1. The Committee has initiated the 1966 consultation with the Republic of South Africa under the provisions of paragraph 4(b) of Article XII. The Committee had before it (a) a basic document prepared by the South African authorities (BOP/61), (b) a press statement of 8 December issued by the Minister of Economic Affairs of South Africa (L/2722), and (c) documentation provided by the International Monetary Fund, as noted in paragraph 3 below.

2. In conducting the consultation the Committee followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). This phase of the consultation was held on 12-13 December. The present report summarizes the main points of discussion at this stage.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with South Africa. In accordance with the customary procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of South Africa. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the background paper which it has provided.

"The Fund is now conducting its 1966 consultation with South Africa and it is expected that a decision taken at the conclusion of the consultation will be transmitted to the CONTRACTING PARTIES in the near future."

Opening statement by the representative of the Republic of South Africa

4. The representative of South Africa, whose full statement is appended in the annex to this report, described recent development in South Africa's economy. He said that his country's economy had continued to enjoy the major cyclical upswing started in mid-1961. Real gross domestic product had increased by 27 per cent from 1961 to 1965. Gross domestic expenditure augmented at a
faster rate, but had recently shown a tendency to level off. Since the last consultation the balance of payments on current account had improved considerably, but this improvement had not been maintained. It passed from a deficit of R 289 million in the first three quarters of 1965 to a surplus of R 26 million in the corresponding period of 1966. For the third quarter of 1966, however, there was a seasonally adjusted deficit of an annual rate of R 48 million, as compared with a seasonally adjusted surplus at an annual rate of R 148 million for the second quarter of 1966. The main reason for the improvement until the second quarter of 1966 was a sharp decline in imports which was only due in part to the stricter application of import control, as this decline in imports was also a natural reaction to excessive inventory and fixed investment as well as being a result of a restrictive credit policy. An increase of manufactured exports further contributed towards the improvement on current account before the second half of 1966. The country's official gold and foreign exchange reserves had reflected these fluctuations, increasing first to a peak of R 604 million at the end of July 1966 and thereafter steadily declining to R 588 million by the end of September and further still in October and November 1966. He pointed out that this covered less than four months' imports and less than three months' total current payments. It was moreover emphasized that the gold and foreign exchange reserves had risen mainly as a result of a substantial inflow of private capital. While there was an increase of R 135 million in the country's official gold and foreign exchange reserves during the first three quarters of 1966 overall, net capital inflow during this period accounted for R 109 million. It was pointed out that this inflow consisted mainly of short-term funds.

5. Since the last consultation disinflationary measures were first reinforced in June and October 1965 by increasing the percentage of liquid assets to be held by commercial banks against their short and medium-term liabilities to the public and by freezing the total amount of discounts, loans and advances to the public at 31 March 1965 level. On 31 March 1966 the freeze was extended for another six months. It became apparent, however, that, mainly due to a substantial inflow of private capital and a high level of public expenditure, further disinflationary action was needed. Accordingly, on 8 July 1966 a series of measures were announced, namely: the bank rate was raised from 5 to 6 per cent; the limitation of the total volume of bank credit at the level of 31 March 1965 was further extended until 31 March 1967; interest rates on deposits with financial institutions were freed from restrictions with immediate effect; Reserve Bank rates for long-term Government securities were progressively increased to 6½ per cent; import control was relaxed on a selective basis; and supporting fiscal measures were included in the budget of 17 August 1966. The effect of the relaxation of import controls was noticeable in the increased volume of imports starting in August 1966. On 7 December 1966 further disinflationary measures were announced, including a considerable further relaxation of import control.
6. This further relaxation of import controls was to take place mainly by adding certain items to the free list of imports, deleting certain items from the restricted list and issuing additional import allocations for the import of plant and equipment and industrial raw materials. Specific details of these relaxations were to be published shortly.

7. The representative of South Africa concluded that these liberalization measures went as far as the extent justified by the current level of reserves. He pointed out that the reserves were by no means excessive and did not provide a basis for the relaxation of import control beyond the liberalization already undertaken. Concerning alternative measures to restore equilibrium, he pointed out that a sequence of measures had sustained the attack on inflation. He also emphasized that, while demand for imports continued to be buoyant, various uncertainties surrounded the future course of exports.

