Anatomy Of The Southern African Customs Union: Structure And Revenue Volatility

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ABSTRACT

This paper studies the evolution of the Southern African Customs Union (SACU), tracing it from its inception in 1889 as the Customs Union Convention, the world's first customs union, to its current status. While the union has operated under different agreements, which have been negotiated and renegotiated with changing circumstances, the study identifies the agreements of 1889, 1910, 1969 and 2002 as key to the union's transformation. It is observed that SACU has evolved from a geopolitical organisation with a repressive colonial foundation to a well-integrated regional trading bloc that is perceived as a possible springboard for larger regional trading blocs in Africa. The study further explores evidence of declining SACU revenue and investigates its implications on government expenditures in the small members of the union; namely, Botswana, Lesotho, Namibia and Swaziland (BLNS countries). It is found that among the members of the union, Lesotho and Swaziland are the most dependent on SACU transfers and, consequently, the most vulnerable to the current downward trend in SACU revenue. While Namibia has traditionally relied on diamond exports, it has also been receiving large SACU transfers relative to its GDP. In addition, the study observes that the present SACU revenue sharing formula adopted in 2002 exposes the BLNS countries to instabilities arising from global business cycles more than it does South Africa.

Keywords: Customs Union; Public Expenditure; Government Revenue

1. INTRODUCTION

While the theory of customs unions is commonly believed to date from the publication of Viner's pioneering work in 1950 (Cooper & Massell, 1965), the history of the Southern African Customs Union (SACU) goes back to more than six decades earlier, in 1889, when the Cape of Good Hope (a British Colony) and the Orange Free State (a Boer Republic) established the world's first customs union which they called the Customs Union Convention (CUC)[1]. The CUC was extended to cover the British territories of Bechuanaland (Botswana) and Basutoland (Lesotho) in 1893, Swaziland in 1903, and the Union of South Africa in 1910, before a renegotiated agreement of 1969 led to the adoption of the name SACU in 1970. SACU has been renegotiated once more, culminating in the 2002 Agreement. Current members of the union include Botswana, Lesotho, Namibia, Swaziland (BLNS countries) and the Republic of South Africa.

SACU member states deposit their customs and excise collections in a common revenue pool (CRP), which they share using a formula that has evolved substantially over the years. The revenue sharing formula (RSF) currently in use was agreed upon following negotiations that started in 1994 and ended with the 2002 agreement. Under this RSF, the BLNS countries combined get nearly half of the collections in the CRP, although their joint gross domestic product (GDP) is less than 10 percent of SACU's GDP. Not surprisingly, income from the CRP constitutes a considerable proportion of total government revenue in the BLNS countries. In Swaziland, for instance, revenue from SACU accounts for over three-quarters of government revenue. In Lesotho, it constitutes nearly two thirds of fiscal revenue and in Namibia, it accounts for more than half of government revenue.

The SACU revenue, however, has been declining in recent years. In Namibia, SACU income was estimated to have declined by 40 percent in 2009/2010 compared to the previous year (Van den Bosch, 2010), while in

[1] See Gibb (2006) and Ettinger (1974) for an elaborate history of SACU.

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Lesotho, the country's SACU revenue was expected to fall by 60 percent in 2010/2011 (Central Bank of Lesotho, 2010). In Swaziland, SACU income declined by 6 percent in 2006/2007, 6.4 percent in 2009/2010 and 12.5 percent in 2010/2011 (Government of Swaziland, 2007). Prospects for the CRP are not good either. It is expected that the BLNS countries will continue receiving declining revenue from SACU. Flatters and Stern (2005) predict that Swaziland's SACU revenue, as a share of its GDP, will decline from 17.6 percent in 2005 to 9.4 percent in 2020; Lesotho's share will go down to 12.6 percent of GDP in 2020, from 21.5 percent of GDP in 2005, while Namibia's and Botswana's shares will drop from 8.1 percent and 5.1 percent of GDP in 2005, respectively, to 4.4 percent and 2.8 percent of GDP in 2020, in that order. For the BLNS countries combined, SACU revenue, measured as a percentage of GDP, is projected to decline from 14.35 percent in 1994 to about 7.3 percent in 2020. Against the declining SACU revenue and the heavy government reliance on income from the CRP, fiscal expenditures and, hence, public programs in the BLNS countries are likely to be adversely affected.

This study analyses revenue trends from the SACU CRP accruing to the BLNS countries and examines implications of the shrinking CRP on government expenditures. The study explores quantitative evidence of the recent rapid decline of SACU revenue and its projections. It opens a discussion on the possible implications of revenue shortfalls and the BLNS countries' ability to manage this unexpected loss in recurrent income. The study finds that among the BLNS countries, Lesotho and Swaziland are the most dependent on SACU transfers. Effectively, the two countries are the most vulnerable to the current downward trend in SACU revenue. While Namibia has traditionally relied on diamond exports, it has also been receiving large amounts of SACU transfers relative to its GDP. In addition, the study observes that the present SACU revenue sharing formula adopted in 2002 exposes the BLNS countries to instabilities arising from global business cycles more than it does South Africa. Customs revenue - a component of the CRP from which the BLNS countries get the largest share of their SACU revenues - is susceptible to large volatility depending on business cycles in SACU's major trading partners, while excise revenue - a portion of the CRP from which South Africa gets the largest share of its SACU revenues - is fairly stable.

