SACU – The new agreement

The SACU agreement can be traced back to the 1889 Customs Union Convention between the Cape Colony and the Orange Free State. Lesotho and Botswana were included in the 1891 and following conventions. With the formation of the Union of South Africa in 1910, a new Customs Agreement was signed between the Union of South Africa and the High Commission Territories (namely the present day Botswana, Lesotho and Swaziland). The independence of Botswana and Lesotho in 1966 and Swaziland in 1968 prompted negotiation of the current 1969 agreement. Ever since the beginning of the nineties, the renegotiation of the 1969 SACU agreement has been ongoing. Initially, the BLNS (Botswana, Lesotho, Namibia, and Swaziland) countries postponed the process until the inauguration of a democratic government in South Africa. Between 1996 and 1998, South Africa put negotiations on hold to formulate its industrial policy. Thereafter, negotiations proceeded rather slowly, with frequent deadlocks over a fair and equitable revenue-sharing formula, and the decision-making process in the union. Of late, negotiations have advanced rapidly to the extent that the final agreement may well be signed before the end of 2001. However it is doubtful whether the new agreement will be in place with the new financial year, that is 1 April 2002, because it needs to be ratified in the parliaments.

| Rationale | Economic integration refers to the commercial policy of reducing or eliminating trade barriers among member states. The degree of economic integration ranges from preferential trade agreements – lower trade barriers between participating nations - to economic unions. Free Trade Areas – such as the SADC FTA - remove all trade barriers among member states, but each country maintains its own trade barriers with non-member states. Customs Unions (CU) remove all trade barriers, such as import quotas and customs tariffs, amongst member states and harmonises trade policies towards the rest of the world through a Common External Tariff (CET). The revenue raised through the CET is then distributed to the member states. The main argument in favour of Customs Unions is trade creation and economies of scale. Trade creation benefits the efficient producers by expanding exports and increasing employment, and is detrimental to inefficient producers, but the overall gains depend on the impact trade creation has on industrial output of the trading block. |
| Definitions | Trade creation occurs when lower cost imports from member countries replace high cost domestic products. Therefore internal trade is created and efficiency is increased. Trade diversion occurs when high cost Custom Union products appear cheaper than externally sourced products, due to the price raising effect and the protective nature of the CET. Therefore trade is diverted from a low cost source to a high cost source. This is of concern because it promotes the inefficient use of resources. |
| Issues | SACU’s endurance – classifying it as the oldest customs union – is something of a surprise. The considerable discrepancies in the level of economic development between the member countries – seen as a factor contributing to the failure of customs unions – and the political situation in South Africa up until 1994 has not caused SACU to break up. While the BLNS countries have been dependent on the South African market for imports and to a lesser extent also for exports, South Africa as the dominant |
economy accounting for over 90% of SACU’s total GDP, trading very little with the small BLNS economies. However, given South Africa’s industrialisation policy based on import substitution protected by the common external tariff, the BLNS have been relevant markets for South Africa’s manufacturing industry. But even this would not fully explain South Africa’s interest in SACU. Its apartheid policy resulted in international isolation leading to strong political interests in SACU rather than simply economic interests. On the other hand, BLNS countries maintained their membership despite various issues being raised within SACU time and again indicating that the benefits outweighed the losses. The main issues have centred on the decision-taking process, the polarisation effect and the revenue sharing formula and have dominated the renegotiations since the new South African government came into power in 1994.

A SACU institutional structure has barely existed. A Customs Union Commission was established to meet once a year or on request, and three liaison committees which have met on an ad hoc basis. Suggestions by the Commission could be rejected by South Africa. South Africa’s customs tariffs and duties had to be applied on all imports into the Customs Union. It was more or less the Board of Tariffs and Trade within the Department of Trade and Industry in South Africa that decided on SACU’s CET. The CET mainly served the purpose of its import substitution industrialisation policy. The lack of influence of the BLNS countries has thus always been an issue.

A further issue that has featured prominently on the agenda is the polarisation effect. South Africa being the most advanced economy attracted further investment, rather than the BLNS countries, although they have had duty-free access to the South African market. The higher purchasing power in South Africa, transport costs to the South African market and the perception of higher risks in the BLNS countries also contributed to the tendency of industries to cluster in more advanced areas. While there is no evidence that SACU is the cause of the polarisation effect, South Africa certainly used its dominating power in the institutions to develop its own economy – thereby strengthening polarisation. It has benefited from additional investment to supply the larger SACU market and subsequently from additional employment and tax income. This resulted in calls for compensation by the BLNS countries, although the effects are hardly quantifiable.

