



# international UPDATE

## 4/96

Tel: 011-339-2021

THE SOUTH AFRICAN INSTITUTE OF INTERNATIONAL AFFAIRS

Fax: 011-339-2154

## REGIONAL INTEGRATION IN SOUTHERN AFRICA: THE SACU STATES

Robin Birchall was the 1995 Barratt Rotary Researcher at SAIIA.

The second in the series of papers on regional integration in Southern Africa deals with those states which, along with South Africa, have reached a high level of integration and interdependence in the region. These states, consisting of the Southern African Customs Union (SACU) member states, are commonly referred to as the BLNS - Botswana, Lesotho, Namibia and Swaziland. This paper will examine their economies and highlight the importance of the establishment of a new regional trade regime for the achievement of natural developmental objectives. The BLNS countries realise that prosperity in the region can only be achieved by planning a common course for economic development. Specifically this paper will contrast their economic and developmental positions, showing how this affects their regional demands and will conclude by assessing the prospects for success along the SACU route.

Currently the BLNS are in the process of re-negotiating the SACU agreement, an important step they believe in the process of regional integration. However, there is a realisation that 'if it is to be successful, regional economic integration, in whatever shape or form will require strong political commitment on the part of each country'.<sup>1</sup> Each of the BLNS states has different desires and needs, which are reflected in their stance toward regional integration. Yet from these different positions the BLNS have to establish a common ground with South Africa to chart their course.

The decision of the BLNS to chose the SACU agreement and its concomitant Common Monetary Agreement (CMA) as the framework for starting the process of regional integration will be explained by way of introduction.

The need to move quickly towards re-negotiating the SACU agreement is clear. As demonstrated in

a number of BLNS government publications, there is a belief that SACU was and remains the best functioning regional trade organisation in Africa, accounting for a comparatively higher level of trade between states with open economies than any other similar body. The theme of similarity in macro-conditions and development is an important foundation to this relationship.

Additionally, the SACU agreement received a widespread vote of confidence in a recent study, showing its popularity not only among the various governments but also with some 300 BLNS firms.<sup>2</sup> This does not disregard the need for substantial changes, but indicates that they rate SACU as having been a net benefit in the past, which with modification could be enhanced. Finally, the BLNS decision to focus on SACU reflects their perceptions of the paramount position of the South African state and economy in a future prosperous region.

This examination of the BLNS states will compare three key facets: *the macro-economic condition, trade options and development potential*. Similarities in these areas allow for a basic division of the BLNS into two groups: Lesotho and Swaziland on the one hand and Botswana and Namibia on the other. These similarities will be highlighted in discussing their stance relative to the SACU re-negotiations.

### Macro-economic conditions

These vary quite widely, reflecting both the competence and the discipline of the various governments. The key macro figures utilised in this paper are mainly fiscal, as monetary issues are not of any relevance except for Botswana, because of the CMA. The key indicators used are: GDP and related growth, government budgetary figures and

the all-important SACU Common Revenue Pool contribution to government financing. Employment will be left to the discussion on development potential.

*Lesotho* currently conceals major structural weaknesses behind its outwardly improving macro figures. The economy appears in a healthy state as GDP and GNP have been growing substantially over the past five years, even as miners' remittances have been levelling out. The reason is that the Lesotho Highlands Water Project (LHWP) has fuelled most growth over this period. With the SACU re-negotiation, Lesotho will face serious fiscal problems with more than 50% of the government budget comes from Customs Union receipts, deriving largely from LHWP imports. The restructuring of the Common External Tariff (CET) towards lower levels of protection could bode ill for Lesotho as government revenues will most likely fall and aggravate an already significant current account deficit. Lesotho's growth is predicated on the decision to go ahead with Phases 1b and 2 of the LHWP which will continue through until the next century; some concern has been expressed of late, however, as to the viability of these follow-up phases.

*Swaziland's* macro position is in some ways healthier, but also reflects serious structural economic problems. GDP growth has been more uneven than Lesotho's over the past five years, and is the result of the impact of world economic conditions on Swazi exports. Fiscally, the Swazi house is in better order, with government budgets more balanced as regards financial structure. Swazi government revenues still rely too heavily upon SACU with Customs Union receipts climbing from 31% in 1989-90 to a projected 47% in 1994-95. However, as we will see, the Swazi situation, while not overly rosy, is much more stable because of the trade situation.

The *Namibian* macro situation is more difficult to analyse because of the state of flux since independence in 1990 and the reintegration of Walvis Bay in 1994. Since independence GDP and GNP growth have fluctuated widely ranging from a high of 7.7% growth to a contraction of 1.9%, making isolation of trends more difficult. The fiscal situation is also somewhat unclear considering recent changes, including the impact of the dismantling of apartheid. Yet it appears that the Namibian government has the situation under control, even though customs revenues also make up a substantial part of government revenues (30% in 1994-95). Forecasts for trade suggest that economic growth should allow the government to remedy this current imbalance.

