Committee on Balance-of-Payments Restrictions

REPORT ON THE CONSULTATION UNDER ARTICLE XII:4(b) WITH SOUTH AFRICA

1. The Committee has conducted the 1962 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/12) and (b) documents provided by the International Monetary Fund, as noted in paragraph 2 below. In conducting the consultation the Committee followed the Plan for such consultations recommended by the CONTRACTING PARTIES (BISD.7/S/97-98). The consultation was completed on 1 October 1962. The present report summarizes the main points of discussion during the consultation.

Consultation with the International Monetary Fund

2. 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 agreed 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 International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision relating to the last consultation with the Republic of South Africa under Article XIV of the Fund Agreement and the background material prepared in connection with that consultation. The background material was prepared before the announcement at the end of August last of further measures of relaxation (see Annex A, paragraph 21). Information concerning these measures was, however, presented to the Fund's Executive Board before it took its recent consultation decision."
"With respect to Part I of the Plan for Consultations, relating to balance of payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, the Fund calls the attention of the CONTRACTING PARTIES to the Executive Board decision of September 10, 1962, taken at the conclusion of its recent consultation with South Africa, and particularly to paragraph 4, which reads as follows:

'South Africa has continued to maintain nondiscriminatory restrictions on trade and current payments, tightening them in the first half of 1961 as reserves declined, and relaxing them to a certain extent in 1962 as reserves increased. The Fund notes the view of the South African authorities that their reserves, while increasing, have not yet reached a level at which the remaining restrictions can be withdrawn on a reasonably permanent basis. In view of the continuing increase in reserves, the Fund considers that South Africa should be able in its 1963 import program to make substantial progress in eliminating restrictions.'

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, the Fund draws attention to the decision taken at the conclusion of its last consultation with South Africa. The Fund has no additional alternative measures to suggest at this time."
Opening statement by the representative of South Africa

3. In his opening statement, the full text of which is annexed, the representative of South Africa explained that, following a noticeable decline in the rate of economic growth during the second half of 1960 and the first half of 1961, the rate of economic growth had shown a gradual increase. The four major productive sectors (agriculture, mining, manufacturing and commerce) had made some further advance. There had, however, been a decrease in fixed private investment and only a moderate increase in fixed public investment. Current expenditure by public authorities had shown an increase of R103 million in 1961/62 (the year ending 30 June 1962) as compared with an average annual increase of R33 million in recent years.

4. Private consumption was estimated to have been lower by R60 million in 1961/62 than in the previous year, despite a steady increase since the third quarter of 1961. The decrease in consumer spending had been particularly pronounced with respect to consumer durables, including automobiles. Despite the reduction in licence allocations which became necessary in May of 1961, commercial and industrial inventories had not decreased during 1961 but had even shown some increase during the second half of 1961.

5. Gross national product in 1961/62 had increased by an estimated 5.3 per cent. This compared with increases of 4.2 per cent in 1960/61 and 7 per cent in 1959/60. In real terms, the increase in GNP in 1961/62 had been of the order of roughly 3.4 per cent. Population was estimated to have increased by approximately 2.3 per cent during that period.

6. Welcome as was the increase in the rate of economic growth, the revival of economic activities had been less pronounced than expected in view of the significant increase in exports and the buoyancy in gold mining production. However, consumer spending was expected to increase in coming months immediately after and information available suggested that manufacturing output might now be increasing more rapidly. Largely as a result of the increase in the Reserve Bank's holdings of gold and foreign exchange, the financial scene had changed from a state of relative stringency and high interest rates to one of increased liquidity throughou
the financial structure and a general downward trend in interest rates. Business confidence being high, the stage was set for further economic expansion in the near future.

7. As regards merchandise exports, major increases had been registered in the 1961/62 calendar year for maize, wool, fruit, pig iron and manufactured products. On the other hand, uranium exports had shown a substantial decline. Merchandise exports in the first eight months of 1962 had amounted to R582 million, or R35.3 million more than in the corresponding period of 1961. During this period, maize exports had more than doubled and exports of sugar had reached a record level. Exports of diamonds had shown a decline of R10 million as compared with the corresponding period of 1961 and there had been decreases also in exports of fish, uranium, ferro-alloys and copper. Compared with 1960, merchandise exports during the calendar year 1961 had increased by approximately R49 million, or 7½ per cent.