On the other hand, it is questionable whether the BLNS countries have fully exploited the opportunities of the SACU market. The relative isolation of South Africa and the pressure on international companies to withdraw from the country could have provided opportunities to attract investment to the then BLS states. Furthermore, the countries made very little use of Article 6 (infant industry protection) and Art. 7 (protection of industries of major importance), although South Africa did not show much enthusiasm for support. South Africa used the tariff structure and subsidies to prevent new industries in the BLNS countries – Namibia was not independent at that time - from competing successfully with its own industries. In addition, decentralisation incentives provided by South Africa to channel investment to its ‘homelands’ have certainly diverted investment from BLNS countries. These incentive schemes clearly indicate that with a stronger political will on the part of South Africa, the objective stated in the preamble to encourage development in the less advanced countries could have been pursued. Thus, instead of compensation, money could have been made available for specific programmes to improve the investment climate in the BLNS states.

Whether the member states received an adequate share of the Common Revenue Pool (CRP) was always contentious. During the negotiations of the 1969 agreement the then BLS countries demanded the inclusion of a compensation factor in the revenue sharing formula. Their demand was based on disadvantages associated with the customs union such as the loss of fiscal discretion, the price raising effect of the CET, and the polarisation effect. A stabilisation factor was included later on to guarantee the BLNS countries revenues of at least 17% up to 23% of their import values, implying that their shares have not been tied to the actual funds available in the CRP.

As stated above, the BLS countries had no influence on SACU income, which was quite evident when South Africa decided to abolish import surcharges and sales duties – which were part of the SACU revenue pool – and introduced General Sales Tax, that is not included in the revenue pool. Moreover, South Africa started to make use of import control measures more often, instead of tariffs to regulate imports. These unilateral decisions have reduced the funds available for distribution and have been based on South Africa’s own development interests, which do not necessarily correspond with the development interests of the BLNS countries. Furthermore, excise duties are included in the revenue pool - a unique feature of SACU, since excise duties are not trade related – determined by the South African Board of Tariffs and Trade. Again, the tax levels were designed to support South Africa’s economic and social objectives and not those of the other member countries. However, whenever countries enter into mutual agreements they sacrifice part of their sovereignty, such as fiscal discretion.
| **Price raising effects** | in the case of customs unions. Thus, the loss of fiscal discretion in general is not a valid reason to claim compensation; it is rather the unilateral – undemocratic – decision-taking process. Price raising effects are caused in two ways by trade tariffs. They can lead to trade diversion from efficient producers outside the area to less efficient and thus more expensive producers inside the area that are only competitive because of the protection provided by tariffs. Secondly, producers inside the customs union can increase prices up to the level of products from outside that often carry high tariff burdens. These effects have mainly benefited South African producers and resulted in welfare losses for consumers, particularly in the BLNS states, who in addition have not benefited from additional employment and additional revenue from individual and company income taxes. Further concerns regarding the revenue sharing formula included the time lag and double counting. Due to statistical problems at the time of the conclusion of the 1969 agreement, transfers from the common revenue pool were based on import data of two years ago. Since customs and excise duties were transferred to the pool on a quarterly basis, this amounted to an interest-free loan to South Africa. Moreover, high inflation rates have reduced the real value of transfers considerably, that BLNS received two years later. Finally, the design of the formula leads to double counting in that, for instance, imported inputs for excisable goods were counted and the total value of excisable goods as well. This inflated the denominator of the formula resulting in the BLNS countries receiving a smaller share of the pool. |
| **Time lag** | The proposed new agreement The new agreement addresses some of the issues raised concerning the 1969 agreement. A more democratic structure will be established comprising a council of ministers – that will decide by consensus; a commission; a secretariat - Lesotho, Namibia and Swaziland have tendered to host this; a SACU Tariff Board; a Liaison Committee, and a tribunal to solve disputes. Meetings of the council and the commission are to be held regularly – at least once a quarter. The creation of the SACU Tariff Board can ensure that development strategies of the BLNS countries be supported by an appropriate tariff structure and can reduce the dominant influence of South African companies on the Board. This new set of institutions can be used to promulgate a new SACU, whose image has been tainted by the colonial past. The revenue sharing formula will be reshaped, scrapping the compensation and stabilisation factor. It will consist of three components and be based on actual funds available in the CRP. Customs duties will be distributed among members according to their share of intra-SACU imports, excluding re-exports contrary to current procedures where they are shared according to the share of total imports into the SACU area. BLNS countries are seen to benefit since they source most of their goods from within SACU – mainly from South Africa. The amount of the Common Revenue Pool will be based on forecasts for the respective year and will be finally adjusted over the coming two years, thus eliminating losses incurred by BLNS countries from the time lag. Excise duties will be split into two components whereby probably 85% of the total will be shared according to each member country’s share of the total SACU GDP. That would translate into a share of 2.2% from this component for Namibia. The remaining 15% will form the development component that will be distributed in reverse proportion to the member countries’ GDP per capita. In other words, countries with a low per capita income will receive a higher proportion than countries with a high per capita income. Based on population and GDP figures of 1999, Namibia would receive 20.3% of the amount of the development component. Combining these two shares, Namibia would receive about 5% of total excise duties. So far, Namibia has been receiving between 8% and 9% of the estimated Common Revenue Pool. Given the roughly 5% from excise duties, Namibia would receive a higher share from the CRP if its share of total intra-SACU imports exceeds 11%. Unofficial figures for 1997 indicate a share of some 26%, which would result in a share of the total CRP of almost 20%. Whether this translates into higher absolute transfers depends on the actual funds available in the CRP. One of the main objectives stated in the Preamble of the 1969 Agreement was to achieve economic development and diversification of the less advanced members. This has not materialised owing to reasons discussed above. The new agreement proposes the design of common policies focusing on industrial development, competition and unfair trade practices to achieve this objective. These areas are addressed only very briefly and will need to be dealt with in detail once the agreement has been ratified. While the design and implementation of policies will take time, there are already incentives to invest in the less advanced economies to counter the polarisation effect. The BLNS countries enjoy preferential |
| **Democratisation of SACU** | |
| **New revenue sharing formula** | |
| **Customs duties** | |
| **Excise duties** | |
| **Additional common policies announced** | |

