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ECONOMIC INTEGRATION BETWEEN THE REPUBLIC OF SOUTH AFRICA AND
BOTSWANA, LESOTHO AND SWAZILAND. (BLS)

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Economic Integration between the Republic of South Africa and
Botswana, Lesotho and Swaziland. (BLS)

P. Robson

INTRODUCTION

An example of a long standing arrangement for economic integration in Africa which operates in a very special environment is the case of the former High Commission Territories of Bechuanaland (Botswana), Basutoland (Lesotho) and Swaziland. (BLS). Geographically and ethnically these three countries, now, or, in the case of Swaziland, shortly to be independent, are closely related to the Republic of South Africa. For many years they had the closest of economic ties with that country. Indeed, for most of their history as separate territories, it was assumed, both by Britain and by South Africa that they would ultimately be absorbed within the latter. Provision for their incorporation was in fact made in the Act of 1909 which created the Union of South Africa, although it was subsequently made clear that this provision would not become effective unless the British Parliament was consulted and the wishes of the inhabitants were considered. During the following fifty years it was an object of South African policy to secure the incorporation of the territories into the Union. (1) With the development of apartheid, voluntary incorporation became out of the question and, by the early 1960's the dialogue about an ultimate transfer of the territories terminated. Britain began to prepare the territories for independence, and the South African government accepted that its future relations with the territories would be those appropriate to sovereign states. Nevertheless, economic links in the shape of legal and de facto integration arrangements continue to operate as in the past. As independence has approached, some consideration has been given by the Colonial office and the local administrations to the merits of these arrangements and to possible alternatives. This has been stimulated partly by the need for the territories to determine their positions in relation to the intention of the South African government to produce new customs agreements for each of the territories in anticipation of their transition to independence. Discussions on new agreements are to take place at the end of 1967. Whatever form they take, which will partly if not mainly

be determined by political considerations, it seems likely that geographical and economic considerations will point to continued close co-operation with South Africa, on the part of BLS unless indeed, no heed is taken of their justifiable claims to a new and improved financial deal.

The Economic Background

Table 1 sets out some of the salient economic and geographical features of the three countries and puts these against the similar magnitudes for the Republic of South Africa.

In area, the three countries taken together amount to more than half the size of the Republic, but a great part of the largest of the three countries, Botswana, consists of the sparsely populated and barren Kalahari desert. Lesotho is wholly an enclave within the boundaries of the Republic of South Africa and adjoins the Provinces of Natal on the east, Cape Province on the south, and the Orange Free State to the north and west. Most of its land is mountainous, and to the east, in the Drakensburgs it attains a height of 11,000 feet. Swaziland is surrounded by the Republic on three sides but shares a border on the east with Mozambique. Botswana is bounded on the west and north by South West Africa, and on the north east by Rhodesia. It also has a very small frontier on the north with Zambia.

The total population of the three countries in 1966 was approximately 2 mn. This includes some 175,000 who were temporarily absent from their homes in the course of employment in South Africa. (2) By comparison, the population of the Republic of South Africa in the same year was 17.85 mn. About 20% of the Republic's population is European. There is no European settlement in Lesotho, but in both Swaziland and Botswana there is a small settled European population which amounts to 3% and 1% of the respective populations. In Swaziland nearly one half of the land is owned by the European population.

Botswana is a vast arid table land with an average rainfall of 19 inches varying from 12 inches or less in the drier portions to 27 inches in the extreme north. The greater part of the area consists of Kalahari sand veld and is largely uninhabited. Population is concentrated in the sub-tropical to temperate eastern region which is better watered and contains areas of higher elevation. The economy is based on agriculture and livestock.

Table 1.

LESOTHO, BOTSWANA, SWAZILAND & THE REPUBLIC OF SOUTH AFRICA

Economic Structure

	LESOTHO	BOTSWANA	SWAZILAND	REPUBLIC OF SOUTH AFRICA
Area - thousand sq. miles	12	220	7	472
Population - thousands, 1966	859	559(a)	375	18,300
Population density - persons per sq. mile	72	3	56	38
Gross Domestic Product 1965 -R '000	37,425	27,390	55,000(b)	7,881,000
G.D.P. per capita - Rand	44	50	160(b)	430
Domestic exports 1966 -R '000	4,385	10,173(a)	38,620	1,080,000(c)
Imports 1966 - R '000	22,917	18,858	26,471	1,645,600
Ordinary Revenue 1965/6 -R '000	4,020	5,443	5,796	1,227,710
Customs & Excise Duties 1965/6 -R '000	1,400	1,021(1964/5)	1,770	299,174
Customs & Excise as % of Ordinary Revenue	35%	23% (1964/5)	32%	24%
U.K. Grant in Aid R '000	5,202	5,320	3,020	-
Total Revenue R '000	9,222	10,763	8,816	
Grants in Aid and Customs Revenue as % of total Revenue	72%	53% (1964/5)	54%	-

Source: Lesotho: Annual Statistical Bulletin 1965; National Accounts 1964/5 and 1965/6; Trade Statement 1966; Bureau of Statistics, Maseru.
Botswana: National Accounts of Botswana 1965, Central Statistical Office, Gaborone; Statistical Abstract, Central Statistical Office.
Swaziland: Annual Statistical Bulletin 1966; Gross Domestic Product 1960-64. Statistical Office, Mbabane.
South Africa: Statistical Yearbook 1966; Bureau of Statistics, Pretoria.
International Financial Statistics, June 1967; International Monetary Fund, Washington, U.S.A.

