Public Health Expenditure Implications of the Southern African Customs Union Revenue Volatility in BLNS Countries

Harold Ngalawa[*], Khaled Ahmed[†] and Alan Whiteside[‡]

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Abstract

This study sets out to investigate how the volatility of income from the common revenue pool (CRP) of the Southern African Customs Union (SACU) is affecting health expenditures, particularly in the HIV/AIDS sector, in Botswana, Lesotho, Namibia and Swaziland (BLNS). Following an outline of SACU's rich historical background as well as its political economy and state of HIV/AIDS, the study provides evidence of declining revenues from the CRP accruing to the BLNS countries. Our investigation further reveals that this decline in receipts from SACU is likely to continue. Some of the factors responsible for the revenue decline include global business cycles, poor performance of the South African economy, and declining global trade tariffs following developments in regional integration involving SACU and other countries/trading blocs. There are several policy options for the BLNS countries to counter the declining SACU revenue. We suggest that in the short run, the BLNS countries should lobby for an increase in donor support to cover a funding gap that is predicted to emerge. 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 way that constricts the economies, relatively larger fiscal deficits may be inevitable. In the long run, the BLNS countries should consider adopting an expenditure plan anchored on domestic revenue. Their fiscal framework may have to be restructured, moving away from reliance on SACU revenue, especially for recurrent expenditures. They will also need to aim at efficient and effective use of public resources.

[*] *School of Economics and Finance, University of KwaZulu-Natal, Westville Campus, Durban. Emails: ngalawa@ukzn.ac.za/ hngalawa@yahoo.co.uk.*

[†] Health Economics and HIV/AIDS Research Division, *University of KwaZulu-Natal, Westville Campus, Durban. Email: Ahmedk@ukzn.ac.za.*

[‡] Health Economics and HIV/AIDS Research Division, *University of KwaZulu-Natal, Westville Campus, Durban. Email: whitesid@ukzn.ac.za.*

1 Introduction

While the theory of customs unions is commonly believed to date from the publication of Viner's pioneering work in 1950 (Cooper and Massell, 1965), the history of the Southern African Customs Union (SACU) goes back to more than six decades earlier in 1889 when Cape of Good Hope (a British colony) and Orange Free State (a Boer Republic) established the Customs Union Convention (CUC)[1]. Claiming a place in modern history as the world's oldest customs union, CUC was extended to cover the British territories of Bechuanaland (Botswana) and Basutoland (Lesotho) in 1893, Swaziland in 1903 and the Union of South Africa in 1910 before a renegotiated agreement of 1969 led to the adoption of the name SACU in 1970. SACU has been renegotiated once more culminating in the 2002 Agreement. Present members of the union include 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 substantially over the years. The revenue sharing formula (RSF) currently in use was derived from negotiations that started in 1994 and ended with the 2002 Agreement. Under this RSF, the BLNS countries combined get nearly half of the collections in the CRP although their joint gross domestic product (GDP) is less than 10 percent of SACUs GDP. Not surprisingly, income from the CRP constitutes a considerable proportion of total government revenue in the BLNS countries. In Lesotho, for instance, revenue from SACU accounts for nearly half of government revenue while in Swaziland, it constitutes more than two thirds of fiscal revenue.

SACU revenue, however, is declining. In Namibia, SACU income is estimated to have declined by 40 percent in 2009/2010 compared to the previous year (van den Bosch, 2010) while in Lesotho, the country's SACU revenue is expected to fall by 60 percent in 2010/11 (Central Bank of Lesotho, 2010). In Swaziland, SACU income declined by 6 percent in 2006/2007, 6.4 percent in 2009/2010 and 12.5 percent in 2010/2011 (Government of Swaziland, 2007). And prospects for the CRP remain gloomy. It is expected that the BLNS countries will continue receiving declining revenue from SACU. Flatters and Stern (2005) 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. For the BLNS countries combined, SACU revenue measured as a percentage of GDP is projected to decline from 14.35 percent in 1994 to about 7.3 percent in 2020.

The declining SACU revenues coupled with heavy government reliance on income from the CRP in the BLNS countries are expected to adversely affect fiscal expenditures and subsequently public programs. Critical areas such as health, education and agriculture, which are paramount for human development, may be scaled down. Considering that SACU is one of the HIV/AIDS hardest hit regions in the world, any scaling down of programs being implemented to contain the pandemic may slow down and in some cases halt or even reverse advances made in combating the scourge. This study sets out to investigate these and other issues with particular attention on government funding to the health sector, especially

[1] See Gibb (2006) and Ettinger (1974) for an elaborate history of SACU.

HIV/AIDS programs. The study analyses revenue trends from the SACU CRP accruing to the BLNS countries and examines implications of the shrinking CRP on government expenditures on HIV/AIDS programs. To the best of our knowledge, no study has been carried out along these lines[2].

The paper is organised as follows. Section 2 presents SACU's historical overview. A discussion of the theory of customs unions and the political economy of SACU is the subject of Section 3. Data sources are summarised in Section 4. Section 5 is a brief overview of key macroeconomic indicators in the BLNS countries. An outline of the state of HIV/AIDS in the SACU member states follows in Section 6. A summary of SACU's operating framework and an investigation of how health expenditures in the BLNS countries are being affected by the volatility of income from the SACU CRP are outlined in Section 7. Policy implications are presented in Section 8 and a summary and conclusion conclude the paper in Section 9.

2 Evolution of SACU: A Historical Overview

Since its establishment as CUC in 1889, SACU has operated under different agreements, which have been negotiated and renegotiated with changing circumstances[3]. The evolution of SACU to its present position, however, can be traced back to a period broadly separated by four major agreements, namely the 1889, 1910, 1969 and 2002 agreements.

2.1 The 1889 Agreement

The history of SACU starts in 1889 when Orange Free State (a Boer Republic) and Cape of Good Hope (a British Colony) established CUC, which was reorganised four years later with the admission of Bechuanaland (Botswana) and Basutoland (Lesotho) as members of the union. Swaziland joined in 1903. The three new members, referred to as British High Commission Territories (HCTs), were admitted under a separate protocol which categorised them as second-class members with diminished rights (see Maasdorp, 1982). Neither of them had the power to amend customs duties, alter the terms of the agreement or vote on new concessions (Gibb, 2006).

2.2 The 1910 Agreement

Following the formation of the Union of South Africa in 1910, all previous agreements were terminated paving way for the Customs Union Agreement, a renegotiated accord which was effected in the same year. It was made clear in the new agreement that the customs union

[2]Besides searching in the arhives of the academic literature, we also contacted the SACU Secretariat in Windhoek, Namibia, the World Bank Office in Pretoria, South Africa, and ministries of finance and central banks in all SACU member states if they have conducted or are in the process of carrying out a similar study and the response was negative.

[3]Different aggreements were reached in 1889, 1893, 1898, 1903, 1910, 1969 and 2002 (see Ettinger, 1974; Gibb, 2006)

was a provisional establishment pending absorption of the three HCTs into the Union of South Africa (see McCarthy, 1992; BIDPA, 1999; Hyam and Henshaw, 2003). The HCTs were perceived as a political and economic burden, and their independence was regarded as not viable (Gibb, 2006). The British, however, later prevented incorporation of the three countries despite receiving pressure from South Africa (BIDPA, 1999).