General

8. Members of the Committee thanked the representative of South Africa for his statement. They welcomed South Africa's recent decision to introduce new disinflationary measures, including new import relaxation measures. They noted that the absence of a recent decision by the International Monetary Fund and the lack of detail concerning both the measures and their effects, due to the very recent date of the action, would make it difficult to reach valid conclusions in the consultation. After some further discussion, recorded below, the Committee decided to continue the present consultation, as there were many points for discussion and clarification, but not to try to conclude the consultation, which would, if it appeared necessary, be resumed at a mutually convenient time after the IMF decision became available and when the scope and effects of the new liberalization measures could be taken into account.

Balance-of-payments position and prospects

9. Members of the Committee reviewed with the representative of South Africa the cyclical upswing which was said to have characterized the economy since about 1961. They noted that drought had afflicted agriculture for some years past and that this had affected exports. However, exports in the manufacturing sector had shown an encouraging increase and the question was asked what efforts were being made to promote exports of manufactured goods. It seemed that the promising elements in the situation might have enabled South Africa to make considerably more progress in dismantling its restrictive system than had been the case. For evidence of the heavy reliance placed on import restrictions and of the lack of net progress toward import liberalization in recent years, they referred to a statement in the background material provided by the IMF to the effect that 1966 import allocations for consumer goods were the same as
those for 1964, with the difference that some goods which could previously be imported without permit now also required a permit and that some previously importable under general permits now required a specific import permit. It was also pointed out that, as of just before the new liberalization move, only about 20 per cent of imports had been free of licensing, and the hope was expressed that this percentage might now become substantially larger, as forecast in the 17 October press release on 1967 import allocations, and that liberalization might proceed at a more rapid pace given the vast potential and resiliency of the South African economy. It was recalled that import restrictions which were now being slightly relaxed had been intensified in 1961 as a transitional or interim measure to alleviate a sharp outflow of capital. Not only had these temporary restrictions been retained for a long time but also, as noted above, there had been no net progress toward liberalization unless it might be in the new measures, which would have to be examined with care.

10. In reply, the representative of South Africa referred first to the new measures announced on 8 December, concerning which he provided the Committee with copies of a press release later issued as L/2722. This new programme would, he said, result in import treatment in most cases as favourable as that existing before July 1965 and, in some cases, more so. It was true that, at the time the IMF paper was drafted, there were certain commodities which were less favourably treated than in the period immediately prior to July 1965 but the new measures now announced would largely correct that. The new measures must be read in conjunction with the earlier announcement concerning initial import allocations on 1 January 1967, since the new measures would become effective at that time. The import liberalization measures included in this series of measures could not be described in very specific terms at this time since final decisions on particular items had been taken after he had left for Geneva. However, in addition to the information contained in his statement, he could indicate that the expected level of 1967 imports was estimated at between R 1,900 and R 1,950 million, compared with estimated imports of R 1,660 million in 1966, R 1,800 million in 1965 and just over R 1,000 million in 1962, which would give some idea of the general effect of those relaxations. These figures indicated the progress which South Africa had made toward liberalization in the past as well as the progress expected in 1967. The figure of 20 per cent, representing the share of total imports admitted free of licensing, was quite misleading, he added, since industrial raw material and capital equipment making up another 56 per cent of imports were being allowed to be imported on the basis of six months' current consumption in respect of raw materials and full requirements in respect of plant and equipment required by industry. A substantial part of the imports of motor vehicles, which account for another 14 per cent of imports, were also licensed freely if for current use, subject to stocks not being excessive. In other words imports were limited by the ability of the importer to sell his products.
11. In reply to a question concerning steps being undertaken to overcome the severe problems connected with irregular water supply, the representative of South Africa said that his Government had long been offering subsidies to farmers to encourage the construction of dams on individual farms and that at least two major dam projects now under construction would contribute significantly to overcoming drought problems. The recent droughts not only created problems concerning incomes of farmers but also resulted in a loss of earnings of foreign exchange through the loss of exports and in addition made it necessary to use the country's limited reserves of foreign exchange for the importation of such items as maize, butter, cheese, milk powder etc. normally exported, and for substantially larger imports of wheat.

12. Another concern voiced by members of the Committee was that the degree of import restriction practised by South Africa might be having side-effects on the competitiveness of South African industry which would not only interfere with her export capacity but also hamper efforts to achieve price stability and control inflation. They inquired about South Africa's efforts to promote exports of manufactures and also about criteria employed to decide which industries should be permitted to be established and which should be refused the facilities they required.

