THE SOUTHERN AFRICAN CUSTOMS UNION

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CONTENTS

LIST OF ABBREVIATIONS

BLS	Botswana, Lesotho and Swaziland
BLNS	Botswana, Lesotho, Namibia and Swaziland
COMESA	Common Market for Eastern and Southern Africa
GDP	Gross domestic product
GNP	Gross national product
HCT	High commission territory
ISI	Import-substituting industrialisation
LDC	Least developed country
RIA	Regional integration arrangement
SACU	Southern African Customs Union
SACUA	Southern African Customs Union Agreement
SADC	Southern African Development Community
SSA	Sub-Sahara Africa
TOR	Terms of reference
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Terms of Reference

The consultant was commissioned to prepare a case study on the *Southern African Customs Union* (SACU) as part of a larger project, *Strengthening capacities for decision making in the process of intensifying economic integration of English speaking LDC countries in Africa* (Project GCP/RAF/362/SWE). The main objective of this project is the assessment and evaluation of the experiences made in the process of deeper economic integration towards the implementation of a common agriculture policy.

The terms of reference (TOR) for the SACU Case Study specify an overview that presents the characteristics of SACU in terms of:

- initial and current objectives

- the scope/domains of common policies in the field of food and agriculture
  - policies harmonised
  - policies decided in common
  - policies implemented in common
  - programmes implemented in common

- institutional arrangements for
  - negotiating/designing
  - implementing existing arrangements, including financial mechanism, dispute settlement, subsidiarity and the participation of civil society
  - monitoring the implementation of arrangements

- specific problems experienced during
  - negotiation
  - implementation, including overlapping membership, policy convergence, harmonisation of standards, changes in trade flows, food security, political tension and WTO agreements

- specific measures taken to deal with the difference in the level of development of member states

- lessons with respect to
  - whether the objectives have been achieved
  - if repeated, what should have been done differently?

In interpreting the TOR the immediate problem was to place the content of the study within the context of a customs union that is in transition. SACU currently operates in anticipation of an agreement which has been renegotiated, agreed upon on now awaits ratification and implementation by the governments of the member states. The new agreement differs quite dramatically form the current agreement. The pending transition from the current to a new agreement and the unique nature and history of SACU required a different approach to sequentially dealing with the points raised in the TOR. These points are addressed in the study

but they will feature at places where the consultant found them to be more appropriately located to fit the logic of the story told. To assist readers the study is concluded with the main points raised in the TOR and a brief discussion of these as summaries from the text of the study.

The case study was primarily undertaken as desk research of published and unpublished sources, which the researcher has accumulated over a long period of involvement with regional integration in Africa and with the Southern African Customs Union in particular. Unfortunately, the restricted scope of the case studies did not allow a budget for visits to the member states and structured interviews with people, both in the private sector and government, involved in SACU affairs. The latter would have been particularly valuable in SACU's case because of the renegotiation of the Agreement.

Interviews with the negotiators of the member states and their advisors as well as with representatives of interest groups in the main industries would have been very helpful to understand the finer intricacies at play. In the case of agriculture this would have been especially valuable. The common external tariff is the defining feature of a customs union and in the course of the paper it will become clear that for the largest part by far of SACU's existence the tariff was and still is principally seen as an instrument of industrial policy and as a source of revenue. Agriculture was protected by quantitative import control and subjected to intensive marketing arrangements. Deregulation and tariff protection only became a factor during the second half of the 1990s.

1. Introduction

1. On 21 October 2002 the heads of state of Botswana, Lesotho, Namibia, Swaziland (BLNS) and South Africa signed a new Southern African Customs Union Agreement (SACUA) in Gaborone, Botswana. This represented a very important development in the history of the oldest operating customs union in the world, a development that gave recognition and content to having a democratic South Africa, the most powerful economy on the continent, in a regional integration arrangement with four much smaller economies. What gives SACU and the new agreement special significance is that SACU is officially recognised to be a building block in the development of a customs union for the Southern African Development Community (SADC). SADC, in turn, is envisaged, together and after consolidation with other continental integration arrangements, notably the Common Market for Eastern and Southern Africa (COMESA), to play an important role in the development of the recently formed African Union (Ngwenya, 2002: 26). SACU, it has been argued, "is likely to form the core of a variable-geometry regional trading arrangement covering the whole of southern Africa" (Gibb, 1997: 68).

2. What makes SACU an interesting case in the African experience with regional integration arrangements (RIAs) is that it is not only the oldest and deepest regional trade integration arrangement in Africa but also that it has survived its colonial origin and South Africa's history of apartheid. Having first three and later four members of the Organisation for African Unity in a deep form of integration with apartheid South Africa, with its much larger and more sophisticated economy, made strange bedfellows indeed. On a continent noted for

its many failed integration arrangements a RIA that works is exceptional and worthy of closer consideration. To derive the lessons that SACU can provide it is necessary to first consider the African setting and the rationale of integration in Sub-Sahara Africa (SSA).

2. The African setting and the rationale of integration

3. SSA is a marginalised region of the global economy. This is reflected in the region's declining share in world production and trade. SSA as a whole has a sizeable population of 628 million, but they live in countries that form the dominant cluster in UNCTAD's defined group of least developed countries. These small and underdeveloped economies have serious problems to cross the threshold to sustainable, diversified development through strategies that focus on domestic or foreign markets.

4. From the beginning of the post-colonial period it was recognised that regional integration will have to form an integral part of Africa's economic development strategy. The outcome has been a rapid growth in RIAs that strongly supplemented the institutions that were carried over from the colonial period. The continent developed a reputation for its large number of RIAs, but also became well known for the large number of failures (De la Torre & Kelly, 1992: 25). The reasons for these failures are many and varied and have been recorded in the literature (McCarthy, 1996). An outcome of the general lack of progress made with regional integration in Africa has been an increase in scepticism and even cynicism on the prospects for successful integration in Africa.

5. From a global perspective, Africa's integration arrangements are inconsequential in the sense that they have virtually no impact on the world trading system. This can be ascribed to ineffectiveness in the operation of the RIAs and to the fact that even the larger groups represent small markets in world terms. In most cases the RIAs also have little impact on the economies of the participating countries themselves, but in this respect there are important exceptions to the general case. The dependent relationship that exists between South Africa and its smaller partners in SACU is a notable example of such an exception.

6. Outside Africa, regional integration has made substantial progress. The growth in regionalism is perhaps as important a development in international trade relations as the conclusion of the Uruguay Round of negotiations and the establishment of WTO and its agreements. Although Africa does not have a track record of regional integration successes the high level of activity in this field would seem to indicate that the continent's experience could be counted as part of the revived interest in regional integration associated with the "new regionalism" or "second wave" of regionalism. In eastern and southern Africa, notable activities include the progress made by COMESA with the establishment a free trade area on 1 November 2000 that aims to become a customs union in the future, the moves to negotiate and implement a free trade area within SADC, the re-negotiation of the SACUA, and the region's own experience of South meeting North with the implementation of a free trade agreement between South Africa and the European Union (the European Union–South Africa Trade, Development and Co-operation Agreement - TDCA). For SACU, South Africa is driving a vigorous process of bilateralism with a free trade agreement being negotiated with Mercosur and agreements mooted with the USA and India.

7. But the overriding history of failure of integration arrangements in Africa compared to arrangements elsewhere in the world has led to questions being asked about the appropriateness of regional integration as an instrument of economic development. Is regional integration is in fact the right route for the typically small African economies to take to development? Charles Harvey (1999) has expressed serious doubts about the conventional view on the role of regional integration in African development. He referred to the African desire to overcome the problem of small economies through integration as "largely an illusion". Clearly, Harvey regards the conventional arguments that are offered in defence of regional integration in Africa as fundamentally flawed. The poor track record of regional integration in Africa and the fact that adding very small markets together still leaves you with a small economy have also prompted some observers to be quite despondent about prospects for regional integration in SSA.

8. Nevertheless, it can be argued that the need for regional integration derives from the salient features of the typical SSA economy. Briefly, the characteristics of the average SSA economy can be listed as follows:

- small in terms of effective market – in 1998 only 5 of the 48 SSA countries had GDPs of more than US$10 billion while no less than 30 countries had GDPs of less than US$5 billion (World Bank, 2000),

- undeveloped, most falling within UNCTAD's classification of least developed countries (LDCs) – of the 48 countries identified by UNCTAD as "least developed" on the basis of 1995 data, 33 were SSA economies (United Nations, 1997),

- lack of capacity to produce tradeable goods competitively especially in manufacturing, poorly developed private sector and entrepreneurial corps,

- poor labour skill base – in 1997 42 per cent of the population of SSA countries that were 15 years old or above was illiterate (World Bank 2000),

- weak infrastructure – in 1997 16.5 per cent of roads in SSA were paved while per capita electric power consumption in the rest of SSA came to only 3.3 per cent of South African consumption (World Bank 2000), and

- Many, no less than 14 countries, are landlocked, thus increasing the transactions cost of trade.