The 1910 Agreement provided for a common external tariff, free trade within the four countries, free transit across each other's territories and a RSF for the distribution of revenue collected from customs duties and excises taxes (BIDPA, 1999). In the 1910 RSF, members shared the union's customs revenue in proportion to their level of external trade and divided excise duties according to their respective production and consumption of excisable goods as recorded between 1907 and 1910, a development which resulted in the HCTs collectively receiving only 1.3 percent (Bechuanaland, 0.27 percent; Basutoland, 0.88 percent; and Swaziland, 0.15 percent) of the total revenue while South Africa's share was 98.7 percent (see Cattaneo, 1990; SACU, 2010). Since the RSF was fixed to trade, production and consumption figures of 1907-1910, there was no scope for the HCTs to increase their share of the SACU revenue pool during years when they grew faster than South Africa. South Africa retained the authority to single-handedly administer the union's CRP, set SACU import duties, and decide upon excise policy throughout the period of the Agreement[4].

2.3 The 1969 Agreement

Following the independence of Botswana and Lesotho in 1966 and Swaziland in 1968, the former HCTs engaged South Africa to renegotiate the Customs Union Agreement. At the time, it had become clear that the share of the CRP allocated to the three countries (1.3 percent) significantly underestimated their contribution to the pool (Gibb, 2006). A new agreement was reached in 1969, and was effected in the following year. Among the major changes, the union adopted the name SACU, a new RSF was introduced, and institutions were designed to help in the management of the union. Using the new RSF, Botswana, Lesotho and Swaziland (BLS) were each given a portion of the CRP based on their share of imports and products subject to excise duties in the SACU area, multiplied by 1.42 (BIDPA, 1999), while South Africa was allocated the residual.

The revised RSF was generally regarded as generous to the BLS countries, shifting away from a bias towards South Africa, to a bias in favour of the three smaller countries (BIDPA, 1999). The formula was modified in 1976 to include a stabilisation factor to reduce fluctuations in the revenue shares accruing to the BLS countries. The stabilisation factor ensured that the BLS countries received at least 17 percent and at most 23 percent of the value of their imports and excise duties (see Fajgenbaum, Sharer, Thugge and DeZoysa, 1999). The domination of the union's affairs by South Africa continued. South Africa retained the sole decision-making authority over customs and excise policies of SACU (Gibb, 2006).

[4]Even the Agreement itself was signed by one person, Lord Gladstone, Govenor of the Union of South Africa and High Commissioner for the three protectorates, who had only to agree with himself and sign the Agreement four times (see Kirk and Stern, 2003).

2.4 The 2002 Agreement

When the apartheid regime came to an end in 1994, there was consensus among all SACU members that the agreement was due for amendment. The 1969 Agreement was perceived as colonial, undemocratic and a legacy of South Africa's apartheid past (Gibb, 2006) whose principal objective was no more than a recognition of the status quo (BIDPA, 1999). Nelson Mandela described the organisation as '*a reflection of the colonial oppressor's mentality,*' (Gibb, 2006, p. 595) and McGowan (1999, p. 4) called it a '*colonial relic.*' After several years of negotiations, beginning in 1994, members reached a new agreement in 2002. A major breakthrough in the agreement was a provision for joint responsibility over decisions affecting tariff-setting, the CRP and overall direction of SACU (SACU, 2008). The 2002 Agreement also spells out a new RSF and an institutional framework for the administration of the union which comprises a Council of Ministers (a supreme decision-making authority), a Customs Union Commission, a Tribunal, a Tariff Board, technical liaison committees and a secretariat (see SACU, 2008).

While the 2002 SACU Agreement settled for the establishment of a joint decision making process, South Africa was retained as a custodian of the CRP. According to the South African Reserve Bank (SARB), the authorities calculate expected customs and excise collections for all member states and the South African Government makes quarterly payments to the BLNS countries in advance[5]. Depending on the actual collections, the BLNS countries are eventually either underpaid or overpaid. If a member is underpaid, the South African Government pays off the difference. In the event of overpayment, the concerned member is *supposed* to pay back the difference. However, paying back has been problematic, and netting off in subsequent payments has been considered as an option.

3 The Theory of Customs Unions and the Political Economy of SACU

Viner's (1950) pioneering work in the customs union theory demonstrates that a customs union can result in either trade creation or trade diversion. Trade creation involves a shift from high cost domestic production to lower cost production in a partner country and trade diversion entails a shift from a low cost external producer to a higher cost producer in a partner country. Viner (1950) concludes that trade creation raises the home country's welfare while trade diversion lowers it, drawing his inference from the postulation that tariffs are an inefficient means of raising revenue. The subsequent literature (see, for example Lipsey, 1960; Cooper and Massell, 1965; Collier, 1979; Kowalczyk, 2006), however, shows that when 'consumption effects' are taken into account, the Viner (1950) conclusion may not necessarily hold.

Lipsey (1960) argues that in the absence of a customs union, imposing a tariff introduces a divergence between relative prices facing consumers and real opportunity costs of goods to the economy, making it identical to an excise tax, which has the effect of constraining

[5] An interview with members of staff in the SARB Research Department.

consumers to a non-optimal consumption equilibrium. Following the establishment of a customs union, some dutiable goods that were previously imported from external sources will, as expected, be replaced by identical goods imported from a partner country, duty free but at a higher real cost. This migration from a lower cost external producer to a higher cost source of supply in a partner country lowers a country's real income and consequently consumer welfare. However, the removal of the constraint on consumption brought forth by the elimination of tariffs in the union may raise welfare. In the event that the second effect outweighs the first, net consumer welfare may go up.

Extending Lipsey's (1960) hypothesis, Cooper and Massell (1965) argue that the welfare effect of a customs union, whether trade creating, trade diverting, or both, can be split into a tariff reduction component and a pure trade diversion component. Cooper and Massell (1965) demonstrate that the tariff reduction component accounts for both trade creation and trade diversion and it is the sole source of any gain in a consumer's welfare that might result from a customs union.

Clearly, SACU cannot be appraised using tools of customs union theory alone. It is evident that the BLNS countries have benefited considerably from free trading of South African products and manufactures. It is equally clear that South Africa has gained immensely from resource extraction and labour imports from its partners in the union. However, we cannot ignore the fact that SACU was originally established within a colonial framework and was supported by an apartheid regime with oppressive institutional structures. This background has been a source of tension between South Africa and the BLNS countries, resulting in the relations between the two being characterised more by acrimony than harmony (Gibb, 2006).

In the literature, the case of SACU has been interpreted by two polar schools of thought with no scope for convergence. One school of thought, the dependency school, has regarded SACU with suspicion, describing it as part of a sub-regional system which emerged under colonialism and was, as a consequence, characterised by relations of economic domination and subordination (see Gibb, 1997). The school maintains that South Africa has derived substantial benefits from its access to cheap resources in the BLNS countries and that the country has undertaken a deliberate stance to develop strong ties of dependence to itself in the BLNS countries (Davies, 1990).

The interdependence school, on the other hand, has perceived SACU as an effectively functioning trading bloc, which is beneficial to all participating parties. The school cites the revenue sharing principle of collections in the SACU CRP as a successfully implemented policy for compensating the trade diverting costs imposed on the BLNS countries (see Matthews, 1983; Gibb, 1997). Matthews (1983) maintains that SACU has survived many years because the arrangement, on the balance, is beneficial to all parties.

