

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Committee on Balance-of-Payments Restrictions

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 (BOF/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 hitherto had 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. Control was being exercised to some extent over the investment projects undertaken, through 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 factor favourable to the balance of payments in the short run and one which with proper supervision should prove to be a long-term advantage to the economy. 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 could put reserves under greater pressure.

6. The representative of South Africa could not agree that reserves at present levels, covering 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 was 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 when controls were relaxed 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 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 were moreover contemplating some simplification measures affecting the restrictive systems. Also his Prime Minister had placed himself on record that it would require 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 moving 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 level. 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. To a certain extent the same thing was happening in diamonds. What could be surely foreseen was a decline in the earnings from these two products as the exploitable resources of both were exhaustible. 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 not be wise 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 regular water supply were through very expensive irrigation projects like the Orange River Project, and even here South Africa 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 appeared to be an 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 fairly good 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 making estimates of 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 sixty-five basic items would be removed from the restricted list and would go mainly to a category under which permits were granted more or less freely (the restricted 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. He added that with respect to all items remaining on the restricted list, the Government had 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 1948 or one of the three recent years 1964-1966, whichever was most advantageous to them, 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). 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 tended 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 developing, 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. Improvement 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 that this action had now fallen away and that this system would be discontinued in 1968.

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 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 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.

ANNEX

Opening Statement by the Representative of South Africa

1. The ten and a half months that have elapsed since South Africa's last consultation with this Committee have in South Africa been characterized by continued and more determined efforts by the Government and the Reserve Bank to combat inflationary tendencies. Inasmuch as what appeared to be adequate steps to deal with the problem had already been taken, the persistence of mild inflationary pressure in South Africa in this period was unexpected. The expectations as to the future course of events, however, were upset by such incalculable factors as the persistent optimistic expectations of businessmen and industrialists, the inflow of private capital and the increased incomes of farmers due to substantially increased yields of agricultural products, resulting from exceptionally favourable climatic conditions over a wide area of our country.
2. It is of interest to note that there was and still is some divergence of opinion among economists in South Africa as to the intensity of the measures which should be taken to counter continuing inflationary trends - this serves to underline the difficulty facing the South African authorities in prescribing appropriate disinflationary measures in the present situation.
3. The major cyclical upswing which South Africa has been experiencing since 1961 has continued. The boom lost some of its buoyancy in the second half of 1965 but regained considerable momentum in the first quarter of 1966 and, as far as can be judged from available statistics, buoyant conditions continued into the first eight months of 1967.
4. The gross domestic product showed a marked rise during the first half of 1966, but increased at a slower rate during the second half of the year and the first quarter of 1967, occasioned in part by a fall off in the value added by agriculture. During the second quarter of 1967, however, the rate of increase of the gross domestic product accelerated sharply, largely due to a substantial increase in the value added by agriculture resulting from a dramatic and very welcome improvement in climatic conditions. In real terms, the gross domestic product valued at constant prices showed only a modest increase in the fourth quarter of 1966 and the first quarter of 1967, but a pronounced rise became evident during the second quarter of 1967.
5. Gross domestic expenditure, on the other hand, reached an annual rate of increase of about 16 per cent during the second half of 1966, but during the first half of 1967 this slowed down to a rate of about 12.5 per cent.

6. The main reason for the slowing down in the rate of increase of total spending was a downturn in private fixed capital expenditure from the beginning of 1967 particularly in manufacturing, commerce and building, attributable, in part, to the disinflationary monetary and financial measures to which I shall refer in greater detail later in this statement. It is also of interest to note that inventory investment was maintained at a high level during the fourth quarter of 1966 and the first half of 1967.
7. The sharp rise in fixed and inventory investment in 1966, together with the upswing in economic activity in general, was associated with an increase in the demand for imported as well as domestic goods and services. In addition, as mentioned in the opening statement last year, import control was relaxed in July 1966. The result was an increase in imports from a seasonally adjusted annual rate of R 1,466 million in April 1966 to R 2,248 million in January 1967, percentually expressed an increase of 53 per cent. Since then, however, imports have levelled off at an annual rate of about R 2,000 million, despite the relaxations of import control in December 1966 and again May 1967. It would appear that the main reason for the failure of imports to rise after January was the Government's disinflationary fiscal and monetary measures. During the first nine months of 1967, imports reached a seasonally adjusted annual rate of R 2,005 million, which was no less than 26 per cent higher than for the corresponding period of 1966, and well-nigh double the level for 1962. At their present level, imports amount to about 22 per cent of the gross domestic product.
8. South Africa's import ratio, as expressed in terms of this percentage, is appreciably higher than is the case with other countries having a comparable economic and trade structure. This is due, in large measure, to the fact that South Africa has traditionally relied on gold production to provide the resources necessary to pay for a large part of its imports. The relatively high level of the percentage bears testimony to the fact that South Africa's import restrictions do not have the effect of hampering trade expansion consistent with the maintenance of a sound balance-of-payments position. In fact, the South African import restrictions, by safeguarding the balance-of-payments position, forestall situations where excessive imports could lead to spasmodic declines in foreign exchange reserves to abnormally low levels. This would in turn necessitate recourse to disruptive and disconcerting emergency action to safeguard the balance-of-payments position.
9. It should also be pointed out that the level of South Africa's reserves of foreign exchange is influenced substantially by the inflow of foreign capital. As a basic tenet of its policy, the South African Government does not exercise any control over the inflow of capital. South Africa is a young