| **Price raising effects** | in the case of customs unions. Thus, the loss of fiscal discretion in general is not a valid reason to claim compensation; it is rather the unilateral – undemocratic – decision-taking process. Price raising effects are caused in two ways by trade tariffs. They can lead to trade diversion from efficient producers outside the area to less efficient and thus more expensive producers inside the area that are only competitive because of the protection provided by tariffs. Secondly, producers inside the customs union can increase prices up to the level of products from outside that often carry high tariff burdens. These effects have mainly benefited South African producers and resulted in welfare losses for consumers, particularly in the BLNS states, who in addition have not benefited from additional employment and additional revenue from individual and company income taxes. Further concerns regarding the revenue sharing formula included the time lag and double counting. Due to statistical problems at the time of the conclusion of the 1969 agreement, transfers from the common revenue pool were based on import data of two years ago. Since customs and excise duties were transferred to the pool on a quarterly basis, this amounted to an interest-free loan to South Africa. Moreover, high inflation rates have reduced the real value of transfers considerably, that BLNS received two years later. Finally, the design of the formula leads to double counting in that, for instance, imported inputs for excisable goods were counted and the total value of excisable goods as well. This inflated the denominator of the formula resulting in the BLNS countries receiving a smaller share of the pool. The proposed new agreement The new agreement addresses some of the issues raised concerning the 1969 agreement. A more democratic structure will be established comprising a council of ministers – that will decide by consensus; a commission; a secretariat - Lesotho, Namibia and Swaziland have tendered to host this; a SACU Tariff Board; a Liaison Committee, and a tribunal to solve disputes. Meetings of the council and the commission are to be held regularly – at least once a quarter. The creation of the SACU Tariff Board can ensure that development strategies of the BLNS countries be supported by an appropriate tariff structure and can reduce the dominant influence of South African companies on the Board. This new set of institutions can be used to promulgate a new SACU, whose image has been tainted by the colonial past. The revenue sharing formula will be reshaped, scrapping the compensation and stabilisation factor. It will consist of three components and be based on actual funds available in the CRP. Customs duties will be distributed among members according to their share of intra-SACU imports, excluding re-exports contrary to current procedures where they are shared according to the share of total imports into the SACU area. BLNS countries are seen to benefit since they source most of their goods from within SACU – mainly from South Africa. The amount of the Common Revenue Pool will be based on forecasts for the respective year and will be finally adjusted over the coming two years, thus eliminating losses incurred by BLNS countries from the time lag. Excise duties will be split into two components whereby probably 85% of the total will be shared according to each member country’s share of the total SACU GDP. That would translate into a share of 2.2% from this component for Namibia. The remaining 15% will form the development component that will be distributed in reverse proportion to the member countries’ GDP per capita. In other words, countries with a low per capita income will receive a higher proportion than countries with a high per capita income. Based on population and GDP figures of 1999, Namibia would receive 20.3% of the amount of the development component. Combining these two shares, Namibia would receive about 5% of total excise duties. So far, Namibia has been receiving between 8% and 9% of the estimated Common Revenue Pool. Given the roughly 5% from excise duties, Namibia would receive a higher share from the CRP if its share of total intra-SACU imports exceeds 11%. Unofficial figures for 1997 indicate a share of some 26%, which would result in a share of the total CRP of almost 20%. Whether this translates into higher absolute transfers depends on the actual funds available in the CRP. One of the main objectives stated in the Preamble of the 1969 Agreement was to achieve economic development and diversification of the less advanced members. This has not materialised owing to reasons discussed above. The new agreement proposes the design of common policies focusing on industrial development, competition and unfair trade practices to achieve this objective. These areas are addressed only very briefly and will need to be dealt with in detail once the agreement has been ratified. While the design and implementation of policies will take time, there are already incentives to invest in the less advanced economies to counter the polarisation effect. The BLNS countries enjoy preferential |
access to EU markets through the Cotonou Agreement and to the USA through the African Growth and Opportunity Act to which producers in South Africa do not yet have access. Part of the revenue from the SACU pool - in particular from the development component - could be spent on infrastructure projects and human resource development to attract more investment. Closer co-operation within SACU and the reduction of visa and permit fees for students would encourage regional capacity building. The proposed new agreement still contains a clause referring to infant industry protection. Namibia made use of this clause in three different industries over the past couple of years, namely for long-life milk, poultry, and recently for pasta. Protection of infant industries for a limited period of time has merits because of the learning curve of new industries and the market power of established enterprises. However, to avoid indefinite subsidies and the creation of non-competitive industries it is necessary to adhere to the strict schedule of phasing out the protection that is required for granting the status. Since the experience with infant industry protection is rather mixed, support mechanisms could be designed to strengthen the international competitiveness of existing and new companies.

