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The wheels may come off

Nic Dawes

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Luxury imports into South Africa provided 56% of Swaziland's budget last year. (Photograph: AP)

A weaker appetite for expensive cars and other imported goods in South Africa could have dire consequences for some of the poorest countries in the region, economists and officials at the national treasury have warned.

South Africa's consumer boom has been financing a huge -- and disturbingly fragile -- surge in the budgets of other countries in the Southern African Customs Union (Sacu), with Lesotho and Swaziland particularly vulnerable to shifts in the spending habits of their much richer neighbour.

Higher interest rates and new credit rules are now cooling demand in Africa's biggest economy, with vehicle sales down more than 12% in June. That is good for South Africa's balance of payments, but to understand why it is likely to hurt some much smaller countries, it is necessary to make sense of the way customs revenues are shared in Sacu.

Botswana, Lesotho, Nambia, and Swaziland (the BLNS countries) have benefited enormously from a 2003 change in the way that members of Sacu share the money collected from tariffs on imports at their borders. The customs union, which dates back to 1909, pools and redistributes customs duties and excise collected by all five countries, enabling them to function in many respects as a single market.

The changes, coupled with a surge in South African consumer spending, have more than doubled the BLNS countries' income from Sacu in three years, pushing it up from R9,7-billion in 2003, to a projected R22,8-billion this year. South Africa's take has increased by a less exuberant, but still substantial 62%, from R13-billion to R20-billion, according to the latest available data.

"We expect [the contribution to the BLNS countries] to reach R29-billion by 2010," director general in the national treasury Lesetja Kganyago told the *Mail & Guardian* in an interview. "There is no other expenditure item that is growing as fast, but the big issue for South Africa is the way the formula is stuctured." He believes the way funds are divvied up should be changed and tight conditions imposed to ensure that the money is better spent (see panel below).

The current formula has a redistributive "development" component, but it is also designed to compensate the BLNS countries for the "costs" they are deemed to incur by handing over their trade policy to South Africa.

It achieves this by giving them a disproportionate share of the tariff take: despite the fact that the vast majority of imports into the customs union go to South Africa, more than half of all duties (54% last year) are paid out to the BLNS countries. The net effect, said Frank Flatters and Matthew Stern in a research paper last year, is a large and growing fiscal transfer to all the BLNS countries, even Botswana, the wealthiest member of the union.

But it is Lesotho and Swaziland, the poorest of the Sacu countries, that have seen the most consequential changes. Lesotho took R2-billion from the customs pool in 2004 and this year it is set to get R3,8-billion. Swaziland should get R4,6-billion, up from R2,8-billion in 2004, according to current trade data.

Even based on last year's lower figures, "the net fiscal transfer [accounts] for 23% of GDP in the case of Lesotho and almost 18% in that of Swaziland. Namibia also gets a large net transfer of 12% of GDP and even Botswana, the richest country in Sacu, gets a net transfer of almost 5% of its GDP. The cost of these transfers to South Africa, the only net donor, is 1% of its GDP," Flatters and Stern wrote.

According to World Bank figures, Sacu revenues last year provided 53% of Lesotho's budget and 56% of Swaziland's.

This situation is a cause for serious concern, treasury officials have told the *M&G*, pointing out that the two countries are now dangerously reliant on South African consumers' continued appetite for imports to fund government spending. Should higher interest rates in South Africa -- and perhaps the imposition of new credit laws -- curb spending, particularly on new vehicles, they could be faced with an abrupt budget crunch.

"You've seen the customs pool swell at a rapid rate," said Stern. "It has been unexpected and everyone has benefited from it, but it is an incredibly volatile source of revenue. Just as it has increased at this kind of rate, it could fall extremely rapidly."

The boom in revenues has two sources: a stronger rand and lower interest rates in South Africa have pushed up the value of imports, but growing vehicle imports play a disproportionate role, Stern and Flatters found.

South Africa's Motor Industry Development Plan (MIDP) effectively subsidises the local vehicle industry by charging high tariffs on car and truck imports, while allowing those manufacturers that export cars or components from their local plants to claim credits against vehicles that they import.

