DRAFT REPORT ON THE CONSULTATIONS WITH THE UNION OF SOUTH AFRICA

1. In accordance with its terms of reference the Committee has conducted the consultations with the Union of South Africa under paragraph 4(b) of Article XII. The Committee had before it: (a) the "basic document" prepared by the secretariat (revised), and (b) documents provided by the International Monetary Fund. In conducting the consultations the Committee followed the "plan" recommended by the CONTRACTING PARTIES. The present report summarizes the main points discussed during the consultations.

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 the Union of South Africa. As a part of the consultation between the CONTRACTING PARTIES and the Fund, the latter transmitted the results and the background material from its most recent consultation with the Union of South Africa. In accordance with the agreed procedure the representatives of the Fund were invited to make a statement supplementing the Fund's documentation concerning the position of the Union. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the results and background material from the last consultation with the Union of South Africa under Article XIV of the Fund Agreement, which consultation was concluded on 13 April 1959.

"With respect to Part I of the Plan for Consultations, relating to balance-of-payments position and prospects, the Fund draws the attention of the CONTRACTING PARTIES to the results of its recent consultation with the Union of South Africa under Article XIV of the Fund Agreement and particularly to the following sentences from paragraph 4:

"The decline in reserves after mid-1957 has led to a slowing down in the pace of removal of restrictions. The Fund hopes that the further strengthening of South Africa's external position, which the Union Government expects in 1959, will make it possible to proceed with the elimination of the remaining restrictions.'

"With respect to Part II of the Plan, relating to alternative measures to restore equilibrium, the Fund draws attention to the results of the last Fund consultation with the Union of South Africa. The Fund has no additional alternative measures to suggest at this time."

1 See Annex I.
Balance-of-Payments Position and Prospects

3. In opening the consultation the representative of the Union of South Africa referred to the documents before the Committee which, in his view, contained a comprehensive account of the main movements in South Africa's external financial position during the past two years. The Fund document drew attention to the relatively favourable position of South Africa in early 1957. Investment had been high in the preceding post-war years and production had expanded rapidly. Although imports rose rapidly between 1956 and 1957, export income was at a high level. Against this background South Africa was able substantially to relax its import restrictions to the point where only a relatively small percentage of total imports still remained under effective restriction.

4. During the first quarter of 1958 imports continued to rise appreciably mainly as a result of the import relaxations introduced in 1957 but also on account of a certain apprehension on the part of importers that these import relaxations would have to be withdrawn and restrictions intensified by reason of the pressure exerted on the country's monetary reserves by the heavy expenditure on imports. At the same time export earnings declined, which might be partly attributed to reduced overseas demand consequent upon the fall in the rate of expansion in certain industrial countries and to the recession in certain economies. The fall in prices affected not only South Africa's primary exports such as wool, lead ores and concentrates, chrome and asbestos but also its exports of manufactures. The decline in the price of copper resulted in a drop in demand in the Federation of Rhodesia and Nyasaland which normally provides an important outlet for South African metal manufactures, machinery and consumer goods. The net outflow of both short- and long-term private funds following the rise in the United Kingdom interest rates in 1957 continued into 1958. The higher rate of interest that prevailed on the London market had caused a considerable reduction in the inflow of funds to South Africa. As a result of these various factors, gold and foreign exchange holdings of the South African Reserve Bank fell from £128 million at the end of May 1957 to £73 million at the end of May 1958. The current account of the balance of payments had moved from a surplus to a deficit.

5. The Union Government decided against an intensification of import restrictions as a means of restoring equilibrium in the balance of payments. Only luxury automobiles were affected by a tightening of import controls. Instead, internal monetary and fiscal measures were introduced, including the imposition of supplementary reserve requirements for commercial banks, higher interest rates and tightened controls over resident transfers to other sterling area countries.

6. The position improved sufficiently during the year to allow some relaxation of the internal measures. Prices of primary commodities showed an upward trend during the latter half of 1958, but still remained well below earlier levels. This fact, coupled with crop failures as a result of drought conditions caused a decline in export income. Total imports for 1958 had risen compared with 1957, but the tighter monetary and fiscal policies, which brought a considerable decline in bank credit in the latter part of 1958, did result in a downward trend for imports.
7. The decrease in imports and a resumption of net capital inflow resulted in an improvement in the reserve position. The representative of the Union of South Africa pointed out, however, that the terms of trade had moved definitely against his country, in consequence of the fact that the lower levels of primary commodity prices had not been followed by any change in the upward trend in the prices of manufactures which represent the bulk of the country's imports. The situation in 1958 would have been quite difficult had it not been for the substantial inflow of capital from abroad; this inflow of capital was responsible for the achievement of a smaller deficit in 1958 than was originally anticipated. The Union was continually faced with the problem of matching total foreign expenditure with external income. Capital inflow, by nature a variable element, had shown a tendency to fluctuate appreciably over relatively short periods. Reliance could hardly be placed on this unpredictable element for balancing the country's external payments.