In the post apartheid period, there has been near consensus that SACU is essential for the well functioning of the Southern African economies. The African Development Bank has observed that 'the appeal for some form of regional integration in Southern Africa is almost intuitive' (see Gibb, 1997, p. 73). Vale and Motlasa (1995) have gone further to suggest that Southern Africa should be viewed as a single well integrated economy. Kirk and Stern (2003) state that the reconstructed SACU could form the core of a larger regional customs union that would facilitate a realignment of the existing regional organisations.

4 Data and Data Sources

This study has utilised data from ministries of finance and central banks of all SACU member countries. Budget documents, national accounts, central bank annual reports, and quarterly financial and economic reports are some of the data sources that were consulted. A large part of the macroeconomic indicators were collected from the World Development Indicators (WDI) online, a World Bank database of economic and demographic indicators. Additional data were collected from the Annual Reports of the SACU Secretariat and publications of the South African Revenue Service and National Treasury. In exceptional cases, data were obtained from media sources. Where this was the case, particular attention was paid to the reliability of the media house. In all cases, we compiled the relevant data up to the most recent date possible.

5 SACU Economies: Key Macroeconomic Features

The defining characteristic of SACU is the demographic and economic dominance of South Africa in contrast to the other four members (Kirk and Stern, 2003). With a population of 48.5 million, South Africa accounts for 88 percent of the total population in SACU (see Table 1). Equally large is the size of the country's economy relative to the BLNS countries. It is estimated that 92 percent of the total output in SACU is produced in South Africa. South Africa also accounts for 89 percent and 86 percent of the total SACU imports and exports, respectively.

Table 1: SACU Economic Indicators (2008)

	Botswana	Lesotho	Namibia	Swaziland	BLNS	RSA	% of SACU	
							BLNS	RSA
Population[1]	1.7	1.88	2.0	1.1	6.68	48.5	12.11	87.89
GDP[2]	8,458	1,059	5,692	1,820	17,030	183,249	8.5	91.5
GDP/capita[3]	4,497	502	2,714	1,557	2,549	3,764		
Imports[2]	2,788	2,061	1,546	2,076	8,470	66,478	11.3	88.7
Exports[2]	4,472	570	1257	1563	7861	50166	13.55	86.45
Inflation[4]	12.7	10.72	10.35	13.3	11.77	9.8		
Interest Rates[5]	8.67	7.64	8.38	8.17		11.61		

[1]millions; [2]millions of constant 2000 US Dollars; [3]constant 2000 US Dollars; [4]Year-on-year percentage changes in the all items national composite consumer price index; [5]deposit rates

Source: World Bank World Development Indicators Online

For most of SACU's history, the BLNS countries have used a common currency, that of South Africa (BIDPA, 1999). The Rand Monetary Agreement (RMA), signed in 1974, formalised the use of the South African Rand as the only legal tender in the region. Botswana pulled pulled out from the RMA in 1975. Presently, each of the four countries has its own currency. Lesotho, Namibia, Swaziland and South Africa, however, are members of a Common Monetary Area (CMA). In the CMA, currencies of Lesotho, Namibia and Swaziland are pegged at par with the South African Rand. While the South African Rand is allowed to be used as money in all countries in the CMA, the national currencies of Lesotho, Namibia and Swaziland are not accepted as legal tender in South Africa.

An important implication of the CMA is that the monetary authorities in Namibia, Lesotho and Swaziland do not have an independent monetary policy from that of South Africa. Accordingly, they are bound to have similar inflation and interest rates to South Africa's. In addition, they do not possess the option of financing their budget deficits through money creation. Although Botswana is in a different position, the country has been running budget surpluses for many years and its exchange rate with the other members of SACU has been maintained at a near constant level to avoid disrupting trade. Botswana's fiscal and monetary policy has drawn the country closer to some convergence with countries in the CMA.

In a complex web of regional trading blocs, all members of SACU are also members of the Southern African Development Community (SADC). However, only Namibia and Swaziland are members of the Common Market for Eastern and Southern Africa (COMESA).

The BLNS countries have generally experienced high growth rates, although sharp contrasts of poverty and prosperity exist among them. On the one extreme, Botswana has transformed itself from being one of the poorest countries in the world at independence in 1966 to an upper middle income economy, outpacing the economic growth of even the Asian Tigers (World Bank, 2010). The country recorded an average growth rate of 9 percent between 1966 and 1999, and it has been the fastest growing economy in SACU. Unlike all the other SACU members, the country has had no record of negative growth since the 1960s (see Figure 1). As at 2008, it had the largest GDP per capita in SACU, estimated at US $4,497.

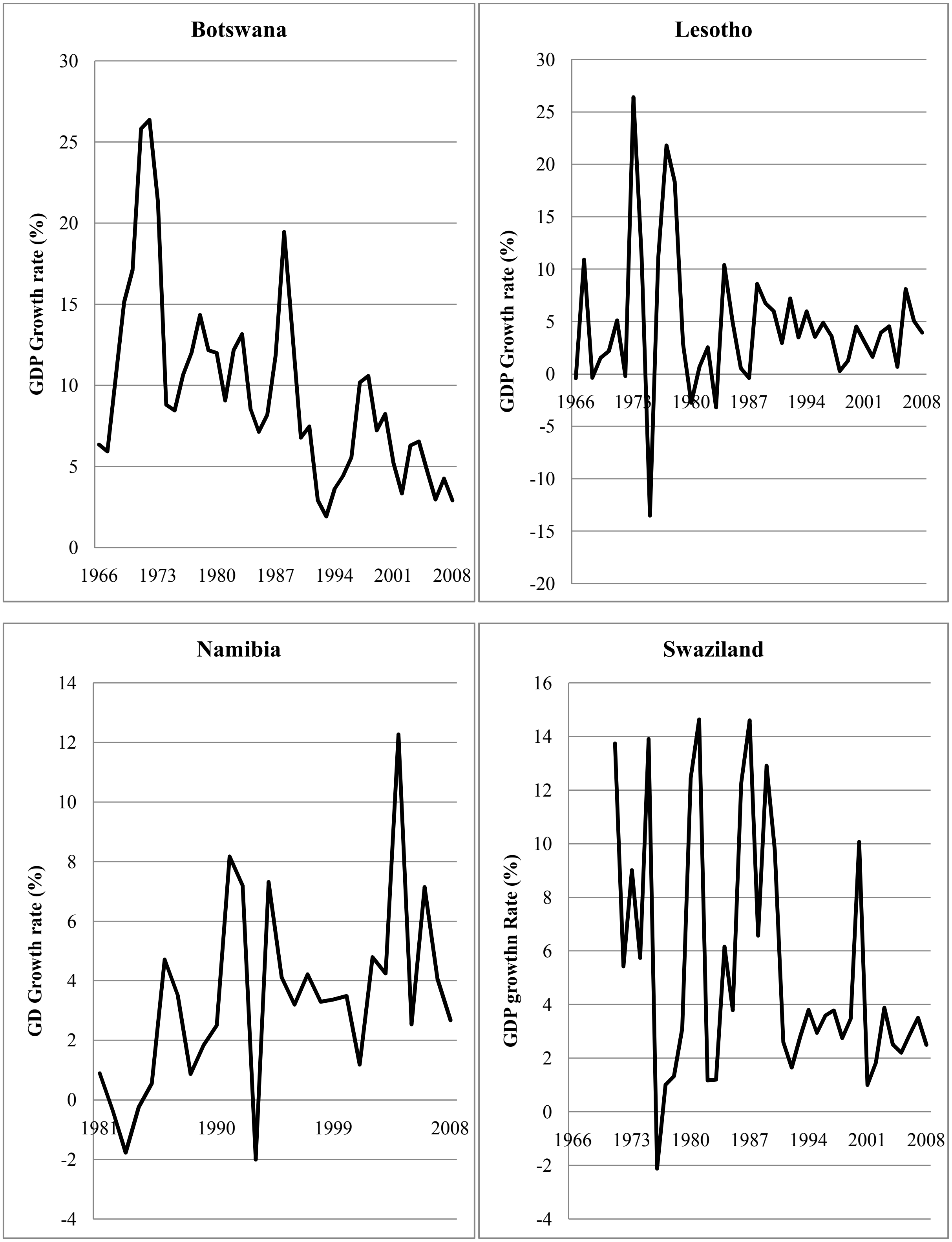
Botswana's success story is attributed to the discovery of diamond reserves in the country after independence, which have been well exploited. While the mining sector has been dominant, accounting for over 30 percent of the country's GDP, the manufacturing sector has suffered, accounting for less than 5 percent of the country's GDP in 2008.

