Committee on Balance-of-Payments Restrictions

DRAFT REPORT ON THE CONSULTATIONS UNDER ARTICLE XII:4(b) WITH THE REPUBLIC OF SOUTH AFRICA

1. The Committee has carried out the 1967 consultation with the Republic of South Africa under the provisions of paragraph 4(b) of Article XII. The Committee had before it a basic document prepared by the South African authorities (BOP/75) and 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). The consultation was completed on 30 October 1967. This report summarizes the main points discussed.

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:

"In the first half of 1967 the South African economy continued to be under considerable demand pressure. Prices and wages continued to rise and the current account of the balance of payments, which had registered a deficit of some $18 million in 1966, showed a deficit of some $253 million in the first half of 1967. After rising by $203 million in 1966, gold and foreign exchange reserves (including the Fund gold tranche) decreased by $155 million; as of June 30, 1967 they amounted to $720 million.

"This turnaround in the balance of payments position was caused mainly by imports which started to rise rapidly in the third quarter of 1966 reflecting both the pressure of internal demand and the progressive relaxation of quantitative restrictions since mid-1966."
"In 1967 further action was taken to curb domestic demand. With the 1967/68 budget taxes were increased and an attempt was made to moderate the increase in public expenditure. At the same time, monetary policy was made more restrictive so as to restrain the growth of credit to the private sector. These measures should help to restore a better balance in the economy and to stem the decline in foreign exchange reserves. Domestic financial policies will need to be kept under constant review with the aim of strengthening the balance of payments to the point where the removal of remaining restrictions maintained for balance of payments reasons would be feasible and would not generate undue pressure on foreign exchange reserves."

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 in detail the further efforts by his Government to combat inflationary tendencies. A considerable increase in imports in the second half of 1966, following relaxation of restrictions, had not been fully maintained, despite further relaxation of controls in May 1967, but even so imports for the first nine months of 1967 were 26 per cent above the corresponding months of 1966. Effective control of the still very buoyant economy had been made more difficult by a marked inflow of capital, both long and short term. This inflow also contributed to increased pressure on reserves of gold and foreign exchange, especially as exports showed only an irregular upward trend, averaging 15 per cent higher in the first nine months of 1967 than in the corresponding months of 1966. The peak reserve figure of R 604 million in July 1966 had given way to a figure of R 488 million by July 1967 and had remained virtually unchanged to the end of August, representing less than three months' imports on the basis of seasonally adjusted imports in the first eight months of 1967. The representative of South Africa mentioned, among the various disinflationary measures taken internally, sterilization of a budget surplus from the 1966-67 account, a budget for the current year in which expenses were being kept low, reduced indebtedness of the Government to the monetary banking sector, increases in various direct and indirect taxes, and a campaign to induce the public to invest more in tax-free savings bonds. Tighter credit conditions had been imposed by the Central Bank, import restrictions had been relaxed in May, and in June higher minimum liquidity ratios were announced for most commercial banks. Even so, there was some feeling that the level and rate of increase of gross domestic expenditure were still too high, though undoubtedly the rate of inflation had been slowed down. The problem was very much in the forefront in South Africa, especially in view of the country's special problem as a producer and exporter of gold, but the representative of South Africa was emphatic that
further substantial relaxation of import controls could not be regarded as feasible at this juncture given the uncertainties facing South African exports, weather uncertainties and the tendency of primary commodities exported by South Africa to lose ground in comparison with prices of manufactured goods. Some simplification of import procedures was planned, but beyond that South Africa relied on the provisions of Article XII authorizing import restrictions required to safeguard the country's external financial position.