and a dynamically developing country which needs to import longer-term development capital. But the unpredictability of foreign capital inflows does, however, increase the elements of uncertainty affecting trends in the balance-of-payments situation, and underlines the need for prudent regulation of physical imports where and when appropriate.

10. The South African authorities concerned are convinced that the import restrictions as maintained to safeguard the external financial position and the balance of payments forestall disruptive developments in import trade and in the overall economy. By avoiding erratic fluctuations in the foreign exchange reserves, the application of appropriate import restrictions has in fact promoted economic stability and orderly development, and has made possible a higher rate of growth in the import trade of South Africa than would have been possible under conditions of erratic fluctuations in the reserves of foreign exchange, due to periodically excessive and untimely increases in imports.

11. South Africa's exports, on the other hand, have shown an irregular upward trend. The seasonally adjusted rate in the first nine months of 1967 was R 1,265 million which was 15 per cent higher than for the corresponding period of 1966.

12. Net gold output rose in the first half of 1967, but it is of some significance that the balance-of-payments figure was lower in 1966 than in 1965. The view of the Gold Producers' Committee is that, although gold production may continue to rise marginally for a few years, the turning point is in sight, and when it is reached, the drop will be alarmingly sharp. A difficult period of readjustment is, therefore, to be expected in the foreseeable future - a period during which it will be necessary for South Africa to earn more foreign exchange by alternative means. To an increasing extent we will have to rely on larger exports of manufactured goods.

13. Reflecting the trends in imports, exports and net gold output to which I have referred, as well as an increase in net invisible payments, the balance of payments on current account deteriorated from surpluses in the first three quarters of 1966 to substantial deficits in the subsequent three quarters. The seasonally adjusted annual rate of deficit in the first half of 1967 amounted to R 325 million, compared with a surplus of R 120 million in the first half of 1966. According to preliminary data, despite a marked increase in exports in July and August, combined with relative stability in imports, there was only a modest decline in the deficit.

14. There has been an unexpectedly strong inflow of private capital, both long term and short term, into South Africa over the past two and a half years. This has increased the difficulties of the Government and the Reserve Bank in controlling inflationary pressures. To some extent, the effects of the inflow, however, were offset by an outflow of central Government and banking capital in the second half of 1966 and the first half of 1967, largely reflecting the repayment of foreign loans.
15. Taking into account a net capital inflow of R 53 million in the first half of 1967, the country's gold and foreign exchange reserves declined by R 118 million in the first half of 1967, which was in marked contrast to the sharp increase in the first seven months of 1966. These reserves declined from a peak of R 604 million at the end of July 1966, to R 455 million at the end of May 1967, but rose to R 488 million at the end of July, remaining virtually unchanged at R 487 million at the end of August. This level is equivalent to less than three months' imports on the basis of seasonally adjusted imports in the first eight months of 1967, and only slightly more than two months total current payments.
16. In the opening statement at the previous consultation, the disinflationary measures which had been taken by the South African Government were mentioned in some detail. Since then, the campaign against inflation has been intensified to a very marked degree in view of the unexpected persistence of inflationary pressures.
17. The disinflationary steps taken in December 1966 were discussed at the previous consultation.
18. In his budget speech in March 1967, the Minister of Finance emphasized the Government's determination to combat inflation. The surplus of about R 35 million on the 1966/67 Revenue Account, and the credit balance of R 36 million on Loan Account at the end of March 1967, were not carried forward to the current financial year, but sterilized, by being kept on deposit with the Reserve Bank or partially invested with the External Procurements Fund. The Minister also made it clear that Government expenditure was being kept as low as possible, and that this expenditure was being financed from non-inflationary sources. The Government had in fact reduced its indebtedness to the monetary banking sector by R 21 million during the second half of 1966 and repaid a net amount of R 15 million on foreign loans in the same period. (This policy has since been continued - during the period April to August 1967, the Exchequer reduced its net indebtedness to the monetary banking sector and the foreign sector by R 26 million and R 30 million respectively.) In addition, substantial increases in loan levies on companies and individuals, income tax

on companies and various other direct and indirect taxes were imposed, and the Minister also stated that more attention would be given to inducing the public to invest substantially larger amounts in tax-free Savings Bonds and Tax Bonds. I might mention, in this connexion, that the savings campaign, with the aid of extensive publicity, is at present in full swing in South Africa, and the results have so far been gratifying. More than R 21 million has been invested in these Bonds.

