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LESOTHO AND THE SOUTHERN AFRICAN CUSTOMS UNION

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Resume´

Lesotho and the Southern African Customs Union

The Southern African Customs Union of 1969 (SACU) modified and updated the Customs Union of 1910. Like the 1910 Agreement it provided for a unified common customs area with almost all collection of duties being undertaken by South Africa (RSA). It differed from the 1910 Agreement in systematising the administration of the customs union, in permitting a limited degree of tariff protection by the smaller BLS members and in the revenue sharing arrangements. The 1910 Agreement allocated revenues to the BLS in a fixed proportion throughout the life of the Agreement, based on their share of import duties in the years 1907-1909. The 1969 Agreement, by contrast, related BLS revenues closely to the growth of BLS imports and furthermore provided for a revenue bonus to off-set some of the recognised disadvantages for a small unindustrialised state in joining a customs union with a developed and much larger partner.

Research undertaken by the project has centered around the evaluation of the advantages and disadvantages of the 1969 Agreement for Lesotho, and analysis of the possibility and desirability of disengagement from SACU and establishing a local protective tariff.

Advantages and Disadvantages of SACU for Lesotho

The basic principle underlying the terms of SACU is that of compensation - that it is possible and reasonable to

Table 1

A Classification of Advantages and Disadvantages to Lesotho of SACU Membership

A. Quantifiable	Advantages	Disadvantages
	Revenue Benefits Trade Creation Administrative Savings Agricultural Marketing Benefits	Trade Diversion - Tariff
B. Unquantifiable	Transit	Trade Diversion - Controls Fiscal Discretion/ Revenue Dependence Loss of Policy Control Polarisation of Development Consumption and Technology Bias.

A glance at the above table immediately reveals that while the advantages of SACU membership fall mostly in the quantifiable section, the disadvantages are mostly classified as off-set the disadvantages of SACU membership to the BLS by inter-governmental fiscal transfer through the revenue sharing formula. Analysis has centered around the following questions:-

(i) How big is the revenue bonus ?

(ii) How serious are the disadvantages of membership ?

(iii) Does the compensation principle work in practice?

(i) <u>How big is the revenue bonus</u> ?

The revenue sharing formula allocates to Lesotho a share of the total pool revenues derived by applying the average ratee of duties in the customs union as a whole to Lesotho's imports multiplied by 1.42 (That is, of course, only a very rough statement):

$$\text{Lesotho's share} = r \times I \times 1.42$$

Obviously, if Lesotho's imports attracted duties at the average rate of duties applicable in the SACU as a whole the bonus would simply be equal to the effect of the 1.42 factor in the formula anc the bonus would be equal to 29.6% (i.e. 42/1.42) of the total revenue accrual. In practice, however, Lesotho's imports do not bear duties at the average rate for a numner of reasons: we import a lot of duty-free food and capital equipment etc). A proper calculation of the revenue bonus thus requires an estimate of the actual duty incidence of Lesotho's imports. If Lesotho's actual duty incidence is below the average rate for SACU as a whole then the formula is more generous than the 1.42 factor alone implies.

The project made estimates of the actual duty incidence of Lesotho's imports. The results by SITC group are in Table 2. They suggest that Lesotho's duty incidence is indeed much lower than the average for SACU as a whole. The basic reason is that Lesotho tends to import those categories of goods which are either duty free anyway (e.g. foodstuffs) or produced by protected industries in South Africa and thus not subject to import duties.

The implication is that the revenue bonus is much larger than the margin which the 1.42 factor purports to provide. The bonus is really the whole difference between the duty content of imports (6.2%) and the revenue accrual (which average about 18-20% of imports).

(ii) How serious are the disadvantages of SACU ?

The most serious disadvantages of the SACU for Lesotho are, firstly, the costs of trade diversion - the price raising effect of the common external tariff in SACU on the cost of Lesotho's imports; secondly, the polarising effects of the SACU which tend to make it more difficult to establish industries in Lesotho; and thirdly the loss of fiscal discretion and creation of revenue dependence implicit in the revenue sharing formula. Each of these are considered briefly.