On the other extreme is Lesotho, one of the poorest countries in the world and the poorest in SACU. An enclave, entirely surrounded by South Africa, the country has a population of 1.88 million and a GDP per capita of US$502 with about 40 percent of the population living below the international poverty line of US$1.25 per day (UNDP, 2009). The country is heavily dependent on remittances from migrants working in South African mines and almost half of the population earns some income from agriculture (Kirk and Stern, 2003). Among its major exports are clothing and textiles, diamonds and water.

Lesotho is well known for a fairly developed textile and clothing industry which sprouted out of the United States initiative in the African Growth and Opportunity Act (AGOA) of 2000. It also exports water to South Africa, feeding the Free State and greater Johannesburg area. Its economic growth, however, has been jumping up and down with wide margins although it somewhat stabilised since the late 1980s (see Figure 1).

Swaziland has a GDP per capita of US$1,557 and falls in the lower middle income category of countries. Poverty levels in the country, however, are high with approximately 63 percent of the population living on less than the equivalent of US$1.25 a day and an estimated 75 percent of the population employed in subsistence farming (UNDP, 2009). This suggests that levels of income inequality in Swaziland are very high.

Figure 1: GDP Growth Rates in BLNS Countries



A predominantly rural agricultural economy, Swaziland's largest single industry is sugar production and processing (Kirk and Stern, 2003). Partly because of its reliance on rain-fed agriculture, the country's GDP growth has been volatile over the years (see Figure 1). Since the 1990s, however, GDP growth in Swaziland has fairly stabilised, fluctuating around 3 percent.

In Namibia, the economy is dominated by mining, fishing and ranching (Kirk and Stern, 2003). Diamonds account for nearly half of the country's exports and the agricultural sector employs a majority of the country's workers (Ibid). The country is also a beneficiary of the AGOA initiative. With a GDP per capita of US$2,714, Namibia is a lower middle income economy. The country's GDP growth has on the whole taken an upward trend since the mid 1980s (see Figure 1).

6 HIV/AIDS in BLNS Countries: Current State, Social Economic Impact, and Public Funding

Southern Africa carries a heavy HIV/AIDS burden. All five SACU member states exhibit national HIV/AIDS prevalence rates at epidemic levels (see Table 2 for key HIV/AIDS figures in the BLNS countries). HIV/AIDS prevalence in the region has stabilised, although at a high level (see, for example UNAIDS, 2009b). It is expected, therefore, that fiscal budgetary implications for the cost of care and treatment for people living with HIV and AIDS and support of those left affected by it (such as AIDS orphans), will continue to apply pressure to already tight budgets.

Currently, the United States President's Emergency Plan for AIDS Relief (PEPFAR) and the Global Fund for AIDS, Tuberculosis and Malaria (the Global Fund) provide the largest part of financial support for treatment in Lesotho, Namibia and Swaziland. The availability of funding to treat people in need of antiretroviral treatment (ART) in the future however, is not secure. PEPFAR's 2009-2014 plan shows a slow down in the rate of enrolling new patients (PEPFAR, 2009) and the Global Fund continues to face funding gaps (MSF, 2010). 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.

The average cost per person per annum of four combinations of ART that is often used is estimated at US$143 in low-income countries and US$162 in lower-middle income countries. Second line drugs for patients who develop resistance costs US$1,105 in low-income countries and US$2,192 in lower-middle income countries per person per annum (UNAIDS, 2009a). With declining receipts from the SACU CRP and reported increases in per capita health expenditure (see, for example Physorg.Com, 2010), it is highly likely that the fiscal ability of Lesotho, Namibia and Swaziland to absorb the costs of treatment for people yet to receive treatment will be under strain.

At the microeconomic level, households with HIV positive members are affected in several ways. First, increased expenditures on health, such as out of pocket payments for clinic ser-

Table 2: HIV/AIDS in BLNS Countries: Key Indicators

	Year	Botswana	Lesotho	Namibia	Swaziland
National HIV Prevalence (percent)	2007/2008	23.90	23.20	15.30	26.10
AIDS deaths	2007	11,000	18,000	5,100	10,000
AIDS orphans	2007	95,000	110,000	66,000	56,000
ARV treatment coverage (percent)	2007/2008	79	26	88	42
Govt health expenditure per capita (US$)	2006	815	98	261	300
Life Expectancy (female)	2007	56	47	61	49
Life Expectancy (male)	2007	56	43	58	47

Source: Kaiser Family Foundation (2010)

vices, transport and nutrition, reduce the availability of household income for other needs. Second, sick members whose pre-sickness wages contributed to household finances mean forgoing income for the duration of their AIDS-related illness. Third, the death of economically active members result in a double household income-shock: the cost of funerals represent a significant percentage of income outflow and a future stream of earnings is lost (Desmond, King, Tomlinson, Sithungo, Vennstra and Whiteside, 2004). Studies have indicated that the disease is expected to worsen poverty (Jefferis, Kinghorn, Siphambe and Thurlow, 2008).

Increasing AIDS-related deaths have reduced average life expectancy and altered demographic patterns in Southern Africa. Population growth projections for 2008-2050 show increases for Botswana (29 percent) and Namibia (3 percent), and declines in Lesotho (11 percent) and Swaziland (33 percent) (Population Reference Bureau, 2008). The world average for less developed countries (excluding China) over the same period is a 59 percent increase. AIDS-related deaths and the absence of descendants from mothers who have died of AIDS are the primary factors that have contributed to the slow population growth in the BLNS countries.

The macroeconomy of BLNS is affected by the epidemic. Increased government spending on HIV and AIDS programs (namely prevention, treatment and care) reduces the availability of resources for other areas that contribute to growth. Depending on the fiscal policy framework, this may crowd-out crucial investments in social welfare programs and in income-earning sectors, such as trade. Private sector productivity and output are expected to be affected owing to AIDS-related mortality and morbidity (Barnett and Whiteside, 2006).

