ASSESSING THE IMPACT OF THE EU - SOUTH AFRICA AGREEMENT ON TRADE, DEVELOPMENT AND COOPERATION (ATDC) ON NAMIBIA’S PUBLIC REVENUE

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ABSTRACT

This study was undertaken to ascertain the revenue losses from the Southern African Customs Union (SACU) Common Revenue Pool as a result of the Trade Pact between South Africa and the European Union (EU) and how that can impact on public revenue and the balance of payments (BOP) in Namibia. This study estimated that the SACU Common Revenue Pool would lose approximately 35 per cent of the customs component over a period of 12 years, when protocol products are excluded from the estimations.\(^1\) The loss to Namibia is likely to be more or less the same percentage. The estimation is based on the 1997 data.

The reduction in the customs revenue is expected to negatively affect the BOP, and the level of foreign reserves in Namibia. With respect to fiscal policy, the fall in SACU revenue will have severe fiscal pressure and may lead to increases in the budget deficit and public debts. In this regard, the paper recommends a number of measures to minimize the adverse effects resulting from reduced SACU revenue receipts including streamlining and strengthening of the revenue collection machinery and tax reforms.

\(^1\) Protocol products refer to agreed derogations to standstill and rollback products as well as the products on the review list i.e. Annex 1 and 3 (6) of the EU-SA Trade Agreement.
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1. INTRODUCTION

The wide-ranging trade pact between South Africa and the European Union holds far reaching economic implications for Namibia, Botswana, Swaziland and Lesotho (BLNS), owing to their economic ties with South Africa through the Southern African Customs Union (SACU). These impacts include increased competition for BLNS products, both in the EU and SACU markets, the revenue loss as a direct result of tariff reductions, and possible displacement of local production by imported EU goods.

The European Union being the source of more than 40 per cent of SACU imports, the reduction in tariffs as provided for by the agreement, implies that SACU faces a significant amount of revenue reductions from this source. In turn, this has implications for fiscal policy and balance of payments in the BLNS Countries. Customs revenue from non-EU imports may also fall as the share of the EU imports in SACU increases due to the lower tariffs and/or duty free entry.

To the extent that there will be increased economic activities due to the trade creation effects of the free trade agreement, this will generate increased indirect taxes, hence more revenue. However, a number of analysts are of the view that this additional revenue will not be sufficient to offset the envisaged loss of the current SACU revenue. In addition, it is expected that the trade liberalization programme in the context of the World Trade Organization (WTO) in terms of which South Africa, as a developed country, has made commitments to substantially reduce tariffs on imported goods on a most favoured nations (mfn) basis, will lead to further decline in revenue from international trade. Jachia and Teljeur (1999) estimated that South Africa’s tariff reduction programme under the WTO would result in customs revenue reductions of approximately R318 million over the implementation period.

Within the regional context of SADC, it needs to be stressed that the implementation of the protocol on trade, establishing a free trade area, commenced in late 2000, in terms of which import duties on SADC-made-goods are to be phased out within eight (8) years of implementation. Although SACU imports from SADC is insignificant, there will still be some revenue losses.

As taxes on international trade make up a significant portion of the government revenue, which stands at about 37 per cent of the total government budget in 2000/01, the fiscal implications of this agreement are considerable. Such revenue losses could have severe effects on the direction of fiscal policy in general and the budget deficits and financing in particular. It will also affect the balance of payments.

The challenge for the government is thus to ensure that the adverse effects of the potential revenue losses are contained and minimized. To this effect, specific measures will need to be undertaken with the main objectives of not only finding alternative sources of revenue, but also to streamline the tax administration and public sector operations.

This study has been undertaken to specifically ascertain the potential SACU revenue losses as a result of the EU-SA trade pact and subsequently how that affects Namibia’s share from the Common Revenue Pool. Secondly, the paper proposes policy measures to effectively overcome the potential adverse effects of the projected reduction in revenue from international trade.

The rest of the paper is organized as follows: A brief overview of the SACU Agreement and the Trade Agreement

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2 See the Eurostep Briefing Paper on the EU-SA Trade, Development and Cooperation Agreement available at www.oneworld.org

3 For more details see Jachia, and Teljeur, 1999, P.3.

4 See the Budget Statement 2001/2002 by Minister Nangolo Mbumbu, attachment, Trade Table 7. Also note that if grants are excluded, taxes on international trade make up 41 percent of the 2000/01 total government revenue.
between the EU and South Africa is outlined in section 2. This section also provides a synopsis of the current trade structure between the EU and South Africa. The method used for data collection and processing and empirical results are in section 3. This is followed by analysis, policy implications and recommendations in sections 4 and 5 respectively. The overall conclusions are stated in section 6.