2. EVOLUTION OF SACU: A HISTORICAL OVERVIEW

Since its establishment as CUC in 1889, SACU has operated under different agreements which have been negotiated and renegotiated with changing circumstances[2]. The evolution of SACU to its present position, however, can be traced back to a period broadly separated by four major agreements; namely; the 1889, 1910, 1969 and 2002 agreements.

2.1. The 1889 Agreement

The history of SACU starts in 1889 when Orange Free State (a Boer Republic) and Cape of Good Hope (a British Colony) established CUC, which was reorganised four years later with the admission of Bechuanaland (Botswana) and Basutoland (Lesotho) as members of the union. Swaziland joined in 1903. The three new members, referred to as British High Commission Territories (HCTs), were admitted under a separate protocol which categorised them as second-class members with diminished rights (see Maasdorp, 1982). Neither of them had the power to amend customs duties, alter the terms of the agreement, or vote on new concessions (Gibb, 2006).

2.2. The 1910 Agreement

Following the formation of the Union of South Africa in 1910, all previous agreements were terminated, paving way for the Customs Union Agreement - a renegotiated accord which was effected in the same year. It was made clear in the new agreement that the customs union was a provisional establishment pending absorption of the three HCTs into the Union of South Africa (see McCarthy, 1992; Botswana Institute for Development Policy Analysis [BIDPA], 1999; Hyam & Henshaw, 2003). The HCTs were perceived as a political and economic burden and their independence was regarded as not viable (Gibb, 2006). The British, however, later prevented incorporation of the three countries despite receiving pressure from South Africa (BIDPA, 1999).

[2] Different agreements were reached in 1889, 1893, 1898, 1903, 1910, 1969 and 2002 (see Ettinger, 1974; Gibb, 2006)

The 1910 Agreement provided for a common external tariff, free trade within the four countries, free transit across each other's territories, and a RSF for the distribution of revenue collected from customs duties and excises taxes (BIDPA, 1999). In the 1910 RSF, members shared the union's customs revenue in proportion to their level of external trade, and divided excise duties according to their respective production and consumption of excisable goods as recorded between 1907 and 1910, a development which resulted in the HCTs collectively receiving only 1.3 percent (Bechuanaland, 0.27 percent; Basutoland, 0.88 percent; and Swaziland, 0.15 percent) of the total revenue, while South Africa's share was 98.7 percent (see Cattaneo, 1990; SACU, 2010). Since the RSF was fixed to trade, production and consumption figures of 1907-1910, there was no scope for the HCTs to increase their share of the SACU revenue pool during years when they grew faster than South Africa. South Africa retained the authority to single-handedly administer the union's CRP, set SACU import duties, and decide upon excise policy throughout the period of the Agreement[3].

2.3. The 1969 Agreement

Following the independence of Botswana and Lesotho in 1966 and Swaziland in 1968, the former HCTs engaged South Africa to renegotiate the Customs Union Agreement. At the time, it had become clear that the share of the CRP allocated to the three countries (1.3 percent) significantly underestimated their contribution to the pool (Gibb, 2006). A new agreement was reached in 1969 and was effected in the following year. Among the major changes, the union adopted the name SACU, a new RSF was introduced, and institutions were designed to help in the management of the union. Using the new RSF, Botswana, Lesotho and Swaziland (BLS) were each given a portion of the CRP based on their share of imports and products subject to excise duties in the SACU area, multiplied by 1.42 (BIDPA, 1999), while South Africa was allocated the residual.

The new RSF was generally regarded as generous to the BLS countries, shifting away from a bias towards South Africa, to a bias in favour of the three smaller countries (BIDPA, 1999). The formula was modified in 1976 to include a stabilisation factor to reduce fluctuations in the revenue shares accruing to the BLS countries. The stabilisation factor ensured that the BLS countries received at least 17 percent and at most 23 percent of the value of their imports and excise duties (see Fajgenbaum, Sharer, Thugge & DeZoysa, 1999). The domination of the union's affairs by South Africa continued. South Africa retained the sole decision-making authority over customs and excise policies of SACU (Gibb, 2006).

2.4. The 2002 Agreement

When the apartheid regime came to an end in 1994, there was consensus among all SACU members that the 1969 Agreement was due for amendment. The Agreement was perceived as colonial, undemocratic and a legacy of South Africa's apartheid past (Gibb, 2006), whose principal objective was no more than a recognition of the status quo (BIDPA, 1999). Nelson Mandela described the organisation as 'a reflection of the colonial oppressor's mentality' (Gibb, 2006, p. 595) and McGowan (1999, p. 4) called it a 'colonial relic.' After several years of negotiations, beginning in 1994, members reached a new agreement in 2002. A major breakthrough in the agreement was a provision for joint responsibility over decisions affecting tariff setting, the CRP and overall direction of SACU (Southern African Customs Union Secretariat, 2008). The 2002 Agreement also spells out a new RSF and an institutional framework for the administration of the union, which comprises a Council of Ministers (a supreme decision-making authority), a Customs Union Commission, a Tribunal, a Tariff Board, technical liaison committees and a secretariat (see Southern African Customs Union Secretariat, 2008).

