DEEPENING SACU INTEGRATION: THE POTENTIAL CONTRIBUTION OF A REGIONAL DEVELOPMENT FUND

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EXECUTIVE SUMMARY

Member states of the Southern African Customs Union (SACU) are currently engaged in discussions on industrial policy and the need to develop regional value chains. Officials have been tasked to identify projects that could anchor cross-border trade and investment within SACU. If a SACU development fund were to be established, it could finance such projects.

This policy briefing[2] summarises the results of four case studies in Botswana, Lesotho, Namibia and Swaziland (BLNS). It describes the experiences of eight small firms[3] in operating across SACU borders, and identifies opportunities for growing or diversifying their businesses within SACU. It also highlights a number of areas in which SACU member states could work together to improve the environment for cross-border trade and deepen regional integration.

POLICY RECOMMENDATIONS

1. Exports generate significant benefits for poor and unskilled workers in the BLNS. Deeper integration has the potential to contribute substantially to employment and poverty alleviation, and any discussions on the role of regional value chains in SACU should consider the particular constraints and opportunities encountered by small and medium-sized enterprises.

2. The customs union, as it is currently structured, is not optimising conditions for exports and the development of regional value chains. The most severe constraint is firms' struggle to get goods across internal SACU borders. SACU should identify and alleviate the main regulatory and logistical barriers that currently impede trade and investment flows.

3. The proposed SACU Development Fund should lift existing barriers to trade and investment; harmonise standards, systems and regulations; and invest in regional infrastructure and facilities. In doing so, it could increase the number and feasibility of individual investment projects hoping to take advantage of an improved regional business environment.

INTRODUCTION

SACU member states are currently deadlocked in discussions on the implementation of the 2002 SACU agreement. This includes negotiations around both the future of the revenue-sharing arrangement and the role of the SACU Tariff Board. At the same time, there are discussions within SACU and between SACU member states on industrial policy in general, and the need to develop regional value chains in particular.

However, SACU negotiations have historically adopted a narrow approach – focusing on the net fiscal outcome of proposed changes – with little consideration of the wider economic impact of SACU on its people, specifically the poor.

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It would therefore seem appropriate that discussions on the future of SACU should incorporate a wider developmental agenda. However, doing so will require a fundamental change in approach. The establishment of a SACU development fund could mark a critical step in this direction. This briefing aims to consider the options and potential for the economic reform of SACU and, specifically, the possible contribution of a SACU development fund.

The research project on which this briefing is based was constructed around eight country-specific case studies, whereby researchers in the BLNS countries were appointed to identify and work with two companies in each country, to describe their experience in operating across SACU borders and identify opportunities for growing or diversifying their business or value chain within SACU.

In Botswana, two firms manufacturing PVC pipes and electrical cables were used as case studies. In Lesotho, the two firms included were involved in the assembly of mechanical and electrical devices, and in Namibia, a pharmaceutical manufacturer and fishing company were used. In Swaziland, both companies produced, packed and exported baby vegetables and high-value horticulture crops.

CONSIDERATIONS FOR DEEPER SACU INTEGRATION

A number of important factors are likely to influence the scope and breadth of regional integration in SACU, the viability of any new integration initiatives and the willingness of SACU member states to engage meaningfully in the reform of the customs union.

Firstly, South Africa is the dominant economy in the SACU region, as well as the primary destination for BLNS exports. It is therefore necessary to explore the extent to which firms in the BLNS are able to link into the supply chains of downstream businesses in South Africa, and the main barriers to such trade.

Secondly, the available 'doing business' rankings suggest that, in general, firms in SACU member states face significant regulatory constraints that increase the time and cost of doing business in and between these countries.[4] These costs make it difficult for SACU countries to compete internationally, as exporters and for inward investment, which may encourage the development of inward-looking businesses and value chains.