13. In reply, the representative of South Africa stated that he did not believe South African industry in any case lacked ability to compete. Under the present system import control allowed the importation of all types of goods including goods on the restricted list in order to keep local prices in line with world prices. South Africa certainly realized fully the importance of building competitive manufacturing industries as the country would be obliged to rely to an increasing extent on exports of the products of secondary industry to make up for gold and other mineral exports which would decline sooner or later. It was expected that the 1965 net gold output would for the first time show no increase over the preceding year, being estimated at R 775 million (i.e., the same as the 1965 net gold output). Though that might not necessarily be true for next year, it was certain that the rate of increase in production was falling off and that increasing reliance must be placed on other exports. The South African Government had helped with the creation of a South African Foreign Trade Organization, which had as its objective promotion of exports by South African secondary industry. South Africa was a young country with a vigorous economy and many private entrepreneurs were seeking to establish new industries. This urge to invest in new industries in South Africa coupled with a feeling of over confidence in the economy were problems with which the South African Government had to contend. Actually the Government of South Africa had no direct way of limiting establishment of new industries or major expansion of old ones except via allocations for importation of capital goods or raw material. There was no system of licensing of industry
in South Africa where the economy was based on private enterprise. A Committee styled the New Industries Committee did however examine applications for the establishment of new industries which required imported plant and raw materials and this Committee was at present being very selective in approving such applications.

14. Whilst recognizing that the relationship between import restriction and domestic policy was a question that fell partly under this and partly under the next section of the plan for the consultations, members of the Committee also referred to their growing concern that South Africa seemed to be involved in a kind of cyclical pattern in which over-expansion tended to bring on balance-of-payment difficulties for which remedy was sought mainly through tightening of import restrictions. This allowed the balance of payments to improve as a result of which restrictions were then relaxed somewhat, allowing imports to increase until the underlying inflationary tendencies brought pressure on external reserves, followed by renewed intensification of import restrictions designed to correct the balance of payments again. Cyclical swings were not unique to South Africa, but the extreme buoyancy of the economy was noteworthy. What troubled these members was what seemed to be the tendency in South Africa to rely mainly upon import restrictions to control the balance of payments and to accomplish the deflationary work which would better be tackled primarily through internal measures. In the conflict between a desire for rapid expansion and the movement toward import liberalization, it appeared that the latter was losing out, and that where conflict arose, internal policies for expansion took priority over fixed objectives with respect to import liberalization. More information concerning South Africa's development programme would be of interest in this connexion as it appeared that a very high rate of growth was assumed, close to that which has prevailed over the past few years, and this seemed to imply continued use of much the same level of import restriction, unless specific steps were contemplated to break out of this circular process.

15. The representative of South Africa replied that the development programme envisaged a growth of gross national product of 5½ per cent per year, as more would risk continued balance-of-payments problems, and also create skilled labour shortages. It was considered that a 5½ per cent per year growth in gross national product should not create balance-of-payments difficulties and controls could possibly be further relaxed after some time. Just now the representative of South Africa did not consider that that would be possible, nor did it appear likely for the next eighteen months. On the more general question of the relationship between domestic anti-inflationary measures versus import restrictions, he did feel that South Africa had used a wide range of internal measures, namely monetary and fiscal measures as well as the relaxation of import controls. Credit restrictions had been discussed in his opening statement. The level of direct taxation in South Africa was generally high;
on an income of £5,000 annually, the rate on marginal increments to income was 40 per cent, and on incomes of £10,000, the marginal rate was 61 per cent. The first of these two rates was higher than any of a representative group of countries and the second was topped by only two countries in the group. Moreover, in order to reduce the tempo of industrial expansion, there were numbers of proposals for establishment of new industries which were being held up by the New Industries Committee. Furthermore, the fact of an 80 per cent increase in imports in the period since 1961, especially when associated with a further expected increase for 1967, was sufficient evidence that the interests of South Africa's trade partners were not neglected. It was emphasized that these imports were paid for in cash and that no credits were piling up.

16. Members of the Committee could not accept that a country reporting such a favourable situation as that described in the summing up of the South African opening statement could require continued heavy reliance on import restrictions. In particular, attention was drawn to the statement by South Africa that the present level of gold and foreign exchange reserves did not provide a basis for further relaxation of import restrictions beyond that already announced. It was recalled that reserves of South Africa in 1962 and 1963, already at high levels, had been characterized as not large enough when they amounted to over $700 million in the latter year. Reserves had subsequently dropped off somewhat but had now increased to an all-time high of close to $815 million at the end of September, yet the Minister of Economic Affairs of South Africa had stated, as recently as 17 October (see L/2711), that exchange reserves would need to be conserved for essential import requirements in the years ahead. It was most discouraging to find that even now the time appeared to be no nearer when remaining restrictions would be reduced and eliminated and that instead South Africa appeared to be thinking of continued building up of reserves for some time to come.