The contribution of government funding relative to donor and private sector funding of HIV/AIDS programs differs significantly across the BLNS countries. It varies from 18.69 percent in Lesotho (2006) to 88.82 percent in Botswana (2007). In Namibia and Swaziland, public expenditures are 50.80 percent (2007) and 39.83 percent (2006) of total expenditures on HIV/AIDS, respectively (see Table 3). This shows that Lesotho is the most dependent on donors and the private sector in funding HIV/AIDS initiatives followed by Swaziland and Namibia while Botswana is the most reliant on public expenditures.

Table 3: Public and Donor/Private Sector Spending on HIV/AIDS in BLNS Countries

Country	Total spending on HIV/AIDS (US$ millions)			Share of Public Spending in Total Spending (%)		
	2005	2006	2007	2005	2006	2007
Botswana	206.94	143.41	229.46	79.25	91.26	88.82
Lesotho	NA	24.436	NA	NA	18.69	NA
Namibia	79.122	NA	130.5	48.73	NA	50.80
Swaziland	NA	49.113	NA	NA	39.83	NA

Source: UNAIDS (2008)

7 Government Revenue and Health Expenditures

Revenue 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. Lesotho's total receipts from the CRP accounted for 51 percent of total government revenue (excluding grants) in 2001/2002 before dropping slightly to 48.6 percent in 2005/2006 and later increasing to 64.66 percent in 2008/2009 (see Table 4). In Swaziland, the figures are relatively higher, with the country's income from the CRP increasing from 54.1 percent of total government revenue (excluding grants) in 2001/2002 to 68.5 percent in 2005/2006 and 76.59 percent in 2008/2009. While Namibia's dependence on SACU revenue is relatively lower, it is estimated to have increased in the recent years. The country's earnings from the CRP as a proportion of total government revenue are estimated to have gone up from 30.4 percent in 2001/2002 to 51.22 percent in 2008/2009.

Resources in the SACU CRP originate from two sources: customs revenue and excise collections. According to the 2002 SACU Agreement, customs revenue are distributed to members according to their share of intra-SACU imports (see the appendix for an analytic presentation of the formula). Accordingly, the country that imports the most from within the union receives the largest share of the customs pool, thereby providing implicit compensation for the 'cost-raising' effect of the customs union (Kirk and Stern, 2003). This approach of sharing customs revenue also encourages trade diversion, at least in theory (ibid). Excise revenue, on the other hand, are re-pooled into two separate funds. The first is a development fund constituting 15 percent of the total excise revenue. Members share these funds nearly equally, each country receiving about 20 percent of the fund. The remaining 85 percent of the excise collections are distributed to members according to their share of GDP in the union (see Figure 5 in the Appendix for a schematic presentation of the RSF).

Given that the BLNS countries have a large propensity to import from within SACU, and particularly from South Africa, they get the largest share of their SACU revenues (estimated at 80 percent) from the customs revenue component of the CRP. South Africa's imports from fellow SACU members, on the other hand, are a relatively small proportion of its total imports (see Table 5). In 2005/2006, South Africa's share of intra-SACU imports was only 21.15 percent compared to 78.86 percent for the BLNS countries. Accordingly, South Africa's share from customs revenue collected in the union has been relatively small. On the other

Table 4: SACU Revenue Receipts

2001/2002					
	Botswana	Lesotho	Namibia	Swaziland	RSA
Receipts from SACU (R million)	2,622	1,438	2,641	1,503	9,897
% of Total Govt. Revenue*	12.8	51.0	30.4	54.1	3.9
% of Revenue Pool	13.8	7.6	13.9	7.9	56.7
2005/2006					
	Botswana	Lesotho	Namibia	Swaziland	RSA
Receipts from SACU (R million)	4,008	1,984	3,228	2,795	13,027
% of Total Govt. Revenue*	12.1	48.6	25.1	68.5	4.4
% of Revenue Pool	14.0	6.8	11.4	9.2	58.5
2008/2009					
	Botswana	Lesotho	Namibia	Swaziland	RSA
Receipts from SACU (R million)	9,473	4,901	8,502	6,009	15,220
% of Total Govt. Revenue*	-	64.66	51.22	76.59	3.3
% of Revenue Pool	21.5	11.1	19.3	13.6	34.5

*excluding grants

Source: Flatters and Stern (2005); Government of South Africa (2010); author's own calculations.

hand, South Africa has a large economy estimated at 92 percent the size of SACU (see Table 1) and since excise collections are distributed to members according to their share of GDP, the country gets a very large share (estimated at 80 percent) of the excise revenue component of the CRP.

Table 5: Share of Intra-Sacu Imports (2002-2006)

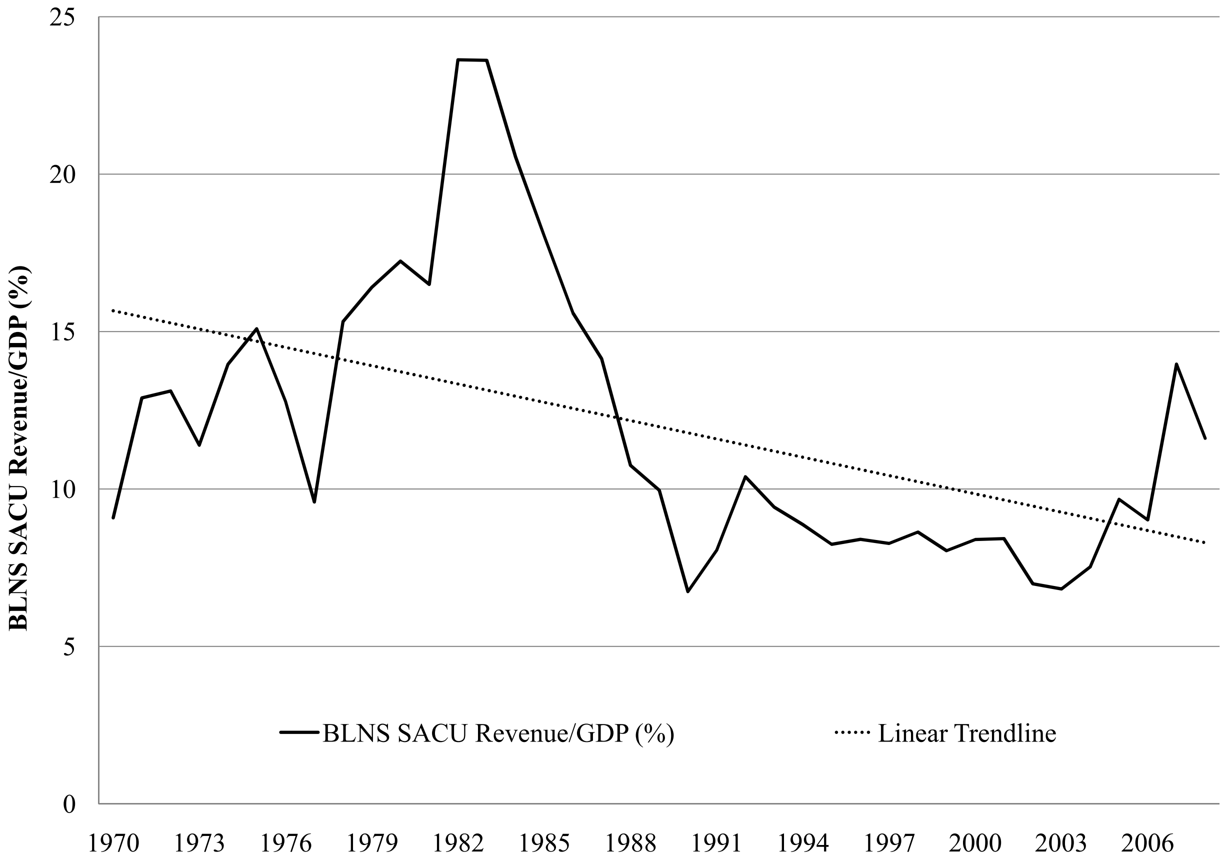
	2002/03	2003/04	2004/05	2005/06	2006/2007
Botswana	29.25	25.39	28.73	26.05	26.41
Lesotho	13.76	12.18	12.59	13.09	13.96
Namibia	23.76	25.49	20.39	23.67	25.16
Swaziland	21.22	16.81	22.83	16.46	14.77
South Africa	12.01	20.13	15.46	20.72	19.70