2. **OVERVIEW OF TRADE AGREEMENTS**

2.1 **THE SACU AGREEMENT**

2.1.1 **BACKGROUND TO THE SACU AGREEMENT**

The SACU Agreement was negotiated and concluded in 1969 between South Africa, Botswana, Lesotho and Swaziland. Namibia formally joined the arrangement soon after independence in 1990. As a customs union, SACU has a common external tariff and unrestricted movements of goods.

Unlike in other typical custom unions, the SACU common external tariffs (CET) are set unilaterally by South Africa without any consultation with her other partners. This is one of the elements that make the SACU arrangement not only undemocratic but also non-transparent. It is also important to point out that SACU members view the arrangement differently. For South Africa, SACU is not only an important captive market for its products, but most importantly the CET is seen as a critical instrument for its industrial policy. Indeed empirical evidence indicates that there has been a polarization of industries in favour of South Africa at the expense of the BLNS. For their part, the BLNS see SACU as an important source of revenue. As indicated earlier, this revenue constitutes more than 30 per cent of total central government revenue in Namibia. This has led to the perception that the Customs Union is essentially a marriage of convenience in the sense that the parties see the arrangement as serving different purposes.

The present SACU Agreement was signed in October 2002 after protracted re-negotiation process, which started in 1994 with the objective of not only democratizing the governance of SACU, especially the role played by South Africa to set external tariffs, but also to put in place new institutional arrangements, a new revenue sharing formula, industrial and competition policies amongst others.

The new agreement is yet to be ratified by parliaments of Member States and will only become operational once all respective parliaments have ratified the agreement. The new agreement provides for transparent and equitable revenue sharing arrangement; equitable participation of all Member States in tariff settings; facilitation of common industrial development policies and strategies that do not unduly disadvantaged any Member State; and deep integration among member states and into the global economy through enhanced trade and investment.

In terms of the institutional arrangements, the 2002 SACU Agreement provides for the establishment of Council of Ministers, the Customs Union Commission, Technical Liaison Committees, Tribunal, and the Tariff Board. A SACU Secretariat has also been established to oversee the day-to-day SACU activities. The headquarters of the SACU are to be located in Windhoek.

2.1.2 **SACU REVENUE SHARING FORMULA**

Under the 1969 revenue formula, changes in the size of the SACU revenue pool have no significant bearing on the revenue that BLNS receive. This is because the formula contains a stabilization factor, designed to ensure...
that revenue paid to the BLNS countries remain at about 20 per cent of the countries total imports (cif), total excisable production and excise duties. If there is a difference in revenue between the amount derived from the 1969 formula, without taking into account the stabilization factor, and 20 per cent of the numerator in the 1969 formula, 50 per cent of the difference will either be added or subtracted to the former. This implies that the stabilization element is equal to 50 percent of the difference. If the amount derived from the 1969 formula exceeds 20 per cent, half of the difference is subtracted, if it is less than 20 per cent, half of the difference is added. The stabilization rate is constrained by the minimum of 17 per cent and the maximum of 23 per cent. This was intended to reduce the size of the annual fluctuations in the revenue paid to BLNS countries. It can therefore be seen clearly that revenue paid to BLNS countries was unaffected by the amount actually collected into the common revenue pool (CRP).6

As a result of this agreement, South Africa’s share of the customs revenue has been diminishing over the years. South Africa has succeeded to avoid a similar situation in the new formula. According to this formula, the share accruing to each member will be calculated from three distinct components: a share of the customs pool, a share of the excise pool and a share of a development component. Each country’s share of the customs component will be derived from the proportion of the country’s c.i.f. intra-SACU imports to the total intra-SACU imports of the Common Customs Area. The excise component for each member state will be calculated from the value of its GDP in a specific year as a percentage of total SACU GDP in that year. Adjustments will be made in the following two years to account for the difference between the forecasts and the actual excise revenue collected in the common pool. Furthermore, a development component is established and shall be funded from 15 per cent of the excise component. Each country’s share of the development component will be calculated from the percentage difference between the country’s GDP per capita and the average GDP per capita of all SACU member countries, reduced by a factor of 10, subtracted from 1 and multiplied by 20.

The fundamental change is that the new formula will translate anything causing a fall in the common revenue pool into reduced revenue for all member countries of the customs union. The EU-South African FTA will exactly do that, on a major scale. It substantially adds to the reductions in revenue already taking place resulting from trade liberalisation in the context of the WTO and implementation of the SADC Free Trade protocol.