17. Members of the Committee felt that South Africa appeared to be using a balance-of-payments rationale to justify what is in effect a highly selective protectionist policy designed to foster the growth of local industries at the expense of its trading partners. In the face of this situation, and subject to the decision of the International Monetary Fund, the Committee strongly urged the Government of South Africa to draw up a plan and precise schedule for the progressive reduction and elimination of the restrictions maintained for balance-of-payment reasons. South Africa's trade partners did, of course, appreciate receiving prompt payment for the goods sold, but it was time to state in plain terms their interest in elimination of the present restrictive system and in knowing when they might expect an end to the uncertainties involved in the constant changing of import restrictions which they had had to endure for the past several years. The buoyancy of the economy, the high living standards which prevailed and the state of South Africa's foreign exchange reserves all pointed to the desirability that South Africa rely for the future on internal measures to bring about any needed adjustment to ensure equilibrium in its external accounts.
18. The representative of South Africa did not agree that reserves could be looked at in isolation from commitments of South Africa as a whole. While it was freely acknowledged that the present level of South Africa's reserves was high, these reserves must be related to the country's commitments which also stood at a very high level. In fact, the reserves covered less than four months' imports and less than three months' total current payments. South Africa had been correct in not liberalizing more than it had done in 1964 even although reserves were then relatively higher than now in relation to external payments. The tendency at that stage was for the reserves to taper and this tendency actually continued until action was taken in 1965. The difficulty was that if reserves were allowed to drop below a certain level, not only would there be an end to the capital inflow which had largely accounted for recent improvement in reserves; there would be a positive reversal of the flow, and foreign investors would tend to take profits out of the country instead of reinvesting them there, with a consequent further deterioration in reserves. South Africa's position could not be compared to that of an established industrialized country and it was only prudent that a very conservative policy had to be followed. He repeated his view that no further liberalization could be contemplated at least until after the close of the current agricultural growing season next March. On the other hand, the representative of South Africa had no objection to a request that South Africa examine what could be foreseen with regard to the phasing out of import restrictions on a short and/or medium-term basis. He did not, however, accept the suggestion that his country was relying only, or mainly, on such restrictions to implement its internal policies, as a whole range of measures, which included monetary and fiscal measures, was being employed, and he did not accept that there was anything objectionable in the fact that changes had been made from time to time in the level of import restriction in line with changing balance-of-payments needs.

Alternative measures to restore equilibrium

19. Although various measures, other than import restrictions, had been discussed, members of the Committee put to the representative of South Africa a further series of questions mainly concerning the nature and operation of particular internal measures or concerning conditions which appeared to call for additional measures of that kind. It was noted first of all that the Minister of Economic Affairs had himself acknowledged some discrepancy between South African and world prices when he explained the need for decreased import restrictions in terms of "bringing prices back into line". This would imply a need for deflationary measures especially of a kind which might curb consumer expenditure rather than investment. The question was asked what had been done in the 1966 budget to curb expenditure and, in particular, how that need was compatible with a plan for the Government to spend considerably more than it would collect in revenues. Interest was also expressed in learning the South African Government's views on the explanation of the encouraging closing in 1966 of the gap between the rate of increase in private expenditure and the rate of increase in gross domestic product. Were there plans for keeping this gap closed?
20. The representative of South Africa agreed that the problem of curbing private consumption was a very difficult one in his country as there was an expanding internal market due not only to immigration, but due also to the fact that more of South Africa's people were being employed in both commerce and industry. Food prices in particular were under constant pressure mainly as a result of the effects of the drought which created shortages. He referred to the recent statement by the Minister of Finance that if the present fiscal measures were inadequate to correct the present unfavourable trends additional fiscal measures would be considered in the budget to be introduced in March 1967. He also referred to the press statement regarding further measures against inflation issued by the Minister of Finance and the Minister of Economic Affairs which was issued on 7 December 1966. This was followed up the next day by a press announcement by the Minister of Economic Affairs regarding the further relaxation of import control (see L/2722). For one thing the August 1966 budget contained certain anti-inflationary measures, particulars of which were given in the background material provided by the IMF. There were, however, two factors which had made it difficult for the Government to comply strictly with the demands of non-inflationary financing. The first was the technical point that the budget was presented four and a half months after the beginning of the financial year, so that only seven and a half months remained in which to collect any increased revenue which might have been needed. The second and more fundamental factor was that necessary expenditures for national security, including economic security, which could not be deferred, had to be financed. The budget nevertheless sought to finance necessary expenditure in as non-inflationary a manner as possible. But more recently there had been a joint monetary and commercial policy action to reinforce the anti-inflationary programme, as indicated in the opening statement and in the press release distributed to the Committee; the Ministers had forecast that there would be further new measures next March if need be. Certainly South Africa could not be accused of lacking an awareness of the need to do all in its power to maintain price stability, especially as its gold exports had to be sold at a fixed price while costs continued to rise. South Africa's trade partners might wish to consider an increase in the price of gold if they cared to help, but meantime South Africa would do everything possible to keep costs and prices down.