(a) 1966

(b) 1964 at 1960 prices

(c) Excluding exports of gold.

The main crops are maize and sorghum, much of which is produced for subsistence. Livestock is the most important source of cash income in agriculture. Mineral production is insignificant at present but surveys have revealed the existence of extensive coal deposits. Recently extensive copper nickel ore bodies have been discovered and their exploitation is likely to commence in 1970. Within the country paid employment amounts to only 30,000. In addition perhaps 35,000 persons, or some 20% of the adult male population are temporarily absent, mainly in the Republic.

The economy of Lesotho is based entirely on the cultivation of crops, mainly for subsistence, and on the raising of sheep and goats on which the export of wool and mohair is based. There is also some export of cattle. Labour migration is a dominant feature of its economy. According to the 1966 census 117,000 or more than 40% of the adult male population was temporarily absent in the Union or elsewhere. Known mineral resources are few and so far of little value. Industries are virtually non-existent. The apparently viable Ox-Bow dam scheme on the Madimamatso river would permit the sale of fresh water and electricity to the Republic. If it is undertaken it may facilitate some small scale industrial development.

Swaziland is the smallest of the three countries, but the most generously endowed in terms of natural resources and minerals. It enjoys a variety of climatic and physical conditions and a good rainfall makes possible a variety of agricultural production. Although subsistence agriculture occupies the bulk of the population, cash crop production of a variety of crops, not only by European farmers but also on estates and by Africans was valued in 1966 at seven times that of subsistence production and it is of growing importance. A rapid growth of irrigation projects in the low ^{veld} region has contributed to this. Swaziland's important mineral resources include asbestos, iron ore, coal and kaolin. Apart from several large industrial units engaged in mining or the processing of local produce (sugar, pulp etc) for export, little manufacturing development exists. The paid labour force within the country amounted in 1964 to about 25,000 (3), many of whom were Africans from other countries. About 19,000 Swazis find employment in the Republic. With the completion of the Swaziland railway the country now has a link to the coast through Mozambique. The railway was constructed primarily to facilitate the

exploitation of the iron ore deposits, but should also make it possible to recommence coal mining and contribute to the more effective exploitation of the country's other resources. In recent years, Swaziland appears to have enjoyed a remarkably high rate of economic growth.

For some years the three territories have experienced budget deficits. With a quickening of the pace of political advance rapid increases in the budget deficits have been experienced as revenues have failed to keep pace with increases in expenditure. The gap has been met by grants in aid from the British government. In 1965/6 these amounted to Rs. 3.0 mn. for Swaziland, or 35% of ordinary recurrent expenditure. For Botswana the corresponding figures were Rs. 5.3 mn. and 53%. For Lesotho Rs. 5.2 mn. and 62%. This financial dependence of the three countries is bound up with the fact that their budgetary and fiscal policies are profoundly affected by their financial and economic relationships with South Africa. These relationships are described in the following section.

The Arrangements for Economic Integration between South Africa and BLS

The economic integration of BLS with South Africa operates at several levels. In the first place there exists a form of common market and customs union between them and South Africa. (4) In the second place there is a de facto currency union, and banking and other financial links are close. Thirdly, a substantial part of the labour force of the three countries is employed in the Republic, mainly in the mines. Finally there are close links in transport and other services.

The origins of economic integration between South Africa and BLS go back to 1889 when the Cape Colony and the Orange Free State Republic, after declaring that it was desirable that there should be a general customs union between all of the colonies and states of Southern Africa, initiated a preparatory union which provided for free trade between the colonies and states, a common external tariff, and an equitable distribution among the participating countries of the duties collected. Political union in 1910 between the Cape Colony, the Orange Free State, the Transvaal and Natal made the terms of the economic union redundant for the members of the political union. The existing customs union was thereupon terminated and replaced by new agreements which took account of the position of those territories which were not parties to the

political union. The Agreement signed at Potchefstroom on 29th June 1910 between the newly established Union of South Africa on the one hand, and Basutoland, Swaziland and Bechuanaland was one of these. (5) At the time of writing it continues to regulate the economic relations of the participating countries.

The essential features of the 1910 Agreement were expressed in brief and general terms. It provides for:

The maintenance of the Customs Union tariff until altered by legislation enacted by South Africa or by the territories.

Free interchange of South African products and manufactures between the Union and the territories.

Payment by South Africa to the territories of an equitable share of the duties on goods passing through the Union to the territories and vice versa.

Conformity by the territories to the relevant tariff laws of South Africa.

Wines, beer and spirits of local manufacture were excluded from the free interchange clause. These goods are imported in bond from South Africa and the territories themselves impose and collect excise duties. Under the Agreement these must be at the rates in force in South Africa.

The Agreement specified the basis of the share of duties to be received by each territory. In effect, revenue from import duties and from excise duties on cigarettes, motor fuel and motor vehicles in the customs area. (but excluding beers, wines and spirits of South African manufacture) is shared between South Africa and BLS on an assumed derivation basis, the figures used for the division being the relative customs revenues of each area in the three base years preceding 1910. The following shares/were yielded by this basis, which has remained in operation as far as South Africa is concerned until today. (6)

Partly as a result of the customs union and partly for geographical reasons the three countries are closely linked in trade with the Republic.

Table 2.

