MONETARY SOVEREIGNTY: A VIEW FROM THE SOUTH

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Claus Zimmermann [1] has observed correctly that few legal concepts have been subject to as little critical scrutiny over the past two decades as that of monetary sovereignty. This omission stands in sharp contrast to the interest which has been exhibited with respect to a broader concept of national sovereignty. Political and economic theory has devoted considerable attention to whether economic globalisation and the increasing integration of both product and financial markets have constrained the scope for national policy and hence has hollowed out the nation state. Little attention has been given to the effect of globalization on monetary sovereignty of the nation state and further whether the concept of monetary sovereignty can be evolved in order to be located more adequately within the context of globalisation.

In analysing these modern developments, Besson[2] notes that 'gradually the exercise of (monetary) sovereignty has turned from an individual exercise to a cooperative enterprise. This form of sovereignty triggers duties of cooperation on the part of the entities which cannot ensure the protection of all the values they should protect, as much as on the part of the entities which can help the former to protect those values they share. They should all be seen as working towards the same end: The realisation of their shared sovereign values and principles'.

But this apparent plea for cooperation needs to be rigorously assessed in the terms of both legal and factual constraints imposed on nation states. There are constraints upon monetary sovereignty that arise from customary international law and international treaties, particularly the IMF Agreement with particular reference to

[1] 2013 (24) The European Journal of International Law 797
[2] Sovereignty and Conflict 8 (15) European Integration Online Papers 2004 at 13

Articles IV and VII. In addition, there are factual economic constraints that arise from economic globalisation which impact significantly on monetary sovereignty.

Briefly, for the purposes of clarity when reference is made to monetary sovereignty we are talking about:

1. The right to create money by way of the issue of currency which constitutes legal tender within the territory of the issuing state.

2. The right to conduct monetary policy; that is to use interest rates and reserve requirements in order to control the money supply.

3. The right to conduct an exchange rate policy; that is to determine the exchange rate regime and to control the exchange rate.

4. The right to decide upon the appropriate amount of current and capital account convertibility by way of the imposition of the exchange controls, thereby controlling the use that can be made of the State's currency outside of its territory.

5. The organisation of financial regulation and supervision, the overall objective of which is to maintain the integrity of the financial systems and to ensure financial stability.[3]

A developing country's experience

A country like South Africa can no longer, if it ever could, exert sovereignty over all these four functions. The factual constraints imposed upon its sovereignty are particularly significant. The increased innovation of financial instruments, the rapid expansion of financial assets, and the manner in which international capital has been privatised all hold significant impact on the financial stability of a small and open economy like South Africa. The volatility of the Rand has been caused, for example, far less by South African regulatory regimes as opposed to the manner in which

[3] See Claus Zimmermann A Contemporary Concept of Monetary Sovereignty (2013) at 3 - 4

international capital invests in South Africa in the short term seeking to arbitrage interest rates. As soon as these interest rates alter to the detriment of South Africa, capital is withdrawn and the currency faces significant devaluation of a sudden and dramatic kind. In short, floating international capital leads to a bubble and disorderly fluctuation of exchange rates. In turn this weakens monetary sovereignty of the country making it almost impossible to develop a coherent monetary policy. Illustrative is the currency crash over a few weeks in February –March 1996 and again in June-July 1998 when the Rand lost more than 30 % of its value forcing the Reserve Bank to impose significant interest rate increases which acted to the massive detriment of the poor and the working classes.

The present form of the global economy raises profound questions for developing countries: they are forced to participate in the global economic intercourse but once they do they are reduced to passivity, their sovereignty seemingly hollowed as a result of developed countries dominance in the global process together with overwhelming influence exerted by the multinational corporations to which I have made reference.

A recourse to data may assist in support of these observations. In 2012 the bond market received an inflow of R 65 b compared with R 54.6 b the previous year ,largely as a result of South Africa's inclusion in the global bond index from October 2012. South Africa constitutes 10% of the global markets local currency bond index and since the end of September 2012 forms part of the Citibank World Government Bond Index. Hence foreign ownership of Rand denominated South African Bonds increased from about 13.8% in 2009 to around 36% in 2014 as a result of this development.

By contrast, foreign flows into the equity market during 2012 were close to zero compared to an outflow of R 17.2 b in 2011. Significantly ,the rand weakened by 3.9% during 2012 year ,more because of the deficits on South Africa's trade and current accounts.

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But as Brian Kahn of the Reserve Bank has noted, excessive openness with lower levels of reserves renders South Africa more exposed to global financial market developments and creates a challenging environment for monetary policy. It is difficult to predict exchange rate movements and hence its impact on inflation. Longer term real exchange rate movements pose significant challenges for the manufacturing sector which find it difficult to deal with this level of uncertainty.[4]

Rating Agencies and their role

The financial crisis after 2008 drew, and rightly so, attention to the role of rating agencies in the financial system. Rating agencies were finally criticised for their failure to rate certain financial products correctly which contributed to the severity of the financial collapse. It appeared that rating agencies failed dismally to challenge the assumption upon which their assessment of the sustainability of sovereign debt was based in the years leading up to the crisis.

At present, there is certainly a need for some form of regulatory authority to rank the performance of rating agencies and particularly a regulatory scheme to ensure that these agencies institute internal controls, proper methodologies and prevent manifest conflict of interests.

Turning to the South African experience , in December 2014 rating agencies Fitch and Standard and Poor's announced that they would maintain South Africa's long and short term foreign currency sovereign credit rating at BBB - / A – 3. The National Treasury Unit issued a statement in immediate response to these ratings saying:

[4] Brian Kahn *Presentation to the IMF Conference on Managing Capital Flow: Lessons from the margin markets for frontiers economies*. March 2015

‘*Important structural reforms are underway in major economic sectors that will boost the economy’s growth. The Medium Term Strategic Framework sets out the government’s actions over the next five years to achieve such a goal. The MTSF plans target a thriving business sector in a strong civil society. As a result, growth enhancing initiative and programmes aimed at improving the competitiveness of the renewable energy sector and sustaining job creation are prioritised*.’

The fact that National Treasury immediately responded to the unchanged rating of December 2014 indicates luminously the extent to which these rating agencies influence the country’s economic policy in general and monetary policy in particular .The 2015 budget contained the attempt to reduce government expenditure by R 15 b and increase taxes by R 15 b. This initiative was a clearly formulated reaction for failure to address the deficit by the government would have meant that the rating agencies would inevitably downgraded South Africa to junk bond status. In turn this would create enormous problems for increased interest rates, banking instability and further constrain any ability to develop a monetary policy for the developmental changes which face South Africa only 21 years out of apartheid.

It raises the question – who controls monetary and fiscal policy .The nation’s duly elected government, the multinational corporations, the international financial institutions , in particular the IMF and World Bank or the rating agencies ? In South Africa’s case the government appears to play a rather junior role .