2.1.3 TRENDS IN SACU REVENUE RECEIPTS AND PUBLIC EXPENDITURES IN NAMIBIA

As stated earlier, SACU is a major source of Namibia’s Central Government revenue. Figure 1 below shows the SACU revenue patterns over the period 1990/91 to 2001/02 financial years. Also shown is the government total revenue including grants and expenditure over the same period.

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6 The current formula is as follows: $\text{SI}(t) = A+B+C/E+F+G \times H(t) \times 1.42$
Where: I = each of the BLNS countries
SI = share of each BLNS
A = cif value of goods imported from all sources including duties paid/payable
B = value of excisable and sales duty goods produced and consumed in country i.
C = Excise and sales duties paid on B
D = cif value of imports into SACU
E = customs and sales duties paid on D
F = value of excisable and sales duty on goods produced and consumed in SACU
G = Excise and sales duties paid on F
1.42 = compensation factor
H(t) = value of the common revenue pool
Of interest to note is that the SACU receipts have been increasing in absolute terms and also relative to the government’s total revenue. For example, SACU receipts increased from N$507.5 million in 1990/91 financial year at independence to N$2.9 billion in the 2000/01, representing more than a fivefold increase. As a percentage of the total government revenue, SACU receipts constituted about 37 per cent in 2000/01 financial year as compared to 25 per cent at independence in 1990.

It is also interesting to note that both the total revenue and expenditure have been rising almost every year. However, throughout the period the expenditure has been over and above revenue receipts, resulting into budget deficits and a rise in public debt. As SACU receipts are set to decline gradually, this has an effect of increasing the deficit further, unless offsetting revenue is found. As a result, government debt and interest servicing will become more pronounced.

### 2.2 The EU—SA Agreement on Trade, Development and Cooperation (ATDC)

The EU—SA ATDC was signed in late 1999, following over three years of protracted negotiations. The agreement covers all trade in goods in all sectors. It also covers a wide range of areas of co-operation including political dialogue; economic co-operation; development co-operation; social and cultural co-operation; and financial aspects.

The programme for the reduction and elimination of tariffs provides that at the end of a 10-year period, the EU will fully liberalize 95 per cent of the current value of South Africa’s total exports entering the EU, lowering the average duty rate from 2.7 per cent to 1.5 per cent. For its part, South Africa will open up its market for 86 per cent of the current value of the EU total exports entering South Africa at the end of a 12-year transitional period, lowering its average duty rate from 10 per cent to 4.3 per cent.

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7 For detailed information see the Text of the Agreement on Trade, Development and Cooperation between the European Community and the Republic of South Africa.
In the industrial sector, at the end of the 10-year transitional period, the EU will increase duty-free access for South African industrial products from the current 86 per cent to 100 per cent save for certain few products. It is important to note that although the EU is reducing its tariffs over a 10-year period, the major phase-down schedule is 6 years from entry into force of the agreement.

For its part, South Africa will provide duty-free access for European industrial products from the current 62 per cent to 86 per cent at the end of South Africa’s 12-year liberalization period.

With regard to the agricultural sector, the EU will abolish tariffs over a 10-year period, starting from the current 21 per cent in value of total South African agricultural exports entering the EU rising to 62 per cent by the end of the period.

On the basis of the Common Agricultural Policy (CAP), the EU has temporarily excluded certain agricultural products from free trade. Therefore, a significant part of the customs duties on agricultural products will only be abolished at the end of the 10-year period. In addition, certain industrial products such as motorcar components are also excluded from the agreement and will be reviewed during the implementation of the agreement. For its part South Africa will allow a faster and higher level of duty-free access to European agricultural products, rising from a starting point of 34 per cent in total value of EU exports entering South Africa duty free up to 81 per cent by the end of the 12-year period.

Noting that the phased in nature of the pact implies that it will mainly affect revenues in the second half of the implementation period, the government has ample time to put in place appropriate measures to address the fiscal impact.

In anticipation of revenue losses as well as other adverse effects of the EU-SA ATDC on BLNS economies such as possible dislocation of domestic production due to increased EU imports, there are initiatives aimed at putting in place safeguard measures. These include possible budgetary support and support towards retraining of personnel that may be laid off. Initially, these support measures were conditional upon the BLNS granting concurrency to the implementation of the ATDC. Although this condition has now been removed, it appears that any EU support in this regard might only be channelled to the BLNS through the Economic Partnership Agreements (EPAs) based on regional groupings, which will be negotiated in the context of the Cotonou Agreement.8

2.3 Current Structure & Direction of Trade Between the EU and SACU

The EU is SACU’s main trading partner. In 1996 SACU exports to the European Union totaled approximately R46 billion representing about 38 per cent of SACU’s total exports.9 EU tariffs on these imports is generally low while most products enter duty free.