Balance-of-payments position and prospects and alternative measures to restore equilibrium

5. The Committee welcomed the statement by the representative of South Africa, which it found to be a very useful, comprehensive and relevant supplement to the documentation on hand. Members of the Committee appreciated the emphasis placed on domestic anti-inflationary measures and hoped that these would continue to be supplemented to allow further gradual relaxation of the import restrictions which they felt had done much to aggravate the tendency toward inflation in South Africa in the past; the running down, in late 1965 and early 1966, of large inventories which had been accumulated earlier, suggested as much. They expressed the view that a somewhat greater use might be made of fiscal measures by South Africa as most of the emphasis had hitherto appeared to be on monetary restraints, notably credit control. Private consumer spending appeared still to be increasing. Even as to credit it did not appear certain that private lending had been as strictly controlled as had been the case with Government borrowing; there was a question too whether the funds being made available for financing agricultural production were not contributing to increases in the money supply in ways which might encourage consumption rather than investment. Even where some supervision was being exercised over the investment projects undertaken, as was done to some extent through the import controls, it was queried whether this form of control provided good assurance that the best use would be made of resources. As for the external position, various members of the Committee found that it was somewhat odd to hear a country complain of the inflationary effect of an inflow of capital, which is more generally regarded as a favourable factor and one which with proper supervision should prove to be a long-term advantage. Any inflationary tendencies resulting from capital inflow could be offset by relaxations in import controls. Finally members queried the rather gloomy description of the prospects of South African exports and felt that with the great natural advantages available the country should be able to look forward to growing exports, especially in manufactures, especially if due care were exercised to ensure effective investment and adequate pressure toward reduction of costs. They felt that the best way of making sure costs were made competitive would be a further relaxation of import restrictions, coupled with sufficient anti-inflationary measures particularly as regards consumption. Increased exports would provide the best means of compensating for the lower
exports of gold that had been predicted. On that basis, South Africa might feel less need for larger reserves of foreign exchange and gold. A consistent policy of restraining cost increases would in any case assist the profitability of gold mining. Some members expressed the opinion that the present level of reserves appeared adequate to finance South Africa's needs and hence the use of a "balance-of-payments" rationale for justifying the maintenance of protective measures would appear to be questionable. However it was pointed out that it was beyond the competence of the Committee to make a judgment on this issue. To some it seemed that South Africa's negative attitude toward use of supplier credits was an indication that even within South Africa there was no unanimous view that reserves were now inadequate, since trading on a cash basis undoubtedly put reserves under greater pressure.

6. The representative of South Africa could not agree that in the light of the fact that reserves at present levels covered only three months at current levels of imports and, if invisibles were taken into account, only two months, provided ground for complacency. The mineral resources of the country were exhaustible, and in the case of gold a dramatic decline in production seemed clearly indicated within the foreseeable future since some 35-40 per cent of current production was from marginal mines, and increases in cost structure were sure to push mining costs to a point where it would be increasingly difficult to mine gold economically. In agriculture, drought was a continuing menace for most of the producing areas. Only 3 per cent of the area was arable. A maize crop as good as that of last season, almost double those of other recent years, could not be counted on as a regular feature. As for the internal measures his country had taken, he agreed it was easy to point out the needs, and to say that preparations should be speeded to find alternative productive employment for the miners who would have to be absorbed into other industries. Very considerable adjustments were involved, and human resources could not be shifted about at will; on the contrary, a continuing gradual movement spread over perhaps a decade would have to be envisaged. As to the more immediate problem of controlling inflation he did agree that initial measures had been found inadequate. This had been realized and, as had been pointed out in his opening statement, substantial increases in taxation had been imposed in the last budget. He could not agree that measures presently in force represented an unbalanced attempt to combat inflation. With respect to directing investment, about which a question had been asked, he pointed out that South Africa is a free enterprise economy and that there were only two ways in which the Government could regulate the establishment of new industries: by imposing restrictions on the use of water where possible, a very drastic measure which, in addition to other disadvantages, was most apt simply to alter the location of the proposed industry; or secondly, through a withholding of permission to import the
necessary capital goods. This could only be done through the import control mechanism. As to the past effects of restrictions, he doubted whether one could attribute much stock-building to anticipation of restrictions, since it was normal in a country far from its sources of supply to carry relatively high inventories. It was certainly true that stocks had been drawn down to unusually low levels by early 1966, but he doubted that potential shortages had contributed much to inflation in that period. He could not agree that restocking was confined solely to raw materials and capital goods. Consumer goods stocks also were substantially increased. In summary, he looked for no dramatic change for the better in South Africa's external position and felt that the country was fully justified in taking the view that foreign-exchange reserves were hardly half of the six months' requirement which in his opinion was necessary. As for the attitude of the Government toward acceptance of supplier credits by its importers to which reference had been made, there had been no consistent attempt to discourage this practice, and it had on occasion been actively encouraged and used extensively. He reminded the Committee that on a previous occasion when South Africa had stressed the fact that largely it paid cash, this attitude had found favourable response from South Africa's trading partners.