9. In adopting a structuralist model of development, the post-colonial conventional wisdom was that the smallness of Africa's economies, their lack of development and the need to "catch up" dictated the use of regional integration as a means to facilitate import substituting industrialisation (ISI). Ideologically, private sector development was not favoured and in the spirit of African socialism the emphasis fell on the establishment of industrial parastatals. Most if not all RIAs have political aims as primary driving force. This is the case

in Africa as well where pan-Africanism and the bringing together of states whose borders were artificially determined by the colonial powers have contributed to the popularity of regionalism in the post-colonial period. The Lagos Plan of Action (1980), which aimed to implement a self-reliant development strategy, propagated the establishment of RIAs that would cover the map of Africa. The intention was to eventually integrate the RIAs into a single African common market.

10. In theory, developing countries would benefit through net welfare gains from non-discriminatory trade liberalisation. However, this is a static approach while most developing countries would be basing the logic of their joining a RIA on the dynamic benefits of growth and development. This is the geographically extended version of ISI: a larger market is created that allows room for scale advantages in production and more competition and thus greater efficiency. The outcome is trade diversion encountered in static, Vinerian analysis, but against the background of the need for growth and development any growth in production and in the creation of production capacity is considered better than no production at all. Compensation for the consumers' loss (because of trade diversion) is found in the growth in income and jobs.

11. In adopting this development route, African economies followed the example of most developing countries in the 1950s and 1960s but achieved very little. In this model regional integration forms an integral part, with import substitution in the larger regional market the principal demand side force of industrial growth. In time, the failure of ISI, shown to have led to a static misallocation of labour and capital across industries with no improvement in the long-run growth in multi-factor productivity (Pack, 2000), became generally appreciated. Attention and acclaim shifted to the new conventional wisdom of outward-looking or export-oriented growth as the true means to achieve high growth and development. In the course of the 1980s and 1990s, structural adjustment programmes also predicated the benefits of unilateral trade liberalisation as the way out of the bind of uncompetitiveness. Trade liberalisation became a condition for financial assistance within programmes of structural adjustment.

12. In the new regionalism the focus has also shifted to the role of regional integration in developing an export capacity, i.e. easing a participating country's entry into the world market. Apparently the regional market must serve as an incubator that will facilitate the development of the skills and economies of scale necessary to produce for the global market. Whether you look at it from the viewpoint of import-competing production or the efficient production of exportables the theoretical underpinnings remain the same. But there are clear differences from an operational point of view, for example, maintaining, increasing or managing down tariff levels.

13. The dynamics of regional integration introduces the problem of polarised growth. All participating countries experience the welfare cost of trade diversion but the larger and more developed economies within a RIA are more successful in reaping the growth benefits of agglomeration. These economies are also those that are likely to have a positive trade balance with the other partners in the RIA. The smaller and less developed partners therefore suffer a double blow of negative static and dynamic outcomes in the allocation of gains from regional integration. Since integration is only politically sustainable if all participants gain, it is crucial

to design a RIA with mechanisms that will facilitate an equitable distribution of net benefits. In southern Africa the dominant position of South Africa causes asymmetry in the outcome of integration with South Africa's dynamic benefits possibly exceeding the static welfare cost. This kind of inequity can destabilise RIAs and thus necessitates special mechanisms. SACU, as will be noted below, has been able to survive because of the special compensatory fiscal transfers built into the SACUA but even these have at times not appeared to be sufficient to sustain the customs union.

14. At this point a number of important questions need to be raised:

- What development option should the typical African economy select, *assuming that industrialisation is a necessary source of growth and development*? ISI or export orientation?

- Given the lack of capacity to produce tradeables competitively, is export-oriented growth really an option? If not, we are left with ISI. Do the small markets allow economically feasible ISI that will make a quantum difference to growth and development?

- Is the history of ISI as bad as portrayed by the new orthodoxy? How does one explain the fact that with the exception of Hong Kong all industrialised and semi-industrialised countries have initially gone through a process of ISI (Shafaeddin, 1998)? To what extent is this ignored/captured in the empirical studies that demonstrate the undeniable association between export orientation and growth? Can it be claimed that import substitution failed in Africa if, as some observers would have it (Bruton, 1993), it was never actually implemented?

- If some degree of capacity-creating import substitution is required to build an economy that can produce tradeables for the global market in economies that currently lack such capacity, does ISI not have a role to play? Considering the small domestic markets, will any improvement in scale advantages provided by RIAs not help? Does the argument that the economies are so small that even as a group the regional market is small by international standards consider the fact that even a limited increase in market size allows firms to move down their average cost curves, which is beneficial even if the optimum level of production is not achieved?

15. These questions and issues could lead to a premise that can guide the argument for RIAs in Africa. *The typical African economy, especially in SSA, has little option in its pursuit of diversified growth through industrialisation but to create some capacity to produce tradeable goods before it can turn to the global market as outlet. This capacity is unlikely to be created by unilateral trade liberalisation as such; investment in human capital and infrastructure with production for the domestic market remains the only option. However, to counter the impact of market smallness, and in many cases a landlocked location, the regional option is an imperative. But this has failed in the past because of errors in design and implementation. The focus should therefore fall on the latter two factors.*

16. It is generally recognised that regional integration *per se* is not a substitute for sound national development policies. It is certainly not a panacea, but there can be little doubt that regional integration remains a necessary condition for industrialisation and growth in SSA. Increasing market size is an important consideration, but a second factor may be even more important. In globalising world, small developing countries hardly have a noticeable voice. Grouped together in an active RIA the situation can be quite different. Organised in a RIA, African economies can, for example, have a more powerful and beneficial position in Geneva, for example, where resources can be combined to serve their interests at the WTO.

17. This diversion into the rationale of the regional integration of developing countries served the purpose of illustrating that the use of this mechanism is closely linked to the goal of economic growth through industrialisation. Mytelka (1973: 240) captured this sentiment in his observation with respect to integration in the developing world: "Integration in many areas of the world is, in fact, a paradigm for industrialization". The structuralist model adopted in Latin America during the 1950s and during the post-colonial years in Africa had one overriding aim and that was to create a larger protected market for inward-looking industrial growth. Essentially, therefore, regional integration in Africa has been an integral part of the sectoral bias in favour of manufacturing industry and at the cost of agriculture that was built into economic development policies. The inappropriateness of these policies, with the terms of trade heavily in favour of manufacturing and the urban areas against agriculture and rural areas, became the standard fare of the literature on development economics and need not further be dwelt on.[1] Suffice it to emphasise that the growth of an agricultural surplus, diversification of agricultural production and food security through common or harmonised agricultural policies for the region hardly featured in the ambitious integration plans that were designed in support of economic growth in African states.

18. In the case of SACU the forces that drove regional integration initially were significantly different from those that applied in those examples where the intention of inward-looking industrialisation *within a larger market* played the dominant role. In SACU's case ISI was very important but in a substantially different way. During the first decades of its existence ISI behind the protective wall of a tariff was used not as a policy to encourage the industrialisation of the common customs area but solely as a policy of successive South

[1] In a recent OECD report the negative outcome of inappropriate agricultural policies was again highlighted. Referring to the state marketing boards that were supposed to stabilise export prices and protect farmers' income from fluctuation in world prices, it is argued that these boards "in fact ….used their monopsonistic power to keep the prices paid to farmers below world prices, Thus siphoning rents away from the agricultural sector to urban elites" (Bonaglia & Fukasaku, 2002: 27). If the resources channelled to the urban economies had stimulated industrial and income growth, a positive feedback to the rural areas and agriculture could have resulted. However, the report observes that this was not the outcome: "Evidence exists…that Africa's earlyefforts at industrialisation were in many cases frustated by the pursuit of non-economic objectives, which undermined the growth of nascent industrial sectors even under import-substitution policies. The combination of heavy import protection and overvalued exchange rates favoured the emergence of unproductive rent-seeking activities" (Bonaglia & Fukasaku, 2002: 27).

African government to promote industrial growth in South Africa. The other SACU members have only incidentally been part of the industrialisation drive. To understand this situation a brief overview of the nature of the economies of the SACU member states and the history of the organisation is called for.

3. Overview of the SACU economies

19. Although all the member states of SACU can be regarded as developing countries, as revealed by their per capita income shown in table 1, the outstanding feature of the customs union is the economic dominance of South Africa. The South African economy is by far the largest, contributing about 93 per cent of the customs union GDP, and most industrialised economy. There is also a significant gap between the per capita GNP of South Africa and Botswana on the one hand and that of the other three SACU members.

Table 1
Economic profile of the SACU economies, 1999

	Population Millions	GDP (const. 1995 prices) US$ million	GNP per Capita US$	Inflation % p.a. 1991-MR	GDP Growth % p.a. 1991-1999
Botswana	1.6	5 893	3 240	11.1	5.3
Lesotho	2.1	1 079	550	11.4	4.5
Namibia	1.7	3 568	1 890	10.2	3.7
Swaziland	1.0	1 421	1 360	11.9	2.9
South Africa	42.1	164 369	3 170	9.9	1.4

Sources:
African Development Bank, 2000; SADC Finance & Investment Sector Co-ordinating Unit (Fiscu), 2001.