On the other hand, the EU supplies more than 40 per cent of SACU’s total imports comprised mainly of machinery, mechanical appliances and electrical equipment. On average, around 60 per cent of EU exports to SACU face much lower tariffs or enter duty free. The remaining 40 per cent are, however, subject to relatively higher tariff duties in excess of 40 per cent.

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8 The negotiations leading to the establishment of EPAs were launched at the end of 2002 between the ACP and the EU.
9 See Jachia and Tijiver (1999), page 10 for further detail. See also Eurostep Briefing Paper p.5.
3. **Method of Analysis and Results**

SACU import data from international sources for the year 1997, together with the corresponding tariff rates were collected. The data was country specific at the 8-digit level of the harmonized tariff system and covered all 99 chapters of the system.

The processing exercise involved adding up all imports into SACU from the respective EU member countries by product code. This was necessitated by the fact that each product code has a specific tariff rate. The total import value per product code was multiplied with the corresponding tariff rate to arrive at the revenue collected for each product code. Summing up the revenue from all product codes resulted into total revenue collected from imports from the EU that will face liberalisation. All imports from the EU into SACU, with an exception of the products that are on protocols i.e. those that are in Annex I and Annex III, list 6 of the agreement will carry a zero tariff by the end of the twelve year period.\(^\text{10}\) The total revenue so obtained constitutes the revenue loss as a result of the free trade agreement. To estimate the effects of the protocol products on revenue, the exercise is repeated with the addition of these products.

<table>
<thead>
<tr>
<th>Country</th>
<th>Imports N$ Million</th>
<th>Proportion (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Namibia</td>
<td>8723</td>
<td>26.79</td>
</tr>
<tr>
<td>Botswana</td>
<td>8000</td>
<td>24.57</td>
</tr>
<tr>
<td>Lesotho</td>
<td>5031</td>
<td>15.45</td>
</tr>
<tr>
<td>RSA</td>
<td>5986</td>
<td>18.38</td>
</tr>
<tr>
<td>Swaziland</td>
<td>4825</td>
<td>14.82</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3266</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Table 1. The value of total intra SACU imports for 1997/98:

Sources of data include the South Africa Revenue Service, EU Delegation Office in Windhoek, Ministry of Finance and Ministry of Trade and Industry.\(^\text{11}\)

The revenue losses for an individual country is estimated by multiplying the proportion of the country’s intra-SACU imports to total Intra-SACU imports with the total loss in revenue (table1). The proportion of imports was calculated on the basis of 1997/1998 figures. For example, during this period Namibia’s import share stood at about 26 per cent of the total intra-SACU imports, implying that its proportion in the revenue loss would be of the same magnitude. The new SACU formula distributes customs revenue on the basis of the share in intra-SACU imports. Therefore, applying the same method to estimate the country’s share of revenue loss is quite in order. A weakness identified during the processing of the data was that the corresponding tariff rates (percentages) for some product codes were not indicated, but given in kilograms instead. That made it difficult to obtain the tariff rates applicable to those product codes. However, these product codes constitute approximately 3 per cent of the total imports from the EU and therefore cannot largely distort the final results of the study.

**Results**

The findings of this study are presented in table 2, in two scenarios. Firstly, we consider a situation without the liberalization of the protocol items. This means that all products contained in Annex I (list of agreed derogations

\(^{10}\) Annex I include products such as wheat flour, cane sugar, butter, unfortified wine, meat of goats, sheep and pigs. Annex III, list 6, include products such retreaded tyres, specified motor vehicles under tariff headings 8701 to 8705, electrical lighting or signaling equipment and hydraulic fluids.

\(^{11}\) It should be noted that some of the tariff rates used in this study are 2000/01 rates and might be different from the 1997 rates.
to standstill and rollback) and Annex III list 6. The latter list lists products to be reviewed periodically during the course of the operations of the Agreement, with the view to effect further liberalization of trade.

Secondly, we consider a situation where all products including the protocol items will be liberalized over a twelve years period. This means that all import products from the EU are assumed to attract zero tariffs within twelve years of the operations of the Agreement.

Table 2   Estimated Revenue Loss (N$ millions).

<table>
<thead>
<tr>
<th>Estimated Revenue Loss (Customs Component)</th>
<th>Excluding Protocol Products</th>
<th>Including Protocol Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated Total SACU Revenue Loss</td>
<td>2052</td>
<td>2127</td>
</tr>
<tr>
<td>Estimated Loss to Namibia</td>
<td>543</td>
<td>569</td>
</tr>
<tr>
<td>As % of GRN SACU Revenue</td>
<td>35.25 (%)</td>
<td>36.53 (%)</td>
</tr>
</tbody>
</table>

Source: Author's calculation.