8. Imports had declined by R106 million or 9.5 per cent in 1961 as compared with 1960. During the first eight months of 1962, imports had shown a decline in value of R25.5 million as compared with the corresponding period of 1961. However, in both July and August 1962, imports had exceeded the levels of a year ago. For 1962 as a whole an expansion of imports over the previous year of R120 million was expected. Provision for such an increase had been made earlier in the year, and these additional allocations to the private sector in respect of consumer goods and textile piece-goods, had recently been announced. (See Annex ....).

9. The total value of gold output had shown a strong upward tendency both during 1961 and 1962. As compared with the corresponding period in 1961, gold production in the first seven months of 1962 had been higher by R32.5 million. Even if no further expansion occurred, the gold output for 1962 as a whole was expected to exceed R600 million.

10. As regards developments in the financial and monetary situation, the outstanding feature in 1961/62 had been phenomenal and virtually continuous surplus in the country’s balance of payments. Provisional estimates for 1961/62 showed a net surplus of R249 million in the overall balance of payments, as compared with a deficit of R71 million in 1960/61. The surplus on current
account was estimated at R353 million as against a deficit on capital account of R104 million, of which a net outflow of capital from the private sector accounted for R21 million. Principal changes in the period 1961/62, as compared with 1960/61, had been a decrease in imports of R142 million, an increase in merchandise exports of R101 million, an increase of R44 million in net gold output and a decrease of R40 million in net current invisible payments. As a result of these factors the Reserve Bank's holdings of gold and foreign exchange had increased from R153.4 million on 30 June 1961 to R407.5 million a year later. By mid-September 1962, reserves stood at R423.6 million. Although reserves during the middle of 1962 had reached their highest point during the years 1945 to 1947, they were still only the equivalent of the value of four and a half months imports calculated on the basis of average annual imports in the past five years. While the Government did not have a particular optimum level of reserves in mind, the present level was considered inadequate. It was the expressed intention of the South African authorities, whenever possible, to build up international reserves to a higher level. The representative of South Africa pointed out that, in the absence of exchange control, the level of South Africa's reserves during most of the post-war period would have been insufficient in view of the sharp fluctuations, particularly in private non-direct investment. The total of such investment had amounted to R872 million at the end of 1960 with ordinary shares accounting for about R580 million. He pointed out that the exchange and the import restrictions maintained by South Africa were closely related measures and that further import liberalization would have to take full account of the level of exchange restrictions. The maintenance of the present restrictions had, however, not caused undue hardship to industry, to commerce or to consumers, and import controls would continue to be applied so as to cause as little hardship as possible.
Balanced-of-payments position and prospects

11. The Committee thanked the representative of South Africa for his clear and comprehensive statement. They welcomed the favourable development of South Africa's trade and the large improvement in the balance of payments which had led to a record increase in reserves. Members of the Committee noted that the present level of reserves was equivalent to four and a half months import payments on the basis of average imports in the last five years, or the equivalent of six months import payments based on imports in the first half of 1962. They recognized that, in addition to the ratio of imports to reserves, various other factors, including movements on capital account, are important in determining the adequacy of a country's foreign exchange reserves. They pointed out, however, that South Africa had had a surplus on current account even at the height of its balance-of-payments difficulties, and that the heavy outflow of private capital, the factor mainly responsible for the deterioration of South Africa's reserves in 1960 and early 1961, had been successfully checked. Members of the Committee suggested that in the changed circumstances, even in the absence of exchange restrictions, a renewed outflow of private capital of anywhere near the proportion experienced in 1959/60 and 1960/61 would be unlikely. They noted that some progress in the relaxation of import and exchange controls had been made recently. Having the above considerations in mind, as well as the degree of liberalization achieved by other contracting parties often with much lower reserves, they felt that there was further scope for import liberalization.

12. In his reply, the representative of South Africa said that the large increase in reserves had been due to a combination of a number of factors, a pattern which was not likely to be repeated. Above all, there had been the effect of import restrictions which had by now been considerably relaxed. Consumer demand had been exceptionally low, a situation which was already changing. Similarly there was reason to expect an increase of industrial activity which in turn would lead to higher import demand for industrial raw
materials and equipment. In this connexion it had to be remembered that under the policy recently adopted by the Government import requirements by industry for most raw materials would be made on the basis of six months' full requirements. As regards developments on capital account it had to be remembered that, in the first instance, the rate of decrease in capital outflows had been brought about by exchange controls. While the factors and considerations which are thought to have contributed to these outflows should have lost much of their significance, there were indications (e.g. the difference in price of South African securities on the Johannesburg and London Stock Exchanges) that further progress in the relaxation of exchange controls would have to be carefully planned and would have to be implemented gradually. Finally, it should be borne in mind that the improvement in the reserve position had partially been brought about by foreign borrowing.