Finally, the current SACU revenue agreement provides for a substantial transfer from South Africa to the fiscus of other member states. Given the extent to which the BLNS depends on SACU transfers, it is difficult for the governments in these countries to forego this revenue for regional development purposes. On the other hand, depending on how these revenues are being spent, the existing arrangement may not serve the long-term interests of businesses operating in the region. This is especially true if the revenue gains from the SACU revenue pool are largely directed to governments' current expenditure (ie, rising salaries), rather than addressing the structural and regulatory constraints to trade and investment across the customs union.

CONSIDERATIONS FOR DEVELOPING REGIONAL VALUE CHAINS

The case studies raised five important issues related to the development of regional value chains:

- Most of the firms were export-oriented, with the domestic market being of much less importance. This was largely a reflection of the small domestic market in the BLNS.
- There was little or no domestic sourcing of inputs for almost all of the firms used as case studies, beyond basic utilities and services and outside of agriculture.
- There was little to no intermediate and primary goods trade between the BLNS across or along these firms' value chains.
- For most of these firms, finished goods were almost inevitably destined for the South African market, with little intra-BLNS trade.
- A large proportion of the workers in these firms were unskilled, and in the agro-processing and fishing industries the vast majority were women. The employment opportunities in these value chains provide a significant avenue for poverty alleviation in the BLNS.

Unfortunately, it does not appear as though the customs union, as it is currently structured, is helping to optimise conditions for exports or the development of regional value chains. It is telling that one of the most severe constraints cited by all firms is their struggle to get goods across the internal (SACU) border, and not to foreign markets. Whereas some improvements have been implemented between SACU member states, the union currently has dual border processes between all member countries. Moreover, these processes do not appear to be particularly efficient, and serve to raise rather than reduce trade facilitation costs in the region.

DOMESTIC AND CROSS-BORDER CONSTRAINTS

The BLNS case studies highlight a number of common domestic and cross-border constraints. These constraints impede both the ability of domestic firms to grow and flourish, and the extent to which effective value chains can develop between SACU member states and across internal SACU borders.

Infrastructure

The BLNS relies on South Africa for a significant portion of its energy requirements. Shortages in energy generation in South Africa have extended to the BLNS, forcing some firms to procure generators and diesel, thereby raising their production costs. The accessibility of water was of further concern for agricultural firms, and the recent drought had raised challenges related to the management of water resources and infrastructure.

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Transport and logistics

In some cases transport costs were found to be punitive, and were aggravated by the fact that almost all industrial inputs had to be acquired from neighbouring countries, specifically South Africa. Road and rail infrastructure, and the high fees charged by regional logistics companies, were cited as the primary problems.

Access to skills and domestic capacity

The firms in the BLNS reported skills shortages and a lack of domestic capacity, which had an impact on their expansion decisions and their ability to source goods locally. Some of the firms also identified challenges related to red tape when importing specialist skills from South Africa, highlighting the need to ease constraints on the movement of business people within SACU.

Permits and standards

There is no unified standard or accreditation system in SACU, and national permits are required for the export of certain goods. In Swaziland, the issuance of export permits caused delays, especially when more than one agent was involved. In Lesotho, the lack of an adequate standards system made local product certification for export purposes difficult and expensive. In Namibia, the absence of mutual standards recognition between SACU member states was cited as an issue that both raised company costs and impeded the ability of firms to export into the rest of SACU.

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Cross-border challenges

Burdensome customs clearance procedures, systems downtime and restricted border hours were major challenges for firms in Swaziland. Moreover, firms contended that the customs systems between Swaziland and South Africa were not harmonised and the value added tax (VAT) claims process affected working capital and export costs. Firms in Namibia and Botswana cited numerous challenges in clearing goods across SACU borders. Examples included inconsistent processes, onerous customs pre-inspection requirements, unreasonable penalties related to the physical inspection of goods trucks, penalties on the re-import of repaired goods beyond the prescribed timeframe, and delays in obtaining import/export permits.