Our estimations show that the CRP will lose in total about N$2.1 billion in customs revenue if tariffs are not reduced on protocol items. This is equivalent to approximately 35 per cent of the 1997 customs component of the total revenue pool or 14 per cent of the total CRP in 1997. The composition of the CRP in 1997 is reported in Table 3.

Table 3   Composition of the CRP, 1997.

<table>
<thead>
<tr>
<th></th>
<th>N$ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs duty</td>
<td>6037</td>
</tr>
<tr>
<td>Ad Valoreem Excise</td>
<td>582</td>
</tr>
<tr>
<td>Excise duty</td>
<td>7354</td>
</tr>
<tr>
<td>Surcharges</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>13971</strong></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

These findings are comparable to those of a similar study done in 1998 by the Sussex Institute of Development Studies in conjunction with the Botswana Institute for Development Policy Analyses (BIDPA), which concluded that the EU-SA ATDC is likely to reduce the size of the customs pool by about 31 per cent if the protocol items are excluded.

When protocol items are added, the results do not change materially in this study. This is in sharp contrast with the results of the BIDPA study, which predicted that the loss in customs revenue could increase to 51 per cent when protocol items are taken into account. The possible explanation for the diverging results could be the fact that the BIDPA study was finalized before the ATDC was concluded and hence data used in the estimation were preliminary. This paper on the other hand has used data obtained from the final agreement.

12 Note that when tariffs on protocol products are removed, the revenue loss increases only by a mere one percent.
The results are, however, within the range projected by the UNCTAD SMART simulation (1999), which showed that the ATDC will result in customs revenue losses of between 1.6 billion and 5.6 billion Rand, which represents about 31 per cent to 51 per cent of the total SACU Customs Revenue.

4. **EMPIRICAL ANALYSIS**

4.1 **EFFECTS ON GOVERNMENT REVENUE**

It is clear that the size of the SACU revenue pool is going to shrink as results of the various trade reforms at play. Unlike in the past, the decline in the size of the SACU revenue will undoubtedly be felt by all members of the customs union due to the nature of the new revenue sharing formula.

With the customs revenue declining by about 35 per cent, Namibia’s revenue receipts are also bound to fall by more or less the same percentage over a 12-year period. This could amount to about N$549 million if the 1997/98 figures are used. However, when this formula is applied to the data of fiscal year 2001/02, the loss in customs receipts increases to N$910 million. This is quite substantial as it accounts for about 10 per cent of the total revenue in the year 2001/02. Table 4 below indicates the revenue flow and expenditure pattern of the central government.

Table 4 Central Government Revenue Flow and Expenditure Patterns for Fiscal Years 1995/96 to 2000/01

<table>
<thead>
<tr>
<th>Millions</th>
<th>95/96</th>
<th>96/97</th>
<th>97/98</th>
<th>98/99</th>
<th>99/00</th>
<th>00/01</th>
<th>01/02</th>
<th>01/02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue and grants</td>
<td>4081</td>
<td>4676</td>
<td>5690</td>
<td>6186</td>
<td>7272</td>
<td>7686</td>
<td>8775</td>
<td>9012</td>
</tr>
<tr>
<td>Total tax revenue</td>
<td>3610</td>
<td>4114</td>
<td>5106</td>
<td>5501</td>
<td>6598</td>
<td>6935</td>
<td>7837</td>
<td>7938</td>
</tr>
<tr>
<td>of which: SACU revenue</td>
<td>1155</td>
<td>1348</td>
<td>1560</td>
<td>1805</td>
<td>2240</td>
<td>2877</td>
<td>2600</td>
<td>2600</td>
</tr>
<tr>
<td>Total non-tax revenue</td>
<td>426</td>
<td>512</td>
<td>530</td>
<td>648</td>
<td>605</td>
<td>671</td>
<td>758</td>
<td>870</td>
</tr>
<tr>
<td>Grants and loans</td>
<td>44.9</td>
<td>50.3</td>
<td>54.0</td>
<td>37.4</td>
<td>68.5</td>
<td>80.0</td>
<td>179.7</td>
<td>203</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>4557</td>
<td>5567</td>
<td>6129</td>
<td>6936</td>
<td>7953</td>
<td>8447</td>
<td>978.2</td>
<td>10.5</td>
</tr>
<tr>
<td>Total current expenditure</td>
<td>3925</td>
<td>4837</td>
<td>5262</td>
<td>6102</td>
<td>6883</td>
<td>7441</td>
<td>8353</td>
<td>8021</td>
</tr>
<tr>
<td>Personnel expenditure</td>
<td>2086</td>
<td>2649</td>
<td>2830</td>
<td>3162</td>
<td>3618</td>
<td>3824</td>
<td>4280</td>
<td>4528</td>
</tr>
<tr>
<td>Total interest payments</td>
<td>145</td>
<td>251</td>
<td>350</td>
<td>469</td>
<td>513</td>
<td>536</td>
<td>650</td>
<td>678</td>
</tr>
<tr>
<td>Total capital expenditure</td>
<td>632</td>
<td>729</td>
<td>867</td>
<td>833</td>
<td>1069</td>
<td>1258</td>
<td>1429</td>
<td>1784</td>
</tr>
<tr>
<td>Overall deficit</td>
<td>-476</td>
<td>-891</td>
<td>-439</td>
<td>-749</td>
<td>-681</td>
<td>-850</td>
<td>-1007</td>
<td>-1472</td>
</tr>
<tr>
<td>Deficit as % of GDP</td>
<td>3.6</td>
<td>5.8</td>
<td>2.5</td>
<td>3.9</td>
<td>3.1</td>
<td>3.5</td>
<td>3.6</td>
<td>5.3</td>
</tr>
</tbody>
</table>