7. Returning to the rôle of import restrictions in the South African experience since 1961, members of the Committee expressed the view that the use of import restrictions had played a considerably larger rôle in aggravating and prolonging the inflationary pressures still evident in the South African economy than was perhaps realized. The tightening of controls in 1964-65, when it might have been wiser to use fiscal measures, had provided some temporary relief to the balance of payments, but unfortunately the underlying inflationary trend appeared to have continued so that even when it became possible and necessary to relax controls, monetary and fiscal measures had to be introduced to check inflation and keep the balance of payments under control. In their view this history clearly pointed to the need for more energetic fiscal initiatives to supplement the monetary measures already taken. Given the well-developed administrative apparatus of South Africa there was no doubt of the Government's ability to choose and carry out one course or the other, and there were not the administrative obstacles to use of taxation that existed in some less-developed countries. Consequently members expressed their strong interest in hearing more about the relaxation of quantitative import restrictions which increased use of fiscal measures would make feasible and expressed their belief that South Africa should increasingly utilize fiscal and monetary policy rather than trade restrictions in dealing with its domestic economic problems.
8. The representative of South Africa noted that the relaxation of restrictions already made effective at the end of 1966 and in May 1967 had been considerable. The South African authorities moreover contemplating some simplification measures affecting the restrictive systems. Also the Prime Minister had placed himself on record as to his view that it would be a serious setback for South Africa to move backward toward any increased use of quantitative restrictions. He could give the assurance that within reason South Africa would continue with this policy. However, it must be left to the judgment of every contracting party to determine what measures it should take to maintain a viable economy and South Africa must reserve its right, in the light of all external possibilities, to take whatever steps it regarded as necessary to safeguard its external and internal financial and economic position.

9. Reverting to the longer-term outlook members of the Committee asked how the Government of South Africa viewed the problem of working away from the present potentially unstable position created by buoyant demand and high capital inflow accompanied by continuing import controls. The representative of South Africa disclaimed any special capacity as a crystal-gazer, and stated that in his view import control for balance-of-payments reasons would never have been necessary if the price of gold had moved in sympathy with the general price levels. Even at its present price, gold alone paid for a third of South Africa's current imports. It was because of the upward trend of prices in general that marginal gold mines were almost certainly going to be forced to discontinue operations soon, and as he had said, the fall was sure to be dramatic when it came. Every 1 per cent increase in the cost structure would mean a considerable loss in gold production. What would surely be seen was a decline in the earnings from these two products. To a certain extent the same thing was happening in diamonds. These commodities were exhaustible yet accounted for one third of South Africa's exports. As regards raw and particularly beneficiated base minerals his country expected an increase in exports. The prospects for uranium seemed good. On agriculture the position could be maintained, but much would depend on the weather. There had been what they called a seven-year drought prior to the past season, when good results had been obtained. But over a long period South Africa had found that self-sufficiency in wheat could be attained in only one year in three; they were large importers of wheat and sometimes even dairy products. Consequently it would be foolish to count on increased agricultural exports. Agricultural production had been stimulated by increasing use of fertilizer in recent years and much benefit had also been obtained from use of improved hybrid maize and other improved seed stock.
But these aids were effective only if there was enough rain, and the only ways of ensuring a water supply were the very expensive irrigation projects like the Orange River Project, and even here they had pruned public expenditure by deferring the construction of the Van der Kloof dam. Internal consumption of agricultural products had gone up to such an extent that South Africa had very few exportable surpluses. Apart from these factors affecting individual agricultural and mineral exports, there was an apparently inevitable long-term movement of terms of trade against exporters of primary products and a cautious approach would therefore have to be maintained. With respect to improvements which might be made in other directions, he noted that South Africa's expenditures on invisible items constituted a very large item of current net payments. There was some hope that this item might decline somewhat. Manufactured exports had recently shown some improvement also and it was hoped that these gains might be maintained and even improved upon. All in all, he felt that South Africa's present situation was not too bad and that other countries could expect her to continue to be a relatively good customer.