While the 2002 SACU Agreement settled for the establishment of a joint decision-making process, South Africa was retained as a custodian of the CRP. According to the South African Reserve Bank (SARB), the authorities calculate expected customs and excise collections for all member states and the South African government makes quarterly payments to the BLNS countries in advance[4]. Depending on the actual collections, the BLNS countries are eventually either underpaid or overpaid. If a member is underpaid, the South African

[3] Even the Agreement itself was signed by one person, Lord Gladstone, Governor of the Union of South Africa and High Commissioner for the three protectorates, who had only to agree with himself and sign the Agreement four times (Kirk & Stern, 2003).

[4] An interview with members of staff in the South African Reserve Bank Research Department.

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government pays off the difference. In the event of overpayment, the concerned member is supposed to pay back the difference. However, paying back has been problematic, and netting off in subsequent payments has been considered a realistic alternative.

3. THE THEORY OF CUSTOMS UNIONS AND THE POLITICAL ECONOMY OF SACU

Viner's (1950) pioneering work in customs union theory demonstrates that a customs union can result in either trade creation or trade diversion. Trade creation involves a shift from high-cost domestic production to lower-cost production in a partner country, while trade diversion entails a shift from a low-cost external producer to a higher-cost producer in a partner country. Viner (1950) concludes that trade creation raises the home country's welfare while trade diversion lowers it, drawing his inference from the postulation that tariffs are an inefficient means of raising revenue. The subsequent literature (see, for example, Lipsey, 1960; Cooper & Massell, 1965; Collier, 1979; Kowalczyk, 2006), however, shows that when 'consumption effects' are taken into account, the Viner (1950) conclusion may not necessarily hold.

Lipsey (1960) argues that in the absence of a customs union imposing a tariff introduces a divergence between relative prices facing consumers and real opportunity costs of goods to the economy, making it identical to an excise tax which has the effect of constraining consumers to a non-optimal consumption equilibrium. Following the establishment of a customs union, some dutiable goods that were previously imported from external sources will, as expected, be replaced by identical goods imported from a partner country, duty free but at a higher real cost. This migration from a lower cost external producer to a higher cost source of supply in a partner country lowers a country's real income and, consequently, consumer welfare. However, the removal of the constraint on consumption brought forth by the elimination of tariffs in the union may raise welfare. In the event that the second effect outweighs the first, net consumer welfare may go up.

Extending Lipsey's (1960) hypothesis, Cooper and Massell (1965) argue that the welfare effect of a customs union, whether trade creating, trade diverting, or both, can be split into a tariff reduction component and a pure trade diversion component. Cooper and Massell (1965) demonstrate that the tariff reduction component accounts for both trade creation and trade diversion, and it is the sole source of any gain in a consumer's welfare that might result from a customs union.

Clearly, SACU cannot be appraised using tools of customs union theory alone. It is evident that the BLNS countries have benefited considerably from free trading of South African products and manufactures. It is equally clear that South Africa has gained immensely from resource extraction and labour imports from its partners in the union. However, the fact that SACU was originally established within a colonial framework, and was supported by an apartheid regime with oppressive institutional structures, cannot be ignored. This background has been a source of tension between South Africa and the BLNS countries, resulting in the relations between the two being characterised more by acrimony than harmony (Gibb, 2006).

In the literature, the case of SACU has been interpreted by two polar schools of thought with no scope for convergence. One school of thought - the dependency school - has regarded SACU with suspicion, describing it as part of a sub-regional system that emerged under colonialism and was, as a consequence, characterised by relations of economic domination and subordination (see Gibb, 1997). This school maintains that South Africa has derived substantial benefits from its access to cheap resources in the BLNS countries and that the country has undertaken a deliberate stance to develop strong ties of dependence to itself in the BLNS countries (Davies, 1990).

The interdependence school, on the other hand, has perceived SACU as an effectively functioning trading bloc, which is beneficial to all participating parties. This school cites the revenue sharing principle of collections in the SACU CRP as a successfully implemented policy for compensating the trade diverting costs imposed on the BLNS countries (see Matthews, 1983; Gibb, 1997). Matthews (1983) maintains that SACU has survived many years because the arrangement, on the balance, is beneficial to all parties.

The defining characteristic of SACU is the demographic and economic dominance of South Africa in contrast to the other four members (Kirk & Stern, 2003). With a population of 48.5 million, South Africa accounts for 88 percent of the total population in SACU (see Table 1). Equally large is the size of the country's economy relative to the BLNS countries. It is estimated that 92 percent of the total output in SACU is produced in South Africa. South Africa also accounts for 89 percent and 86 percent of the total SACU imports and exports, respectively.