*Main budget 2001/02.

**Revised figures as outlined in the revised budget 2001/02. Note that the total expenditure increased from 9.8 billion in the main budget to 10.5 billion, representing a net increase of N$702 million. Similarly, the budget deficit increased from N$1 billion in the main budget to 1.4 billion. As a percentage of GDP, this represents an increase from 3.6 per cent to 5.3 per cent.

If the loss in revenue would fall on one year, the effects on the government budget could be substantial. However, since this agreement will be implemented over twelve years, the pressure on the budget could be spread over the entire liberalization period. Therefore the increase in the budget deficit resulting from customs revenue is not
expected to be dramatic in the short to medium term. This is, however, based on the assumption that the effects of tariff reduction will be evenly distributed over the 12-year period, which is unlikely, as the highest tariffs will only be cut in the latter part of the reform process.

4.2 **Effects on the Balance of Payments (BOP)**

The fall in SACU revenue as a result of the EU-SA ATDC is expected to result in the current account loosing the equivalent of 35 per cent of its SACU receipts over the twelve years transitional period of the EU-SA ATDC. As the Rand in which SACU receipts are denoted is a foreign reserve, the reduction in SACU receipts will lead to the decline in reserves. The impact could be felt with respect to import cover as well as the currency cover in the context of the Common Monetary Area (CMA) arrangement.

5. **Policy Implications and Recommendations**

As stated earlier, this study shows that the free trade agreement between South Africa and the EU will lead to a substantial reduction in revenue that accrue to SACU Common Revenue Pool as a direct outcome of tariff reductions. Clearly, this holds implications for fiscal policy. Namibia’s budget deficit as a percentage of GDP is already above what is generally considered a sustainable norm of 3 per cent.\(^{13}\) This means that the country cannot afford to absorb the permanent loss in revenue by further increasing its budget deficit ratio because this will put more pressure on the national budget. The budget is already experiencing pressures especially those stemming from the heavy public sector wage bill, the continued fiscal transfers to loss making parastatals, and the rising public debt servicing.\(^{14}\)

This situation is likely to be aggravated further by the various trade liberalization initiatives being undertaken in the context of the WTO and SADC. It is expected that the trade liberalization programme in the context of the WTO in terms of which South Africa, as a developed country, has made commitments to substantially reduce tariffs on imported goods on MFN basis, will lead to further decline in revenue from international trade. As stated earlier, estimations are that South Africa’s tariff reduction programme under the WTO will lead to custom revenue reductions of approximately N$318 million. In addition, the implementation of the SADC Trade Protocol is also expected to result in further revenue reductions from international trade.

Furthermore, initiatives geared towards negotiations for further regional trade agreements such as the one proposed between South Africa/SACU and MERCUSOR trade block, implies that the era in which governments rely on trade taxes as a source of revenue is coming to an end.

It is clear from the above discussion that unless alternative domestic revenue sources are found, the fiscal pressures will be immense and could constraint the effectiveness of the budget as an important instrument of economic development. It is against this background that the following recommendations are made.

**Revenue Mobilization and Tax Reforms**

The Government is encouraged not only to design fiscal measures to streamline public sector operations and fiscal management, but most importantly to replace SACU revenue with equivalent domestic revenue. In this

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\(^{13}\) Given that the targeted budget deficit of 3% of GDP set in NDP1 was evidently not achieved, it remains to be seen whether the objective to keep the budget deficit at less than 3.3% of GDP during the NDP2 period will be realized. Much higher reductions will have to be made in order to achieve this target.