(a) Costs of trade diversion

The common external tariff and import controls in SACU are used to encourage and protect the growth of manufacturing industry within the customs union. They do so

Table 3

DIRECT DUTY CONTENT OF IMPORTS TO LESOTHO - 1976

SITC	Item	Imports 1976	Origin		Duty Liability			Direct Duty Content			Total Duty Content 1976	Duty as % of C.I.F.
			RSA	Other	CUS.	1-S	EXC.	CUS.	1-S	EXC.		
00	Live Animals	2,427	2,427	-	-	-	-	-	-	-	-	-
01-09	Foodstuffs	35,301	34,301	1,215	-	-	-	-	-	-	-	-
11	Beverages & Tobacco	7,863	7,500	363	42.9%	4.8%	36.8%	155.9	17.5	2,760.1	2,916.0	37.1%
21-27	Crude Materials	1,295	1,243	52	1.3%	1.3%	-	0.7	0.7	-	0.7	-
32-35	Mineral Fuels & Lubricants	11,742	8,881	2,862	43.7%	0.2%	39.1%	1,249.3	6.5	3,476.1	4,725.4	40.2%
41-42	Animal and Vegetable Oils	1,561	1,459	102	9.2%	7.6%	-	9.4	7.8	-	9.4	0.6%
51-59	Chemical Elements & Compounds	9,525	7,172	2,353	7.6%	7.9%	2.2%	179.4	185.8	160.2	339.6	3.6%
61-69	Manufactured Goods classified by Material	41,809	34,568	7,239	11.1%	7.0%	-	804.6	508.6	-	804.8	2.2%
71-73	Machinery & Transport Equipment	22,730	14,083	8,647	6.3%	4.2%	7.2%	541.1	359.7	1,014.4	1,555.5	6.8%
81-94	Miscellaneous Manufactured Articles	45,140	39,349	5,791	13.3%	6.3%	2.9%	768.3	362.4	77.3	845.6	1.9%
	Total:	179,608	150,983 (84.1%)	28,624 (15.9%)				3,708.9	1,449.0	7,488.1	11,197.0	6.2%

by raising the price of selected categories of imports and thus allowing producers within the union to sell their output at a price higher than the competitive price of imports in the absence of the tariff. In this way the consumer pays a higher price for protected goods from whatever source than he would if imports from outside the union entered duty free. The higher price he pays goes directly tothe domestic producer who is subsidised in this way. The effect of the Tariff is thus to tax consumers and subsidise protected producers. Within the customs union the industrialising states benefit at the expense of the consuming states. Within SACU in practice South Africa has benefitted from protected industrialisation whereas BLS and especially Lesotho have picked up the bill as consuming economies.

Estimates were made of the additional cost to Lesotho's import bill resulting from the protective price raising effect of the tariff on goods of South African origin (see Table 4). The estimates were made on the assumption that the tariff tends to raise the price of RSA produced goods to the full extent of the tariff rate. For example, if imported trousers cost R10 with no tariff then RSA produced trousers would also sell at R10 in order to remain competitive. If a 10% tariff is imposed then the price of imported trousers will rise to R11 and so too will RSA produced trousers which now have 10% (nominal) protection. The estimates suggest that this disadvantage of SACU is very important, that the tariff imposes a very substantial burden on the consuming Lesotho economy, a burden estimated as 8.5% of the value of Lesotho's imports in 1976

Table 4 THE ORIGIN OF LESOTHO'S IMPORTS FOR PURPOSES OF CALCULATING THE DIRECT DUTY CONTENT CONTENT

Commodity or Group	S.I.T.C.	B.T.N.	c.i.f. Lesotho	Origin %		Origin by dutiable Value	
				R.S.A.	Other	R.S.A.	Other
Live Animals	00		2,427	100	-	2,427	-
Foodstuffs	01-09		35,518	96.6	3.4	34,301	1,215
Beverages and Tobacco	11		7,863	95.4	4.6	7,500	363
Crude Materials	21-27		1,295	96.0	4.0	1,243	52
Mineral Fuels & lubricants	32-35		11,742	75.6	24.4	8,881	2,862
Animal & Vegetable fat and Oils	41-42		1,561	93.5	6.5	1,459	102
Chemical Elements and Compounds	51-59		9,525	75.3	24.7	7,172	2,353
Manufactured goods classified by Material	61-69		41,807	82.7	17.3	34,568	7,239
Machinery and Transport Equipment	71-73		22,730	62.0	38.0	14,083	8,647
Miscellaneous Manufactured Articles	81-94		45,140	87.2	12.8	39,349	5,791
			179,608	84.1%	15.9%	150,983	28,624