Table 1: SACU Economic Indicators (2008)

	Botswana	Lesotho	Namibia	Swaziland	BLNS	RSA	% of SACU	
							BLNS	SACU
Population[1]	1.7	1.88	2	1.1	6.68	48.5	12.11	87.89
GDP[2]	8,458	1,059	5,692	1,820	17,030	183,249	8.5	91.5
GDP/Capita[3]	4,497	502	2,714	1,557	2,549	3,764		
Imports[2]	2,788	2,061	1,546	2,076	8,470	66,478	11.3	88.7
Exports[2]	4,472	570	1,257	1,563	7,861	50,166	13.55	86.45
Inflation[4]	12.7	10.72	10.35	13.3	11.77	9.8		
Interest Rates[5]	8.67	7.64	8.38	8.17		11.61		

[1] millions; [2] millions of constant 2000 US Dollars; [3] constant 2000 US Dollars; [4] Year-on-year percentage changes in the all items national composite consumer price index; [5] deposit rates. Source: World Bank World Development Indicators Online

For most of SACU's history, the BLNS countries have used a common currency, that of South Africa (BIDPA, 1999). The Rand Monetary Agreement (RMA), signed in 1974, formalised the use of the South African Rand as the only legal tender in the region. Botswana pulled out from the RMA in 1975. Currently, each of the four countries has its own currency. Lesotho, Namibia, Swaziland and South Africa, however, are members of a Common Monetary Area (CMA). In the CMA, currencies of Lesotho, Namibia and Swaziland are pegged at par with the South African Rand. While the South African Rand is allowed to be used as money in all countries in the CMA, the national currencies of Lesotho, Namibia and Swaziland are not accepted as legal tender in South Africa.

An important implication of the CMA is that the monetary authorities in Namibia, Lesotho and Swaziland do not have an independent monetary policy from that of South Africa. Accordingly, they are bound to have similar inflation and interest rates to South Africa's. In addition, they do not possess the option of financing their budget deficits through money creation. Although Botswana is in a different position, the country has been running budget surpluses for many years and its exchange rate with the other members of SACU has been maintained at a near constant level to avoid disrupting trade. Botswana's fiscal and monetary policy has drawn the country closer to some convergence with countries in the CMA.

The BLNS countries have generally experienced high economic growth rates, although sharp contrasts of poverty and prosperity exist among them. On the one extreme, Botswana has transformed itself from being one of the poorest countries in the world at independence in 1966 to an upper-middle income economy, outpacing the economic growth of even the Asian Tigers (World Bank, 2010). The country recorded an average growth rate of 9 percent between 1966 and 1999 and it has been the fastest growing economy in SACU. Unlike all the other SACU members, the country has had no record of negative growth since the 1960s. As at 2011, it had the largest GDP per capita in SACU, estimated at US$4,378 compared to US$532 for Lesotho, US$1,812 for Swaziland, US$2,758 for Namibia, and US$3,825 for South Africa. Botswana's success story is attributed to the discovery of diamond reserves in the country after independence, which has been well exploited.

On the other extreme is Lesotho, one of the poorest countries in the world and the poorest in SACU. An enclave entirely surrounded by South Africa, the country has a population of 1.88 million and a GDP per capita of US$502 with about 40 percent of the population living below the international poverty line of US$1.25 per day (UNDP, 2009). The country is heavily dependent on remittances from migrants working in South African mines and almost half of the population earns some income from agriculture (Kirk & Stern, 2003). Among its major exports are clothing and textiles (which sprouted out of the United States' initiative in the African Growth and Opportunity Act of 2000), diamonds and water.[5]

[5] Lesotho exports water to South Africa, feeding the Free State and greater Johannesburg area.

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4. THE 2002 SACU REVENUE SHARING FORMULA AND PUBLIC EXPENDITURES IMPLICATIONS

Resources in the SACU CRP originate from two primary sources - customs revenue (C) and excise collections (E). According to the 2002 RSF (see Kirk & Stern, 2003), each member of the union (i) gets an allocation from the customs revenue (C_i) based on its share of intra-SACU imports (M_i). This can be presented as:

$$C_i = \frac{M_i}{\sum_{i=1}^{n} M_i} * C \quad (1)$$

where n is the number of countries in SACU. Accordingly, the country that imports the most from within the union receives the largest share of the customs pool, thereby providing implicit compensation for the 'cost-raising effect' of the customs union (Kirk & Stern, 2003). This approach of sharing customs revenue also encourages trade diversion (Kirk & Stern, 2003). Excise revenues, on the other hand, are placed into two separate funds. The first is a development fund (D) constituting 15 percent of the total excise revenue. The development fund is distributed among members nearly equally using the formula:

$$D_i = \left[1 - \left(\frac{n * Y_i}{\sum_{i=1}^{n} \frac{Y_i}{n}} - 1\right) / 10\right] * \frac{D}{n} \quad (2)$$

which can be reduced to

$$D_i = \left[11 - \left(\frac{n * Y_i}{\sum_{i=1}^{n} Y_i}\right)\right] * \frac{D}{10n} \quad (3)$$

where D_i is the allocation for country i and Y_i is the country's gross per capita income (GDP). While the allocations are not exactly equal, each country gets nearly 20 percent of the fund. The remaining 85 percent of the excise collections are distributed to members according to their share of GDP in the union:

$$E_i = \frac{Y_i}{\sum_{i=1}^{n} Y_i} * E \quad (4)$$

where E_i is the allocation to country i. The total payment to a member state (P_i) from the SACU CRP, therefore, is given by:

$$P_i = C_i + D_i + E_i \quad (5)$$

Since the BLNS countries have a large propensity to import from within SACU, and particularly from South Africa, they get the largest share of their SACU revenues (estimated at 80 percent) from the customs revenue component of the CRP. South Africa's imports from fellow SACU members, on the other hand, are a relatively small proportion of its total imports (see Table 2). In 2005/2006, South Africa's share of intra-SACU imports was only 21.15 percent compared to 78.86 percent for the BLNS countries. Accordingly, South Africa's share from customs revenue collected in the union has been relatively small. On the other hand, South Africa has a large economy estimated at 92 percent the size of SACU and since excise collections are distributed to members according to their share of GDP, the country gets a very large share (estimated at 80 percent) of the excise revenue component of the CRP.

Table 2: Share of Intra-SACU Imports (2002-2006)

	2002/03	2003/04	2004/05	2005/06	2006/07
Botswana	29.25	25.39	28.73	26.05	26.41
Lesotho	13.76	12.18	12.59	13.09	13.96
Namibia	23.76	25.49	20.39	23.67	25.16
Swaziland	21.22	16.81	22.83	16.46	14.77
South Africa	12.01	20.13	15.46	20.72	19.70

Source: SACU (2008)

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An important implication of the 2002 RSF is that the volatility of the two components of the CRP (customs revenue and excise collections) is different. Since South Africa and the BLNS countries derive the largest proportion of their SACU revenue from different components of the CRP, it can be inferred that the two are also different in their vulnerability to global business cycles transmitted through the SACU revenue. Customs revenue, a component of the CRP from which the BLNS countries get the largest share of their SACU revenues, is susceptible to large volatility, depending on business cycles in SACU's major trading partners, while excise revenue is fairly stable.

Revenue from the SACU CRP constitutes a significant proportion of total government revenue in the BLNS countries. Governments of Lesotho and Swaziland stand out as the most dependent on SACU revenue among the SACU member states. Lesotho's total receipts from the CRP accounted for 51 percent of total government revenue (excluding grants) in 2001/2002, before dropping slightly to 48.6 percent in 2005/2006, and later increasing to 64.66 percent in 2008/2009 (see Table 3). In Swaziland, the figures are relatively higher, with the country's income from the CRP increasing from 54.1 percent of total government revenue (excluding grants) in 2001/2002 to 68.5 percent in 2005/2006 and 76.59 percent in 2008/2009. While Namibia's dependence on SACU revenue is relatively lower, it is estimated to have increased in recent years. The country's earnings from the CRP, as a proportion of total government revenue, are estimated to have gone up from 30.4 percent in 2001/2002 to 51.22 percent in 2008/2009.

Table 3: SACU Revenue Receipts

	Botswana	Lesotho	Namibia	Swaziland	RSA
2001/2002					
Receipts from SACU (R'million)	2,622	1,438	2,641	1,503	9,897
% of Total Govt. Revenue*	12.8	51.0	30.4	54.1	3.9
% of Revenue Pool	13.8	7.6	13.9	7.9	56.7
	Botswana	**Lesotho**	**Namibia**	**Swaziland**	**RSA**
2005/2006					
Receipts from SACU (R'million)	4.008	1,984	3,228	2,795	13,027
% of Total Govt. Revenue*	12.1	48.6	25.1	68.5	4.4
% of Revenue Pool	14.0	6.8	11.4	9.2	58.5
	Botswana	**Lesotho**	**Namibia**	**Swaziland**	**RSA**
2008/2009					
Receipts from SACU (R'million)	9,473	4,901	8,502	6,009	15,220
% of Total Govt. Revenue*	NA	64.66	51.22	76.59	3.3
% of Revenue Pool	21.5	11.1	19.3	13.6	34.5

*excludes grants. Source: Flatters and Stern (2005); Government of South Africa (2010); author's own calculations

The available statistics show that SACU income in the BLNS countries has been declining. SACU revenue expressed as a ratio of GDP in the BLNS countries combined, took a downturn from 23.63 percent in 1982 to 6.74 percent in 1990 (see Figure 1). Thereafter, it somewhat stabilised until 2000/2003 when the trend became upward, rising from 6.82 percent in 2003 to 13.97 percent in 2007, before starting another sharp downturn, reaching 11.61 percent in 2008. While Figure 1 clearly shows that the SACU revenue as a ratio of GDP in the BLNS countries has been going up and down, a simple linear trendline for the period 1970-2008 reveals that, on the average, the trend has been downward.