**Conclusion**

The new agreement turns SACU into a more participatory institution, opening opportunities for Namibia to influence the design of the CET and of common policies to suit its national development objectives. It is expected that Namibia will receive a higher relative share of the SACU revenue pool, while the absolute amount needs still to be determined. Obviously, the size of the pool will decline during the coming years because of free trade agreements entered into – e.g. within SADC - and the general trend towards trade liberalisation. Last but not least, the success or failure of an agreement depends more on the spirit in which it is concluded than in its phrasing. It is expected that South Africa will play a more forthcoming role than in the past. Though the BLNS markets are rather small, it would be in South Africa’s own interest to support economic development there since it will contribute to stabilising the region, which in turn will have a positive impact on South Africa’s economy. In this respect the inclusion of suitable SADC member countries into SACU could be considered, which would in addition strengthen and accelerate economic integration in the region.

**Policy Recommendations**

- Use the SACU institutions to represent the region and actively promote investment to the region;
- Shift the focus from SACU as a source of income to SACU as a potential engine for economic development in the region;
- Use the SACU Tariff Board to design a CET that suits Namibia’s development objectives;
- Reduce the CET to eliminate the anti-export bias rather than to build new trade barriers;
- Use SACU revenue to strengthen the international competitiveness of new and existing industries rather than shelter industries over a long period of time;
- Reduce administrative barriers to foster human resource development in the region; and
- Consider enlarging SACU through inclusion of suitable SADC member countries.

**References and further reading**


**Compiled by: Klaus Schade and Namene Kalili. Technical editing: Aldenia Chaka**

**Funded by: Konrad Adenauer Foundation – Windhoek / Namibia**

**NEPRU 2001**