Health Expenditure Implications of SACU's Revenue Volatility in BLNS Countries

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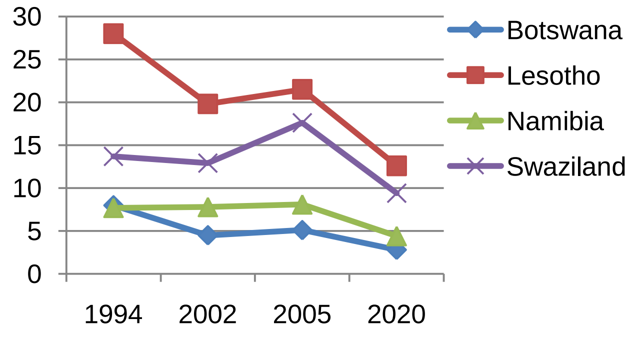
Executive Summary

The Southern African Customs Union (SACU) is the world's oldest customs union. Established as Customs Union Convention in 1889, the union operated under different agreements, which were negotiated and renegotiated with changing circumstances [1,2]. Presently, the union is being governed by the 2002 Agreement. Its members are Botswana, Lesotho, Namibia, Swaziland (BLNS countries) and the Republic of South Africa.

SACU member states deposit their customs and excise collections in a common revenue pool (CRP), which they share using a formula that has evolved over the years. Under the 2002 revenue sharing formula (RSF), the BLNS countries together get nearly half of the collections although their joint gross domestic product (GDP) is less than 10 percent of SACU's GDP. Not surprisingly, income from the CRP constitutes a considerable proportion of total government revenue (about half in Lesotho, more than two thirds in Swaziland and nearly 40 percent in Namibia).

SACU revenue is on the decline. Flatters and Stern [3] predict that Swaziland's SACU revenue as a share of its GDP will decline from 17.6 percent in 2005 to 9.4 percent in 2020; Lesotho's share will go down to 12.6 percent of GDP in 2020 from 21.5 percent of GDP in 2005; while Namibia's and Botswana's shares will drop from 8.1 percent and 5.1 percent of GDP in 2005 to 4.4 percent and 2.8 percent of GDP, respectively in 2020 (Figure 1).

Figure 1: SACU Revenues as a share of GDP (%)



Source: Flatters and Stern (2005)

Against the declining SACU revenues and the heavy government reliance on income from the CRP, fiscal expenditures and hence public programs in the BLNS countries will be adversely affected. A likely effect is that critical areas such as health, education and agriculture, which are paramount for human development, may be scaled down. This is an issue of major concern given that SACU countries carry the world's worst HIV/AIDS epidemic. Any scaling down of prevention, care and treatment programs will decelerate current initiatives and, in some cases, reverse advances made in combating the scourge.

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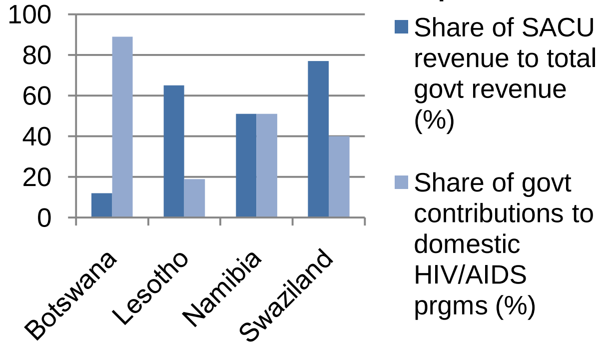
To counter the problem, we suggest that, in the short term, the BLNS countries should lobby for more donor support, exercise fiscal restraint and allow for relatively higher budget deficits. In the long run, the solution lies in restructuring their fiscal frameworks to move away from reliance on SACU revenue, especially for recurrent expenditures. This will necessitate the adoption of an expenditure plan anchored on domestic revenue. The BLNS countries may also aim at efficient and effective use of public resources ■

The State of HIV/AIDS in BLNS Countries

The state of HIV/AIDS in Southern Africa is alarming. Continued new infections, especially amongst infants, national sero-prevalence rates among pregnant women and aggregate numbers of people living with HIV/AIDS are all very high in SACU member states. In Swaziland the United Nations Development Program warned that *`if the current trends are not reversed, the longer term survival of Swaziland as a country will be seriously threatened'* [4]. Existing levels of poverty and poor access to health services compound the impacts HIV/AIDS is having. The cost of care and treatment for people living with HIV and AIDS as well as support for those affected (such as the millions of AIDS orphans), applies pressure to already tight budgets.