\(^{14}\) Public debts have been growing rapidly from a lower of N$535 million in 1990 to N$6 263 million in 2001. As a percentage of GDP, public debts grew from 8.2 percent in 1990 to 22 percent in 2001.
regard, alternative domestic sources of tax revenue need to be explored as a matter of urgency. This will be
difficult a task. In particular, the option of raising the rate of domestic taxation is limited because these rates are
already relatively higher in international and regional terms. Table 5 shows the various tax rates in Namibia and
its two neighbours, namely: Botswana and South Africa.

Table 5  Tax Rates in Namibia, Botswana, and South Africa, 2002.

<table>
<thead>
<tr>
<th>Income Tax</th>
<th>Namibia</th>
<th>Botswana*</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxable income for:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individuals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0% (&lt;N$20 000)</td>
<td>0% (N$0 - 39 500)</td>
<td>0% (23 000)</td>
<td></td>
</tr>
<tr>
<td>18% (20 000-40 000)</td>
<td>5% (39 500 - 69 177)</td>
<td>18% (&lt;38 000)</td>
<td></td>
</tr>
<tr>
<td>30% (40 001 - 80 000)</td>
<td>10% (69 177 - 98 825)</td>
<td>26% (38 001 - 55 000)</td>
<td></td>
</tr>
<tr>
<td>35% (80 001 - 200 000)</td>
<td>15% (98 825 - 128 472)</td>
<td>32% (55 001 - 80 000)</td>
<td></td>
</tr>
<tr>
<td>36% (&gt;200 000)</td>
<td>20% (128 472 - 158 120)</td>
<td>37% (80 001 - 100 000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>25% (&gt;Over 158 120)</td>
<td>40% (100 001 - 215 000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>42% (&gt;215 001)</td>
<td></td>
</tr>
<tr>
<td>Corporate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Diamond Mining</td>
<td>55%</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Non-diamond</td>
<td>35%</td>
<td>25% (non-resident company)</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>15% (resident company)</td>
<td></td>
</tr>
<tr>
<td>VAT</td>
<td>15%</td>
<td>10%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance: Namibia, SARS, Ministry of Finance: Botswana.

* The Botswana Pula was converted to the Namibia Dollar at the exchange rate of 0.63 to the Namibia Dollar, being the
average exchange rate for the Month of December, 2002.

From the above table, it is clear that taxable income rates in Namibia are relatively higher than those in
Botswana. Both the effective and marginal tax rates are very low in Botswana than those in Namibia. However,
the taxable income rates in Namibia are more or less similar to those in South Africa. Although the marginal tax
rates in South Africa are higher than similar rates in Namibia, it should be pointed out that the effective tax rates
are much lower in South Africa than those in Namibia. Furthermore, it should be pointed out that the South
African taxpayers are only subjected to a VAT rate of 14 per cent as compared to 15 per cent in Namibia. In
Botswana, VAT is much lower at only 10 per cent. In addition, people earning less than N$23,000 are exempted
from paying income taxes in South Africa as compared to N$20,000 in the case of Namibia.\[15\] In Botswana, this
amount stands at approximately N$40,000.

\[15\] The non taxable amount of R23 000 in South Africa is to be increased to R27 000 in 2003 for taxpayers below the age of 65, while the exemption for
taxpayers above the age of 65 is R42 640 in 2003 as compared to R39,154 in 2002.

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The conclusion that can be drawn from the above discussion is that raising tax rates in Namibia will make them un-competitive, especially against Botswana and may constraint investment and growth. Therefore, the Government will have to look at alternative measures. This could take different facets such as the introduction of new taxes such as capital gain, inheritance, donation etc. Other measures geared towards strengthening the tax collections including more vigorous and frequent auditing of firms are highly recommended.

It needs to be stated that in addition to the introduction of the VAT in 2000 as a significant tax reform measure in Namibia, the Government has taken initiatives to review its taxation system. It is expected that such a review will not only allow for an assessment of the efficiency and effectiveness of the current domestic revenue collection process of the Ministry of Finance, but most importantly, it will explore new ways and means of alternative revenue sources to replace revenue delivered from international trade.

With regard to efficiency and effectiveness of the revenue collection administration, it is recommended that Government should seriously consider instituting institutional reforms of the tax administration. In this regard, the tax collection Department could become autonomous and divorced from the core functions of the Ministry of Finance. Countries that have instituted such reforms have seen positive results. In the case of Uganda, it is estimated that since the establishment of the semi-autonomous Uganda Revenue Authority in 1991, domestic revenue has more than doubled in real terms during the first half of the 1990s (Chen et al, 2001). Similarly, the South African Revenue Services (SARS) has achieved its revenue target within 9 months of operations.