Finally, *Botswana* is the shining star of the BLNS when it comes to macro criteria and particularly fiscal austerity. Botswana's GDP grew between 1980 and 1990 at an annual rate of 10.1% on the back of the diamond industry growth. This growth is projected to fall off to 4.7% over 1991-97 but is still very impressive. On the fiscal side, high growth has been translated into budget surpluses from 1982-83 to 1994-95. Coupled to fiscal discipline, the share of government revenue made up of customs receipts has grown only moderately since 1989 from 12.8% to 15.4%. On the monetary side Botswana has shown an ability to maintain a stable currency and keep Consumer Price Index (CPI) inflation to a reasonable level, given the inherent links to the South African economy. The Bank of Botswana has managed its surpluses so well, that these will now be used to finance the projected shortfalls in government budget funding arising from GDP growth stagnation. However, despite fiscal discipline, all does not bode well in Botswana. The current trade figures illustrate some key structural problems in the economy. When GDP growth drops below 3%, budget growth cannot be sustained, posing serious problems for the Botswana. 'The diamond boom, having lasted so long, is perceived as a permanent feature by many Botswana yet the boom appears to be ending'.<sup>3</sup> Botswana's GNP growth attributable to growth in the diamond industry is forecast to be only 0-0.5% for the coming 5-10 years. Thus some other engine of growth must be sought.

### Trade potential and development options

This section will examine each country individually, looking at the prospects for trade and how these can resolve underlying macro-economic obstacles to sustainable development.

Trade options available to the BLNS vary widely and do not reflect the continuity of the macro-economic conditions in the four countries. The prevailing trade conditions illustrate the basic problems that the BLNS face in the both the regional and the global environment and which underlie basic, structural macro problems.

With Botswana fresh in the mind it is useful to examine the constraints that its trade options place on the resolution of its potential macro-economic problems.

Over the past 5-7 years, Botswana has performed comparatively well in terms of trade, with the value of exports rising comfortably by an annualised rate of 5.4% since 1989-90 coupled to a significant trade surplus because of strong diamond exports.

Yet again the apparently positive situation in Botswana is deceptive. Manufactured exports over the same period have fallen slightly, and the contribution of diamond revenues to GDP is forecast to stabilise at less than 1%. Hence if Botswana wants to meet its target of 6% annual GDP growth it must find another sector to produce this increase. The *Seventh National Development Programme* singles out manufacturing and services as the 'engine of growth'. 'Only manufacturing and services for the export market can grow substantially faster than the economy in general and pull the whole economy with them'<sup>4</sup> - an odd sentiment given the massive, if not impossible, growth that would be required to lend credence to this belief. Export manufacturing would have to grow so dramatically it is virtually inconceivable: for 1994-95 manufactured exports would have to jump from roughly 500m Pula to 1.1bn Pula - a jump of 112%, making manufacturing exports roughly 10% of GDP. This initial increase would require follow-on rates in the manufacturing sector high enough to translate into overall 6% per annum GDP growth, or around 700m Pula (63% growth) for 1995-96. This scenario is highly unlikely as the region is unable to absorb these levels of sustained exports, and globally Botswana lacks a clear competitive advantage to achieve such growth especially in light of its strong currency, relatively high wages and low productivity. Botswana may have a lot of sand but it will not become a silicon valley!

Development prospects are poor given that Botswana is unlikely to achieve a high enough GDP growth rate to increase per capita income. As with all the other BLNS states, the population growth rate is astronomical and shows little sign of abating. If the population continues to grow at 3.5% (and GDP at under 4%), per capita income will double roughly every 145 years! Currently manufacturing is forecast to grow at 5% per annum when 112% is needed this year, 63% next year and 42% the year after. The implications are obvious. The restructuring of SACU as a core regional objective is thus a key determining factor for Botswana's economic future.

In terms of trade, Namibia has the brightest future of all the BLNS. Namibia's situation is hard to quantify because of inconsistencies in trade statistics and GDP figures. However, manufacturing as a share of GDP is rising, and overall exports are increasing at a healthy 13% annualised since 1989. The structure of Namibia's exports is also less problematic than Botswana's. Although a heavily resource-dependent export economy, exports are not confined to one sector. Namibia has three key sectors: mining, fisheries

and agriculture. Of these, fisheries and agriculture are highly sustainable and can be efficiently labour intensive. For Namibia the restructuring of SACU could be of great benefit, reducing the cost of factor inputs and thus making the already existing local industry more competitive, at the same time allowing for the development of new value-adding industries in the fisheries and the manufacturing sectors.