21. Further interest was expressed in details concerning the December policies recently announced by the Ministers of Finance and Economic Affairs, some of which appeared to be traditional, such as further restrictions on bank credit. However, the import of some of the others, such as the imposition of further selective price control, the sanctioning of earlier repayment of foreign loans, the control of unsound trade practices and the discouragement of speculation, was less clear. It was appreciated that the advance repayment of foreign debts could have deflationary tendencies but this would also reduce reserves currently available. The representative of South Africa again explained
that he had no further details concerning the new measures except on import control. It was possible, however, that the early repayment of overseas loans was intended to drain off excess bank liquidity where possible. With respect to price control, no specific measures were contemplated but the public had been asked to watch prices and to report any excessive price increases which might occur; these would be investigated and if necessary suitable action would be taken. Combat of unsound trade practices probably referred to retail price maintenance, which had been much discussed in South Africa recently. There was a feeling that agreements on retail prices tended to prevent the operation of supply and demand forces and maintained prices at an unduly high level.

System and methods of the restrictions

22. Members of the Committee noted the further relaxation of restrictions mentioned in the South African delegation’s opening statement; appreciation of the reasons that made it necessary to maintain them was expressed. In answer to a question, the representative of South Africa explained that in respect of textile piece-goods the 1966 quota allocations to merchants had been fixed at 100 per cent of a merchant’s 1965 quota, and that for 1967 this quota would be 15 per cent higher. Manufacturers were given facilities to hold six months’ stocks at current consumption rates.

23. Members of the Committee referred to the seemingly protectionist policy which South Africa was pursuing in relation to local industry and mentioned a statement made by the Minister of Economic Affairs on 17 October 1966 (L/2711) in which he asked South African merchants to give first priority to domestic manufacturing sources of consumer goods. The Minister also placed increasing emphasis on the local content of domestic products, primarily in the automotive industry, where high local content producers are rewarded by bonus import permits, rebates on excise taxes and tariff protection. Such policies, they pointed out, were bound to work to the detriment of the interests of South Africa’s trading partners. The representative of South Africa replied that it was natural to stimulate consumption of products incorporating local content and that he saw nothing unusual in it.

24. Members of the Committee reiterated that they found the local availability criteria as applied to the restricted list and to other licensing arrangements objectionable and considered it a definite protectionist device which should be abolished, the more so if it was also extended to substitutes for imported goods. In this respect, the representative of South Africa said that strict considerations of price, quality and delivery period were taken into account and that where preference was given to a locally produced item it was measured in these terms. This system was applied mainly to plant and equipment. Today South Africa was able to supply some 50 per cent of its needs in this field. A member of the Committee made the point that if the criterion was
that preference was only given if these goods were produced on a fully competitive basis, it would seem unnecessary to maintain the restrictions, especially as the local product was likely to have a delivery advantage anyway. He further pointed out that in his view, the rule according to which a merchant had to surrender R 3 of his original import permits for every R 1 of a specific permit seemed extremely objectionable and asked whether such a requirement were really necessary for products which were already restricted. He considered that the whole of the restrictive list should be abolished, but that if this were not possible, at very least this provision and the local availability criterion should be abolished. The representative of South Africa replied that goods subject to specific import permits were goods which are manufactured in South Africa in both quantity and comparable quality so that to restrict their importation was the best way of making the best use of the country's foreign exchange reserves. He added that in any case a considerable volume of these products were actually imported under the concessions whereby the first R 5,000 of the annual quota could be used on a R 1 for R 1 conversion basis.