System and methods of the restrictions and effects of the restrictions

10. Members of the Committee, turning to a review of trade measures in effect, expressed the view that quotas and licensing still were relied upon too heavily in controlling the level of imports in the interest of bolstering foreign-exchange reserves. Registration of importers by category was maintained and importers were required to file returns; South Africa was still calculating foreign-exchange receipts and adjusting quotas to those estimates so that users were in continuing uncertainty concerning the supplies which they might be able to obtain. This whole apparatus inevitably pushed up costs. South Africa's contribution to the Kennedy Round had also been disappointingly small. It was sobering to reflect that the original import restrictions had been imposed as an interim measure to check the sharp increase in capital outflow in 1960-62. They were not now being abandoned and their original "transitory" nature seemed to have been forgotten. At the previous consultation, members of the Committee had asked whether South Africa could submit a plan and schedule indicating when and how the country planned to rid itself of remaining restrictions and wondered whether and when this would be possible.

11. The representative of South Africa called attention once more to the account in the background document of the country's moves toward liberalization and of the easing of the administration of import control. Without going into detail, it was plain that the net achievement had been quite considerable. To be sure, the system might appear complicated to civil servants removed from the scene, and the authorities were indeed planning certain simplifications, but it worked smoothly enough and South African importers were on the whole less disturbed by its effects than were representatives of other countries. Revision and simplification would be the continuing aim of the Government, but considering the incalculabilities on the horizon, it would be impossible for South Africa to draw up any meaningful specific plan for elimination of remaining import control measures. Members of the Committee expressed their appreciation that simplification of the import system was under consideration, especially since they believed the system had been characterized by extensive administrative discretion and they believed the system might
hinder rather than help the South African Government in attaining its general economic policy objectives.

12. With respect to the feasibility of South Africa's drawing up a programme for the reduction and elimination of import controls the question was asked whether it should be understood that no such programme could be expected at present or whether it was also to be understood that none could be drawn up in the foreseeable future. Further, members of the Committee wished to know in greater detail what would be the nature of the relaxation or simplification now under consideration, that is, whether items would be transferred from the restricted list to the free list or if not what the new treatment would be. The representative of South Africa replied that the items to be removed from the restricted list would go mainly to a category under which permits were granted more or less freely. He added that with respect to all items remaining on the restricted list, the Government have in mind to grant a new concession whereby the conversion rate for general merchandise permits into specific import permits would be two-for-one instead of the rate of three-for-one now in force for conversions in excess of a value of R 5,000. An innovation which had recently been placed in effect was to change over from use of a single remote base year, 1948, and to offer merchants instead a choice of one of the three recent years 1964-1966 as a base from which their current import entitlements for general merchandise would be calculated. Currently the entitlement was to a basic quota with an additional possible quota up to 120 per cent of the base year chosen. This reform, already in effect, applied to the whole range of goods on which annual quotas were granted (see BOP/75, Annex B.II). In addition it was the intention to remove a further sixty-five basic items from the restricted list (that list as presently drawn up is shown in BOP/75, Annex C). A number of the items taken off the restricted list could then be imported under general merchandise permits whilst for the others annual quota allocations would be made. The change in base years was expected to give some recognition to relatively new firms and to allow for even more new firms to become established in import trade. South Africa also hoped to be able, in the long run, to do away with the restricted list as far as possible but this could not be achieved overnight. The new regulations now under consideration were being simplified as far as possible in conjunction with organized commerce and would go some way toward answering some of the points that had been raised.