Distribution of Customs and Excise Revenue under the 1910 Potchefstroom Agreement

<u>Country</u>	<u>Percentage</u> <u>Share</u>	
South Africa	98.68903	
Lesotho (Basutoland)	0.38575	
Botswana (Bechuanaland)	0.27622	Total share of BLS 1.31097%
Swaziland	<u>0.14900</u>	
	<u>100</u>	

Although accurate data on the origin of imports and destination of exports is not available for the territories, necessarily a high proportion of their imports and exports pass through South Africa. Moreover, in all three countries South African products dominate the internal markets although in the case of Botswana a substantial part of its imports (estimated at a quarter in 1966) normally comes from Rhodesia. Botswana's trade with Rhodesia has been facilitated by a Customs Agreement which was concluded with the Federation of Rhodesia and Nyasaland in 1956. (7) This agreement continues to be operated between BLS and Rhodesia but it is of practical importance only for trade between Botswana and Rhodesia. Both Botswana and Lesotho market a high proportion of their exports, mainly of agricultural products in the Republic. The bulk of Swaziland's exports on the other hand are destined for the outside world (80% in 1966) though much of these are exported through the Republic.

Currency, banking and financial institutions

Currency, banking and financial institutions are a second field in which there is economic integration with South Africa. A currency union exists and South African notes and coins are legal tender in each territory. Unlike the customs union the currency union does not rest on any agreement between the territories and the Republic.

The territories, like South Africa, are part of the sterling area and there are in consequence no restrictions on the transfer of funds from the U.K. to the territories. The territories allow their own residents to make payments freely to other sterling area countries. Their practice in this

respect is more liberal than that of South Africa. Residents of BLS are treated by South Africa as residents of the rand currency area for current account transactions and there are in consequence no restrictions on payments of this kind between South Africa and BLS. For transactions involving the sale of South African securities owned by residents of BLS, South Africa treats such residents as non resident (to prevent evasion through BLS of South African controls on the export of capital) but it is prepared administratively to give special treatment. It is believed that South Africa administratively restricts the export of capital in excess of amounts of R100,000 for investment in BLS. With these exceptions, capital can move freely between South Africa and BLS.

Because of the free flow of funds between BLS and South Africa their interest rates and credit conditions generally are closely linked. When credit is generally tight in the Republic, commercial bankers tend to restrict their lending in BLS whatever the state of those economies and vice versa. The two commercial banks which operate in BLS are both branches of banks incorporated in the United Kingdom and are closely linked with banks in South Africa. Banks operating in BLS customarily employ in South Africa the reserve of liquid assets which is maintained against their deposit liabilities. At present there are no opportunities for employing such assets in BLS. South African building societies and insurance companies collect funds in BLS but invest no funds there.

The remaining field in which BLS are closely linked with the South African economy is communications and services. In Swaziland road haulage is undertaken mainly by South African Railways. The railway in Botswana is operated by Rhodesia Railways which is linked closely with South African Railways. In the past the Post Office Savings Banks, and the Post Offices were operated by the South African authorities on behalf of the three countries but each now has its own system. All external mail, telephone, telegraph and international air services operate through South Africa. South African Airways provide part of the scheduled services linking the three countries with Johannesburg, though small internal air services also participate in this traffic.

The Costs and Benefits of Existing Integration Arrangements

Customs unions and common markets such as exist between South Africa and BLS may have a number of advantages. In the first place costs of administration may be reduced and smuggling avoided. In this particular case the territories are spared the burden of administering their own customs and excise system which other things equal is an undoubted advantage assuming that the attribution of customs revenue is approximately correct. It would be surprising if the proportions received by the three territories based as they are on imports in 1906/8 accurately reflected current trade relations at the end of a period in which, as a result of protection, and tariff changes, the character of import demand in South Africa has greatly changed and in which the rates of growth of the three territories appear to have varied considerably, particularly in recent years.

In 1963, in anticipation of proposals from the Republic of South Africa for the revision of the customs agreement on the independence of the territories, an enquiry was made into this matter. The British Government appointed a British statistician, Mr. F. M. M. Lewes, to examine the workings of the South African Customs Union as it affected the three territories and in particular to examine the share of the customs revenue which they received. In his unpublished report he concluded, on the basis of admittedly meagre statistics, and estimates of trade movements of the main dutiable articles, that the overall share received by the territories continued to be about right, but that in the light of current conditions a reapportionment among the three countries would be appropriate. (8) The suggested reapportionment is indicated below and compared with the original allocation. It involved practically halving the share of the poorest of the three, Basutoland, and a more than threefold increase in the share of Swaziland the richest of the three.

The shares proposed by Lewes were imposed administratively by the British Government for 1965/6 onwards and the grants in aid to the recurrent budgets of the territories were adjusted in compensation. The present position therefore is that South Africa pays out to each country on the basis of the original percentages and transfers take place from Lesotho to the other two countries.

Table 3

South African Customs Union

	<u>Share under the 1910 Agreement</u>	<u>Proposed Reallocation</u>
Lesotho	0.88575	0.47093
Botswana	0.27622	0.30971
Swaziland	0.14900	0.53033
	<hr/>	<hr/>
	1.31097	1.31097
	<hr/>	<hr/>

An important disadvantage of the South African customs union is that, in practice, BLS have no control over what is, in other less developed countries, a major source of government revenue and a powerful instrument of economic policy, namely customs and excise policy and rates. It is true that the agreement provides that the common external tariff may be altered both by South Africa and the territories, but in practice, alterations are initiated only by the South African government. During the colonial period informal consultations did take place between South Africa and Great Britain acting on behalf of the territories, but the effective voice was naturally that of South Africa.