13. The representative of South Africa further stated that it was against the background of the persistent danger of large-scale and unpredictable capital movements and the not-altogether-promising export prospects, that his Government's determination to increase the level of international reserves should be appreciated. While due to the factors referred to above, South Africa's reserves were at their highest level since 1947 it had to be remembered that South Africa's reserves during most of the post-war period had been inadequate to permit uninterrupted progress in import liberalization. It was in the interest of greater stability, which in the long term would be beneficial to economic development in his country and to trade in general, that his Government wished to place trade and payments on a sounder basis by providing a more adequate level of reserves. This did not, however, mean that his Government would abandon its traditional liberal trade policy or decrease its endeavours to make progress in import liberalization in step with improvements in the reserves and in the balance of payments. Under the circumstances it was not considered possible to go beyond the present level of import liberalization.
14. Referring to the expected development of imports and exports, the representative of South Africa explained that his Government had planned for an increase of R120 million in public and private imports in the calendar year 1962.

Because of a lag in Government imports, the expected increase in the public sector was now not expected to materialize, but increased imports in the private sector, estimated at some R80 million, were expected to materialize, and might perhaps be exceeded. The level of imports in July 1962 had been 23.4 per cent higher than in July 1961, and imports in August 1962 had been at the highest level of any month during the past fifteen months. In general, imports during 1963 were expected to show a further increase as a result of an acceleration in economic activity. At this stage, however, it was not possible to make a firm forecast of the general level of imports during 1963 because of several factors which might interfere with export earnings. These factors included the severe drought which the country was at present experiencing, the 10 per cent increase in duties for practically all categories of goods recently imposed on imports into the Federation of Rhodesia and Nyasaland, which was traditionally an important buyer of products of South African secondary industries, and the general uncertainty arising from the increasing economic integration in Western Europe. These factors made it impractical to define at this stage a clear picture for 1963.

Alternative measures to restore equilibrium

15. The Committee noted, that primarily due to the considerable improvement in South Africa's balance of payments, liquidity had increased and interest rates had shown a downward trend. They noted that the current budget for the present fiscal year was expected in balance. The Committee expressed the hope that the South African authorities would continue to be successful in keeping prices relatively stable. They noted that, as a result of these favourable internal factors, and because business confidence was high, the South African authorities expected the level of economic activity to increase. They expressed the hope that the expected increase of the economic tempo would not lead to strains on the level of reserves.
System and methods of restrictions

16. Members of the Committee said that, although they appreciated the relaxation of import restrictions announced at various dates during the year, in their view, the significant improvement in the reserve position provided scope for a greater degree of import liberalization, including the raising of consumer goods quotas which still restricted imports below the level attained in the years 1959 and 1960. They called attention to the International Monetary decision which states that "in view of the continuing increase in reserves, the Fund considers that South Africa should be able in its 1963 import program to make substantial progress in eliminating restrictions". They expressed the hope that further progress towards import liberalization would soon be made.

17. Commenting on these observations, the representative of South Africa stated that, if account was taken of a number of changes in the administration of controls, the progress made by South Africa since the last consultation would be more apparent. He pointed out that more than half the imports (on the basis of 1961 figures) comprising most raw materials, capital equipment, agricultural machinery and pharmaceutical and medicinal requisites, were now licensed on the basis of manufacturers receiving six months full requirements. As regards imports of the "general merchandise", quotas in category A had been increased by one third and category B quotas by more than 14 per cent. The actual increase in quota allocations for general merchandise was still larger, however, since the assessment basis for many importers had recently been increased under the government policy of reviewing every two years the assessment basis on which quotas were allocated. This review was based on the principle that as a firm increased its volume of business, it needed also to increase its level of imports. As a result of the recent adjustment in the assessment basis, the total increase for group B quotas was estimated to have been of the order of 20 per cent. Quota restrictions were such that even with the present level
of permits issued, many importers did not use their full entitlement. There was indeed at present no shortage of variety or stocks of consumer goods, including imported goods as a result of present import restrictions.

18. In clarification of information in the background document concerning the proportion of imports under the various control categories, the representative of South Africa explained that on the basis of 1961 figures, 9 per cent of total imports fell into the general merchandise category. Imports under this heading were admitted under either group A or group B which, respectively, accounted for 3 & 6 per cent of total imports in 1961. Imports of motor vehicles, including CKD material, were admitted under quota and imports of these had accounted for 11 per cent of total imports in 1961.

