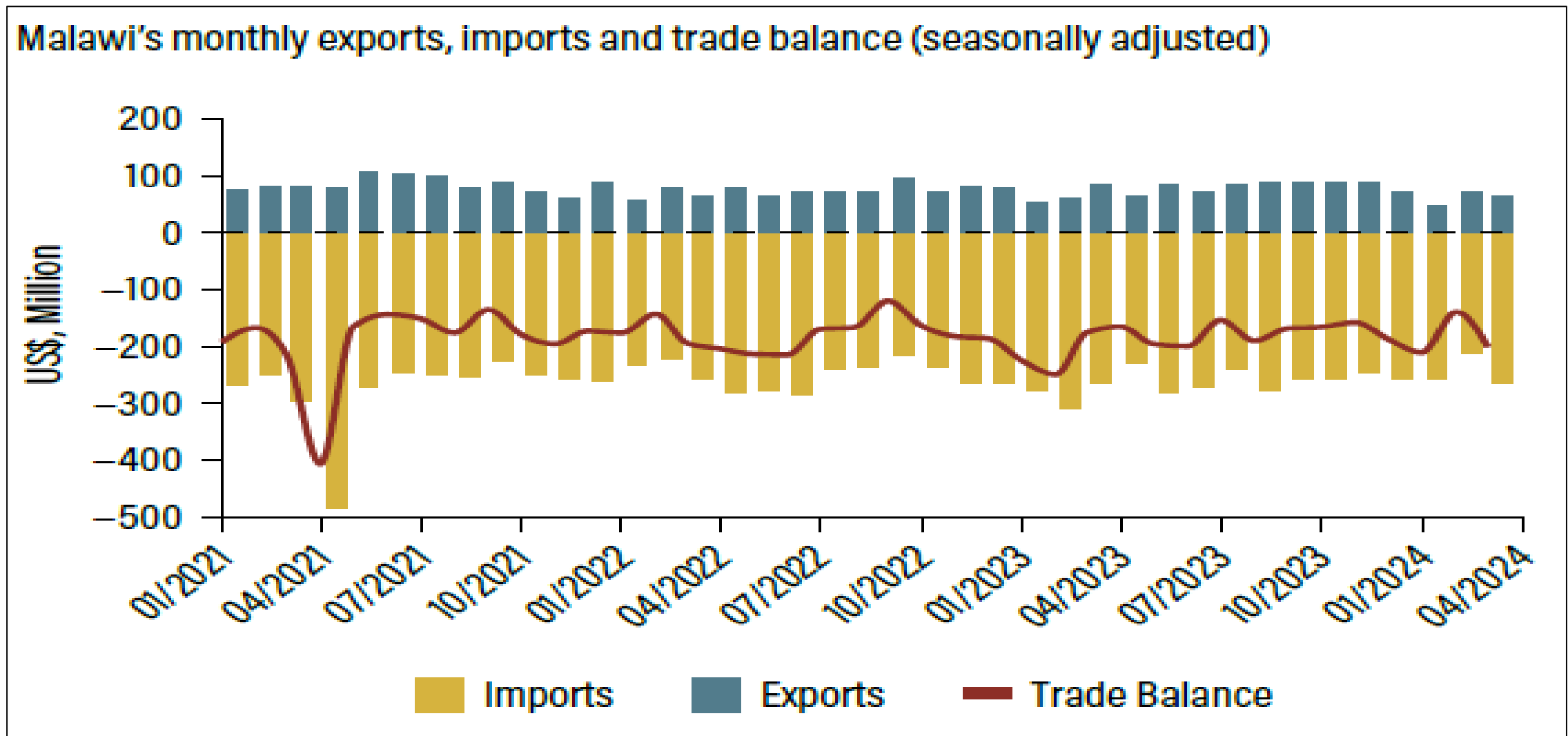


### Holders of government debt



Source: World Bank (2024)