Thus there is no direct relationship between economic growth in BLS and the growth of their customs revenues, for the latter depend on the state of trade in the Republic and the level of its duties. A recession in the Republic leading to a drop in imports and a fall in customs revenue would automatically reduce the revenue of BLS proportionately. A large proportion of tax revenue in BLS is effectively out of the control of the governments of BLS and cannot be influenced by any measures taken by those governments. As can be seen from Table 1 the percentage of ordinary revenue falling into this category in 1965/6 amounted to 00%, 35% and 32% for Botswana, Lesotho and Swaziland respectively. This situation evidently greatly complicates the fiscal problems which accompany economic growth. Moreover, to the extent that the South African government limits imports by protective tariffs or quantitative restrictions for the purpose of building up its domestic industries, revenues in BLS will be lower than they otherwise would have been.

It is these considerations, together with the heavy dependence of BLS on South African products which results from the customs union, which helps to explain the relatively low contribution of customs and excise revenues to total revenues. In other African countries at comparable stages of development the proportion contributed by this group of taxes is commonly between 50 and 60%.

Partly for this reason, even if the three countries receive their properly attributable share of South Africa's customs and excise revenues it does not follow that the customs agreement necessarily results in a fair fiscal deal for them, still less than the arrangements are necessarily favourable to their economic development. Broader considerations are obviously relevant. They are particularly so in this case because of the great disparity in size of the members of the union and the high degree of trade dependence of the smaller members which is unparalleled in any other customs union in Africa. Market integration creates a wider market for manufactures and products in the customs area, which may benefit all partners. But the smaller non-industrialised members may not benefit in the absence of a redistribution of income towards them by fiscal means, some agreed means of directing industrial development towards them, or favourable markets for their primary products. The non-industrialised partners have to meet the higher costs of goods from their partners which accompany trade diversion and they are unlikely to be able to establish industries to enjoy access to the larger market without protection. Although in principle they may benefit from the spread effect or from preferential access to the markets of their partners for their primary products, the balance of advantage need not be favourable. The Lewes inquiry altogether neglected these considerations.

So far as concerns the market for local manufactures, there is little reason to believe that the operation of the common market has been other than detrimental to the three territories. Since 1925, South African policy has been designed to encourage her secondary industries behind a protective tariff (9). Quantitative import restrictions have been used for the same purpose. The protection afforded to South African products in the markets of BLS has enabled them to assume a dominant position in those markets. Although in some cases the South African products are certainly competitive with imports, often the imported product would be cheaper. The excess cost

falls on the three countries. As noted already, the protective nature of the South African tariff and import restrictions have also operated to reduce the amount of revenue which would be available for distribution, although the Republic's need to impose duties for fiscal as well as protective purposes has ensured that there has been no absolute decrease in the yield of the South African tariff.

Although in principle the customs agreement offers BLS access to the large South African market for its manufactures, not surprisingly few manufactures have been established. Except in rare cases establishment of manufacturing industry in the face of the advantages of the economies of large scale production, modern technology and a developed infrastructure which are enjoyed by South Africa is unlikely. Admittedly some such industries have been set up, but this has occurred mainly in Swaziland where development has been able to take place in fields which are not competitive with South Africa's protected industries. The absence of job reservation in BLS might appear to offer some offsetting advantages for the establishment there of labour-intensive industries serving the South African market, but the ambiguity of the present agreement, and the administrative discretion which can be exercised by the South African authorities in relation to capital export and other matters limit the possibilities.

In this connection it must be noted that although the present agreement provides for "free interchange" of product and manufactures between South Africa and the territories, the term "free interchange" is ambiguous. It has been interpreted to mean free of duty, leaving it open to South Africa to impose quantitative restrictions. This she has done in the case of primary products exported from the territories and in the case of manufactures the same interpretation could be employed. Admittedly, the same alternative is presumably open in principle to the territories but this is of limited interest since few industries are likely to be established unless they have access to the South African market.

Nevertheless, although in some cases South Africa has imposed quantitative import restrictions on primary products coming from the territories, within the limits of the quotas the products of BLS are treated on the same footing as products from South Africa and enjoy access to its highly protected

internal market. Wool, meat, citrus, and cotton are marketed through South African marketing boards (10) and so, until 1964, was Swaziland's sugar. In the absence of empirical data it is impossible to determine the balance of advantage to the territories in respect of their access to the South African domestic and overseas market for primary products, but they may have been quite favourable in terms of savings in marketing costs, and prices obtained. But the quotas imposed (as with livestock) limit the gains. Moreover, for some product not marketed through boards such as timber, there appears to have been a tendency for the South African government to discourage the purchase of the products of BLS by administrative means when the interests of South African producers have demanded this.

Apart from the customs union itself, it is necessary to consider the costs and benefits which arise as a result of the monetary integration of BLS with South Africa. As already noted, the three countries use the notes and coins of the Republic and are served by commercial banks which are very closely linked to those operating in the Republic. These arrangements have both advantages and disadvantages as compared with the alternative of an independent monetary system. A most important advantage is that trade is facilitated by the absence of any exchange risk, restrictions, inconvenience or cost in transactions with the principal trading partners of BLS. In addition, membership of the currency union should facilitate the flow of private capital to BLS to the extent that the general credit conditions of the Republic permit this, and so long as there are no administrative interferences. Moreover, no foreign exchange problem arises in servicing external debts, which is a consideration which should facilitate the raising of loans for development purposes from places other than the Republic. Provided that a project is viable in the sense that it can produce an operating surplus sufficient to service the loans raised to finance it, there is no difficulty in securing foreign exchange as sometimes occurs in countries having their own currencies. These are important advantages.