19. Members of the Committee expressed concern about the apparent severity of the restrictions applied to goods on restricted list which covered a wide range of goods of interest to exporters in foreign countries and urged an early relaxation of these restrictions. In reply to a question, the representative of South Africa explained that under the current import programme, licences for goods on this list could be obtained on the basis of general merchandise, import permits being surrendered at the rate of R2 category B import permits for R1 import permit for goods on the restricted list. If category A permits were surrendered, the conversion rate was R4 to R1, taking account of the more liberal issue of category A import permits. In 1961, the conversion rate had been R3 to R1 in respect of category B permits. In addition to the greater import facilities for goods on the restricted list as a result of the change in the conversion factor, the list of restricted items had on balance been shortened for 1962. In addition to the conversion rates, importers in 1962 were granted the additional concession of converting the first R3,000 of their quota on the basis of R1 for R1. Members of the Committee inquired about the reason for the addition to the restricted list of such items as hand-knitting wool and buttons which, although of significance to the trade, accounted
for only a small proportion of total imports, so that their addition to the list could hardly be expected to result in a significant saving of foreign exchange. The representative of South Africa explained that the step had been taken to correct an administrative anomaly, as it was not his Government's policy to include in the list of goods which could be imported into South Africa without permits those goods which were manufactured to any great extent locally. Both items referred to above were manufactured in South Africa. The change in classification did not necessarily mean that there would be a decrease in the imports of the items concerned.

20. In the further discussion of South Africa's import policy, members of the Committee expressed concern over what appeared to be a protective element in the formulation and implementation of licensing controls. They noted that for goods subject to import permits, an important consideration for the issue of import licences was the availability of supplies from domestic sources. They felt that this policy tended to shield domestic producers from foreign competition and might thus prevent the establishment of the industries concerned on an efficient basis. The representative of South Africa said that this requirement had been introduced to assure the best utilization of the country's foreign exchange resources. In considering licence applications for imports of raw materials and capital equipment available from domestic supplies, full account was being taken of such considerations as price, quality and delivery time. Only if local industries were competitive in respect of all of these criteria would applicants for an import licence be expected to meet their requirements, in the first instance from local production. Although the Government, in licensing imports, took account of domestic production, licensing controls were exercised so as to cause the least damage to traditional suppliers. As regards the recent decrease in imports of timber and newsprint, this was due to a recession in demand for the products at a time when domestic availabilities had increased.
21. In reply to questions regarding the licensing of motor vehicles, the representative of South Africa explained that, although no quotas were at present being issued for built-up passenger cars with a retail list price exceeding R1,900, import of CKD material for the local assembly of such cars was permitted. The possibility of providing facilities for the import of luxury cars was currently under review.

Effects of the restrictions

22. Referring to the earlier discussion, members of the Committee stated that the system of licensing controls in force in South Africa placed considerable emphasis on demand being met in the first instance from local suppliers. Indeed, the emphasis given to this consideration in granting licences raised the question as to whether the protective effect of the balance-of-payments restrictions was purely incidental. They pointed out that the protection of uneconomic industries was not in the best interest of the country. The prolonged maintenance of restrictions, which tended to shield domestic producers from foreign competition, would lead to adjustment difficulties for the industries so protected, when restrictions would have to be dismantled in step with the improvement in the balance-of-payments and the reserve position. The representative of South Africa stated that in order to eliminate the possibility of uneconomic industries being established, a special Government Committee had been set up in May 1961, to review in detail all applications to establish industries requiring import facilities; therefore there was little likelihood of the establishment of uneconomic industries being allowed.

General

23. The Committee thanked the South African representatives for the frank and co-operative manner in which they had responded to the many questions put to them. The Committee welcomed the relaxation of import restrictions
put into effect by South Africa at various dates during the year. They felt, however, that in view of the very large increase in reserves, and in view of the continuing favourable development of the balance of payments, there existed scope for substantial import liberalization. They expressed the hope that South Africa would soon make further progress in the direction of import liberalization and that, in reviewing their import policy, the South African authorities would also examine the administration of restrictions with a view to minimizing incidental protection.

24. The representative of South Africa thanked the Committee for the friendly spirit in which the consultation had been conducted, and said that his delegation would not fail to bring the views expressed by members of the Committee during the consultation, to the attention of his authorities.