8. All discrimination as between sources of supply had been removed in South Africa as long ago as 1954. It was the Government's policy progressively to eliminate all import restrictions as quickly as the balance-of-payments situation permits. South Africa's record in respect of import relaxations since 1957 was evidence of its determination to carry out this policy. When faced with balance-of-payments difficulties the Government had shown no hesitation in choosing measures of internal restraint rather than the more expedient measure of import restriction.

9. As for future prospects the representative of the Union of South Africa considered that much would depend on prices of primary products and on the possibility of a fairly substantial inflow of capital. While it remained his Government's firm desire that the residual restrictions should be further reduced and eliminated as soon as possible, any such action must be a firm step forward; it would be in nobody's interest if liberalization measures, hastily taken, were to be followed by the reimposition of restrictions.

10. The Committee took note of the statement of the South African representative, and particularly noted that despite adverse developments which occurred in South Africa's balance-of-payments position towards the end of 1957 and continued during the first half of 1958, the degree of liberalization achieved up to 1957 had been largely maintained; that at present a large proportion (estimated by the South African Government to be approximately 91 per cent) of South African import requirements might be imported either without the formality of an import permit or under import permits which were granted for the country's full requirements; and that the South African Government was looking forward to a further strengthening of its external position in 1959.

11. The Committee showed considerable interest in the reference by the representative of the Union of South Africa to the important part played by the capital account in the Union's balance of payments. One member expressed the view that, in as much as a fall in capital inflow was generally accompanied by a fall in imports, the deficit would not increase proportionately. Further, while it was true that difficulties could result from a fall in export earnings, it did not follow that reduced external receipts need always be followed by a reduction in imports; there was no
reason why imports must always be matched with export earnings over short periods. Apart from national reserves which might be drawn upon for external payments, the availability of the resources of the International Monetary Fund should help to alleviate a good deal of the anxiety which a country had to face. In reply, the representative of the Union of South Africa stressed the fact that the net balance of South Africa's capital account was always substantially a marginal factor and that experience had not indicated correlated movements of capital and imports. South Africa had to count on a fairly liberal capital inflow to achieve a balance. The South African Government considered a certain level of reserves to be an absolute minimum and it was to hold them at that level that the present quantitative restrictions were being maintained. The remaining restrictions covered a large number of semi-luxury goods, which might flood the internal market if import controls were abolished. For this reason South Africa had adopted a cautious attitude stressing that any move forward must be a sustainable one.

12. Another member of the Committee asked to what extent the capital movements referred to were movements of external capital or movements of South African domestic capital. The representative of South Africa explained that as a young country South Africa was heavily dependent on external capital, the only movements of South African capital of significance being those entering and leaving the Federation of Rhodesia and Nyasaland, which held a special place in South Africa's external financial and trade relations.

13. A member asked whether the measures that had been taken by South Africa to restrict resident transfers to the rest of the sterling area had contributed to the easing of its balance-of-payments position and had reduced its need to maintain reserves at what has been described as a "safe" level under conditions when such restrictions were not in existence. The representative of South Africa pointed out that the exchange restrictions imposed on transfers to other sterling area countries had been taken as exceptional measures and were being maintained for the time being; basically the South African policy was to move away from financial controls just as it was also its policy to move away from import controls.

14. A member of the Committee referred to the provision in Article XII requiring that restrictions be progressively relaxed as conditions improved, and questioned the appropriateness of a government following an over-cautious policy of not taking liberalizing action until it could be certain of no need to retrogress. The representative of South Africa pointed out that it had never been the policy of the South African Government to build up reserves to an excessive level and that in point of fact the recent fall in export earnings had substantiated the earlier fear and borne out the wisdom of a cautious policy.

15. A member of the Committee asked whether, in the opinion of the South African Government, the dangers of heavy imports had not been lessened on account of such factors as the heavy imports that had taken place in 1957 and the reduced purchasing power in the economy due to the tightened monetary and fiscal policies. In answer to this and other related questions the representative of South Africa pointed out that a large part of South Africa's foreign earnings was taken up by major development projects mainly in the
services sector. These included substantial foreign expenditure on improvements and expansion of rail and electrical services and also in the mining industry. These programmes, with the exception of rail services, were now reaching the final stages. With these expenditures of foreign exchange removed, the Union Government should be in a position to make further progress in the implementation of its policy of eliminating the remaining import restrictions.