In manufacturing for export, Namibia has good opportunities. Figures for trade show that after stumbling somewhat in the mid-1990s, manufacturing is in a recovery phase especially with the return of Walvis Bay and the opening of regional markets to Namibia after independence. Finally, while the verdict is still out on Export Processing Zones and their ultimate benefit to developing economies, this is a positive trend towards adjusting and balancing the structure of the Namibian economy.

Namibia still faces severe developmental problems inherited from the apartheid days of the South African administration. Like its BLS cousins, the key problem remains population growth and the related joblessness rate. Namibia's GDP is extremely unevenly distributed. In 1991, 75% of GDP accrued to 5% of the population (chiefly white), netting a per capita GDP of N\$16,300. A further 40% of the population in the formal sector only accounted for only 25% of GDP or N\$750 per capita. Unemployment in Namibia is officially assumed to be around 40-60,000 with 16,500 new entrants to the labour force every year and formal sector employment only growing by 3-6,000. Herein lies the country's key problem: Namibia faces serious social dislocation because of an extremely high population growth rate. The government is currently attempting to address this problem by both fostering economic growth *via* exports and increasing the level of value added to Namibian products. Namibia, like Botswana, is in a critical period of economic adjustment and suffers similar macro-economic problems, although it does not have to rely on an unrealistic boost in manufactured exports to sustain development.

Swaziland represents an interesting case because of its comparatively peculiar trade patterns in the BLNS. In the past, the country has pursued a strong import substitution policy coupled to intensive export development. Hence in terms of trade, the Swazi economy is heavily dependent on exports for its GDP, with the manufacturing sector making up over one-third of the value of exports. Unfortunately, over the past few years Swaziland's exports in the manufacturing sector have been heavily hit by world recession and regional shifts.

Exports themselves are said to have averaged about 20% growth since 1989, although this statistic, as with the macro figures, must be taken with a grain of salt because of the relative devaluation of the Rand as the CMA currency. Swaziland's trade balance is currently very respectable, running slightly in the negative but with the current account slightly positive.

Changes to the SACU agreement are expected to have a severe impact on the Swazi exports as a large percentage are destined for the South African market, and are potentially threatened by international competition as South Africa's protectionist practices erode. Again, Swaziland faces the dire population growth problem of the other BLNS with its GDP in the 1-3% range and with the impact of fiscal constraints imposed by falling custom revenues. Even a forecast export growth of 12% per annum will not resolve Swaziland's per capita GDP crisis especially when coupled with bureaucratic inefficiencies and an undemocratic (and wasteful) political order. Regional trade will be of significant importance to Swaziland in stemming the tide, but more important will be compensation received *via* SACU.

Lesotho is currently viewed as the 'basket case' of the BLNS. It faces the consequences of rampant population growth which can only be resolved by an economic miracle. In terms of trade, Lesotho is in trouble, running a giant trade deficit (importing over R1.5bn more than it exports) and having only a slightly smaller current account imbalance. This is skewed by the LHWP, though the project also accounts for a huge chunk of GDP and is the only significant economic activity in the whole country. Export trade is so small that even large growth rates will barely affect GNP. Regionally, Lesotho's plight demands economic union and a pressure release for its chronic over-population problem.

In developmental terms, population pressure and resulting destruction of agricultural land through erosion combine to destroy Lesotho. The country has only a limited natural resource base, is geographically isolated and is not competitive in manufacturing.

### The SACU Renegotiations

The future of SACU as a regional trade organisation must be examined from within these macro-economic, trade and developmental conditions in the BLNS. Each state has a set of criteria that create a fairly common position as well as country specific demands. To start with the common features: the BLNS 'need to establish an

arrangement which would enable them to be involved in devising a common strategy aimed at deepening their industrial sectors and further penetrating the Republic of South Africa's market'.<sup>5</sup>

The key features of SACU that the BLNS countries require changed are:

- (1) The democratisation of decision-making and tariff setting.
- (2) The adoption of a 'clean' revenue formula to cover the cost of the price raising effect of the CET.
- (3) The harmonisation of industrial policy and incentives at a regional level.
- (4) The general lowering of the CET to reduce factor prices thus increasing competitiveness and reducing anti-export bias.
- (5) The implementation of a competition law to counter South African 'dumping' and unfair trade practices.

All of these are aimed at fostering regional interdependence and strengthening economic recovery in Southern Africa.

Apart from these common goals there are also areas of controversy, exemplified by the belief that 'each country should not only perceive that it will benefit on balance but that special measures may be required to ensure the more rapid development of the less economically advanced member countries'.<sup>6</sup> As previously indicated the countries fall roughly into two groups: Lesotho and Swaziland, on the less developed end of the scale, with Botswana and Namibia on the higher growth end.

