SPECIAL REPORT

NEW EURO CHALLENGES DOLLAR HEGEMONY, IMPACT ON SADC STILL TO COME

by Munetsi Madakufamba

The euro, a common currency for 11 of the 15 member countries of the European Union (EU), was launched at the beginning of this year, marking an end to the US dollar's century-old hegemony as the leading reserve and trading unit.

The historic occasion received widespread media coverage in Europe, the US and Asia. However, very little has been explained about the possible impact of the fledgling currency to southern Africa despite the fact that the EU is the region's largest trading partner in the world.

Between 20-50 percent of exports from the Southern African Development Community (SADC) region find their way to Europe, most of them under the Lome pact which expires next year. The major trading partners are Britain, Germany, France and Italy.

Since the emergence of market-driven economic policies, and their eventual consolidation through the formation of the Bretton Woods Institutions – the World Bank and the International Monetary Fund (IMF) – in 1944, the US dollar has become the globally acceptable prime reserve and trading currency. The more US dollars a country has in its coffers, the stronger its national currency is against other currencies and ultimately, the stronger its economy.

For SADC, like other African states, the use of the US dollar as the main trading unit was not just the legacy of colonialism, but an outcome of the current wave of globalisation that is shaping the international economic landscape.

Although the euro wi'' only exist as a book currency, tradable between ' ınks in electronic form, notes and coins are tc ,e introduced in the year 2002. Options on stock markets and other international transactions have been widened.

The 36-month transition phase which is laid out under the Maastricht Treaty, forbids invoicing or use of euros in the EU countries as the sole legal tender until 2002.

The currencies of the 11 EU countries will continue to exist as denominations of the euro during the transition period. Exchange rates of the currencies were fixed against the euro at the time of its launch.

The 11 EU countries – Germany, France, Italy, Spain, Portugal, Belgium, the Netherlands, Luxembourg, Austria, Ireland and Finland – may at a latter stage be joined by Britain whose membership at the moment remains in abeyance, as is that of Denmark, Greece and Sweden.

Although Britain, one of key European destinations for SADC exports, is not yet speaking the euro language, its private sector will be compelled to open parallel euro accounts for transactions with companies in fellow EU countries and beyond.

Official transactions by governments and central banks in the zone will be denominated in the new currency. Likewise, foreign exchange reserves of the 11 EU currencies held by African central banks, SADC included, will be redenominated in euros with effect from 1 January 1999.

An independent European Central Bank (ECB) also began operating at the beginning of the year, and all open market operations including monetary policy will be handled in euros by the mother bank. The ECB, based in Frankfurt, Germany, assumes the 11 euro members' right to finance budget deficits by printing more money and to boost exports temporarily by devaluation.

The euro is the EU's biggest economic adventure since its formation in 1957, with a prime desire to avoid war, after the devastating first and second world wars that ended in 1918 and 1945 respectively. As individual countries, national currencies of the EU have largely tracked the US dollar.

Since its establishment more than 200 years ago, the US dollar has dominated world transactions, more so after the US's majority shareholding in the Bretton Woods Institutions ensured the country total political and economic control of the world.

World Bank figures show that about 50 percent of trade flows are invoiced in dollars compared with about 30 percent in EU currencies. Similarly, the denomination of global assets is skewed in favour of dollars. For instance, almost 70 percent of official foreign reserves are held in dollar accounts, compared with 20 percent in EU currencies.

World Bank estimates show that 43.3 percent of sub-Saharan Africa's US$222.6 billion external debt in 1997 was in dollars, while 21.3 percent was in Europe's major currencies – the British pound, French franc and the German deutschmark.

But the euro has now challenged the dollar hegemony. If combined, the 11 "euroland" countries emerge as one of the world's economic superpowers, representing more than 300 million consumers and responsible for one-fifth of world output – a little behind the US.

With the 11 founding member countries, the euro is set to be the world's second major currency after the US dollar, and will be followed by the Japanese yen.

If all the 15 EU countries join the euro, they will exceed the US, both in terms of gross domestic product (GDP) and foreign trade, and is expected to eventually overtake the dollar. Available statistics show that the EU's GDP in 1996 was US$8,573 billion compared to US$7,342 billion for the US. Similarly, the EU enjoyed 21 percent of world trade in the same year, compared to 19.6 percent for the US.

On the foreign exchange market, analysts say the arrival of the euro is going to reduce over-reliance on the dollar. The IMF believes the new currency will complement the dollar as a prime reserve currency especially for market intervention purposes.

The US dollar's dominance on international transactions has not only left developing countries at the mercy of externally determined forces, but has put to question the effectiveness of free market economies. Without enough hard currency, a country is doomed.

Developing countries, SADC included, have had to beg for US dollars from the World Bank and the IMF to bail out ailing currencies. For instance, Zimbabwe, whose currency, the Zim dollar, has been on a freefall since November 1997, is still looking to the IMF to release US$53 million that is needed to cushion the local currency from further collapse.

SADC countries, like any others on the continent, settle their import bills mainly in US dollars despite the fact that north America is not the region's biggest trading partner.

At the continental level, Africa's 1997 exports to the EU were US$48 billion or 43 percent of total exports, while imports reached US$52 billion or 50 percent.

With the arrival of the common currency, the euro, trade transactions between the two regions are likely to be less complex. Trade could be further boosted if the African, Caribbean and Pacific (ACP) countries secure a favourable deal out of the on-going Lome negotiations.

At micro level, the euro should make life easier for institutions such as banks as the single currency will allow companies to use services of fewer major banks in Europe for handling all EU commitments. Local businesses will also have to deal with one exchange rate risk, as opposed to 11.

While the euro received a lukewarm reaction in SADC, partly because the impact has not been so direct, it was a totally different story in the French-speaking west African nations that share the CFA franc.

The euro was greeted with panic as the west Africans were concerned that the French franc, to which the CFA franc is pegged, will eventually give way to the new currency.

The CFA franc lost half of its value in 1994 when it was devalued by the French Central Bank from 50 to one French franc to 100:1 against the same currency, the rate at which it will be interlocked in relation to the euro. The French Central Bank will likely hand over its powers to control the CFA franc to the ECB, which could mean another devaluation.

The CFA zone comprises Benin, Burkina Faso, Cote d' Ivore, Cameroon, Central Africa Republic, Chad, Congo-Brazzaville, Equatorial Guinea, Gabon, Guinea-Bissau, Mali, Niger, Senegal and Togo.

For Africa, the impact of the euro will be much clearer after the outcome of the current talks on the Lome pact which will be concluded next year. And for the business community in SADC, the impact will be gradual as their EU counterparts will run parallel invoicing in euros and existing currencies for the next three years. (SARDC)