20. The GDP growth figures summarised in table 1 show that the smaller SACU members have done much better than the poor performance associated with most SSA economies, which is highly suggestive that these economies do benefit from being integrated with Africa's largest and most industrialised economy. In the case of Botswana, rich mineral (diamond) resources that provide a mineral rent that is much better managed than in most mineral-rich economies enhance this benefit.

21. On the macro-economic front, the broadly similar inflation rates, shown in table 1, also suggest that SACU provides a framework for macro-economic convergence. No doubt, the integration of Lesotho, Namibia and Swaziland into the South African money and capital market through the Common Monetary Agreement between these states and South Africa plays an important role in this regard.

Table 2

Value added of Agriculture and Industry as a percentage of the GDP of SACU economies, annual average for 1997 and 1998

	Value added in Agriculture* % of GDP	Value added In Industry** % of GDP
Botswana	3.6	44.6
Lesotho	12.7	29.0
Namibia	9.5	28.0
Swaziland	13.4	34.1
South Africa	4.2	30.7

* Net output of agriculture, forestry, hunting and fishing, with the exception of Botswana in which case it represents gross output at market prices, i.e. intermediate inputs included.
** Net output of mining, manufacturing, construction, electricity, water and gas, with the exception of Botswana in which case it represents gross output at market prices, i.e. intermediate inputs included.

Source: World Bank, 2000.

22. The SACU countries are not, as shown in table 2, predominantly agriculture-driven economies. In the case of Botswana and South Africa, the relative contribution of agriculture is overshadowed by industry, which in turn is dominated by mining in Botswana and manufacturing in South Africa. It will be argued at a later stage that the SACU tariff has primarily been an instrument used in the development of South Africa's manufacturing sector and that the development of modern, market-oriented agriculture has not been an important issue. It may be noted in table 3, however, that while South Africa has developed the most substantial and diversified manufacturing capacity on the African continent, its domination of agricultural output within SACU more or less equals its domination of industrial output.

Table 3

Member contributions to SACU Value Added in Agriculture and Industry

	Agriculture (1995 constant prices) US$ million	% Distribution	Industry (1995 constant prices) US$ million	% Distribution
Botswana*	220	2.9	2 690	5.0
Lesotho	132	1.7	276	0.5
Namibia	326	4.3	992	1.8
Swaziland	187	2.5	477	0.9
South Africa	6 701	88.6	49 431	91.8
TOTAL	7 566	100.0	53 866	100.0

* As noted in Table 2 the values for Botswana represent gross output (i.e., including the value of intermediate inputs); hence, they tend to overstate Botswana's comparative position.

Source: World Bank, 2000.

23. What do these features of the SACU economies tell us? The first and most obvious one is that South Africa dominates the customs union economically. This applies not only with respect to size in terms of total production, the population and the market, but also as far the level and sophistication of industrial development is concerned, and also with respect to agricultural production. Furthermore, note has to be taken of the integration into and dependence on South Africa's well-developed infrastructure. Botswana, Lesotho and Swaziland are landlocked economies, Lesotho being a unique case of being totally landlocked within South Africa. This means that these economies largely depend on the South African infrastructure for sea-borne transport links with the rest of the world. It may be noted that Namibia differs from the other smaller member states in having a more developed infrastructure, which it inherited from having until 1990 been governed as the "fifth province" of South Africa.

24. The difference in size and development explains the intra-regional trade surplus that is heavily in South Africa's favour, with the latter being the principal supplier of manufactured goods to BLNS. In the case of Botswana about 14 per cent of its exports in 1997 were destined for the SACU market, whereas 72 per cent of its imports were sourced in South Africa. For Lesotho (in 1995) the respective figures are 52 and 91 per cent, for Namibia (in 1996) 23 and 84 per cent and for Swaziland (in 1996) 67 and 90 per cent.[2] A feature of the Lesotho economy that distinguishes it from the other smaller states is the extent of factor exports in the form of labour to South Africa. For many years now Basotho migrant workers have earned more on the mines, remitting the largest part of their income to their families in Lesotho, than the income earned by workers in Lesotho.

[2] These shares were calculated on the basis of trade data published in SADC (2000). It should be noted that the figures for Botswana, Lesotho and Swaziland refer to trade with the rest of SACU. However, because of the negligible trade among these economies they effectively refer to trade with South Africa. In the case of Namibia the trade figures are those with South Africa.

4. The 1910 Agreement[3]

25. An understanding of the issues that currently feature when the customs union is appraised is only credible if the history of SACU and the forces that brought the members together, and kept them in the union with its incongruous structure. The explanation of the longevity of this customs union of unlikely member states must be sought in the distinctive politics and economics of the region.

26. SACU can trace its roots to the late nineteenth century but currently functions in terms of a treaty signed in 1969 between South Africa and the three previous high commission territories (HCTs) of Bechuanaland, Basotholand and Swaziland. At independence in the 1960s they became the Republic of Botswana (1966) and the Kingdoms of Lesotho (1966) and Swaziland (1968) - the so-called BLS states. When Namibia gained its independence in 1990, it formally joined SACU, having earlier been indirectly part of SACU as an area administered by South Africa.

27. The 1969 Agreement was preceded by the 1910 Agreement, which created a customs union between South Africa and the HCTs at the time of the establishment of the Union of South Africa in 1910. The 1910 Agreement determined that no customs duty would apply to goods flowing between the member countries. The member states applied the same rate of duty on goods entering the customs union from outside the common customs area. Although each member could in principle initiate a change in duty level, South Africa in practice set the duty, which meant that the South African duty effectively was the common external tariff.

28. The revenue generated was included in a common revenue pool administered by South Africa and distributed among members on the basis of fixed (i.e. not trade related) percentage shares. South Africa's share was fixed at 98.69 per cent of revenue and for a long time the shares of the smaller members were fixed with Basutoland allocated 0.88 per cent, Bechuanaland 0.28 per cent and Swaziland 0.15 per cent, which constituted a total share of 1.31 per cent for the HCTs. These were amended in 1965 to lower Basutoland's share to 0.47 per cent while increasing Bechuanaland's to 0.31 per cent and Swaziland's to 0.53 per cent.

29. Economically, the HCTs were administered as an integral part of South Africa with no tariff constraints on the flow of goods between the countries. The unusual step of including excise revenue in the common revenue pool of a customs union illustrates the integrated nature of the four countries and their porous borders. Politically the intention to incorporate the HCTs into the Union of South Africa remained a strong desire on South Africa's part for a very long time. The heavy economic dependence of the HCTs on South Africa counted in favour of incorporation. According to Jack Spence (1971: 497) the overwhelming dependence of the HCTs on trade with South Africa made it "difficult to escape the conclusion that economic logic dictated that absorption by South Africa should be their ultimate political

[3] In this and the following section the author to some extent benefitted from a chapter written for a forthcoming book on the Lesotho economy (Lundahl, McCarthy & Petersson).

destiny". The envisaged incorporation of the HCTs in the Union of South Africa meant that independent customs regimes and an own tariff made little sense for the HCTs. Furthermore, the economic development of the HCTs beyond natural resource extraction for overseas markets was not really considered a viable strategy (Gibb, 1997: 75). The entrenchment of South Africa's apartheid policies after 1948 and South Africa leaving the Commonwealth in 1961 put an end to any idea of incorporation. However, political independence did not put an end to economic dependence.

30. Namibia joined SACU at independence in 1990 and has a different history from the HCTs. South West Africa, a colony of Germany, was entrusted to South Africa by the League of Nations to be governed as a so-called C Mandate.[4] This allowed South Africa to govern Namibia effectively as the "fifth province" of South Africa. This meant that in addition to integration into the South African political system with direct representation in Parliament, the territory was also integrated into South Africa's infrastructure and factor and goods markets. This brought about a substantial degree of integration into the South African economy, even to the point of dependence, but also a more developed infrastructure.

31. The development of a common infrastructure focused on South Africa and on the need to serve its inland mining and later industrial complexes. The landlocked HCTs were development backwaters that only received peripheral attention. In South Africa the Board of Trade and Industry, which later became the Board on Tariffs and Trade, was established in 1921 on a part-time basis with the express function of developing manufacturing industry. In 1924 the Board was reconstituted as a permanent body and assigned the task of advising the South African government on the recasting and revision of the customs tariff. The outcome was the adoption of the Customs Tariff Act of 1925, which introduced a deliberate and purposeful policy of tariff protection (Lumby, 1983).

32. Hence, from 1925 the import tariff was used extensively by South Africa to protect domestic industries as part of a strategy of import-substituting industrialisation that did not include the HCTs, which remained producers of primary commodities. While the common external tariff encouraged domestic production within the common customs area, the outcome was that South Africa benefited most from a tariff designed to meet its needs. An economy, with a substantial industrial sector by African standards, was the outcome. During the sanctions years the common external tariff and South Africa's ostracism from the international community encouraged industrial growth in the BLS countries. Some South African firms established production subsidiaries in the SACU neighbours in order to escape the impact of sanctions or to gain preferential access (GSP and Lome) to the large markets of the developed world.