Lesotho, because of its dire developmental problems, has a natural inclination towards transforming SACU into a Common Market or Economic Union. Policymakers in Lesotho are quite comfortable with a 'variable geometry arrangement' as long as it allows for an outflow of labour and an inflow of revenue. At the same time, Lesotho is not as interested in price raising but rather would appear to view the issues of compensation and development aid together. Industrial depolarisation compensation is not relevant to Lesotho unless it can bring in large amounts of revenue to the government coffers. With a trade agreement, Lesotho will not shift heavily to export manufacturing but could try to restructure its rural agricultural practices and hive off its excess population to the regional market.

Swaziland has a similar view on the issue of development and compensation. It would appear to be more interested in the net position of Swaziland than the overall efficiency of the system. Yet this is tempered by the potential for growth in light-manufacturing in Swaziland for the Southern African and particularly the South African market. While supportive of the idea that compensation for price raising is not a grant from South Africa to the BLNS but a quantifiable cost to these states, Swaziland is clearly interested in the issue of compensation over and above such price raising, and has also advanced the idea of a separate development fund which would compensate for industrial polarisation and help to foster natural manufacturing growth. This fund would specifically provide additional funds to Swaziland for depolarisation, coupled to competition laws to foster economic growth. Finally, Swaziland has addressed the key issues of the widening of membership by suggesting that new candidates meet strict fiscal economic and monetary criteria.

At the more developed end of the scale, given their fiscal circumstances, Namibia and Botswana differ on several key points.

Botswana and Namibia are clearly concerned with removing as many obstacles to openness and efficiency in trade as possible. Both apparently would want a re-negotiated SACU agreement to reflect the objectives of developing the private industrial sector to become internationally competitive. They are interested in changing the CET for three reasons: first, to get rid of its anti-export bias; secondly, to improve efficiency through expanding the scale of production; and finally, to reduce the costs of production through falling input costs. On the development side, both are interested in the maintenance of a clean revenue formula, but disagree over any form of industrial polarisation compensation. Namibia, like Lesotho and Swaziland, would seem to favour more the developmental approach of depolarisation through a specialised fund or body, but Botswana is adamantly opposed to any such idea. Gaborone argues that individual states should each receive a share of compensation to be dealt with nationally, particularly as development organisations are bloated and inefficient at distributing benefits to developing nations. Botswana thus wishes to administer its own share of funds. This begs the question of whether Lesotho and Swaziland could benefit from a concentration of regional funds for projects particularly of an infrastructural nature which would help address both the development needs of these nations as well as the relative lack of competitive advantage because of weaknesses in these sectors. Yet in North America, for example,

infrastructure was not necessarily built as commercially efficient ventures, but instead as part of regional and national development projects.<sup>7</sup>

Currently, as the previous paper in this series (*International Update* 11, 1995) illustrated, the objectives of the BLNS and South Africa mesh quite well. During the research conducted for this paper various groups expressed negative sentiments about the South African mindset, and also criticism that there has been no particular change in stance between that of the old regime and the new government. However it appears that the SACU negotiations are progressing well and are on target to be completed some time in early to mid 1996. Although there are clear signals of problems arising in the negotiations with respect to depolarisation and development, this does not mean that the process is doomed.

More importantly, there appears to be little thought at the moment given to post-SACU integration attempts and the divide between the Customs Union and SADC. The place of Mozambique - and more importantly Zimbabwe - in the regional integration process will be the subject of the third and final paper in this series.

#### Endnotes

1. Taken from the African Development Bank Regional Integration Study. Abidjan Côte D'Ivoire: ADB, 1992, p.143.
2. See *Namibia: Trade Policy Reform Study*, Vol.1, Main Report. London & Windhoek: Maxwell Stamp.
3. Ministry of Finance and Development Planning, *Botswana National Development Plan Mid-Term Review of NDP 7*. Gaborone: Government Printer, August 1994, p.1.
4. Ministry of Finance and Development Planning, *ibid*. Gaborone: Government Printer, August 1994, p.36.
5. From the ADB Regional Integration Study, *The Case for Regional Co-operation in Southern Africa*. Abidjan Côte D'Ivoire: ADB, 1992, p.63.
6. *Namibia: Trade Policy Reform Study*, vol.1, Main Report. London & Windhoek: Maxwell Stamp, p.144.
7. For example the hydro-stations of the western United States, which were built as New Deal make-work projects, still today bestow the West with huge gains in efficiency and competitive advantage because of cheap power sources.

#### STATEMENT OF PURPOSE

*The South African Institute of International Affairs is an independent organisation which aims to promote a wider and more informed understanding of international issues among South Africans.*

*It seeks also to educate, inform and facilitate contact between people concerned with South Africa's place in an interdependent world, and to contribute to the public debate on foreign policy.*