19. Further supplementary disinflationary measures were taken in succeeding months. The South African Reserve Bank's pattern of rates for short-term and medium-term Government stock were adjusted upwards in March and April, while in May a further substantial relaxation of import control was announced, with the specific objective of combating inflation. In June it was announced that the minimum liquidity ratios for merchant, hire-purchase, general and savings banks, would be increased as from the end of July.

20. This was followed in August by an authorization to the Reserve Bank to issue directives to banking institutions concerning the extension of credit, and to impose severe penalties if these directives were not complied with. The significance of this authorization lay in the fact that the Reserve Bank had in December requested the monetary banks to ensure that their discounts, loans and advances to the private sector, excluding the Land Bank, should be at least 7.5 per cent lower at the end of September 1967, than at the end of March 1965. In the light of the then prevailing conditions in the agricultural sector, the set limits could be exceeded by 2.5 per cent in respect of credit extended for agricultural purposes. Furthermore and also, in terms of the authorization, the Reserve Bank also directed compliance with the terms of its original request, not only at the end of September 1967, but also at the end of every subsequent calendar month. By normal standards of monetary policy, this is a drastic measure which eloquently demonstrates the determination of the monetary authorities in South Africa to succeed in their fight against inflation.

21. With regard to further action to combat inflation, it may be mentioned that, following the endeavours before the budget to cut public expenditure to a minimum, the Government has again scrutinized the expenditure for the current financial year with a view to effecting additional economies or postponing capital projects, and substantial success has been achieved in this direction. It has, for example, been decided to postpone, inter alia, the following major projects: a third iron and steel works, a second oil-from-coal installation, and the R 50 million Van der Kloof Dam which forms part of the Orange River Project.

22. In a statement released by the Prime Minister on 30 September 1967, he stated that the Government was prepared to effect a drastic curtailment of its own expenditure, even essential expenditure, in order to lower the level of total domestic expenditure.

23. The present trend of prices in South Africa gives grounds for guarded optimism that some success is being achieved in the battle against inflation. Having risen by 3.8 per cent between December 1965 and December 1966, the seasonally adjusted consumer price index increased at an annual rate of 3.3 per cent between December 1966 and August 1967, while the wholesale price index rose by 4.5 per cent in the former period and at a seasonally adjusted annual rate of only 2.1 per cent in the latter period.

24. In the view of the Reserve Bank, the measures taken to combat inflation over the past year have reduced the threat of an acceleration of the rate of inflation and even succeeded in slowing down the rate of increase in monetary demand, but the level and rate of increase of gross domestic expenditure are considered to be still too high. It is relevant to observe in this connexion, however, that the latest monetary and fiscal measures have probably not yet had their full effect. The Government is keeping a close watch on the position, and will not hesitate to take further action if this should later appear necessary.

25. I have dealt at some length with the steps to combat inflation in my country because I feel it is necessary to emphasize that South Africa is determined to solve the problem by means of fiscal and monetary measures. The measures taken have had, and will continue to have a favourable effect on the country's balance of payments. Because of the relaxation of import control, however, the gold and foreign exchange reserves have fallen to a comparatively low level, and I trust that the Committee will accept that they hardly provide scope for a further substantial relaxation of import control at the present juncture, especially if the uncertainties which face the future course of South African exports, such as the possible accession of the United Kingdom to the European Economic Community, are borne in mind. I might add, in this connexion, that agricultural and other primary commodities constitute a very high proportion of South Africa's export package, which accordingly is particularly prone to the ravages of unfavourable weather conditions such as drought, as well as to the tendency of primary commodity prices to fluctuate widely, and to lose ground in comparison with prices of manufactured goods over the long term.

26. I am aware that this Committee attaches importance to the simplification of South Africa's import control measures, and I should accordingly like to mention that my country's import control measures have recently been examined with a view to achieving greater simplicity. A Government notice will appear in the near future to give effect to the results of this exercise.

27. I trust, in conclusion, that the Committee will take due note, firstly, of the measures taken by my Government in various fields to maintain the stability and soundness of the economy, secondly, of the relaxations introduced since our last consultations, thirdly, of the sizable increase in South Africa's import trade, and fourthly, of the intention of my Government to simplify the system of import control.

28. I should not fail to emphasize, however, that my Government regards the provisions of Article XII which authorize restrictions of the quantity or value of merchandise permitted to be imported in order to safeguard our country's external financial position and its balance of payments, as an essential part of the General Agreement as far as South Africa is concerned. The Government of the Republic of South Africa will accordingly continue fully to reserve its right of recourse to measures which it considers appropriate and essential to safeguard its external financial position and its balance of payments.