33. Considering the early history of SACU it is clear that three factors were of fundamental importance.

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[4] A "C" Mandate, in contrast to A and B Mandates, provided for the substantial integration of the area into the country to which the mandate has been entrusted.

- A customs union was necessary to accommodate the flow of goods among territories that were locked into an integrated economy with separate political jurisdictions.

- The South African tariff served as the tariff of the customs union and since 1925 this tariff was used as an instrument of industrial policy to encourage the industrialisation of South Africa.

- A common external tariff generates customs revenue that has to be divided among member countries; consequently, the customs union agreement had to provide a mechanism and formula for the distribution of revenue.

5. The 1969 Agreement

34. Independence of the HCTs necessitated the negotiation of a new customs union agreement. The subsequent SACUA of 1969 maintained some basic elements of its predecessor but also introduced fundamental changes. The South African tariff remained the common external tariff of SACU. The same applies to excise duties. Article 5.1 of the Agreement requires South Africa to give "the other contracting parties adequate opportunity for consultations before imposing, amending or abrogating any customs duty…". However, consent of the other parties are not required, while Article 5.2 also obviates the need for consultations where interim measures are implemented to protect an industry pending a full investigation by the South African authorities, i.e. the Board on Tariffs and Trade. South Africa can in practice change the tariff levels unilaterally.[5] The responsibility for the administration of the common revenue pool also remained in South African hands. But the way in which revenue is distributed changed fundamentally, with respective shares in trade and consumption of dutiable goods becoming the basis for the determination of enhanced revenue allocation to the BLS countries, with South Africa keeping the residual of revenue.

35. The 1969 agreement takes as its immediate point of departure the fact that the level of economic development in the customs union is highly unequal. Hence, the Agreement, sets out to "ensure in particular that … [the] arrangements encourage the development of the less advanced member of the customs union and the diversification of their economies, and afford to all parties equitable benefits arising from trade among themselves and with other countries …"(Republic of South, 1969: 2). By "diversification of their economies" the intention has been the development of manufacturing industries in the smaller member states. The unequal distribution of industrial activity in the common customs area created the expectation that industries to be established as an outcome of economic integration would tend to locate in the

[5] Although the tariff is set by South Africa, the eventual collection of revenue is influenced by the ability of each member state to implement systems of rebates. South Africa, for example, makes extensive use of tariff rebates and drawback of duties. A case in point is rebate provision 470.03 of the Customs and Excise Act that allows, under specified conditions, the import of goods duty free if these are exclusively used in the production of export goods. Rebates reduce the customs revenue pool and BLNS, with their emphasis on revenue, object to South Africa's extensive use of rebates. Under the current revenue distribution system such criticism, however, is meaningless since, as will be explained, BLNS revenue accruals are not impacted on by the size of the revenue pool.

industrialised areas of the common customs area. Here infrastructure facilities are already available and a manufacturing tradition and a much larger market exist. Polarisation was foreseen, with industrial development concentrating in the high-growth metropolitan areas of South Africa along the lines of the conventional economies of agglomeration.

36. Because of the unequal size and development of the SACU members and the polarisation foreseen the Agreement contains special provisions for the benefit of BLNS industrial growth, demonstrating the intention to encourage the industrialisation of the smaller member states. If cognisance is taken of the development strategies adopted by these countries, economic diversification and growth through industrial development has clearly been the chosen approach (McCarthy, 1994: 175). To achieve this the SACUA provides for an exception to the single tariff and the free flow of goods among member states by allowing the smaller member states to protect industries designated as infant industries (article 6) or as of special interest to the smaller economies (article 7). But deviations from the protection of industry through a common external tariff are also provided for in article 11 of the Agreement that allows import and export prohibitions. This allowed South Africa's earlier protectionist use of quantitative restrictions since "(t) he contracting parties recognise the right of each party to prohibit or restrict the importation into or exportation from its area of any goods for economic, social, cultural or other reasons" (article 11.1). Furthermore: "The contracting parties shall co-operate in the application of import restrictions with a view to ensuring that the economic objectives of any import control legislation in any country in the common customs area are attained" (article 11.5)

37. Customs union revenue is not distributed among member countries in a proportional fashion on the basis of the share in revenue-generating trade. A formula is used to calculate revenue shares for the BLNS countries, with South Africa's share of the revenue being the residual after payments to the smaller member states have been determined. The formula has a multiplier built into it that enhances BLNS revenue receipts by a nominal 42 per cent. However, when the volatility of the revenue flows to BLS countries become clear it was decided to introduce a stabilised revenue rate. Since 1977 the revenue rate (the rate of revenue earned on imports and excisable consumption) has been stabilised by means of an averaging formula that ensures that deviations around a target level of 20 per cent are kept to a minimum within a band of 17 per cent at the lowest end and 23 per cent as the maximum. In practice this means that BLNS have been guaranteed a minimum revenue rate of 17 per cent on import values and excisable consumption.

38. SACU revenue is a very important fiscal resource for BLNS and has been the principal consideration of their customs union membership. Swaziland and Lesotho, in particular, depend on SACU revenue, which equals more than half their recurrent expenditure. Comparative data indicates that the collected tariff rate (import tax revenues divided by imports, which can also be referred to as the tariff rate) is high for a selected group of African countries, but especially so for Lesotho (Lundahl, McCarthy & Petersson, forthcoming). Namibia and more so Botswana have broader tax bases and hence are less dependent on SACU revenue.

39. The justification for the enhancement factor in revenue payments is to compensate BLNS for the disadvantages of being in a customs union with a much larger and more developed economy and for the way in which the customs union is organised.

- BLNS are not in the position to set tariff and excise duties, which means that they experience a loss of fiscal autonomy and restricted sovereignty over trade and industrial policy.

- The second drawback arose from South Africa's protectionist policies that meant that the BLNS economies have been buying South African goods at prices higher than what would apply if the goods were bought in the global market. The imposition of trade barriers such as tariffs, as well as import surcharges and import licensing controls, which previously had been used by South Africa, increased prices for domestic consumers to levels above world prices. For BLNS consumers this has been tantamount to a tax on imported goods and a transfer of income from consumers to the common revenue pool of the customs union or to the producers located in South Africa. Of course, all consumers in the customs area have been suffering a welfare loss because of the higher prices but for South Africa the negative welfare impact has been compensated for by the benefits that accrue to South African industries.

- The third disadvantage is associated with the spatial dynamic of polarised growth, with economic activity settling disproportionately at the industrial centres of South Africa where industry can benefit from agglomeration advantages. During the 1980s the location of industry outside South Africa's metropolitan areas was also biased against BLS by the generous incentives that the South African government offered firms that located in the homelands of Grand Apartheid.

40. For the smaller SACU members the issue has been to weigh up these drawbacks against the compensatory revenue payments, duty-free access to a comparatively large market and the benefit of not having to administer a customs revenue organisation, i.e. obtaining their customs revenue at low administrative cost. Trade diversion, i.e. having to pay higher prices for goods than what could be obtained in the world market, must in recent years have become less of a problem since South Africa's policy of trade liberalisation has led to lower tariff levels on all manufactured goods.

41. Two characteristics of the revenue distribution mechanism that reflect on the relevance of the size of the revenue pool should be noted. The first is that the stabilisation of the revenue rate has effectively de-linked revenue payments to BLNS governments from the size of the pool. The second characteristic is that the description of BLNS imports, according to article 14.2 of the SACUA, includes all imports, i.e. also imports from South Africa. This implies a further break between the revenue payments to BLNS and the size of the pool since revenue is earned on imports that do not generate revenue for the customs union.

42. This de-linking, as well as the rapid economic growth of the BLNS and their imports, the slower growth in customs union revenue because of the phasing out of import surcharges (which South Africa had implemented to protect the balance of payments) and the lowering of tariff levels have resulted in a sharp fall in residual revenue. In 1983/4 the payment of customs and excise revenue from the central pool to the BLNS governments came to 20.5 per cent. This grew to 30.2 per cent in 1993/4 and 38.4 per cent in 1997/8. The South African National Treasury has estimated revenue from customs and excise duties for 2002/03 at R21653.2 million and SACU payments at R9127.0 million, which means that BLNS will receive approximately 42 percent of the revenue pool (Republic of South Africa, 2001).

43. The SACUA aims to do more than arrange the free flow of trade and the distribution of revenue. As noted earlier, the preamble of the Agreement propagates the economic development of the smaller members. Reviewed against the background of the history of economic and political relations in southern Africa, some SACU features define the special nature of the customs union.

- SACUA allowed an ostracised South Africa and BLNS to accommodate their close integration; BLNS were reluctant members of an integration institution necessitated by their integration with and dependence on a pariah. The goals of SACU changed significantly from the pre-independence 1910 Agreement to the post-independence 1969 Agreement but for BLNS it essentially remained a source of revenue and a mechanism to accommodate integration with and dependence on the apartheid state from which they would have preferred to maintain some distance. For South Africa, SACU brought about formal links with three independent African states. However, in South African government circles enthusiasm for SACU varied from the Department of Foreign Affairs, which placed a premium on SACU, and the Department of Finance that protested the drain on the Treasury of SACU payments.