25. Members of the Committee pointed out that South Africa's restrictive system was extremely complicated, and recalled previous recommendations by the Committee that it be simplified. The representative of South Africa reiterated what he had said in other meetings of the Committee, namely that the restrictive system was a mere shadow of what it had been in 1961 and that it was not really as complicated as it appeared. He said that for 20,000 regular importers and 26,000 occasional importers the administrative machinery deployed consisted of only ninety-five persons. Furthermore, the level of imports envisaged for 1967 was of R 1,900/1,950 million, a substantial increase over the peak year of 1965.

26. In answer to a question on the system and methods of the restrictions the representative of South Africa explained that import permits were freely issued to private individuals for the importation of vehicles with a f.o.b. value exceeding R 1,900. For those under that price permits were issued freely only if the vehicle had been used outside South Africa by the applicant for a certain period of time which had been six months and had now been reduced to two months. In such cases the individual concerned was granted the necessary foreign exchange in addition to his normal allowance of foreign exchange for foreign travel. A member of the Committee expressed the hope that this discrimination against small cars would be abolished. In answer to a further question, the representative of South Africa said that permits for manufacturers were not allocated on a commodity basis, but on a group basis, so that for each manufacturer there was usually only one permit issued at a time, expressed in general terms, which applied to a wide range of products. Actual imports were permitted on the basis of each manufacturer's needs based on his current consumption and stock requirements of up to six months. For merchants, quotas
were allocated on the basis of their 1964 imports. This base year was used because it was a particularly liberal year for imports as compared to 1965. It was envisaged that 1966 would be used as a base year for 1967 quota allocations, but no commitment could be given at this moment. It was normal practice for quotas to be announced in November and March, and, according to the balance-of-payments situation, supplementary allocations might be issued in July.

27. In answer to a question the representative of South Africa said that imports of second-hand machinery were discouraged. In the case of industrial machinery, this was done because use of old machinery did not seem to be the best way of establishing competitive industries. In the case of agricultural machinery, the same policy was followed, mainly because of the maintenance problem. Second-hand agricultural machines were normally bought directly by the end-user in the rural areas from overseas organisations which were not in a position to provide permanent after-sale maintenance. A member of the Committee pointed out that the lack of after-sale servicing was probably the result of the restrictions and the low level of imports.

28. A member of the Committee enquired into the reason why tariff rates had been increased on certain products which were included in the restricted list, and suggested that they should be removed from the list. These products were: articles of goldsmiths' and silversmiths' wares; parts of precious metals or rolled precious metals excluding articles of a personal kind; domestic laundry washing machines; electro-thermic domestic appliances; household refrigerators and parts, both electrical and non-electrical; vacuum or gas filled electric filament lamps and baby carriages and parts. He also drew attention to the fact that many hand tools had been placed on the restricted list in July 1966 and asked that these too should be removed. The representative of South Africa replied that this matter was now under review and that according to the press announcement made on 8 December by the Minister of Economic Affairs, a number of items would be deleted from the restricted list, but he could not at this time give any details.

29. A member of the Committee asked whether companies investing in South Africa were more likely to obtain import licences and expressed the hope that he could be assured that there was no linking of the availability of licences to a willingness to invest. The representative of South Africa in reply said that the criterion guiding allocations was an historical one - that is, previous imports by the same merchant. It was possible, he stated, that a degree of confusion had arisen in this matter as a result of the general policy under which new industries approved by the New Industries Committee were granted facilities to import goods similar to what they proposed manufacturing three months before actual production commenced to enable such new industrialists to build up their sales organizations.
Effects of the restrictions

30. It was noted that many of the concerns of members of the Committee in regard to South Africa's system of import restriction had already been discussed in previous parts of the consultation. At this point members simply wished to ask whether import restrictions might not be leading to encouragement of uneconomic industries and to inquire whether the original 1962 policy of screening applications to establish new industries was still functioning and if so what proportion of applications was refused. The representative of South Africa confirmed that the policy was still in force, through the New Industries Committee which reviewed applications for import licences required in connexion with establishment and operation of new industries. There was no actual control over the establishment of industry as such in a free-enterprise economy like South Africa, and an entrepreneur could do whatever he liked so long as no imports were involved, or could even obtain imported goods through merchants. The control was nevertheless quite effective and approximately two thirds of all applications for import licences in connexion with establishment of new industries were presently being rejected or postponed in order to avoid too rapid a rate of expansion and to relieve some of the pressure on the economy. South Africa had not thought it desirable to adopt a formal licensing system which would require that every industrial establishment be approved, as there was some feeling that to do so might tend to stimulate uneconomic industrial expansion sheltered behind such a restrictive practice.