Table 5 THE PRICE-RAISING EFFECT OF TARIFF PROTECTION ON LESOTHO'S IMPORTS 1976

SITC	Import Category	Imports CIF 1976	Origin: %		Direct Duty Content		Protective Price		Total Price Raisi-	
			RSA	Other		As % of C.I.F.	Raising Effect	As % of C.I.F. Imports	Effect	As % o C.I.F. Import
00	Live Animal	2,427	100	-	-	-	-	-	-	-
01-09	Foodstuffs	35,518	96.6	4.4	-	-	2,261.4	6.4%	2,261.4	6.4%
11	Beverages & Tobacco	7,863	95.4	4.6	2,916.0	37.1%	473.2	6.0%	3,389.2	43.1%
21-27	Crude Materials	1,295	96.0	4.0	0.7	-	51.8	4.0%	52.5	4.1%
32-35	Min.Fuels & Lubs.	11,742	75.6	24.4	4,725.4	40.2%	212.9	1.8%	4,938.3	42.2%
41-42	Animal & Veg. Fats & Oils	1,561	93.5	6.5	9.4	0.6%	135.4	8.7%	144.8	9.3%
51-59	Chemical Elements & Compounds	9,525	75.3	24.7	339.6	3.6%	510.3	5.4%	849.9	8.9%
61-69	Manuf. Goods by Materials	41,809	82.7	17.3	804.8	1.9%	3,073.1	7.4%	3,877.9	9.3%
71-73	Machinery & Transport Equipment	22,780	62.0	38.0	1,555.5	6.8%	2,409.1	10.6%	3,964.6	17.4%
81-94	Misc. Manuf. Articles	45,140	87.2	12.8	845.6	1.9%	6,055.9	13.4%	6,901.5	15.3%
	Total	179,608	84.1%	15.9%	11,197.0	6.2%	15,183.1	8.5%	26,380.1	14.7%
	Duties net of Rebates	179,608			9,725.0	5.4%	15,183.1	8.5%	24,908.1	13.9%

Table 6   **Lesotho: Trade Creation Benefits of Market Access to South Africa - 1976**

Exporter and Product	Export to SACUA R 000	% of Total Exports of Exporter	Tariff Heading (External Tariff)	Tariff
AFRO Tapestries	96	21%	58.03	20% + 1-S
Kolonyama Pottery	38	90%	69.11.10	25% + 1-S
RLTW Tapestries	195	53%	58.03	20% + 1-S
Thaba Bosigo Pottery	46	70%	69.11.10	25% + 1-S
Thorkild Woolens	26	96%	?	30% ?
Frasers: Door Frames	271	100%	44.23.30	20%
Kolonyama Candles	69	100%	34.06	40% + 1-S
I. Sheepskin Products	327	100%	?	25% ?
Maluti Furnishers	756	100%	94.01	25% + 1-S
Secrest	(113)	100%	–	
Total:	1,937			

Notes: Only manufacturing exporters with an export value to SACUA exceeding R20,000 are included.

Secrest has gone into liquidation.

1-S : Import Surcharge.

Source: (Exports to RSA): Ministry of Commerce and Industry.

Table 7 Quantifiable Advantages and Disadvantages to Lesotho and South Africa of Lesotho's Membership of SACU. - 1976

(Million Rand/year)

	Lesotho		South Africa	
	Cost	Benefit	Cost	Benefit
Trade Creation	-	1.5	-	66.1
Revenue Transfer	-	22.6	22.6	-
Administrative Cost/Saving	-	0.5	-	-
Trade Diversion of Tariff	15.3	-	0.1	-
Agricultural Marketing	-	1.0	1.0	-
	15.3	25.6	23.7	66.1
Net Cost/Benefit	-	10.3	-	42.7

The implication is that roughly two thirds of the revenue bonus (estimated above as being between 12-14% of the value of imports) is required to compensate for the costs of tariff trade diversion alone. A further trade diversion burden arises from the protective effect of import controls but it was not found possible to make quantitative estimates of this additional burden.