- SACU is administered by South Africa and tariffs levels are decided by the South African Board for Tariffs and Trade, on which the BLNS have no representation. Import tariffs and excise duties have been set at levels that primarily addressed South Africa's industrial policy and revenue needs. This represented a lack of democracy in SACU management. However, it cannot be denied that BLNS would not, for political reasons, have wished closer links with South Africa in managing the affairs of SACU. For BLNS the major concern was to improve revenue payments from the revenue pool in the belief that they were not adequately compensated for being in a customs union with the economically larger and more advanced South Africa who regards the tariff principally as an instrument of industrial policy. BLNS, in varying degrees, preferred an "at arms length" relationship with South Africa.

- The only customs union body that the SACUA provides for (in Article 20) is a Customs Union Commission that has no administrative powers as a supra-national body. It merely serves as a consultative organ.

44. It is difficult to determine whether SACU has achieved its goals since the counterfactual needs to be considered. It is even more difficult to establish where the balance of benefits and costs falls: is South Africa benefiting at the cost of BLNS, as the latter argue, or does the opposite apply as many observers in South Africa would claim, or is it possible to claim that SACU creates a win-win situation for all member states? The clearest indication is that it has been successful in channelling revenue to the BLNS countries, but then BLNS have argued that the compensatory revenue transfer has not been adequate. What further complicates judgement on the adequacy of the revenue transfer is that the lowering of tariff levels must have contained trade diversion. Whether SACU has been successful in aiding economic growth and development in BLNS is more difficult to argue although the economic growth rates noted earlier, which are better than those of most SSA economies, suggest that BLNS have benefited from their customs union membership.

45. For South Africa, the main benefit is to be found in the market for manufactured exports provided by BLNS, while on balance the revenue distribution mechanism represents a costly drain on the Treasury. On *a priori* grounds it is possible to argue that the customs union has played an important role in facilitating the growth of South African exports to BLNS. However, in the absence of a customs union the trade flow would have been substantial. Therefore, it is not possible to be accurate about the customs union's contribution in this regard. Nevertheless, the argument has frequently been made in BLNS circles that the growth in income generated by these exports adequately compensates South Africa for the revenue transferred to the BLNS.[6] Again, it might be noted that during recent years the relative importance of BLNS as a market for South African exports has been eclipsed by the growth in manufactured exports to the rest of Africa and the rest of the world.

6. Agriculture and SACU

46. The story told so far emphasises that revenue and industrial development have been at the heart of SACU. The question remains: where do agricultural development and related issues like food security fit into logic and operations of SACU?

47. In South Africa, agriculture has in the post-1994 period gone through substantial transformation, from a highly regulated and subsidised regime to deregulation, market orientation and little government intervention. The SACUA, in the spirit of a customs union, provides for the free flow of agricultural products among member states. However, article 12

[6] In 1993 the Minister of Finance of Botswana stressed these benefits at a ministerial meeting of SACU, emphasizing that in 1992 the value of South Africa's exports to BLNS was equal to more than 70 per cent of South Africa's net gold exports and more than twice the value of South Africa's exports to the rest of Africa. The trade surplus with BLNS was over R8 000 million, more than twice South Africa's overall current account surplus. On an estimate of 20 per cent protection for manufacturing industry, the Minister, in referring to the phenomenon of trade diversion, stated that this implied an income transfer from BLNS to South Africa of at least R2 700 million in 1992. While figures like these make an important point, caution in their interpretation is required. Again, the counterfactual is important. Many of these comparisons seem to ascribe the relevant data in toto to the existence of the customs union and its arrangements. However, it is very likely that had SACU not existed, trade between South Africa and BLNS, notably Lesotho, would still have been significant and heavily in South Africa's favour.

of the Agreement reflects the era of pervasive regulation of South African agriculture, which dates back to the passing of the Marketing Act in 1937 and the Co-operative Act in 1939. Regulation was embodied in marketing arrangements for most commodities through a system of single-channel marketing boards, while in a few extreme cases, like vineyard and wine production, there were even a system of production quotas in operation. The intention to maintain this regulatory framework in a customs union was captured in article 12.1 of the SACUA, which determines that if "an arrangement for regulating the marketing of an agricultural commodity is in operation in any area of the common customs area, such arrangement shall be applied on an equitable basis to similar commodities produced in any other area of the common customs area and marketed in the area where the marketing arrangement is in operation." (Republic of South Africa, 1969). This clause in a double-edged fashion ensured that in the case of a member state implementing a marketing arrangement, the arrangement might not discriminate against imports from other member states, hence the reference to "equitable basis". But it furthermore meant that the relevant imports from other members would be included within the ambit of the marketing arrangement, i.e. the imports could not be traded freely outside the framework of the marketing arrangement.

48. In article 12.2 of the Agreement provision is made for parties "to consult from time to time on matters affecting production and consumption of agricultural commodities and the improvement and extension of marketing arrangements..". Also pertinently relevant to the farming sector is article 18 that provides for consultations on zoo-sanitary and phyto-sanitary requirements to prevent the spread of animal and plant diseases, parasites and insects. It must be emphasised that these articles were not included in SACUA to serve as the basis for a common agricultural policy or the eventual development of such a policy.

49. Given the dominance of South Africa in SACU's agricultural production and furthermore the regime of regulated marketing as a cornerstone of South African agricultural policy, the application of these marketing arrangements to goods imported from BLNS could have been a constraint on the development of BLNS production for trade with the largest part of the common market. It has been noted earlier that decisions on the customs tariff were dictated by South African industrial policy. It is not often recognised that a more or less similar situation has applied with respect to agricultural policy.

50. Since the protection of South African agricultural production against import competition and the encouragement of self-sufficiency and food security relied on quantitative import control, and not on customs duties, there was overall no need for a customs tariff policy in respect of agricultural products. Since the early 1990s this situation has changed dramatically. A new approach to agricultural policy and the Uruguay Round of multilateral negotiations brought about the replacement of quantitative control over agricultural imports with customs tariffs. The tariffication of import control was started in 1994 and for the majority of products completed early in 1996. During this period time constraints that prevented in-depth investigations and the absence of development strategies for key agricultural sectors forced the Board on Tariffs and Trade to recommend tariff levels on the basis of the guideline that the tariff should result in domestic production and consumption that were about the same as under import control (Board on Tariffs and Trade, undated). This meant that the tariff equivalents of import control were sought and the outcome has been

average tariff levels that far exceed the relatively modest rates that apply to manufactured goods.[7]

51. Since the early 1990s, the deregulation of South African agriculture has proceeded apace and government intervention has been removed (South Africa is a member of the Cairns Group). Successive policy documents threw light on the underlying objectives – the White Paper on Agriculture in 1995, a Green Paper on customs tariff policy with regard to agricultural products in 1996 and in 1998 a document *Agricultural Policy in South Africa – a discussion document*. The key concepts and ideas that featured in these documents included:

- the need for competitiveness, the importance of market forces in guiding production and trade, and development of agriculture according to comparative advantage;
- the replacement of self-sufficiency with household and national food security;
- a customs tariff policy that would assist agriculture in improving its international competitiveness and to adapt to deregulation and competition from imported products; and
- the need to protect agriculture, while adjusting to deregulation and the forces of international competition.

52. Within the context of SACU it is important to observe that the tariffication of South African agricultural protection implied the extension of the common external tariff to include not only manufactured goods but also agricultural products that previously were subject to import control, marketing regulations and the incorporation of these in article 12 of the SACUA. All these changes were brought about in the interest of South African agriculture and in the absence of a common agricultural policy for the common customs area. Also, the South African Board on Tariffs and Trade, which effectively acts as the tariff body of SACU but without BLNS representation, has the task of investigating tariff amendments and to recommend accordingly. However, an important institutional dilemma that exists amidst the process of agricultural deregulation and the tariffication of imports is the fact that the *Board on Tariffs and Trade Act* tasks the Board "to promote industrial growth within the framework of the economic policy of the Republic" (Republic of South Africa, 1986: article 3). This is a legacy of the history of the Board, which, as noted earlier, was set up to encourage the industrial development of South Africa.

53. Within SACU three product groups are given special attention in inter-government discussions: maize, wheat and wheaten flour and dairy products. These are considered important by all member states because of the importance attached to food security. The customs tariff policy with respect agricultural products is to have a fixed tariff per tariff line. However, in the case of maize, wheat and wheaten flour as well as sugar (an important commodity in South Africa and Swaziland) exceptional circumstances are regarded as existing and hence variable duties are applied. The tariff formulas are based on international reference prices, to which the applicable tariff is inversely related, and tariff adjustments are triggered when the respective reference price changes within a specified range. The "exceptional circumstances" that justify variable duty formulas include the key role of these

[7] This method resembles the one adopted when the South African government was compelled by GATT obligations to replace import control (referred to in par. 36) with tariff protection.

industries in rural areas and in the economy as a whole, the short term volatility of international markets where these products are traded as commodities, the sensitivity of these products to changes in the climate and the ability of these industries to adjust to distorted international markets.