Procedure

31. The Committee decided to hold open the consultation with South Africa until such time as the situation could be appraised in the light of the decision expected to be taken by the Executive Board of the International Monetary Fund and of full information concerning the scope and effect of the monetary and commercial policy measures announced on 7 and 8 December. At that time the Committee would if necessary reconvene at the call of the Chairman. In the meantime, and subject to the decision of the IMF, the Committee strongly urged the Government of South Africa to draw up a plan and precise schedule to show when South Africa's trading partners may expect to see a progressive reduction and elimination of remaining import restrictions maintained on balance-of-payments grounds.
ANNEX

Opening Statement by the Representative of South Africa

Nineteen months have elapsed since South Africa’s last consultation with this Committee, and I might preface my remarks by stating that this has been an unbroken period of full employment and rising standards of living in my country. As has been indicated in information which has been furnished to this Committee previously, South Africa's economy has been enjoying a major cyclical upswing from about the middle of 1961, and conditions of prosperity and rapid economic growth are still being experienced.

The real gross domestic product, i.e. the gross domestic product valued at constant prices, increased by as much as 27 per cent between 1961 and 1965. In 1965, the increase amounted to about 5 per cent, despite the adverse effect of unusually severe drought conditions on agricultural production, and according to preliminary indications this rate of increase of about 5 per cent was maintained in the first half of 1966.

Gross domestic expenditure, on the other hand, while increasing at a faster rate than the gross domestic product between 1961 and 1965, has recently shown a tendency to level off. It actually fell below the gross national product in the first half of 1966, reflecting a small surplus in the balance of payments on current account.

This tendency of gross domestic expenditure to level off was mainly attributable to a sharp decline in inventory investment during the fourth quarter of 1965 and the first half of 1966, which was partly due to the tightening up of import control. Of the other components of gross domestic expenditure, both private consumption and current government expenditure continued to rise sharply throughout this period, while public and private investment increased further during the fourth quarter of 1965 before declining in the first half of 1966.

A development of considerable importance since the last consultation has been the substantial improvement in the current account of the balance of payments. In the second quarter of 1965, the seasonally adjusted balance of payments on current account reached a peak deficit, at an annual rate, of R 424 million. In the following quarter, the deficit was still uncomfortably high at R 400 million, but by the second quarter of 1966 the position had improved to such an extent that a seasonally adjusted surplus, at an annual rate, of R 148 million was registered. This was, however, followed by a deficit of R 48 million in the third quarter.
The main reason for this improvement was a sharp decline in imports which began in the middle of 1965. On a seasonally adjusted basis, imports reached a low point in April, 1966, since when there has been a substantial increase. During the first ten months of 1966, imports reached a seasonally adjusted annual rate of R 1,640 million, compared with R 1,863 million in the corresponding period of 1965. Declines were particularly marked in the case of machinery and transport equipment, manufactured goods classified chiefly by materials, and inedible crude materials except fuels.

While the decline in imports was partly due to the stricter application of import control, it would also appear to have been, to some extent, a natural reaction to excessive inventory and fixed investment, as well as a result of the restrictive credit policy pursued by the monetary authorities.

Merchandise exports, at a seasonally adjusted annual rate, rose from R 1,040 million in the first ten months of 1965 to R 1,152 million in the corresponding period of 1966. The increase was mainly accounted for by manufactured goods classified chiefly by materials.

The balance of payments on current account improved from a deficit of R 289 million in the first three quarters of 1965 to a surplus of R 26 million in the first three quarters of 1966 reflecting -

- an increase of R 80 million in merchandise exports,
- an increase of R 3 million in net gold output,
- a decrease of R 205 million in merchandise imports, and
- a decrease of R 26 million in net current invisible payments.

This improvement in the current balance has, however, not been maintained, and, as I have already indicated there was a seasonally adjusted deficit, at an annual rate of R 48 million, in the third quarter of 1966, compared with a surplus of R 148 million in the previous quarter.