Access to finance

All the firms raised the issue of financing (at different stages of the production and trade process) as a potential constraint. This was related, in part, to VAT issues, and to the fact that the firms had limited access to short-term bridging and trade finance. In some cases, firms claimed they had limited access to capital for expansion purposes, despite their good credit histories and the availability of suitable projects.

RECOMMENDATIONS FOR DEEPENING THE SACU INTEGRATION AGENDA

One of the main purposes of this study was to identify specific projects where a regional approach, such as a SACU development fund, would be able to assist in growing intra-SACU value chains. However, most of the opportunities for improvement identified by the firms were cross cutting and would require substantive reforms to SACU, investment in regional infrastructure or the development of SACU-wide rules or facilities. Such programmes and reforms include:

- investment in regional energy, water and road (and potentially rail) infrastructure – this would increase reliability across the SACU region while reducing the BLNS's dependency on South Africa;
- the harmonisation of standards and regulations or the development of a common SACU accreditation process or institution;
- increased competition or the improved regulation of critical services such as transport and telecommunications;
- improved access to skills, particularly management and supervisory skills, possibly through the negotiation of a SACU agreement on the movement of people (this may also require the development of mutual recognition agreements for key skills and sectors);
- more efficient border controls and systems, including the establishment of at least one 24-hour one-stop border post between each SACU member state;
- attempts to make trade finance more widely available in SACU (through a regional trade finance facility, or possibly by extending the mandate of existing development finance institutions in South Africa);

- the establishment of a regional facility to provide access to key farming inputs such as fertiliser, seeds and farming equipment; and

- the improvement of market access to (primarily South African) distribution and retail value chains through SACU-wide initiatives (this could include export-promotion and supplier development activities in the BLNS, and supporting deeper interaction between SACU countries' chambers of commerce).

Progress in any or all of these areas would bring marked benefits to all of the firms interviewed, and would certainly assist in strengthening the intra-SACU value chains in which they currently operate. More importantly, these changes would contribute to significant improvements in the overall business environment in SACU and would likely lead to the generation of many more cross-border opportunities.

The establishment of a SACU development fund would present SACU with a unique opportunity. Such a fund could finance the direct costs of agreed reform initiatives while protecting individual member states from the unintended consequences of any adverse changes

This would help to take SACU forward in meeting its objective 'to promote the integration of Member States into the global economy through enhanced trade and investment'.[5]

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These results suggest that SACU should consider a two-pronged approach to deepening intra-regional value chains. Rather than focusing only on individual projects that serve the interests of specific countries and firms, it should first look to identify and alleviate the regulatory and infrastructure barriers that currently impede trade and investment flows across all sectors. With such an approach, the fund would likely also increase the number and feasibility of individual investment projects that would emerge to take advantage of improvements to the regional business environment.

ENDNOTES

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2 These case studies were undertaken by the following in-country researchers: Montle Phuthego (Botswana), Mohato Seleke (Lesotho), Willem Nekwiyu (Namibia) and Phiwayinkhosi Ginindza (Swaziland). The brief also incorporates comments from a workshop providing business and government stakeholders with feedback on findings from these case studies. This workshop was held in Pretoria on 31 January 2017.

3 The study deliberately targeted small and medium-sized enterprises, because larger firms generally have the capital and human resources needed to overcome the structural and regulatory challenges related to trading across borders.

4 See World Bank, 'Doing Business 2017', http://www.doingbusiness.org/, accessed 6 February 2017.

5 SACU (Southern African Customs Union), 2002 SACU Agreement, http://www.sacu.int/show.php?id=566, accessed 6 February 2017.

A future paper by GEG Africa 'Why does a SACU Development Fund matter? Lessons from other development funds and SACU trade practitioners' will review the focus and performance of regional development funds in other customs unions, and draw lessons on how such funds are used to address the constraints that have been raised in this briefing.

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