7. Problems with the SACU Agreement

54. As is clear from the review so far SACU, although a successful regional integration arrangement, has been exposed to strains and perceptions of weaknesses. To a large extent the debate on SACU could be summarised as a dispute on the distribution of the benefits and costs associated with membership while BLNS believed that net benefits were disproportionately biased in South Africa's favour. Many South African observers have argued the opposite.

55. While South Africa gains from the captive market in the common customs area, BLNS have contended that they are not adequately compensated for the drawbacks they suffer from SACU membership. Apart from polarised development, the loss of fiscal sovereignty and having to pay prices for imports from South Africa above world market levels, they have also drawn attention to other operational drawbacks, most of these derived from the subservient position of BLNS in SACU:

- Difficulties with the establishment of new industries in BLNS in terms of the SACUA that provides for infant industry protection for BLNS industries (Article 6) and for the protection of industries that are specified as of major importance to BLNS (Article 7);

- Inadequate procedures for consultation on actions by South Africa that BLNS find detrimental to their economies;

- Obstacles to the conclusion of preferential trade arrangements with non-SACU governments; and

- A time lag of two years in the distribution of customs union revenue, which follows from the way in which the revenue formula is implemented.

56. From the South African viewpoint, SACU has become an expensive fiscal exercise, with the stabilised revenue rate having produced an effective multiplier far in excess of the formula's 42 per cent. The growth in the BLNS share in the revenue pool has been discussed earlier. It can be envisaged that with the fall in revenue associated with the multilateral and preferential trade liberalisation of South Africa, on the one hand, and the guaranteed revenue rate of at least 17 per cent for BLNS on the other, the South African revenue transfer to the BLNS could eventually exceed the size of the pool. Hypothetically, South Africa would then have to supplement revenue from other sources since there is no stipulation in the SACUA that the residual that remains for South Africa must be a positive sum. It should also be noted that the current revenue distribution mechanism, which leaves South Africa with the residual, means that only South Africa is affected by the size of the pool and the impact that trade liberalisation has on it.

57. Although it never featured prominently in the post 1969 debate on the impact of SACU on member states, the deregulation of South African agriculture and the replacement of quantitative import control with tariff protection represent a crucial challenge to SACU relations. BLNS have interpreted article 12 of SACUA as giving them the right to close their borders for certain products, mainly from South Africa. Botswana and Namibia, in particular, have regularly done so on a wide range of products, while Swaziland has taken similar action with respect to wheat and maize products. The official South African view is that this interpretation of article 12.1 is incorrect.

58. Therefore, the current situation is that while South Africa has abolished marketing control in agriculture, BLNS still regulates agricultural marketing, falling back on their interpretation of article 12 to let South African imports into their markets or to keep them out, depending on what the domestic supply position is. This practice has impacted on agricultural production in South Africa and on the price of products in BLNS. The practice of Botswana to open or close its border to South African produce[8] has, for example, encouraged farmers in the neighbouring North West Province of South Africa that supply the Gaborone market to switch production to field husbandry and/or meat production, or to switch their sales to the Gauteng market of South Africa. When the domestic supply situation changes negatively in Botswana this have cost implications for Botswana since they now have to import from more distant sources such as the Johannesburg Fresh Produce Market. Similar problems are also reported to occur in the milling industry, especially with respect to wheat flour. This is seen as an explanation for the cost of a 12.5-kg bag of wheat flour, in spite of a 100 per cent tariff rebate, being 40 per cent more expensive in Namibia than in South Africa. When South African millers do export under these price conditions they have in the past faced charges of dumping even if they have not been selling below their prices in the South African market.[9]

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[8] The most recent action in this respect was the decision communicated by Botswana on 20 January 2003 that their border has been closed for the next three months for the importation of tomatoes.

[9] Article 2.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* defines dumping in the following terms: "For the purpose of this Agreement, a product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country" (World Trade Organzation, 1999:147). To be accused of dumping this definition would require South African millers to sell wheat flour at a lower price in BLNS than in South Africa, a price discrepancy that can be verified with relative ease.

59. To conclude the discussion on the current Agreement, the ability to have survived for so long requires brief consideration. In spite of the elements of developmentalism embodied in the 1969 SACUA, the Agreement essentially remained an arrangement that had to deal with the situation of small but politically independent African states being locked into an integrated economy with apartheid South Africa. How does one, in view of these considerations, explain the longevity of SACU compared to many other arrangements that have failed? The answer to this question might perhaps be found in two prominent reasons for the failure of regional integration arrangements. The first is the existence of economic asymmetries and consequently the unequal distribution of the benefits of integration and the second is the unwillingness of member states to sacrifice control over economic policy, i.e. policy sovereignty, to a supra-national regional body (McCarthy, 1998).

60. Applying this situation to SACU, two factors could explain its durability. The first is that the SACUA provides for an explicit and clear compensation mechanism for economic asymmetry, with the dominating economic member willing to bear the cost of such an arrangement, a fact that cannot be disregarded even if BLNS claim that they have not been compensated adequately. Part of this compensation has been for the loss of policy independence that BLNS have to face in terms of the 1969 Agreement. Delegating the affairs of SACU to South Africa effectively serves as a substitute for the supra-national body that would have been required to act in the common interests of the customs union. These observations might only provide a partial answer to question asked above, but they cannot be ignored if the longevity of SACU is considered.

8. A new Southern African Customs Union Agreement (2002)

61. When the new South African government came to power in 1994 it immediately took the initiative in setting the renegotiation of the SACUA in motion. As could be expected the broad intentions of the new Government were derived from certain principled viewpoints that the ANC have propagated before 1994, namely the democratisation of SACU and the avoidance of hegemonic ambitions on the part of South Africa. SACU had to be transformed into an institution that would promote mutually beneficial co-operation and integration in southern Africa. At the Ministerial Meeting of SACU ministers on 11 November 1994 the South African Minister of Trade and Industry, Trevor Manual, in his opening remarks raised the contentious issues that had to be addressed in the renegotiations of the SACUA by the Customs Union Task Team (CUTT), made up of senior officials of all the member states. The Team's terms of reference also clearly spelt the issues out. These included the following:

- The lack of consultation and the democratisation of SACU's decision-making procedures;
- The question of revenue, which is of significance to the South African Treasury;
- Specific complaints of the BLNS economies, notably the price-raising effect of the South African tariff, delays in the disbursement of revenue and the perceived influence of SACU provisions and practices on the industrial development of the BLNS;

- The establishment of a permanent SACU authority (a secretariat) to regulate and manage the affairs of the institution as well as the provision of dispute settlement and customs tariff consultation mechanisms;

- An appropriate industrial strategy and closer co-operation regarding industrial development policies, including infant industry protection and the development of industries that are of major importance to the members of the Customs Union;

- The development of agriculture and agro-industries and the marketing of agricultural products in the CCA; and

- The retention or exclusion of excise duties as part of the revenue pool.

62. The CUTT was briefed to report to the SACU Governments by the end of March 1995, but negotiations lasted for seven years. A final agreement was concluded in October 2002, signed by the heads of state and it now only awaits ratification by the member states.

63. In considering the outcome of the negotiations it is important to take cognisance of the new trade policy environment within which the negotiations have taken place. The point has been made that the SACU tariff had in earlier years been determined by a South African policy of inward-looking industrialisation. Protectionism and hence a relatively high tariff formed the backbone of this policy, which in turn created room for BLNS accusations of having to bear the cost of trade diversion. The new agreement was negotiated in a new environment in which trade liberalisation and the lowering of the tariff is the mantra of South African trade policy. The lowering of the MFN tariff rates during the 1990s has been substantial; in 1999 the un-weighted mean of all rates was 7.3 per cent compared to 29 per cent in 1990 (Beli *et. al*., 1993, p.13; Lewis, 2001, p.5). To trade liberalisation within the WTO framework must be added preferential trading arrangements, notably the free trade agreement between South Africa and the European Union, the SADC Free Trade Agreement and the commencement of free trade negotiations between SACU and Mercosur and the USA respectively. As will be noted below the new policy regime, and its envisaged continuation in the Doha Round of trade negotiations, have significant implications for SACU and its revenue.

9. Revenue distribution under the new agreement

64. For BLNS, revenue distribution will always be a fundamental part of SACU arrangements. The new revenue sharing formula is dramatically different from the 1969 formula. Under the latter dispensation the size of the revenue pool, made up of customs and excise revenue, is of little concern to BLNS. Under the new agreement, South Africa will not receive its share of revenue as a residual, but will share on the same basis as BLNS. The new revenue sharing formula will also differ from the current one in dealing separately with the distribution of excise revenue. It is important that excise revenue will be kept in the SACU revenue pool for distribution. This is contrary to normal practice in customs unions and during the early phases of the negotiations a change was anticipated.

Apparently the difficulty to administer separate excise regimes in a region with porous borders has led to the decision to keep a common excise in the revenue pool.