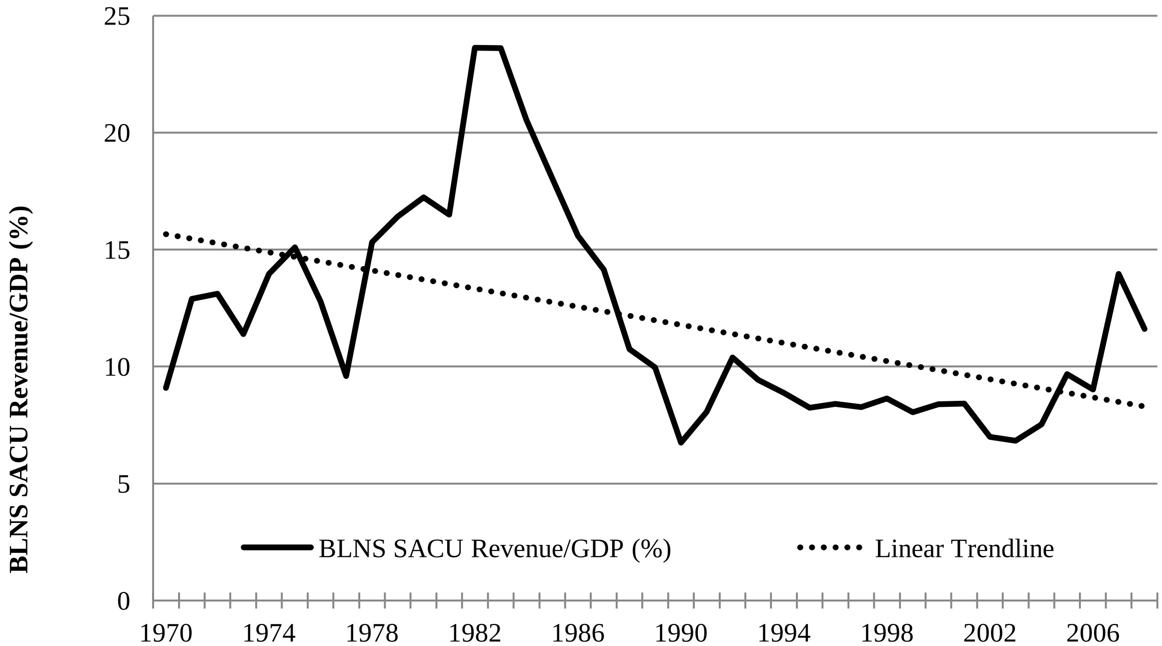

Figure 1: SACU Revenue as a Ratio of GDP in BLNS Countries (1970-2008)
Source: World Bank World Development Indicators Online, South African Reserve Bank (SARB), Southern African Customs Union Secretariat and author's calculations.

Data from the respective BLNS countries show that the recent decline in SACU revenue is continuing and is likely to maintain the same path. The Central Bank of Lesotho (2010) predicted that the country's SACU revenue would decline by 60 percent in 2010/2011, owing to the global recession and a consequent decline in imports worldwide, including SACU member countries. SACU revenues (expressed as a ratio of GDP) in the Lesotho Government Budget have declined steadily from 36.1 percent in 2009/2010 to 13.1 percent in 2010/2011 and 9.3 percent in 2011/2012. In Swaziland, SACU receipts declined by 6 percent in 2006/2007 and went up by 13 percent in the following fiscal year before dropping by 6.4 percent and 12.5 percent in 2009/2010 and 2010/2011, respectively (Government of Swaziland, 2007). A similar trend has been recorded in Namibia where SACU revenues, as a ratio of GDP, went down from 12.03 percent in 2006 to 8.2 percent in 2008. The observed decline in SACU income in the BLNS countries has been projected to continue. Flatters and Stern (2005) predict that Swaziland's SACU revenue, as a share of its GDP, will decline from 17.6 percent in 2005 to 9.4 percent in 2020; Lesotho's share will go down to 12.6 percent of GDP in 2020 to 21.5 percent of GDP in 2005; while Namibia's and Botswana's shares will drop from 8.1 percent and 5.1 percent of GDP in 2005 to 4.4 percent and 2.8 percent of GDP, respectively, in 2020 (see Table 4).

Table 4: SACU Revenues as a Share of GDP

	1994	2002	2005	2020
Botswana	8.0	4.5	5.1	2.8
Lesotho	28.0	19.8	21.5	12.6
Namibia	7.7	7.8	8.1	4.4
Swaziland	13.7	12.9	17.6	9.4
BLNS	4.4	11.3	13.1	7.3
RSA	1.6	1.2	0.9	0.8

Source: Flatters and Stern (2005)

A number of factors explain the declining SACU revenue. First is the poor performance of the global economy. A global economic downturn, particularly poor economic performance in SACU's major trading partners, would generally lead to a decline in trade between SACU and its partners, consequently causing a fall in SACU customs revenue and hence a drop in the BLNS countries' income from the CRP. The global recession of 2006/2007 is an instance that has had an impact on SACU revenue caused by a decline in trade between SACU and the

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international community. The European Union (EU) Sovereign Debt Crisis is another example with a similar effect. This crisis is expected to have negative effects on SACU Revenue. Analysts have reported that the bailout in the Eurozone will only postpone recovery rather than solve the crisis, suggesting that the adverse effects of the crisis are likely to last for a long time (British Broadcasting Corporation [BBC], 2010b; BBC, 2010a).