Simply put, if BMW exports cars worth R1-billion from its local plant to Europe, it earns enough credits to import R1-billion worth of BMWs duty free. Alternatively, it can sell its export credits to another importer and use the proceeds to support its local operations. It is effectively a complex subsidy scheme designed to support the development of the local industry.

If imports and exports were increasing at an identical rate, there would be no change in the amount of duties flowing into the Sacu customs pool -- import charges and export credits would balance out. Since 2005, however, booming local demand has upset this balance. Demand for imports from cash-flush South Africans has grown much more rapidly than exports from local plants. That has in turn dramatically increased the amount of duty collected at South African ports of entry.

In 2003, vehicles accounted for just 5% of the customs pool, yet two years later, in 2005, they contributed 32%, Flatters and Stern found.

The threat of a sudden reversal now seems very real: new vehicle sales in South Africa fell 12,1% on an annualised basis last month as successive interest rate increases started to bite.

If imports and exports returned to the near balance they were in just three years ago, Lesotho and Swaziland would face dramatic declines in revenue.

All this has a distorting effect on the policy choices of both South Africa and its neighbours. It means the BLNS have a stake in South Africa's maintenance of tariff barriers, even though these were designed to protect South African, not BLNS industries, and even though they cost BLNS citizens in the form of higher prices.

For South Africa, it complicates trade reform efforts by linking tariffs to what is essentially a regional development funding mechanism.

Plans to replace Sacu with a Southern African Development Community-wide customs union are now gathering momentum.

If that happens, the mechanism will have to change, Stern suggests, to a “more neutral, economic formula that will make sense in the longer term”.

Director general wants strings attached to booming customs payments
Lesetja Kganyago (pictured below) is director general in the national treasury. He told Nic Dawes why he thinks Sacu funds must come with strings attached.

“The formula is deliberately lopsided. The trouble is that the development component of the formula does not benefit the poorest countries the most, not by far. And there are other problems. If you look at other customs unions, like Europe, they have a large redistributive element, but there are very strict targets as to how the funds should be used.

“In Sacu, there are absolutely no guidelines saying how the money should be used. If development funds were to become a bigger component of the revenue pool and there were very clear guidelines as to how it was to be used, we could make a very real difference in the lives of the poor.

“There are other fiscal policy concerns too. If South African imports decline, some of these countries are going to have a serious problem. Also, if there is a breakthrough in the [Doha trade negotiations] that results in different global trade arrangements, there would be major changes for Sacu, but I don’t see countries preparing themselves for a significant loss of revenue. It is very worrying.

“[To limit the risks and ensure money is well spent], you could create a fund and all the countries would have to decide whether a particular project qualifies, or you could just set criteria that projects have to meet, but the current laissez-faire approach, where countries just take the money and say ‘this is ours’, is not sustainable.

“South Africa has written a letter to the other countries requesting that the formula be reconsidered. It was initially in support of Namibia. They wanted to build a dam and they said, ‘Why should the tariffs on the things that we need to import go to Sacu?’ We thought about our own infrastructure programme leading up to 2010, which has a large imported component, and we agreed that it has nothing to do with Sacu.

“The negotiations are going to be tough, and in international negotiations economic rationality must often be sacrificed at the altar of diplomacy, but we need to give the process a chance. In the end, we need to ask, ‘Have we changed the status of some of these countries from least developed countries to something better?’”

The impact of car tariffs
Did you know that, when you buy an imported car, you may be helping to finance a school in Lesotho or a new Maybach for King Mswati II of Swaziland?

The tariff on cars currently stands at 25%. To avoid complicating the argument, let us imagine a fully imported luxury station wagon bought from a manufacturer that exports no cars from South Africa. Call it a Volbaru.

A rough indicative calculation breaks down the revenue pool like this: If the local distributor paid R200 000 for your new family wagon, then R50 000 in duties would have been levied before markups and VAT were added. Volbaru has no export credits, so all of that goes into the Sacu customs pool.

Just over half is divided among the BLNS, with about R5 000 going to the Swaziland government and about R4 100 to Lesotho. Unfortunately, due to a lack of budget transparency in Swaziland, we cannot tell you how much of that might have been spent on Mswati’s peccadilloes. -- *Nic Dawes*