These autonomous bodies have largely been successful due to their incentive systems, which are designed to attract highly skilled officials, promote efficiency and effectiveness of the revenue collection mechanism.

In light of the aforesaid, it is strongly recommended that Government commission a study to investigate the pros and cons of establishing an independent revenue authority. This entity should be run strictly on business lines in order to realize efficiency and professionalism.

PUBLIC EXPENDITURE REFORMS

The public expenditure pattern was discussed earlier in section 7 of this paper. In order to minimize the negative effects arising from revenue reductions from international trade, there is a need to streamline and strengthen the public expenditure management. The introduction of a Medium Term Expenditure Framework (MTEF) with the main objective of strengthening fiscal policy management, greater efficiency and effectiveness in fiscal operations by integrating government policy-making and public expenditure management is a positive development. However, there is a growing concern that provision for additional budget may undermine the objectives and purpose of the MTEF, hence recommendation that the additional budget should be avoided.

Another important measure to curb public expenditure is the acceleration of the civil service reform along the lines proposed by Wages and Salary Commission (WASCOM). In this context, the reduction in public employment (through attrition, early retirement etc) should result in less pressure on the budget. It will also permit an increase in real remuneration of professionals and skilled workers, coupled with efforts to achieve a closer link between pay and performance. Although such an exercise will result in job losses in the short term, it is expected that it will benefit the country in the long-term.

Further, in view of the fiscal pressures from parastatals, it is recommended that the commercialisation and privatisation reform processes be accelerated. There is a pressing need for the Government to seriously consider
privatising some of the public enterprises. To this effect, a clear strategy regarding parastatals reforms needs to be designed and implemented as a matter of urgency. In the immediate term, a pilot privatisation program comprising few firms can be initiated.

It is to be appreciated that Government has taken initiatives to critically address some of these issues including the creation of the Governance Council on Parastatals. Other measures taken by the Government include commercialisation and outsourcing of non-core functions of the government such as those involving the Ministry of Works, Transport and Communications, and provision for early retirements.

Finally, the growing public debt and servicing are likely to put more pressure on the budget, hence the need to guard against further increases. There is a need to map out a prudent and a coherent debt and borrowing strategy that takes note of the increasing levels of debt servicing and the negative effects it might have on the overall economy.

6. CONCLUSION

The results of this study show that the SACU Common Revenue Pool would lose approximately N$2.1 billion or 35 per cent of the customs component if the 1997 figures are used due the trade pact between South Africa and the EU. This is equivalent to about 14 per cent of the 1997 total common revenue pool. The loss to Namibia is likely to be approximately 35 per cent of the 1997 SACU receipts, which is equivalent to 10 per cent of Namibia’s total Revenue in 1997/98.

Given that Namibia relies heavily on revenue from the SACU Common Pool, this holds implications for fiscal policy and the balance of payments in Namibia. In the first place, the country has been running a budget deficit ranging between 3 and 5 per cent. Unless equivalent domestic revenue source is found, further increases in the budget deficit will become unsustainable in the long term. Second, the scope for raising the rate of taxation is very limited, as tax rates are already relatively higher in regional and international terms.

Apart from the revenue reductions due to the EU-SAATDC and the new Revenue Sharing Formula, it is expected that taxes on international trade will continue to decline as the trade liberalization programmes in the context of the WTO and in the context of regional trade arrangements take effect. The BIDPA study (1999) is correct to state that unless there is a sharp change to the trend of global trade policy, the era in which governments could rely heavily on trade taxes as a source of revenue is coming to an end.

In light of the aforesaid, it is imperative that Government takes appropriate measures in order to minimize the adverse effects resulting from the loss of revenue from international trade. In this regard, it is of urgency that the government embarks on tax reforms with a view to broadening its tax base. This should include possible introduction of new taxes and streamlining the revenue collection administration including a consideration for the establishment of an independent revenue authority.

In addition, the Government is encouraged to exercise prudent fiscal management and operations taking into account the declining revenue, the growing public debt and servicing on one hand and growth and development on the other. Finally, the increased direct fiscal transfers to parastatals and the bloated public service sector wage bill need to be addressed speedily so as to lessen excessive demands on the budget.
On the positive side, a free trade area has the potential to increase the overall economic activities and welfare. More specifically, consumers are likely to benefit from trade liberalization through lower prices due to increased competition. To the extent that trade liberalization results in increased economic activities, this may result in increased revenue generation to offset the revenue fall from international trade. However, this possibility depends largely on the supply side response, hence it cannot be quantified at this point in time.
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