Second, a poor performance of the South African economy impacts negatively on SACU revenue because of associated lower demand for goods and services and reduced imports. In recent years, the economy of South Africa has been growing, albeit more slowly each consecutive year. It grew by 5.3 percent in 2006, 5.1 percent in 2007 and 3.1 percent in 2008. In 2009, the South African economy contracted by 6 percent and 3 percent in the first and second quarters, respectively. This poor performance of the South African economy has had an adverse effect on the CRP. As illustrated in Figure 2, SACU revenue accruing to the BLNS countries (plotted on the primary vertical axis) are highly correlated with GDP in South Africa (plotted on the secondary vertical axis), with a correlation coefficient of 0.9424, which is statistically significant at 1 percent.

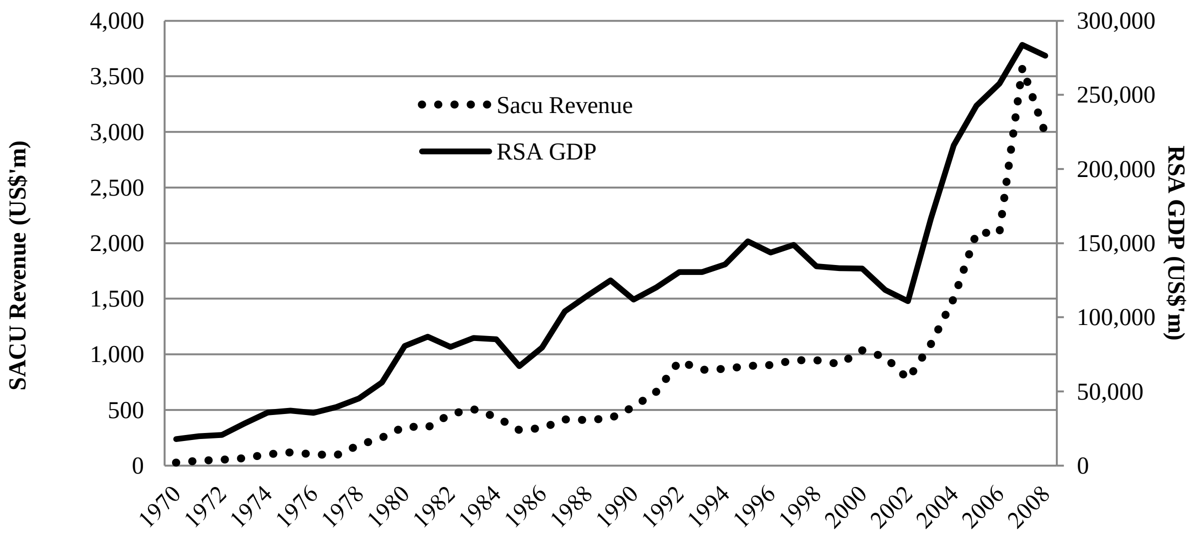

Figure 2: SACU Revenue in BLNS Countries and South Africa's GDP (1970-2008)

Third, related to the previous argument, is that a shock to the South African economy is bound to be felt in the BLNS countries through changes in their SACU revenue (positive changes for a positive shock and negative changes for a negative shock). A particular case in point are the large scale construction works and capacity expansion in the electricity and transport sectors associated with the 2010 FIFA World Cup (Southern African Customs Union Secretariat, 2008), which inevitably resulted in a jump in aggregate demand and large amounts of imports into South Africa. At the end of the World Cup, most of these projects came to completion. A sharp decline in imports into South Africa is, therefore, expected to follow, leading to a drop in SACU revenue.

Fourth, global trade tariffs have shown a declining trend and they may decline further as trade agreements between SACU and other trading blocs/countries are concluded. SACU has in recent years been negotiating free trade agreements with China, India, the United States of America, EU and MERCOSUR (Argentine, Brazil, Paraguay and Uruguay), among others. In addition, SACU has committed itself to be an anchor of the Southern African Development Community (SADC) Customs Union (Central Bank of Lesotho, 2010). Conclusion of any free trade agreement is associated with a reduction and, in some cases, an elimination of tariffs leading to a decline in the size of the CRP.

Besides its direct impact on government revenue, the declining SACU revenue is also expected to adversely affect the macroeconomic performance of the BLNS countries. As demonstrated in Figure (3), growth in SACU income (plotted on the primary vertical axis) is highly correlated with economic growth (plotted on the

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secondary vertical axis) in the BLNS countries, with a correlation coefficient of 0.9438, which is statistically significant at 1 percent level.