Among the disadvantages of monetary integration are that outflow of savings and capital cannot be prevented and that money and credit conditions are determined by conditions in the Republic. In addition, the three countries derive no income from the capital which the holders of South African currency are in effect making available to the South African authorities. Nor do these

countries derive any capital finance from the currency circulation. Normally a currency union which is based on mutual agreement includes provision for distributing among its members the interest income made possible by the investment of the currency backing. Where a 100% reserve is not maintained, some provision of fiduciary finance is also possible. In the Equatorial and West African monetary unions, profits from the currency are distributed on the basis of the known currency distribution. In the case of East Africa, the profits of the former East African Currency Board were distributed on the basis of a formula which attempted to approximate to the unknown currency distribution amongst its members. The amounts which might justly be claimed by BLS on this account cannot be ascertained precisely in the absence of firm knowledge of the currency circulation. Nevertheless, with the aid of national income estimates and using relationships between income and currency circulation which are found in countries at a comparable level of economic development elsewhere in Africa, a plausible estimate could certainly be made (11).

The third important economic link between BLS and South Africa concerns the labour market. Here the balance of advantage of the present arrangements appears less open to doubt. The benefits are certainly important and on balance the arrangements are certainly advantageous to BLS. A substantial contribution to the national income of Lesotho and to a lesser extent in Botswana and Swaziland, is derived from remittances by or on behalf of migrant workers employed in South African mines and agriculture. It has been estimated that in 1964/5 £3,659,000 was sent or taken back to Lesotho on behalf of migrant labourers. In Botswana for the same year the corresponding total was £1,139,000. For Swaziland the estimate was £383,000.(12) To some degree such incomes are likely to be earned at the cost of foregone agricultural production in the territories since the migrants tend to represent mainly the more enterprising and able bodied members of the male labour force, but even so there is certainly a substantial net gain to the three countries.

A Revision of Economic Relationships in Southern Africa

It is only in the last few years with the approach of independence that there has been any attempt on the part of the Colonial Office or within the local administrations to evaluate the merits of the economic links with

the Republic, the possibility of negotiating improved arrangements and alternative courses of action. In relation to the customs union itself, a stimulus was provided by the prospect of having to form a view on a new customs agreement for which the Republic produced a draft in anticipation of the forthcoming independence of the territories. The deteriorating budgetary position of the three countries also prompted economic surveys (13). The reports which resulted gave some attention to fiscal policy but did not consider the possibility of improvement in the fiscal deal except for some changes which would make it possible for BLS to raise more revenue, primarily from their own consumers.

If the present economic and fiscal arrangements are deemed to be unsatisfactory and a satisfactory improvement is impossible to negotiate, it would in principle be possible/one or more of the three countries / for to opt out of them. They could establish their own customs system and possibly a tariff more suited to their own needs, and proceed to protect their infant industries. They could also establish their own monetary systems. The costs of administration would have to be borne by the country introducing them.

At the time of writing there has been no detailed evaluation of the practicability and the costs of operating separate customs services although rough estimates have been made of the likely capital and recurrent costs which involved in the operation of border posts/would have to be counted against any additional revenue made possible by a separate system. It would also be necessary to negotiate a transit agreement for goods in bond with South Africa and the cost of its operation would have to be borne by any territory seeking to establish its own service.

Clearly the benefits from operating separate customs services would depend on the character of the tariff structure established and the effectiveness with which duty on the major dutiable imports could be collected. In discussing the possibility of separate customs services, the report on The Development of the Swaziland Economy suggests that the revenues derived by Swaziland from the existing customs agreement "are not less than she would raise if she had her own customs administration levying the same rates of duty" (14). A similar statement is found in the Botswana Report (15).

These statements presumably reflect the findings of the Lewes Report and imply that South African products would not be taxed. But there would clearly be little purpose in having a separate customs administration if South African products were not taxed. A more relevant question would be how much revenue could be raised if a non-discriminatory tariff on all imports were raised.

Obviously the revenue raised from a separate customs administration is not the only consideration to take account in deciding the policy options. Except to the extent that the prices of South African goods fell as a result of the tariff or it resulted in a diversion of demand to cheaper sources outside South Africa, the increased revenue would not represent a real income gain but merely a transfer from consumers in the three countries to the exchequers. On the other hand, at the present time the prosperity of the three countries depend, though in varying degrees, on free access to the domestic or overseas markets of South Africa. Any income gain from a change in the fiscal system would have to be weighed against the corresponding income losses which might ensue if access to markets in the Republic were to be limited as a result of a change in the customs union. Important factors in this respect are the proportion of their exports which are marketed in the Republic; the prospects for the development of additional production which could only be marketed profitably in the Republic; and alternative markets outside the Republic. The lack of empirical data on these questions and uncertainty about the response of the Republic make it difficult to form a judgement on this issue.

Currency and banking is a second area where in principle alternative arrangements could be considered. The advantages and disadvantages of the present arrangements have been noted above. On the eve of independence in 1966 both Lesotho and Botswana sought expert advice about their future currency arrangements. (16) The issue of a separate currency for any of the three countries would present no great difficulty. The main advantage would be that if it were backed by the rand or a major international currency, the income from the assets backing the currency could be expected to yield a small profit after deducting operating costs. New currencies could be introduced without reference to South Africa if the backing were rand deposits or securities.