Source: SACU (2008)

An important implication of the 2002 RSF is that the volatility of the two components of the CRP is different. Since South Africa and the BLNS countries derive the largest proportion of their SACU revenue from different components of the CRP, it can be inferred that the two are also different in their vulnerability to global business cycles transmitted through the SACU revenue. Customs revenue, a component of the CRP from which the BLNS countries get the largest share of their SACU revenues, is susceptible to large volatility, depending on business cycles in SACU's major trading partners, while excise revenue is fairly stable.

The available statistics show that SACU income in the BLNS countries has been declining. SACU revenue expressed as a ratio of GDP in the BLNS countries combined took a downturn from 23.63 percent in 1982 to 6.74 percent in 1990 (see Figure 2). Thereafter, it somewhat stabilised until 2000/2003 when the trend became upward, rising from 6.82 percent in 2003 to 13.97 percent in 2007, before starting another sharp downturn, reaching 11.61 percent in 2008. While Figure 2 clearly shows that the SACU revenue as a ratio of GDP in the BLNS countries has been going up and down, a simple linear trendline for the period 1970-2008 reveals that on the average, the trend has been downward.

Figure 2: SACU Revenue as a Ratio of GDP in BLNS Countries (1970-2008)



Current data from the respective BLNS countries show that the recent decline in SACU revenue is continuing and is likely to maintain the same path. The Central Bank of Lesotho (2010) predicts that the country's SACU revenue will decline by 60 percent in 2010/2011 owing to the global recession, which has led to a decline in imports worldwide, including SACU member countries. SACU revenues (expressed as a ratio of GDP) in the Lesotho Government Budget have declined steadily from 36.1 percent in 2009/2010 to 13.1 percent in 2010/2011 and 9.3 percent in 2011/2012. In Swaziland, SACU receipts declined by 6 percent in 2006/2007 and went up by 13 percent in the following fiscal year before dropping by 6.4 percent and 12.5 percent in 2009/2010 and 2010/2011 respectively (Government of Swaziland, 2007). A similar trend has been recorded in Namibia where SACU revenues as a ratio of GDP went down from 12.03 percent in 2006 to 8.2 percent in 2008.

The observed decline in SACU income in the BLNS countries has been projected to continue with the downward trend. Flatters and Stern (2005) 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 to 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 (see Table 6).

Table 6: SACU Revenues as a Share of GDP

	1994	2002	2005	2020
Botswana	8.0	4.5	5.1	2.8
Lesotho	28.0	19.8	21.5	12.6
Namibia	7.7	7.8	8.1	4.4
Swaziland	13.7	12.9	17.6	9.4
BLNS	14.4	11.3	13.1	7.3
South Africa	1.6	1.2	0.9	0.8

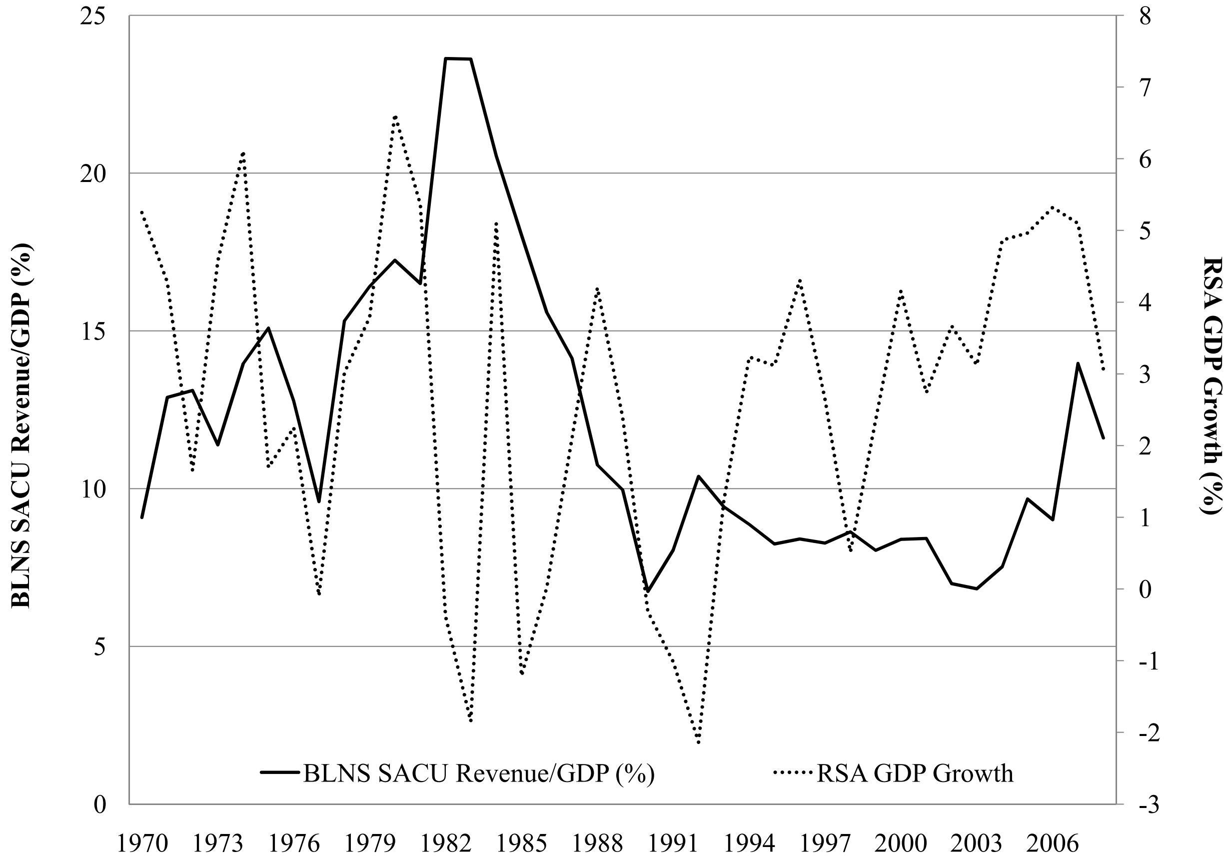
Source: Flatters and Stern (2005)

A number of factors explain the declining SACU revenue. First is the poor performance of the global economy. A global economic downturn, particularly poor economic performance in SACU's major trading partners would generally lead to a decline in trade between SACU and its partners, consequently causing a fall in SACU customs revenue and hence a drop in the BLNS countries' income from the CRP. Furthermore, a worldwide recession is associated with a general decline in aggregate demand that may have a negative impact on excise revenue. The global recession of 2006/2007 is an instance that has had a major negative impact on SACU revenue caused by a decline in trade between SACU and the international community. The looming European Union (EU) Sovereign Debt Crisis is expected to bring further negative effects on SACU Revenue. With the EU and the International Monetary Fund (IMF) agreeing on a bailout package of US$145 billion for Greece and a further US$950 billion to prevent the Greek Debt Crisis from affecting other Euro-zone countries, it is evident that the euro-problems are for real (BBC, 2010b; BBC, 2010a). Analysts have reported that these bailout plans will only postpone rather than solve the crisis, which is predicted to spillover to Spain, Italy, Ireland, Portugal and the United Kingdom (outside the Euro bloc), in that order (Ibid).