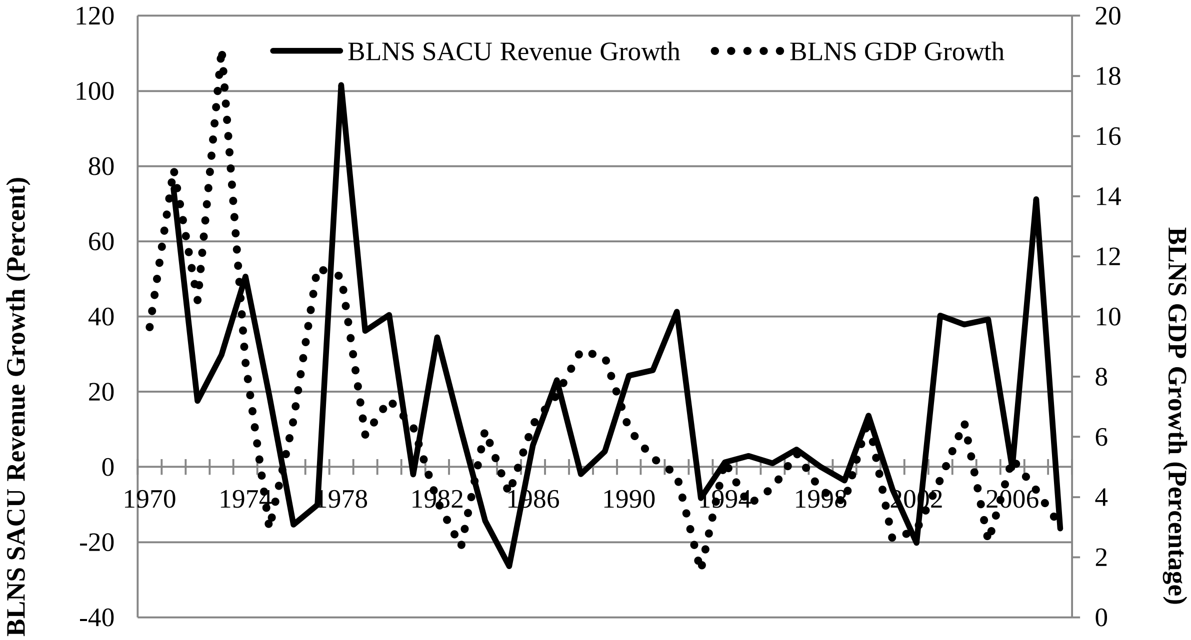

Figure 3: GDP and SACU Revenue Growth for BLNS Countries (1970-2008)

In theory, we expect a two-way causal relationship between the growth of SACU revenue and GDP growth in the BLNS countries. Given the importance of SACU revenue in the government budgets of the BLNS countries, an increase in SACU revenue is likely to be associated with higher GDP growth. Similarly, an improvement in the macroeconomic performance of the BLNS countries is expected to increase aggregate demand and hence imports, which in turn may lead to an increase in customs revenue and excise collections.

However, since the BLNS countries account for only less than 9 percent of the total GDP of SACU, movements in their GDP are likely to have an equally small impact on SACU revenue. That is, changes in SACU revenue may not be influenced, to a large extent, by GDP in the BLNS countries. The BLNS countries, on the other hand, get nearly half of the SACU revenue, which constitutes a large proportion of their fiscal budgets. Since government expenditure and GDP are positively related, it is safe to presume that SACU revenue has a significant impact on macroeconomic performance in the BLNS countries. This result is corroborated by a number of studies that have found a one-way causal relationship between government revenue and economic growth running from the former to the latter (see, for example, Anastassiou & Dritsaki, 2005; Balducci, 1990). The study concludes, therefore, that the high correlation between SACU revenue and GDP growth in the BLNS countries is dominated by a one-way causal relationship running from SACU revenue to GDP growth. In effect, it is argued that the declining SACU revenue will have a negative effect on economic growth in the BLNS countries.

5. SUMMARY AND CONCLUSION

This paper studies the evolution of SACU from its establishment in 1889 to its present status. The study also investigates the recent rapid decline in income from the SACU CRP for members of the union, explores quantitative evidence of this decline and opens a discussion on the possible implications of revenue shortfalls for the BLNS countries and their ability to manage this unexpected loss in recurrent income. The study observes that SACU has evolved from a political entity with a colonial foundation to a well-integrated regional trading bloc. Prior to 1969, SACU operations reflected a repressive colonial regime with no regard for the BLNS countries. A new agreement that changed the union's name to SACU, effective 1970, transformed the geopolitical landscape, with the BLNS countries now getting a generous share of revenue from the union's CRP. A renegotiated agreement of 2002 further raised the operating platform, providing for joint responsibility over decisions affecting tariff-setting, the CRP and overall direction of SACU, besides introducing a new RSF favourable to the BLNS countries.

The study confirms reports that SACU revenue, as a share of government revenue and as a ratio of GDP, is on the decline and may continue going down. The recent global recession that peaked in 2006/2007, the European Union Sovereign Debt Crisis, poor performance of the South African economy, negative shocks to the South African economy, and declining global trade tariffs arising from developments in regional integration involving SACU and other trading blocs/countries, are some of the factors that are responsible for the declining SACU revenue.

There are several policy options facing the BLNS countries. In the short run, they may have to lobby for an increase in donor support to cover the funding gap in critical areas such as HIV/AIDS-related expenditure. The donor funding may have to be complemented with fiscal restraint, cutting down expenditures in non-priority areas in order to realign the declining government revenue with public expenditures. Realising that the expenditure cuts need not be done in a way that chokes the economy, relatively larger fiscal deficits may be inevitable. In the long run, the BLNS countries should consider adopting an expenditure plan anchored on domestic revenue. The fiscal framework may have to be restructured, moving away from reliance on SACU revenue, especially for recurrent expenditures. There is also the need to aim at efficient and effective use of public resources. This may involve adherence to public expenditure ceilings, priority targeting of public expenditures towards more urgent productive projects, and streamlining the public sector to ensure that government is involved only in services that cannot be efficiently provided by the private sector.

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