Taking into account a net capital inflow of R 109 million in the first three quarters of 1966, and after allowing for omissions and errors, there was an increase of R 135 million in the country's official gold and foreign exchange reserves, compared with R 149 million in the corresponding period of 1965. They then rose sharply to reach a peak of R 604 million at the end of July 1966, thereafter declining to R 588 million at the end of September, and the
preliminary indications are that a further substantial decline took place in October and November. The level at the end of September was equivalent to less than four months' imports, valued f.o.b., on the basis of the value of imports in 1965, and less than three months' total current payments.

The disinflationary measures mentioned by me to this Committee on the occasion of the last consultation were reinforced in June 1965, by an increase in the ratio of liquid assets to be held by the commercial banks against their short-term and medium-term liabilities to the public to the statutory maxima of 40 per cent and 30 per cent respectively.

It was thought that with the co-operation of the financial institutions and that of the public and private sectors in reducing, postponing or stretching out investment and consumption outlays, these measures might prove sufficient to restore a satisfactory degree of stability to the economy.

Developments in the ensuing months indicated, however, that the restraints imposed were insufficient to achieve this objective. The deficit on the current account of the balance of payments remained large; the gold and foreign exchange reserves had started to rise again, but this was mainly due to an inflow of capital, mainly in the form of short-term funds; and prospective Government expenditure remained heavy despite efforts to reduce it.

The South African Reserve Bank accordingly announced further restraints on credit on 29 October 1965. These took the form basically of a request to the monetary banks to ensure that the total of their discounts, loans and advances to the private sector as at 31 March 1966 would not be higher than the corresponding level on 31 March 1965.

By 31 March 1966 the monetary banks had complied with this request, but it was evident that a certain degree of inflationary pressure still existed in the economy, and the restrictions on the volume of credit which might be extended by the monetary banks to the private sector were accordingly extended for a further period of six months. A 2½ per cent increase in credit was, however, permitted in order to assist the farming community who were suffering from the effects of prolonged drought.

With the passage of time it became apparent, however, that mainly due to a substantial inflow of private capital and a high level of expenditure by the public authorities on essential projects and services, further disinflationary action was needed.

The Minister of Finance accordingly announced the following measures on 8 July 1966:
(a) the Bank rate was raised from 5 to 6 per cent;

(b) the request to the monetary banks not to increase their discounts, loans and advances was extended for a further six months from 30 September 1966;

(c) restrictions on interest rates payable on deposits with financial institutions were lifted with immediate effect;

(d) the Reserve Bank's pattern of rates for long-term Government securities would be progressively increased so that the rate for stocks of twenty-five years and over would be 6½ per cent;

(e) fiscal measures to complement the monetary measures would be included in the forthcoming budget; and

(f) import control would be relaxed on a selective basis.

Import control relaxations in respect of stocks of raw materials and capital equipment were in fact effected after the Minister's announcement, and on 17 August 1966 the Minister introduced a budget aimed at financing the necessary Government expenditure as far as possible in a non-inflationary manner.

The effects of the relaxation of import control which was one of the measures taken in the attack on inflation and which were announced in July 1966 are reflected in the increased volume of imports from August of this year.

During November 1966 it became apparent, however, that despite the measures taken in July 1966 further disinflationary measures were necessary and a further announcement was accordingly made on 7 December.

Among the measures announced is a further relaxation of import control which will now take the form of:

(a) adding certain consumer goods and other items to the Free List of Imports, i.e. items which are free from import control and which may be imported without an import permit;

(b) deleting certain items from the Restricted List of Goods which may only be imported under a special import permit;

(c) additional import allocations for the import of plant and equipment and industrial raw materials.

Specific details of these relaxations will be published shortly.
My Government feels that, despite the loss on current account during the third quarter of 1966 and the likelihood of a further additional loss on current account in the fourth quarter of 1966, the present level of the country's reserves of foreign exchange justifies this further step being taken and is one which conforms to the desire of my Government to relax progressively import control as and when circumstances allow this to be done.

The picture which I have presented is accordingly mainly one of a sustained attack on inflation, one of the disinflationary measures employed being the relaxation of import control. Bearing in mind the continued buoyant demand for imports, and various uncertainties surrounding the future course of exports, however, it is my Government's view that the present level of the gold and foreign exchange reserves is by no means excessive and does not provide a basis for the further relaxation of control beyond the extent of the relaxations to which I have already referred - the last of which was announced only last week.