Second, a poor performance of the South African economy impacts negatively on SACU revenue because of associated lower demand for goods and services and reduced imports. In recent years, the economy of South Africa has been growing, albeit more slowly each consecutive year. It grew by 5.3 percent in 2006, 5.1 percent in 2007 and 3.1 percent in 2008. In 2009, the South African economy contracted by 6 percent and 3 percent in the first and second quarters, respectively. This poor performance of the South African economy has had an adverse effect on the CRP. As illustrated in Figure 3, SACU revenue accruing to the BLNS countries (plotted on the primary vertical axis) are correlated with GDP in South Africa (plotted on the secondary vertical axis).

Third, related to the previous argument, is that a shock to the South African economy is bound to be felt in the BLNS countries through changes in their SACU revenue (positive changes for a positive shock and negative changes for a negative shock). A particular case in point are the large scale construction works and capacity expansion in the electricity and transport sectors associated with the 2010 FIFA World Cup (SACU, 2008), which have

Figure 3: SACU Revenue in BLNS Countries and GDP Growth in South Africa (1970-2008)

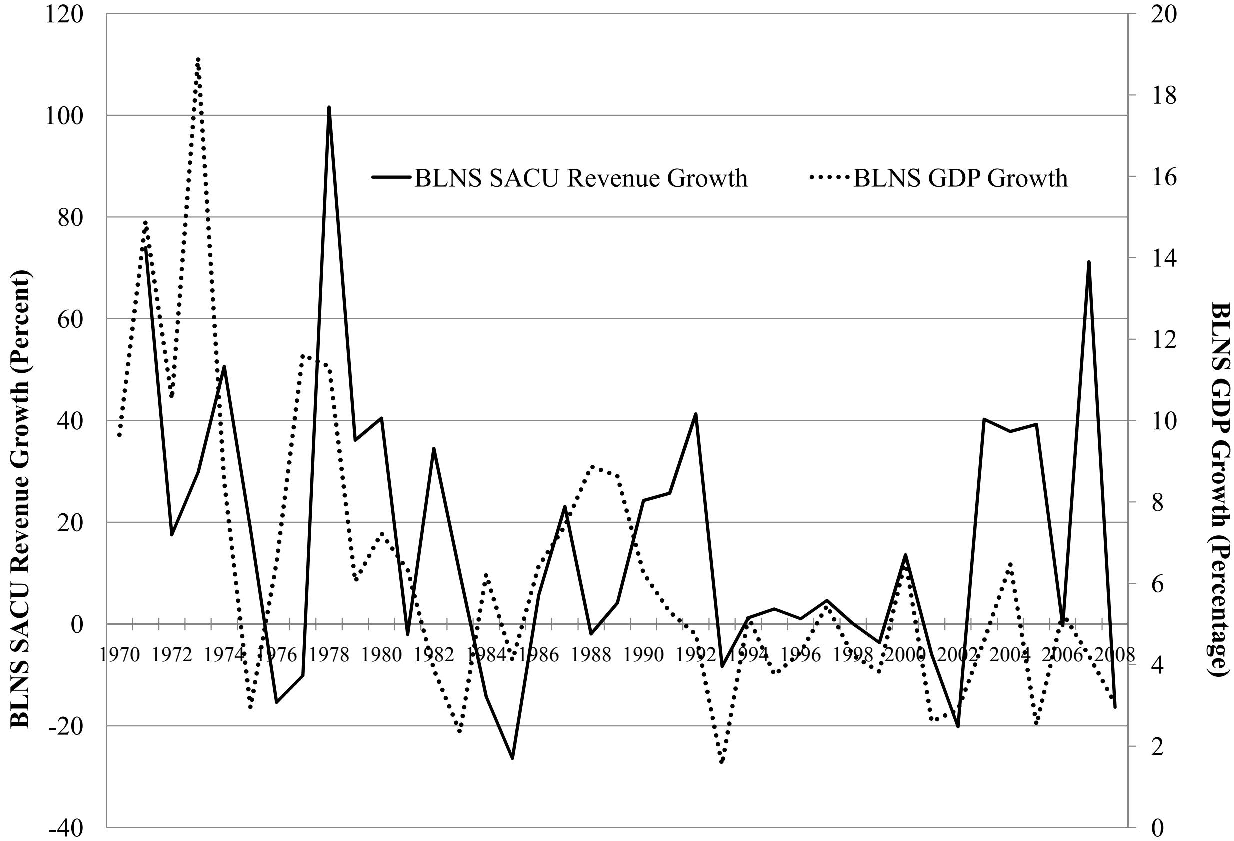


inevitably resulted in a jump in aggregate demand and large amounts of imports into South Africa. At the end of the World Cup, most of these projects will have come to completion. A sharp decline in imports into South Africa is, therefore, expected leading to a drop in SACU revenue.

Fourth, global trade tariffs have shown a declining trend and they may decline further as trade agreements between SACU and other trading blocs/countries are concluded. SACU has in recent years been negotiating free trade agreements with China, India, the United States of America, EU and MERCUSOR (Argentine, Brazil, Paraguay and Uruguay), among others. In addition, SACU has committed itself to be an anchor of the SADC Customs Union (Government of Lesotho, 2010). Conclusion of any free trade agreement is associated with a reduction, and in some cases an elimination, of tariffs leading to a decline in the size of the CRP.

Besides its direct impact on government revenue, the declining SACU revenue is also expected to adversely affect macroeconomic performance of the BLNS countries. As demonstrated in Figure (4), growth in SACU income for the BLNS countries (plotted on the primary vertical axis) is highly correlated with economic growth in these countries (plotted on the secondary vertical axis). While we cannot draw conclusions on causality from such a simplistic presentation, it is clear from the illustration that SACU revenue and macroeconomic performance in the BLNS countries change together in the same direction. To ascertain the co-movement,

Figure 4: GDP and SACU Revenue Growth for BLNS Countries (1970-2008)



we computed a pairwise correlation matrix of SACU income for the BLNS countries and their GDP growth. The matrix showed a correlation coefficient of 0.9438 for the two variables, confirming their close correlation observed earlier.

In theory, we expect a two-way causal relationship between the growth of SACU revenue and GDP growth in the BLNS countries. Given the importance of SACU revenue in the government budgets of the BLNS countries, an increase in SACU revenue is likely to be associated with higher GDP growth. Similarly, an improvement in the macroeconomic performance of the BLNS countries is expected to increase aggregate demand and hence imports, which in turn may lead to an increase in customs revenue and excise collections.