65. The change in revenue sharing immediately brings to mind two important issues. The first is that, with the removal of the guaranteed revenue rate, the size of the revenue pool becomes a crucial consideration for BLNS. This is especially true if the second issue is brought into the picture, namely the process of trade liberalisation. A significant fall in SACU MFN tariff rates and the conclusion of free trade arrangements, notably the one between South Africa and the European Union, which is South Africa's most important trading partner, could have a major impact on the size of the revenue pool. Depending on growth in import volumes, the lowering and removal of tariffs could lead to a declining revenue pool.

66. The customs and excise revenue to be distributed will consist of the gross amount of duties less a deduction to finance the cost of the supra national SACU Secretariat the agreement provides for. In distributing this revenue the architects of the new agreement have recognised the dependence of the smaller SACU members on customs union revenue and consequently agreed on a revenue sharing formula that would provide BLNS with revenue protection. Customs revenue shares will not be based on the members' shares in SACU imports. In stead, each member state's share will be calculated on the basis of the value of goods imported from all other member states during a given year as a percentage of total intra-SACU imports during that year. This peculiar ratio is explained by the desire to weigh revenue distribution in favour of BLNS. Intra-BLNS trade is not substantial, while intra-SACU trade is largely characterised by substantial balances in South Africa's favour. BLNS import far more from South Africa than what they export to the latter. Hence, their shares in intra-SACU imports will be higher than that of South Africa and so their percentage shares in customs union revenue will be enhanced. The intention is clear: to create a favourable regime that will avoid or at least contain a fall in the custom union revenue of BLNS.

67. The South African government has estimated on the basis of 1998/99 trade figures that with this method, BLNS will be allocated about 80 per cent of the customs pool (made up of 27 per cent for Botswana, 13 per cent for Lesotho, 25 per cent for Namibia and 15 per cent for Swaziland) and South Africa 20 per cent (Ngwenya, 2002: 28). This share is expected to remain more or less the same, but the size of the pool will change with changes in import values and the tariff regime.

68. In the case of the excise pool a different approach, namely one of proportionality, is to be adopted. The proposed new dispensation provides for allocations to be determined by the share of each member state in the gross domestic product of SACU. But first it should be noted that in addition to the subtraction of a contribution towards the cost of the secretariat, an amount determined as a fixed percentage of excise revenue will also be set aside to fund a development component, which constitute the third element of revenue distribution. The development component shall initially be set at 15 per cent of the excise pool.

69. A member's share in the remaining excise component will be the value of its GDP during a particular year as a percentage of the combined GDP of all SACU countries. The implication is clear: South Africa, which is by far the largest market and consequently the principal source of excise revenue, will receive the lion's share of this revenue. This share has been estimated as 80 per cent of excise revenue collected, bearing in mind that 15 per cent is allocated to the development fund (Ngwenya, 2002: 29). This will address the concern in some South African circles that emphasise excise duties as an important source of revenue. It is a progressive tax, or linked to the consumption of "sin goods" (tobacco and alcoholic beverages), and an appropriate instrument to raise tax revenue for much needed social expenditure. Under the current dispensation the large spillover into the coffers of BLNS makes it an unproductive tax from a South African point of view. It can be assumed that the new formula to divide excise revenue would have been a major consideration for South Africa to accept that excise be kept in the common revenue pool of the customs union.

70. Combining the customs and excise component it appears that, according to a South African government estimate for 2003/03, South Africa will retain about 52 per cent of the R21 358 million revenue pool (Ngwenya, 2002: 31). Considering the fact that South Africa contributes about 92 per cent to the SACU GDP, this relative high share indicates a substantial compensation for the BLNS of being in a customs union with South Africa. However, looking into the future one encounters many imponderables but it would not be unrealistic to envisage a scenario that will work against BLNS and in favour of South Africa, in relative terms at least. This could come about if future trade liberalisation should lower the customs component of the revenue pool while excise tax rates increase and South Africa maintains its dominant share of the regional GDP.

71. The final component to be included in revenue distribution specifically addresses the unequal distribution of development in SACU. A development component is envisaged that will be funded, as noted above, out of excise revenue. All members will share in the development fund but the distribution will be weighted in favour of the lesser-developed members of SACU.

72. Article 33 of the new agreement determines that the SACU Council may appoint a member state or a SACU institution to manage the common revenue pool. However, South Africa will manage the revenue pool for a transitional period of two years from the entry into force of the Agreement.

73. An important but perhaps not readily recognised outcome of the new revenue distribution formula is that it will be easier to accommodate an expansion of SACU membership. Article 6 determines that new members may join the customs union following a unanimous decision by the Council to this effect. Removing the residual factor for South Africa's share and building each member's share on the basis of proportionality, albeit weighted in favour of BLNS in the case of customs revenue, will be less onerous for South Africa than a guaranteed minimum revenue rate.

10. Industrial and agricultural development

74. The new SACUA follows the 1969 Agreement in acknowledging the lesser *industrial* development of the BLNS economies. Provision is made for the protection of infant industries in these member states. Article 26 allows these member states to levy additional duties on goods imported into its area to meet competition from other producers in the common customs area. To qualify as an infant an industry may not have been established for more than eight years in a member state. The additional protection may also not be applied for a period of longer than eight years.

75. As far as *agriculture* is concerned article 12 of the 1969 Agreement is with minor changes carried over into article 29 of the new agreement. In article 29.1 it is now determined that any marketing *regulation*, in the 1969 agreement referred to as a marketing *arrangement*, shall be applied on a non-discriminatory basis to similar commodities produced in any other part of the common customs area, thus replacing the "equitable basis" of the 1969 agreement. Article 29.2, like article 12.2 of the 1969 Agreement, provides for consultation "on matters affecting the production and consumption of agricultural commodities and the improvement and extension of marketing arrangements for such commodities". While South Africa has abolished the regulation of agricultural marketing, article 29 will allow BLNS to maintain and implement marketing arrangements. However, article 29.4 determines that each measure of regulation shall be subject to a negotiated sunset clause that outlines the conditions and period involved. At a formal level the provision for market arrangement serves as an indication that SACU does not have and does not in the foreseeable future plan a common agricultural policy for the customs union. Nevertheless, article 29.5 commits member states to simplified and harmonised agricultural trade formalities and documents and working towards the harmonisation of standards.

76. Articles 38 and 39 in the new agreement are novelties in explicitly stating positions on *industrial* and *agricultural* policy. Article 38.1 recognises "the importance of balanced industrial development of the Common Customs Area as an important objective for economic development", while article 39.1 recognises the importance of the agricultural sector to the economies of the member states. A major difference, however, reveals itself with respect to industrial and agricultural policy. Article 38.2 states that to achieve 38.1 the member states "agree to develop *common policies and strategies* with respect to industrial development" (italics added), whereas 39.2 only states that member states "agree to co-operate on agricultural policies in order to ensure the co-ordinated development of the agricultural sector within the Common Customs Area". *A common industrial policy is envisaged for SACU but not a common agricultural policy*. Co-operation in agricultural policies could eventually lead to such an outcome but according to sources near the negotiation process a common agricultural policy was definitely not the intention of the drafters of the Agreement.

77. It should be noted that BLNS each has its own agricultural development policy in place and all consider dairy, wheat and wheaten flour and maize to be important. In the

case of dairy, for example, Botswana aims to develop primary and secondary dairy industries in line with the National Master Plan for Arable Agriculture and Dairy Development, Lesotho is engaged in the development of the primary industry at subsistence level through the provision of extension services, and Swaziland seeks to increase milk production through livestock development, extension services, credit provision and improved milk processing. In all cases food security is a crucial objective. What these examples illustrate is that the development of agriculture and the encouragement of food security appear in the first place to be domestic affairs and not the objective of a common SACU policy.

11. New institutional arrangements

78. One of the principal aims in renegotiating the SACUA has been the democratisation of the customs union. The 1969 Agreement is administered by South Africa and the tariff set to serve the interests of South African industrial development. Hence, democratisation of SACU could mean only one thing: the BLNS should be given a greater say in the operation of the customs union and in the decisions that are taken on behalf of all SACU members. This condition touches directly on the institutional arrangements that govern the customs union and specifically the establishment of supranational bodies that will have to tend to SACU affairs.

79. The view has been expressed that the "need to institutionalise and democratise SACU is much less controversial" than decisions on new revenue distribution arrangements (Gibb, 1997: 83). This interpretation is true if it only refers to the consensus on the need to institutionally democratise SACU. However, to give operational content to the consensus has turned out to be more difficult than originally anticipated. The obvious problem is to reconcile the interests of disparate member states in an institutional, supra-national arrangement that will serve the need for democratic decision-taking while addressing the development requirements of the larger and more industrialised South Africa and those of much smaller BLNS. In view of such considerations it is not surprising that Gibb (1997: 83) would observe that "it is hard to envisage a situation where Lesotho has the same voting rights as South Africa", and consequently he envisaged a "form of proportional and/or qualified majority voting". Surprisingly, this has not been the outcome. Article 17 determines that the decisions of the SACU institutions shall be made by consensus. The exception is the Tribunal, composed of three members, that shall decide by majority vote.