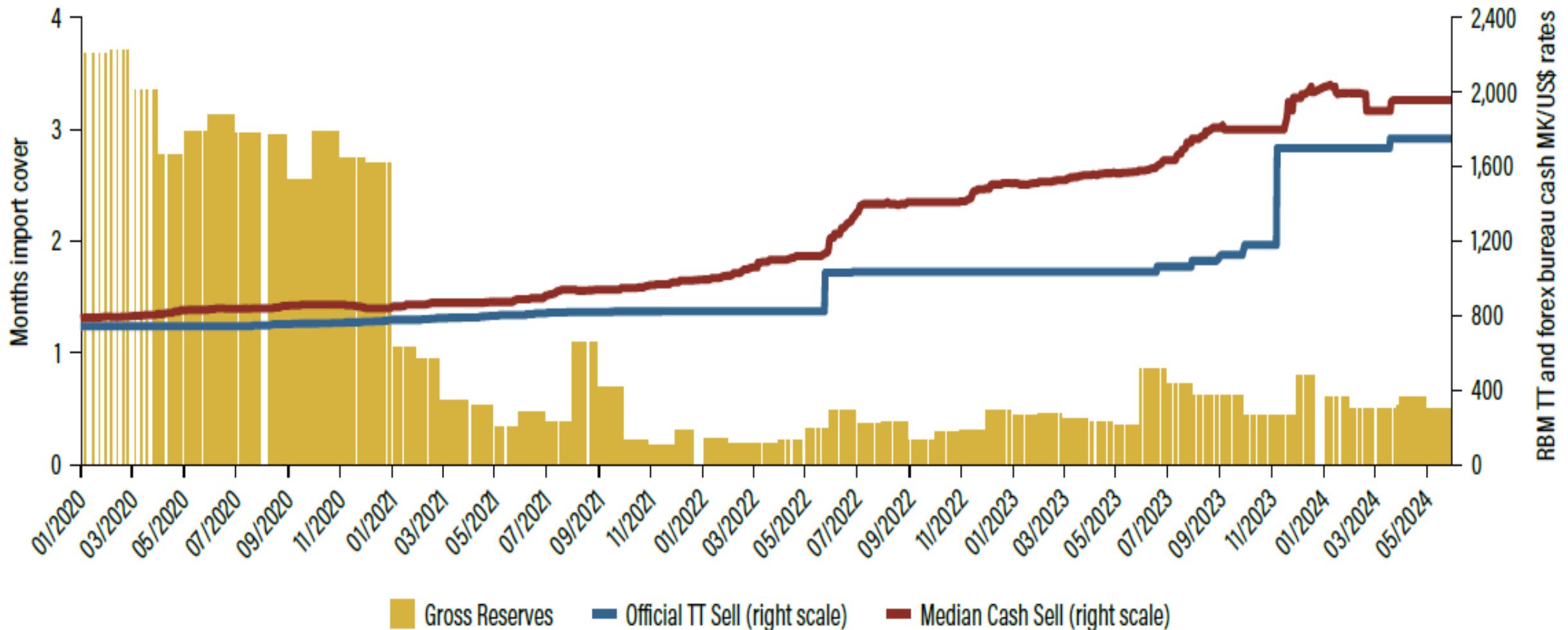
## 4. In the external sector, Balance of Payments Crisis persists<sup>37</sup>



Source: World Bank (2024)

# It's de javu

Telegraphic transfer and forex bureau cash MK/US\$ rates and spreads through May 31 and gross official reserves in months of import coverage



# Exchange Rate Regimes for Industrialized Countries

Four main exchange rate regime switches

- 1. 1870 – 1914: International gold standard. [FIXED]**
  - The value of most currencies was denominated and expressed in terms of gold.
- 2. 1929 – 1933: Fluctuating/flexible exchange rates**
  - Prior to WW II, over 50 countries had reverted to the gold standard
- 3. 1944 – 1972: The Bretton Woods par value system [FIXED]**
  - The U.S. dollar was the official reserve asset, and currencies were paired to it.
  - The U.S. dollar was, in turn, pegged to gold at \$35 per ounce.
  - If necessary, a country approached the IMF to adjust the pegged value of its currency.
- 4. 1973 – date: Independent or joint floating exchange rates**