16. A member of the Committee noting the statements in the "basic document" that for general merchandise imports there had been "a substantial carry-over of 1957 permits into 1958", and that for other articles in the restricted category available supplies exceeded demand in 1957, asked whether this could not be regarded as inconsistent with the statement by the representative of the Union that the removal of restrictions would result in a substantial increase in imports. The representative of South Africa explained that the carry-over in 1957 simply reflected over-importation that had been made by merchants in the preceding year on the basis of extended advances of credit and in apprehension of the possible reimposition of restrictions. In conclusion the representative of South Africa stated that, as far as long-term objectives in removing import controls were concerned, an important factor would be the completion of major projects and improvement in export earnings. Although prices of primary exports had been depressed for the past two years, there had been no corresponding softening of prices for South Africa's major imports. Developments in the field of prices and capital movements would determine the pace at which South Africa could carry out its policy of moving forward in the elimination of the remaining quantitative restrictions.

Alternative Measures to Restore the Equilibrium

17. In discussing the possible effects of an elimination of the restrictions, the South African representative had stated that many of the items which remained subject to control wore of a semi-luxury nature and that liberalization would in all probability result in substantial imports. Members of the Committee wished to know whether the South African Government had considered alternative ways of dealing with this problem, such as by the application of a purchase tax. The South African representative informed the Committee that South Africa had no system of purchase or sales taxes but that hire-purchase restrictions had been intensified.

18. One member asked whether South Africa would take further monetary or fiscal measures to correct the situation if present forecasts proved over-optimistic. The representative for South Africa stated that it was his Government's policy to go as far as possible with internal restraints. It would be as a last resort that South Africa would go back on any liberalization achieved.

19. In reply to a question on the special measures introduced in the monetary and fiscal field in 1958, the representative of South Africa stated that the commercial banks' lending capacity was generally decreased after the imposition of supplementary reserve requirements. This had the effect of contracting the ability of the banks to extend credit for the financing of imports.
20. A Committee member asked whether South Africa had taken any steps to increase the inflow of capital and avoid the capital movements which had proved so costly to South Africa's balance of payments. The representative of South Africa stated that his Government maintained a liberal policy regarding capital, there being complete freedom of repatriation of foreign capital and earnings for funds which had been invested in South Africa through the normal banking procedures. An attempt was being made to interest foreign investors but it was not within the power of the Government to influence foreign investors who might be attracted by temporary higher rates of interest elsewhere.

21. A member of the Committee was of the opinion that the balance-of-payments difficulties of South Africa which became manifest in the second half of 1957 reflected principally the effects of the general recession and falling commodity prices. To attribute the difficulties purely to domestic causes or to credit exclusively internal measures with having brought about the subsequent recovery might be an over-simplification of the situation. The member asked whether it was realistic to expect that further contributions could be made to the foreign currency reserves by the introduction of still more restrictive internal measures when the present policy was already regarded as very severe. The South African representative noted in reply that, in choosing a line of action, a contracting party operating under Article XII had always to bear in mind the principles which must underlie such a choice. While recognizing that internal measures on their own could not lead to the restoration of lasting equilibrium in the balance of payments, his Government also did not regard import restrictions as a permanent solution to the balance-of-payments problem. The overriding objective was always to ensure sound and balanced development of the available resources and to secure the best long-term advantage for the nation through expanded production and international exchange. The South African policy was to promote the simultaneous expansion of all sectors of the economy and not to push the development of one sector at the expense of any of the other sectors.

System and Methods of Restriction

22. The Committee discussed with the South African representative the question whether it was accurate to say that only 9 or 10 per cent of South Africa's total imports was subject to restriction, having regard to the fact that such a percentage must be calculated not in relation to actual imports but to total imports that would obtain in the absence of all restrictions. The South African representative explained that, with the exception of the general merchandise category which was still subject to quota limitations, there were no effective restrictions on the other main categories of imports. It was estimated that the removal of restrictions on this category could possibly cost the country an additional expenditure of approximately £50 million on imports which would represent approximately 9 per cent of current total imports of £580 million. He went on to explain that the allocation of quotas was based on past performances of individual importers, and with regard to newcomers licences and quotas might be accorded in the light of the commercial position of the merchant in a preceding representative period.
23. It was noted that under the South African import control system imports were divided broadly into three categories:

(a) goods which could be freely imported without licences;
(b) goods subject to import permit but free of quota restrictions;
(c) goods subject to both licensing control and quota restrictions.

Certain members of the Committee questioned the necessity of continuing licensing control of goods which were no longer effectively restricted. They noted that during the 1957 consultations held with the Union, the representative for South Africa had explained that the licensing controls retained on goods in Group (b) were generally for statistical and precautionary reasons and that, since these reasons had largely disappeared, consideration was being given to their complete abolition. These Committee members appreciated that since that time the balance-of-payments position had worsened in 1957 and 1958, but wondered whether consideration could now be given to the removal of the licensing controls on goods in Group (b). The South African representative noted that his Government was fully aware of its obligations under the General Agreement to dismantle the restrictions as and when the need for their maintenance disappeared, but that the judgement as to when such a stage had been reached must rest with his Government. It was necessary to take into consideration all such factors as fluctuations in export earnings, crop conditions, capital flow, general prospects in world markets and demand conditions. He emphasized that it was the fixed policy of his Government to eliminate all controls as soon as it could be done without jeopardizing the country's external financial stability.