However, since the BLNS countries account for only less than 9 percent of the total GDP of SACU, movements in their GDP may have an equally small impact on SACU revenue i.e. changes in SACU revenue may not be influenced to a large extent by GDP in the BLNS countries. The BLNS countries, on the other hand, get nearly half of the SACU revenue, which constitutes a large proportion of their fiscal budgets (e.g. 69 percent in the case of Swaziland in the 2005/2006 fiscal year). Assuming government expenditure and GDP are positively related, it is safe to presume that SACU revenue has a significant impact on macroeconomic performance in the BLNS countries. This result is corroborated by findings in a number of studies that have concluded that there is a one-way causal relationship between government revenue and economic growth with direction running from the former to the latter (see, for example Anastassiou and Dritsaki, 2005; Balducci, 1990). We conclude, therefore, that the high correlation between SACU revenue and GDP growth in BLNS countries is dominated by the one-way causal relationship running from SACU revenue to GDP growth. In effect, we argue that the declining SACU revenue will have a negative effect on economic growth in the BLNS countries.

8 Policy Proposals

We present six policy proposals, not mutually exclusive, addressed to the BLNS countries, aimed at counteracting the problem of falling SACU receipts against a background of a favourable RSF and a heavy government reliance on SACU income. These are: (i) Lobbying for increased aid to offset the declining SACU revenue; (ii) Fiscal restraint aimed at realigning the declining government revenue with public expenditures; (iii) Enlarging the fiscal deficit to avoid disrupting public projects amid the declining government revenue; (iv) Restructuring the fiscal structure to move away from relying on SACU revenue for recurrent expenditures; (v) Developing a long-term expenditure plan anchored on domestic revenue; and (vi) Efficient and effective use of public resources.

(i) Lobbying for increased aid to offset the declining SACU revenue

This is a short term solution. The BLNS countries 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 (81 percent and 9 percent, in that order). In Swaziland and Namibia, the dependency levels are relatively high, estimated at 60 percent for the former and 49 percent for the latter. The funding gap in HIV/AIDS projects, however, will not only depend on the dependency ratio of public to donor funding but also on the extent to which the BLNS countries have relied on SACU revenue to finance government budgets. Table 4 shows that Botswana is the least dependent on SACU revenue followed by Namibia, Lesotho and Swaziland, in that order. Putting the two sides together, it is not clear as to which country will need the most donor support. Nonetheless, it remains evident that the BLNS countries as a group will require increased donor funding if a reversal of the advances that have been made in the fight against HIV/AIDS is to be avoided. Needless to say, the BLNS countries will have very little control over the levels of international aid required to cover the financing gap. At most, they can only lobby for increased support.

(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 decide to fill-up the financing gap between government revenue and required expenditures on HIV/AIDS by exercising fiscal restraint, cutting down on non-priority fiscal expenditures. In some instances, even some HIV/AIDS projects may have to be downsized. This approach will ascertain that the BLNS countries do not go into unnecessary accumulation of public debt. A certain level of boldness, however, may be required to follow this approach. The 2009/2010 Budget Statement of the Government of Lesotho, for instance, states that the 'declining

SACU revenue implies that Government spending will have to decline drastically in the near future' (Government of Lesotho, 2009, p. 24). It is this level of boldness that the BLNS countries may have to have.

(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. Our suggestion is that they must gradually move away from using SACU revenue for recurrent expenditures, in particular wages and salaries. Instead, the SACU revenue should be channeled 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. There is need to enhance 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. Evidently, this is a long term plan intended to re-align public expenditures with domestic revenues. Measures to expand the domestic revenue base may include diversifying the tax base e.g. introducing or expanding the Value Added Tax, and enhancing the administration of all taxes through stronger enforcement and expansion of the tax base.

(vi) Efficient and effective use of public resources.

This is a long term solution that may involve streamlining the public sector to ensure that government is involved only in services that cannot be efficiently provided by the private sector, adherence to public expenditure ceilings, and priority targeting of public expenditures towards more urgent productive projects.

9 Summary and Conclusions

This study set out to investigate trends in SACU revenue and the associated implications on government expenditure, particularly on HIV/AIDS, in BLNS countries. Commencing with a historical overview of the union, the study observes that SACU has evolved from a political entity with a colonial foundation to a well integrated regional trading bloc. Prior to 1969, SACU operations reflected a repressive colonial regime with no regard for the BLNS countries. A new agreement that changed the union's name to SACU effective 1970 transformed the geopolitical landscape, with the BLNS countries now getting a generous share of revenue from the union's CRP. A renegotiated agreement of 2002 further raised the operating platform, providing for joint responsibility over decisions affecting tariff-setting, the CRP and overall direction of SACU besides introducing a new RSF favourable to the BLNS countries.

The study confirms reports that SACU revenue as a share of government revenue and as a ratio of GDP is on the decline and may continue going down. The recent global recession which peaked in 2006/2007, the looming European Union Sovereign Debt Crisis, poor performance of the South African economy, negative shocks to the South African economy and declining global trade tariffs arising from developments in regional integration involving SACU and other trading blocs/countries, are some of the factors that are responsible for the declining SACU revenue. Among the policy options facing the BLNS countries are lobbying for increased aid to offset the declining SACU revenue, fiscal restraint aimed at realigning the declining government revenue with public expenditures, increasing the fiscal deficit to avoid disrupting public projects amid declining government revenue, restructuring the fiscal framework to move away from relying on SACU revenue, especially for recurrent expenditures, developing a long-term expenditure plan anchored on domestic revenue and efficient and effective use of public resources. These policy options, however, are not mutually exclusive.

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. The 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 way that chokes 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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Appendix

Analytic Presentation of the 2002 RSF[6]

Resources in the SACU CRP originate from two sources: customs revenue (C) and excise collections (E). Each member state (i) gets a share of the customs revenue (C_i) according to its share of intra-SACU imports (M_i):

$$C_i = \frac{M_i}{\sum_{i=1}^{n} M_i} * C \tag{1}$$

where n is the number of countries in SACU. Excise revenue are re-pooled into two separate funds. The first component is a development fund (D) constituting 15 percent of the total excise revenue. The development fund is distributed among members nearly equally using the formula:

$$\begin{aligned} D_i &= \left[1 - \left(\frac{YPC_i}{\sum_{i=1}^{n} YPC_i/n} - 1\right)/10\right] * \frac{D}{n} \\ D_i &= \left[11 - \left(\frac{n * YPC_i}{\sum_{i=1}^{n} YPC_i}\right)\right] * \frac{D}{10n} \end{aligned} \tag{2}$$

where D_i is the allocation for country i and YPC_i is the country's per capita income (GDP). While the allocations are not exactly equal, each country gets nearly 20 percent of the fund. The remaining 85 percent of the excise collections (E) are distributed to members according to their share of GDP (Y) in the union:

$$E_i = \frac{Y_i}{\sum_{i=1}^{n} Y_i} * E \tag{3}$$

where E_i is the allocation to country i. The total payment to a member state (P_i) from the SACU CRP, therefore, is given by:

$$P_i = C_i + D_i + E_i \tag{4}$$

[6] (see Kirk and Stern, 2003)

Figure 5: Schematic Diagram of the 2002 SACU Revenue Sharing Formula