13. Members of the Committee welcomed the recognition by South Africa of the need to keep local industry competitive with producers in other countries, though it was also noted that 1964-1966 were years in which imports had been at a rather low level, so that the new base gave relatively little additional entitlement to import. They expressed satisfaction at a statement that South Africa would not lightly decide to tighten import controls again, but feared that even now there might be a good many cases in which the import restrictions gave substantial protection to local industry, as in the motor-vehicle industry, where there was a premium on use of domestically-made components in the assembly of complete vehicles. In particular they noted that the Government had only last autumn published a list of seventy-one industries in which protection could be made available to anyone who chose to engage in production. This suggested that the total number so protected already might be very large. The hope was expressed that due account would be taken of the
potential economic losses that would flow from South Africa's announced policy to promote economic self-sufficiency through the establishment of high-cost import substitution industries. The representative of South Africa replied that it was the definite policy of his country to use protective tariffs only to establish viable industries. If balance-of-payments measures appeared to have a protective effect, this was purely incidental and South Africa was making serious efforts to minimize or eliminate such effects. South Africa had no thought of attempting to achieve self-sufficiency.

14. A member of the Committee observed that South Africa appeared to use balance-of-payments restrictions to protect and foster the growth of certain domestic industries, for example, industries in the forest products area. The representative of South Africa pointed out that the official notices on import restrictions tend to give a false impression of the extent to which any restriction in fact existed. Many raw materials which were listed were licensed virtually on request. Forest products might be regarded as something of an exception, since South Africa did have a local supply which exceeded requirements. Forestry offered particular opportunities to South Africa, which in a certain sense was still a developing country, to diversify and stabilize land use, and in addition the southern hemisphere climatic conditions gave certain advantages in terms of the quantity of timber which could be produced in a comparable period of time, even though the quality was not up to that of the best northern hemisphere timber. The quality difference meant that northern hemisphere timber was available only at a price premium, notwithstanding the improvement which could be effected in local timber through laminating processes, so that there was good reason to believe that liberalization of imports would not greatly increase the quantity used; in fact licensing was not highly restrictive as matters now stood.

15. The question was also asked whether the lists of products appearing in the background documentation really represented the whole of what was restricted. In a specific case it had been ascertained that certain unlisted pharmaceutical products were, for example, completely prohibited. Accordingly it would be appreciated if, at the time of the next consultation, full information could be given to the Committee concerning restrictions then in force. The representative of South Africa stated that the case in question was one of very few items on which, as a purely strategic and temporary measure, restrictions not listed in the official gazette had been imposed but had more recently been terminated. The necessity for these restrictions had now fallen away and an assurance was given that it would shortly no longer be operative.

16. Members of the Committee inquired about the status of South Africa's bilateral agreements with Spain, Portugal, Rhodesia, Malawi, Botswana and Lesotho which, they recognized, were in some cases of lesser importance but which might in certain instances contain special features. The representative of South Africa was asked for a general description of them, for some information on the nature of the trade involved and for any indications he might give of an intention to terminate them. If any new agreements were contemplated, information on such plans would be appreciated. The representative of South Africa stated that the agreements with Spain and Portugal gave no special benefits in trade matters but simply incorporated a general
most-favoured-nation commitment. The agreement with Mozambique, dating from 1928, not only granted most-favoured-nation treatment with respect to South Africa's merchandise imports, but also contained some special provisions for harbour and transportation facilities. Agreements with Malawi and Rhodesia were of a different nature and were merely a renegotiation of the previously existing agreements with the Federation of Rhodesia and Nyasaland; they only continued the benefits enjoyed under the agreement. No similar renegotiation had taken place in so far as Zambia was concerned. In regard to the other three territories, Botswana, Lesotho and Swaziland, a complete customs union had been in existence since 1910. It was currently the intention to renegotiate the terms of these agreements with the individual independent territories on the same basis, i.e. a complete customs union with a common currency and exchange system, in the not too distant future.

Conclusions

17. The Committee thanked the representative of South Africa for his frank and informative replies to their questions. They felt that very real progress had been made by South Africa since their last consultation in switching over to control of inflationary tendencies through internal measures but also considered that more needed to be done, particularly through adoption of new fiscal measures, to establish more firmly a basis for movement toward liberalization of import policy, without recurrent pressures which would threaten the maintenance of the relaxation already achieved. Further relaxation of imports would, they felt, help to strengthen those of South Africa's new industries which had valuable contributions to make to the economy, and would place those industries in a better position to stabilize the country's export trade and so contribute to external equilibrium. The representative of South Africa thanked the Committee and promised to convey to his Government the views which had been expressed.