On the other hand if sterling or some other international currency were employed, it would be necessary because of the operation of exchange control in South Africa, to enter into negotiations with that country in order to arrange for withdrawn South African currency to be converted into the chosen international currency. In the circumstances, use of the South African Rand would be a natural choice. It would be the best way of avoiding the possibility that South Africa would introduce exchange control on transactions with BLS. Moreover, if agreement were reached on the interchangeability of notes within BLS and South Africa little, if any convenience for trade would result. Bearing in mind the fact that the establishment of a separate currency would create very little scope for the pursuit of independent monetary or credit policies the conclusion of the experts called in to advise Lesotho on this question was "it seems highly questionable whether the advantage Basutoland could derive from a separate currency at the present time would compensate for the disadvantages" (17), but they avoided trying to quantify the gains.

The common market and the currency are the principal fields in which there is likely to be on balance some net disadvantage to BLS from the existing arrangements. In the labour market there is on the other hand a large positive gain. Evidently the possible repercussions of a change in present customs and currency arrangements on the earnings of migrant labour in South Africa would have to be weighed up. Nevertheless there is no reason to suppose that a revision of the customs and currency arrangements would in themselves entail major changes in the present or prospective position of these countries' nationals working in South Africa. The long run policy of the South African government with respect to foreign "bantu" labour is quite clear. During the Verwoerd government a committee was appointed to examine the position of "foreign" Africans in the Republic (18). Among the Committee's main recommendations was that the dependents of foreign workers should be immediately repatriated and that the long term aim should be the repatriation of the workers themselves. It was recognised that this would be impracticable immediately and an exception was therefore proposed for workers in mines and on farms. For these an annual quota for admission was recommended, in which BLS would receive preference. The principal recommendations of the committee were later accepted by the

South African government and indicate the long term framework in which, in the absence of change in South Africa, the labour policies of BLS must be formulated. In the immediate future however, BLS need probably have little fear of a curtailment of employment opportunities in South Africa, for although these benefit BLS, the addition to the labour supply also benefits South African industry and agriculture substantially and these benefits are not likely to be foregone. It seems to be widely agreed in South Africa that it would be impossible at present for her to replace much of this labour from domestic sources. The effect of any substantial reduction in the supply of foreign labour on the wage level in mines and farms in South Africa could therefore be considerable and this repercussion is unlikely to be overlooked by a government whose internal price level is somewhat inflexible, geared as it is to the fixed price of gold. When it becomes in the domestic interests of South Africa to repatriate workers from BLS or to reduce the inflow this will no doubt be done. A failure to recast the customs arrangements may well impede the development which will ultimately be necessary not only to absorb displaced migratory workers but also to provide a living for the steadily growing labour force of BLS.

In the light of all the uncertainties concerning the benefits from opting out of the existing arrangements it is not surprising that thinking in BLS has centred not on removing but on improving the existing arrangements on the most favourable terms possible. Evidently access to the large markets of South Africa could be a major asset to the three countries although the need for South Africa to look after its Bantustans (19) first may sharply limit what can be hoped for in this direction. Nevertheless there is no indication that South Africa may not be persuaded to support a substantially more favourable arrangement than the present one.

The foregoing review of the working of the existing arrangements has indicated some of their more important disadvantages from the standpoint of BLS which may be summarised as follows. It is not in practice possible for BLS to protect their infant industries. The present agreement provides only for free interchange of products and manufactures and has been interpreted to permit the imposition of quantitative restrictions which have been imposed on primary products. There is no consultation on fiscal or monetary policies.

The attribution of revenue though probably correct overall (and, after the administrative reallocation, for each territory individually) does not provide a fair fiscal deal. And no revenue is derived from the use of the Rand as currency. Many matters are undoubtedly settled to the disadvantage of the territories in the field of trade as result of the exercise of administrative discretion. Import prohibitions in particular may operate to the disadvantage of the three countries. These disadvantages indicate the general lines of the new deal which the territories should seek. Four important changes seem to be desirable in any new agreement.

In the first place, some formal provision should be sought for the establishment of a consultative body to be concerned with the operation of the customs union. Evidently the great disparity between the economic power of the Republic and the three territories make it unreasonable and unrealistic to suppose that the territories can have any important voice in the determination of fiscal and tariff policies, and the machinery employed in the East African Common Market and elsewhere is hardly likely to be acceptable to South Africa. Nevertheless, a situation in which the territories have no right even to be informed of prospective changes in tariff policy by South Africa or to represent their own needs is clearly unsatisfactory and hardly consistent with the new status of these countries. Consultation may improve the chances of avoiding at least some changes which are clearly detrimental to the interests of BLS and could facilitate consideration of their needs for certain protective tariffs which may be of decisive importance for their own development. For instance, a protective tariff on soda ash could be of considerable benefit to Botswana by reserving the South African market to it and the cost to the Republic might be relatively small.

In the second place, it is highly desirable that a revision of the agreement should include provision permitting the three countries temporarily to impose either quantitative import restrictions or a tariff upon South African products which compete with prospective infant industries. The change of BLS being able successfully to establish manufacturing industries in the absence of such provisions are small. It is understood that the draft agreement first proposed by South Africa contained no provision for protecting infant industries in BLS but would, on the contrary, have permitted South Africa's already established industries to receive protection against competition from BLS.