24. In response to a request for an indication of the methods used to provide information to the trade on quotas available for a particular period, the South African representative reported that quotas were normally announced in October for the first part of the following quota year so as to give ample time for traders to place orders. Similar announcements were made in advance of subsequent allocations for the remainder of the quota year. Copies of these announcements were normally forwarded to the CONTRACTING PARTIES.

25. The Committee noted that the Union of South Africa is not resorting to the provisions of Article XIV of the Agreement. It was brought out, however, that goods imported from the Federation of Rhodesia and Nyasaland, if such goods were grown, produced or manufactured in that country, were free of all import restrictions while certain goods from other countries were subject to restrictions. When questions were raised as to the justification of this discrimination by South Africa, the representative of South Africa referred to the history of the trade relations between South Africa and the constituent territories of the Federation. Reference was made to the earlier free trade arrangement between the Union and Northern Rhodesia to the Customs Union (Interim) Agreement between the Union and Southern Rhodesia in 1949, which had been approved by the CONTRACTING PARTIES at their third session in 1949, and to the decision taken on the occasion of the establishment of the Federation that the Federal Government would have to terminate the arrangements
between the two Rhodesias and the Union consequent upon that Government assuming responsibility for the external trade relations of the Federation as a whole. The South African representative also invited attention to the Trade Agreement concluded in 1955 to regulate the Union's commercial relations with the new Federal State and referred particularly to the Decision of the CONTRACTING PARTIES of 3 December 1955, (see Fourth Supplement, pages 17-20) in which the CONTRACTING PARTIES noted "that, in connexion with the adoption of this tariff the Federation and the Union of South Africa terminated the Customs Union Agreement with the Union of South Africa and Southern Rhodesia, effective 1 July 1955, and concluded, effective on the same date, a new trade agreement to govern tariff and trade relations between the Federation and the Union of South Africa". The South African representative was of the view that as the new agreement was noted by the CONTRACTING PARTIES it could be implied that all the arrangements provided for in that agreement had been sanctioned by the CONTRACTING PARTIES. He also pointed out that the share of South Africa's total market which was supplied by the Federation was relatively small; it amounted to 2.2 per cent of South Africa's total imports in 1958 and approximately one-half of the goods supplied by the Federation to South Africa were under the heading of metals, metal manufactures and machinery although tobacco, textiles and some foodstuffs were also important South African imports from the Federation.

26. Members of the Committee considered that the Decision taken by the CONTRACTING PARTIES in 1954 included no indication of express approval of a preferred position with respect to quantitative restrictions on trade between the two countries; it was intended merely to deal with the customs preferential arrangements. The representative of South Africa contended that the record showed that the CONTRACTING PARTIES took note of the new trade agreement which covered not only tariffs but all "trade relations" between South Africa and the Federation.

Effects of the Restrictions

27. Members of the Committee referred to the various products in the restricted sector and discussed with the South African representative the inter-relationship between his Government's policy regarding internal investment and development of secondary industries and its commercial policy. Mention was made of the paper industry which had developed rapidly. The South African representative stressed the fact that the remaining restrictions were of a marginal character and as a general principle, no commodity (other than a few articles which, for various reasons, were not allowed to be imported) was excluded from the import allocations. In this manner a reasonable measure of foreign competition was being maintained in the domestic market. This also ensured that no undue damage was being caused to the trade interests of the contracting parties. He pointed out that although South Africa's production of a number of products exceeded the domestic demand and consequently left a surplus available for export, the importation of such products into South Africa was nevertheless permitted even under prevailing conditions of foreign exchange shortages in order to take account of the interests of countries which were exporters of such goods. The South African Government had repeatedly made it known that it was its basic policy that the controls on imports were to be applied only for balance-of-payments reasons; producers were regularly warned that they could not count on the continued maintenance of any such restrictions beyond the time when they could be justified on balance-of-payments grounds.
General

28. Members of the Committee expressed gratification over the maintenance by South Africa of the degree of liberalization achieved up to 1957 despite adverse developments. They welcomed the reaffirmation of a policy directed towards the complete elimination of quantitative restrictions and expressed appreciation for the direct replies and frank manner in which the South African representatives supplied answers to the questions put forward by members of the Committee and participated in the discussions. The Committee expressed the hope that the conscious policy pursued by the South African Government would be followed by further improvements in its balance-of-payments situation so that a time would soon arrive when the residual restrictions could be totally eliminated.