It is of course, true that Lesotho has also benefitted to some extent from protected industrialisation within the SACU. This benefit relates to industrialisation which has occurred in Lesotho only becasue of the free entry to the large South African market with protection from outside producers. Direct estimates were made to this benefit to Lesotho for 1976 (see Table 3). The benefit to Lesotho from this type industrialisation was found to be extremely small. Only a small number of small scale producers fell into this category with a gross output of about R2m per year in 1976.

(b) <u>The polarising tendency of SACU</u>

The advantages and disadvantages considered so far are all relatively easily quantified. They are summarised in Table 5. The costs of polarisation of development within SACU is inherently unquantifiable. It refers to the development which has not taken place (especially in the growth of manufacturing) because of the free flow of goods within SACU. Throughout the world there is evidence that the effect of a free market between areas of different levels of development is to promote the rapid growth of industry in the already industrialised areas leaving regional pockets of industrial stagnation and unemployment. Lesotho is a classic case of such a region within the wider

Southern African economy. The failure to develop a manufacturing sector for even the most simple basic needs of the economy must be at least partly attributed to the ready availability of South African goods with no protection in the domestic economy, and hence to membership of SACU.

Membership of SACU has also led to distortions in the pattern of consumption, tending to produce a bias towards types of goods which are prodoced by high technology processes in South Africa. Such a pattern is inappropriate for an economy which is unable even to meet the basic requirements of the Poverty Datum Line basket for the broad mass of its rural population.

(c) <u>Loss of Fiscal Discretion and Revenue Dependence</u>

Membership of SACU involves, in practice, abrogating the use of a wide range of fiscal instruments which are typically of vital importance to developing countries. It involves a wide loss of discretionary powers to increase or lower rates of indirect taxation in line with the budgetary needs of the government and the economy. In SACU this problem has been exacerbated by wild fluctuations in the revenue accrual under the revenue sharing formula. These fluctuations have been caused by the various adjustments to the formula (First Adjustment, Final Adjustment and Stabilisation Factor). They would have been avoidable with locally collected and administered duties. Since 1969 customs revenues have varied from 9.2% to 26.3% of imports (Taken as a proportion of the current year's imports). Nodeveloping country outside SACU permits such wild fluctuations of import duty yields.

Secondly, while customs revenues have grown very rapidly, in doing so they have generated an acute form of dependence of South Africa - the dependence of the Lesotho Government on the continued operation of the present arrangements for the government recurrent budget. Pretoria holds the purse strings for payments of civil service salaries and other unavoidable expenses. While payments should be made quarterly interruptions in the flow can be and have been used by Pretoria as an instrument of political control. The situation is particularly acute because of the high proportion of the budget which customs revenues form - about 73% of the recurrent budget in 1979/80. This type and intensity of dependence is something which has grown up with the SACU since 1969 and is inherent in the bonus element in the formula.

(iii) Does the Compensation Principle work in Practice ?

The principle of compensation underlying the terms of SACU assumes that the revenue bonus can be and will be used by the Lesotho Government to off-set the disadvantages of SACU. This raises two questions: firstly, whether it is adequate for the purpose; and secondly whether it will actually be appropriately applied. The preceeding discussion suggested that the bonus is not in fact adequate: after compensating for the costs of trade diversion there is not much left for off-setting the polarising tendencies of SACU. Regarding the second question it is dubious whet er the actual pattern of government is such as to off-set the disadvantages of SACU.

Analysis of Lesotho government expenditure suggests that the rapid growth of revenues which has come out of the revenue sharing formula has led firstly to the rapid growth of an extremely inefficient and unproductive civil service and secondly to an extensive public building programme (public service buildings and hotels). There has been a marked dearth of expenditure on the creation of an industrial infrastructure. It is concluded that the compensation principle underlying SACU does not really work in practice - the funds are either inadequate or misspent.

The conclusions of this survey of the advantages and disadvantages of SACU membership are that on the whole SACU is bad for Lesotho. The benefits are immediate, obvious and short term - revenue bonus for the government, the availability of goods for the consumer and the lure of the South African market for the producer. The disadvantages are insidious and long term - the creation of revenue dependence of the Lesotho government on Pretoria, the high cost structure facing consumer and producer because of the trade diversion costs of the tariff, and above all the failure to develop industrially.