In the third place an upward revision of the fiscal payment to the territories should be sought. The grounds for this are that the customs agreement results in the replacement of lower cost foreign products by higher cost products from the Republic. Although the case for some additional compensation seems strong, the amount which might justly be claimed is difficult to determine. Moreover, as we have seen, each of the countries probably enjoys some offsetting gains from its access to the markets of the Republic for their primary products. A further complication is that South Africa's gains from the present arrangements need not be equal to the losses which may be incurred by the territories.

One commonly advocated method of dealing with the cost of trade diversion to the smaller members of a common market involves providing fiscal compensation based on the revenue losses assumed to be incurred by the country importing the products of its partners duty free. Such a basis was employed in the Trade Agreement of 1964 between the Government of Nyasaland and the Government of Southern Rhodesia. (20) Under this agreement the Government of Southern Rhodesia agreed to pay to the Government of Southern Rhodesia 10% of its trade surplus with Nyasaland after excluding certain products such as those subject to excise in Nyasaland (beer, cigarettes, etc.) and unmanufactured local products. The rate of 10% appears to have been fixed as a rough approximation to the average rate of duty foregone by Nyasaland as a result of the maintenance of the customs union between the two countries after the break up of the Federation of Rhodesia and Nyasaland.

Of course, the customs revenue loss is not a particularly relevant basis for fiscal compensation except in a limiting case. Part of any revenue loss from the free trade arrangements in ELS represents merely a foregone transfer from their producers and consumers to the public exchequer and not any loss of real resources. On the other hand, any fiscal payment from the Republic would represent an increment of real income to the territories, part of which could properly be regarded as compensation for their having to buy South African products at a higher price than imports from the rest of the world. The customs revenue loss calculations should be taken to represent an upper limit to the real income losses imposed on the territories.

An alternative base for providing compensation suggested by Professor D. V. Cowen (21) would involve allocating the shares of South Africa import revenues to the territories on the basis of the ratios of the total net manufactured imports of the four territories, irrespective of whether these imports come from abroad or are manufactured in South Africa.

Yet another suggestion entails retaining the shares indicated by the attribution procedures currently employed, and giving the territories in addition a share of the income tax on the profits of the manufacturing and commercial sector in South Africa. There is a precedent for this in the arrangements adopted in East Africa for the Distributable Pool which was set up on the recommendations of the Raisman Commission.

Data are not available to show the effects of these alternative bases except for that based on the ratios of the net manufactured imports, the effects of which are indicated in Table 4, for 1965. As can be seen this basis would result in more than doubling the shares received by the territories as a whole.

Table 4: The South African Customs Union

	<u>Botswana</u>	<u>Lesotho</u>	<u>Swaziland</u>	<u>Total</u>
(i) Present Effective proportion of S. African Customs & Excise Revenue	0.30971	0.47093	0.53033	1.31097
(ii) Amount 1965/6 (R.000)	(1,021)	1,222	1,393	
(iii) Share based on Ratios of Net Manufactured Imports (excl. imputed into BLS) wines, beers, spirits	0.84	0.76	1.46	3.06
(iv) Amount based on (iii) (R.000)	1,912	1,735	3,333	6,986.

Sources: Statistical Yearbook, Pretoria,
Swaziland Annual Statistical Bulletin, The Statistical Office, Mbabane,
Lesotho, Annual Statistical Bulletin, Bureau of Statistics Maseru
Botswana, Statistical Abstract, Central Statistical Office, Ministry of Finance, Gaborone

Notes

(1) 1964/5.

Fourthly, in considering the terms of any revised agreement it would be desirable to try to provide increased scope for the territories to increase their indirect tax revenues by autonomous action. For instance, it would be desirable to authorise the territories specifically to impose export taxes on their primary products. Almost certainly the incidence of these taxes is on the producers and the tax represents a very convenient way of taxing cattle producers. Two out of the three territories already impose such taxes, although it is doubtful if their actions are consistent with the Customs Agreement. Apart from this it would be desirable to give the territories flexibility to determine their own excise duties on beer wines and spirits instead of requiring them to conform to the rates in force in the Republic which are on the whole low. Evidently the scope for major differences would be limited by the need to prevent smuggling. There may even be grounds for going beyond this and permitting the territories to impose levies taking the form of a turnover tax on a limited range of other commodities.(22)

If such levies were imposed on a non discriminatory basis they would not upset South Africa's privileged position in the markets of the three and, since the incidence would be largely on the consumers, the levies could not be represented as seriously harmful to South Africa's interests or inconsistent with the spirit of the integration arrangements.

Finally, it would be desirable to seek either as part of a broader economic agreement, or separately, provisions which would meet some of the problems on the monetary side. In the first instance some machinery needs to be established for consultation between the monetary authorities in South Africa and the Finance Ministeries in the three countries. Possibly representation on the board of the Reserve Bank of South Africa might be sought. One of the main purposes of this consultation would be to acquaint each party with the thinking of the other on monetary and credit policies, and in particular to try to ensure that credit in BLS was adjusted as far as possible in conformity with their needs rather than those of the Republic. Scope could easily be provided for the exercise of a differential credit policy. In addition, measures might be discussed which would lead to a greater proportion of the savings of BLS being invested locally rather than in South

Africa. Finally efforts should be made to obtain an annual payment from South Africa in consideration of the circulation of South African currency in the territories. The annual income which might be obtained from separate currencies backed by the Rand might be of the order of £80,000 for Lesotho, £40,000 in the case of Botswana and £40-80,000 in the case of Swaziland. (23)

A successful outcome to the negotiations might be encouraged if the British government were to give assurances that its budgetary assistance to the territories would not be cut immediately in proportion to any increased payments from South Africa. If this is not done, any increases will not immediately benefit the territories and could be represented as transferring funds from South Africa to Britain, which is hardly a helpful background for negotiation.