80. A Council of Ministers will be the supreme governing body of SACU and will take decisions on the tariff. Other supra-national institutions provided for are a Customs Union Commission, a Secretariat to be located in Windhoek, Namibia, a Tariff Board that will make recommendations on tariff levels, and Technical Liaison Committees. The latter is provided for in article 12 of the new agreement and what is important is that it provides for an Agricultural Liaison Committee, which will operate on par with the Technical Customs Liaison Committee and Liaison Committees for Trade and Industry and for Transport. A Tribunal for dispute settlement is also provided for. Each member state can also have its own national tariff body that may refer any matter to a SACU

institution and will have the standing to appear before and make representations to a SACU institution. In South Africa, legislation has been adopted that will establish the International Trade Administration Commission as the national body. The Commission will replace the Board on Tariffs and Trade.

81. Operating a workable institutional framework in a way that is acceptable to all member states will be a very difficult and contentious task. Working out an acceptable revenue distribution arrangement, by comparison, must have been relatively easy. For South Africa, with it diversified tax base, the tariff is not an important consideration as a source of revenue. Hence, South Africa could afford to be generous with the distribution of customs revenue. This attitude does not apply with respect to excise revenue, in which case a more conservative approach would have been expected.

82. But the different views that South Africa and the BLNS have about the tariff as a policy instrument create severe complications when it comes to designing and operating an appropriate institutional framework and a set of rules for the customs union. The underlying problem is obvious: South Africa has a much larger and more diversified economy with a relatively sophisticated manufacturing sector, which becomes difficult to manage if policy sovereignty is sacrificed to supranational decision-taking. Bluntly put, the issue for South Africa, by far the largest and most diversified but still only a single member of the club, will be to participate in a democratically organised customs union, but in a way that will allow it to remain master of its own development policy. Metaphorically speaking, the challenge will be to operate a system that will not allow the tail to wag the economic dog. As noted earlier, decision taking in SACU institutions will be by consensus and it can be expected that in this arena the tensions and problems of integrating unequal economies will feature strongly. Recalling the observations made in paragraphs 59 and 60 on the conditions for a regional integration arrangement to survive, it can only be hoped that the new institutional arrangements and absolute equality in decision-making will not prove to be a fatal pitfall for the oldest customs union in the world.

12. Conclusion

83. The terms of reference for the SACU Case Study are used as a framework for presenting the conclusions of the paper.

Initial and current objectives of SACU

84. SACU has evolved over time, with its original roots being of a pragmatic nature and deeply bedded in the colonial history of the region. Therefore, it cannot be compared to more recent integration arrangements where explicit objectives, often of a lofty nature, have motivated their establishment. Since its inception SACU has been an arrangement to deal with the de facto economic integration of politically separate members. The common external tariff has been determined by South Africa, and administered in the industrial interests of the much larger and more developed economy.

85. At the independence of the HCTs the current, 1969 Agreement was negotiated. This agreement continued as an arrangement that had to deal with the economic integration of politically independent and economically unequal countries, with the additional political burden of having to manage a customs union between apartheid South Africa and members of the Organisation for African Unity. The Agreement recognised the development needs of the smaller member states and the drawbacks for BLS to be in a customs union with South Africa. The SACU tariff remained the South African tariff, used intensively as an instrument of South African industrial policy, which for many decades sought industrial growth through import substitution. A new and important feature of the agreement was the introduction of compensatory revenue payments to BLNS, which guarantees BLNS a 17 per cent minimum revenue rate, while leaving the residual of revenue for South Africa.

86. While the current arrangement is noted for South Africa's role in managing the customs union along lines that in the first place suits her policy objectives, a new agreement has been negotiated and was signed by the heads of state in October 2002. This agreement, which now awaits ratification and implementation, reflects the spirit of the transition to democratic government in South Africa in April 1994. A new revenue distribution formula has been agreed on that still favours BLNS with respect to customs revenue and the envisaged development fund, but perhaps the most notable feature is the supra-national institutions that will manage the affairs of SACU in a democratic fashion.

The scope/domains of common policies in the field of food and agriculture

87. SACU does not have a common agricultural policy. South Africa is the dominant agricultural producer who until the 1990s followed a policy of government intervention and regulated marketing. The SACUA, which in article 12 provides for regulated marketing, has allowed South Africa to bring agricultural imports from BLNS within the ambit of domestic marketing arrangements. Since the early 1990s South African agriculture has been deregulated, quantitative import control replaced with import tariffs and government intervention withdrawn. However, BLNS still regulates their markets, including closing their borders to South African produce when their domestic production is judged to be sufficient to meet domestic demand and in the case of wheat to protect their domestic milling industry. Import tariffs are also much higher for agricultural products than for manufactured goods, the reason for this being that tariffication took place by seeking tariff equivalents for import control.

88. The key groups of products within the SACU context are the food products dairy, maize, wheat and wheaten flour, and sugar (the latter for South Africa and Swaziland). Dairy, maize and wheat and wheaten flour have been the subject of a number of recent meetings of SACU members in order to co-ordinate development policies.

89. In the new agreement relatively little changes with respect to agricultural production and intra-SACU trade. BLNS will still be able to implement marketing arrangements. Part 8 of the Agreement is devoted to common policies. While common industrial policies and strategies are envisaged in article 38.2, article 39.2 commits the member states to co-operation

on agricultural policies "to ensure the co-ordinated development of the agricultural sector within the common customs area".

Institutional arrangements

90. Although the 1969 SACUA provides for a Customs Commission and has a number of technical sub-committees in operation, the important consideration is that South Africa manages the customs union. The defining characteristic of a customs union is the common external tariff and for SACU this is the South African tariff, determined by the South African government on the recommendation of the Board on Tariffs and Trade on which BLNS has no representation.

91. The new agreement, seeking to democratise SACU, provides for a major change in this situation by creating a number of supra-national institutions that will make decisions by consensus, with the exception of the Tribunal that will be tasked to settle of disputes, on which it will decide by majority vote.

Specific problems and measures to deal with inequality

92. A specific problem of SACU has been what experience has shown to be the general dilemma of integration arrangements of unequal economies, namely the distribution of the benefits in a way that will leave all member states as winners. There can be little doubt that the compensatory revenue transfers contained in the current agreement has played a crucial role in keeping BLNS within SACU and it is clear that in the re-negotiation of SACUA the maintenance of such transfers has been a decisive factor. In the new agreement the major part of customs revenue (about 80 per cent) and the development fund will go to BLNS, while South Africa in turn, because of the size of its economy, will keep the largest part of excise revenue (about 80 per cent)

93. In the current institutional regime the absence of appropriate supra-national bodies and equal participation in SACU deliberations and management is a conspicuous feature. This made the democratisation of SCAU an important objective in the process of re-negotiation. Consequently, the range of supra-national bodies that has been agreed on is not surprising. What was unexpected is the consensus basis on which decisions will be taken. Within the context of a customs union, in ways that are quite different from a free trade area, issues pertaining to trade and industrial policy are pivotal and it becomes difficult to envisage how the diverse development needs of South Africa and BLNS can be reconciled without creating sharp differences in views. Obtaining common positions for the sake of multilateral (WTO) and bi-lateral trade negotiations could prove to be a difficult task. In view of South Africa's strong commitment to such negotiations, especially the expansion of bilateral arrangements, difficulties may come to the fore sooner than expected. Sacrificing policy sovereignty might turn out to be a major stumbling block, however regrettable this may be.

94. The possibility that SACU may serve as the inner core of expanding economic integration in southern Africa has been alluded to in the text. SACU represents deep economic integration, characterised by a quite remarkable degree of convergence with respect to

macroeconomic variables, noted for the macroeconomic stability they reflect. Expanding the membership of a stable integration arrangement of long standing could prove to be the only way to deal with the problem of overlapping membership found in SADC and COMESA with their competing integration agendas.

Lessons to be learnt

95. The development of SACU over many decades has largely been driven by exogenous forces contained in the economic and political history of the region, and, therefore, can only in a qualified sense provide lessons for countries set to design and implement integration arrangements *de novo*. The political independence of BLS introduced the important lesson of the necessity to deal with the equity problems that arise when economically unequal countries integrate. Common political values and systems among members can be regarded as an essential ingredient for the success of an integration arrangement Prior to 1994 SACU has shown that even irreconcilable political differences can be overcome, but whether this was due to fiscal compensation or to economic dependency is open to question.

96. The re-negotiated agreement has built on the past but introduced major changes to create a modern integration arrangement governed by supra-national bodies. Integration arrangements are often focused on a regional economic power and the success of an arrangement will often depend on the role adopted by this country in the negotiation and implementation of an agreement. In the negotiation of the new agreement South Africa, with its 93 per cent share of the regional economy, must have demonstrated significant magnanimity in sacrificing sovereignty over a substantial element of trade and industrial policy to supra-national bodies in which the smaller integration partners will have an equal say.

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