Lesotho, Namibia and Swaziland presently shoulder a significant share of the financial responsibility for HIV/AIDS given their development indicators (see figure 2). If more people are to be enrolled onto ART programs, funding may increasingly have to be from these overstretched governments since donor commitment is uncertain. The US President's Emergency Plan for AIDS Relief (PEPFAR) and the Global Fund for AIDS, Tuberculosis and Malaria (the Global Fund) provide the greatest financial support for treatment in Lesotho, Namibia and Swaziland. The availability of funding to treat people in need of antiretroviral treatment (ART) in the near future however, is not secure. PEPFAR's 2009-2014 plan shows a slowdown in the rate of enrolling new patients [5] and the Global Fund continues to face funding gaps [6]. With major donors increasingly reluctant to lock themselves into long-term funding for AIDS, the financial responsibility falls onto these countries at a time when revenue injections from SACU are declining.

Figure 2 SACU revenue and Govt contributions to HIV/AIDS prms



Sources: UNAIDS (2008) [7]; Flatters and Stern (2005)

Declining SACU Revenues

Receipts from the SACU CRP constitute a significant proportion of total government revenue in the BLNS countries. Governments of Lesotho and Swaziland stand out as the most dependent on SACU revenue among the SACU member states, while Namibia's dependence, albeit slightly lower, has been gradually increasing in recent years.

Available statistics, show that SACU income has been on the decline and is likely to continue going down. A number of factors explain the declining

SACU revenue. These include the recent global recession, the impact of the recession on the South African economy and declining global trade tariffs. The European Union (EU) Sovereign Debt Crisis and a slowdown of imports associated with the 2010 FIFA World cup infrastructure are additional factors that are expected to keep the CRP declining.

Policy Options

BLNS countries are largely left on their own to face the impending financial battle of falling SACU revenues. The strategic geopolitical links between southern African countries, that allowed high SACU revenue recepits, are largely obsolete. Regional intervention, therefore, cannot be realistically expected.

We present six policy proposals, not mutually exclusive, to counter the problem, both in the short run and in the long run.

(i) Lobbying for increased aid to offset the declining SACU revenue: This is a short term solution. Everything else remaining the same, the BLNS countries are likely to face a widening gap between government revenue and required public expenditures on HIV/AIDS, which can be filled by a corresponding increase in donor funding. Donor funding for HIV/AIDS programs in BLNS countries vary from country to country. Lesotho and Botswana, respectively, are the most and least dependent on donors for their HIV/AIDS projects among the BLNS countries. The funding gap will depend both on the dependency ratio of public to donor funding and on the extent to which the BLNS countries have relied on SACU revenue to finance government budgets.

(ii) Fiscal restraint aimed at realigning declining government revenue with public expenditures: This is both a short and long term solution. The BLNS countries can address the financing gap between government revenue and required expenditures on HIV/AIDS by exercising fiscal restraint. This means cutting down on non-priority expenditures and, in some instances, even HIV/AIDS projects may have to be downsized. This approach will ascertain that countries do not unnecessarily accumulate public debt.

(iii) Increasing the fiscal deficit to avoid disrupting public projects amid declining government revenue: The BLNS countries can choose to maintain the present level of fiscal expenditures and let the running projects continue undisrupted. The declining government revenue, however, will imply a corresponding increase in the budget deficit. This may be an inevitable short to medium term solution pending restructuring of the fiscal framework.

(iv) Restructuring the fiscal framework to move away from relying on SACU revenue, especially for recurrent expenditures: This is a long term solution. Taking this approach, the BLNS governments may have to reconsider how they utilise SACU revenue. A way forward is to move away from using SACU revenue for recurrent expenditures, in particular wages and salaries. Instead, the revenue should be channelled to finance investment projects such as infrastructure development.

(v) Developing a long-term expenditure plan anchored on domestic revenue: It is imperative for the BLNS countries to develop fiscal strategies aimed at moving away from reliance on external sources of revenue. This entails enhancing efforts to improve domestic revenue collection. Larger amounts of domestic revenue will provide a

cushion against any shock to the budget arising from the volatility of SACU revenues. This is a long term plan intended to re-align public expenditures with domestic revenues.

(vi) Efficient and effective use of public resources: This is a long term solution that involves streamlining the public sector. This is to ensure that government is involved only in services that cannot be efficiently provided by the private sector, that government adheres to public expenditure ceilings, and there is priority targeting of public expenditures towards more urgent productive projects.

Policy Recommendations

In the short run, the BLNS countries should lobby for an increase in donor support to cover the funding gap in critical areas such as HIV/AIDS. Donor funding may have to be complemented with fiscal restraint, cutting down expenditures in non-priority areas. Realising that the expenditure cuts need not be done in a manner that constricts the economy, relatively larger fiscal deficits may be inevitable. In the long run, the BLNS countries should consider adopting an expenditure plan anchored on domestic revenue. The fiscal framework may have to be restructured, moving away from reliance on SACU revenue, especially for recurrent expenditures. There is also need to aim at efficient and effective use of public resources.

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