Evidently the scope for improving the terms of economic association between South Africa and BLS is greatly influenced by the interplay of political factors and the greatly disparate bargaining power of the interested parties. The absence of empirical data on a range of important matters also makes it difficult to base the negotiations on hard facts and increases the uncertainty of the outcome. It is unlikely that any future arrangements will be satisfactory in all respects to every party and it will be necessary for each to make a judgement on their overall effects from their own standpoint. A generous response on the part of South Africa to the changes which considerations of economics and equity seem to justify need cost relatively little but could make the maintenance of economic association of decisive advantage to the territories. In the absence of such a response some at least of the territories seem likely to have alternatives open to them which on further analysis may turn out to be more attractive than the maintenance of the status quo.

References for Economic Integration between the Republic of South Africa
and Botswana, Lesotho and Swaziland

- (1) See Hailey, The Republic of South Africa and the High Commission Territories, O. U. P. 1963.
and Basutoland, The Bechuanaland Protectorate and Swaziland; History of discussions with the Union of South Africa, 1909-1939. H.M.S.O.
CMD 8707, 1952.
- (2) See G.M.E. Leistner, Foreign Bantu Workers in South Africa; Their Present Position in the Economy. South African Journal of Economics Vol. 35 No. 1, March 1967. The 1966 Censuses of Population of the three countries also have data bearing on this question.
- (3) I.L.O. Report to the Government of Swaziland on Manpower, 1964.
- (4) See Customs Agreement-Union of South Africa-Territories of Basutoland Swaziland and the Bechuanaland Protectorate, Potchefstroom, 29.6.1910
High Commissioner's Notice 65 of 1910. South-West Africa is also part of the South African Customs area.
- (5) Similar agreements were entered into between South Africa and the Rhodesias and between the three former High Commission territories and the Rhodesias. These are no longer in force although a form of customs agreement between the High Commission territories and Rhodesia still operates. See footnote (7) below. The historical background to the 1910 agreement is described in J. van der Poel, Railway and Customs Policy in South Africa.
- (6) See page below for a discussion of the reallocation of the overall share among the three territories by decision of the British Government.
- (7) See Basutoland, Bechuanaland Protectorate, Swaziland, High Commissioner's Notice 63 of 1956. (High Commissioner's Office, Capetown 24th May 1956. Customs Agreement Between the Federation of Rhodesia and Nyasaland and Basutoland, The Bechuanaland Protectorate and Swaziland.
- (8) See Report of the Ministry of Overseas Development Economic Survey Mission, The Development of the Basutoland Economy October 1965 para. 237.

- (9) On this see H.M. Robertson M. Kooy, The South African Board of Trade and Industries; The African Customs Tariff and the Development of South African Industry, South African Journal of Economics Vol. 34 No. 3, September 1966 and the references cited therein.
- (10) The arrangements for Swaziland are discussed in Report on the Marketing of Agricultural and Livestock Produce in Swaziland, by H. C. Biggs, Ministry of Overseas Development, London, 1966.
- (11) An I.M.F. Staff Paper quoted for August 1966. estimate for Botswana of 2.5 mn. Rand
- (12) All these figures are derived from Leistner, op. cit.
- (13) The Economic Development of Swaziland Economy; The Economic Development of the Basutoland Economy, The Development of the Bechuanaland Economy, Ministry of Overseas Development, London, 1965.
- (14) op. cit. para. 35.
- (15) op. cit. para. 40.
- (16) See for instance H. Kessels and H. J. Tomkins, Report to the Basutoland Government on A National Savings and Development Bank, The Monetary System And Certain Aspects of Land Tenure, April 1966.
- (17) op. cit. page 23.
- (18) See Report of the Committee re. Foreign Bantu (Froneman Report) Pretoria 1962 (mimeo)
- (19) Some of the economic problems of these areas and the South African government's policies towards their industrial development are discussed in C.R. Hill's book Bantustans - The Fragmentation of South Africa. London 1964, Institute of Race Relations and Oxford University Press.
- (20) Southern Rhodesia Government Notice No. 25A of 1964, Trade Agreement between the Government of Nyasaland and the Government of Southern Rhodesia. (Supplement to the S.R. Government Gazette Extraordinary dated 7th January 1964, Government Printer, Salisbury. See also A. Hazlewood, The Malawi-Rhodesia Trade Agreement, Bulletin of the Oxford University Institute of Economics and Statistics, May 1965.

- (22) See the three reports on the economic development of the three territories cited above, in which some suggestions are made for the introduction of new taxes and levies in the territories.
- (23) If currency per head in BLS were the same as in East Africa, the respective circulation would be approximately R 1.75 in Lesotho; R 2.5 in Botswana and R 1.75 in Swaziland. Assuming a rate of inflation of 5% and agency costs of 20% gives the above figures. The initial cost of the currency would also have to be taken into account of the annual income for an initial

development of the three territories. The initial cost of the currency would also have to be taken into account of the annual income for an initial