GENERAL AGREEMENT ON
TARIFFS AND TRADE

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Committee on Balance-of-Payments
Restrictions

REPORT ON THE EXAMINATION OF SOUTH AFRICA'S IMPORT DEPOSIT SCHEME

1. On 17 September 1976 the Council of Representatives referred the examination of the temporary import deposit scheme introduced by South Africa on 2 August 1976 (L/4386) to the Balance-of-Payments Committee. The Committee examined the measure on 3 November 1976 in the context of all relevant aspects of South Africa's balance-of-payments situation and generally followed its usual plan of discussion.

2. The Committee had before it a basic document supplied by the South African authorities (BOP/168), as well as the notification of the import deposit scheme (L/4386), and supplementary background material supplied by the International Monetary Fund, dated 7 October 1976.

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 the consultation with South Africa. Upon the invitation of the Committee, the representative of the Fund made a statement as follows:

> "Over the past 15 years, South Africa has generally experienced deficits in the current account of the balance of payments which have been more than covered by private long-term net capital inflows. This trend continued in 1974 and early 1975, although the current account deficits were unusually large in this period.

"A rapid expansion in domestic activity in 1974 was initially the major cause of the deterioration in the external accounts. Since the end of 1974, however, a decline in the terms of trade and weak overseas demand have contributed to a widening in the current account deficit. To help correct the imbalance in the current account and also, in part, to stem speculation against the rand, the authorities depreciated the rand vis-a-vis the U.S. dollar by 4.3 per cent in June 1975 and again by 17.9 per cent in September 1975. In support of these changes, monetary policy was tightened during the second half of 1975 by way of increases both in the liquid asset requirements of the banks and in key interest rates.

"Financial policies were tightened further during the first half of 1976. Credit ceilings on bank lending to the private sector were imposed in February, and a restrictive budget for the fiscal year 1976/77 was introduced in March. Supplementing the monetary and fiscal measures, the temporary policy of voluntary price and wage restraints introduced in October 1975 was extended for six months in March 1976.

"Despite these policy changes and a continuation of the slowdown in domestic activity, particularly in the first half of 1976 when real GDP appears to have declined, the large external imbalance persisted during the first half of 1976 when the current account deficit rose to SDR 1,100 million. Simultaneously with the further deterioration of the current account, there was a marked weakening in the balance of private external capital transactions, in part reflecting uncertainties of a political nature. Of necessity, substantial recourse had to be made by official entities to short-term foreign borrowing of a compensatory nature. In addition, in order to strengthen the foreign exchange component of reserves, the Reserve Bank in March 1976 entered into a gold swap agreement with overseas parties, whereby it sold at market-related prices approximately 5 million ounces of gold spot and repurchased it forward. Gold reserves (valued at SDR 35 per ounce) thus declined from SDR 621 million at end-1975 to SDR 450 million at end-March 1976. Total reserves at end-March 1976 stood at SDR 1,280 million (SDR 240 million higher than at end-December 1975), with the more readily usable foreign exchange component at SDR 783 million (more than SDR 400 million higher than at end-1975). Since March, however--and notwithstanding further compensatory borrowing--the reserve position has weakened at an average monthly rate of over SDR 100 million.

"In August 1976, the Fund granted South Africa a new stand-by arrangement. However, South Africa's external position continued to deteriorate as political uncertainties constrained the authorities' ability to increase official borrowing still further or even to roll over some of the short-term credit which had built up during the first half of the year; in

the third quarter of 1976, the net inflow of private capital is estimated to have been extremely small, perhaps in part due to the uncertainty in gold markets. By end-August 1976, total reserve assets had fallen to SDR 720 million (about one month's imports), compared with SDR 1,025 million at end-May 1976, and net official foreign liabilities had risen from R 305 million at end-May to R 630 million at end-July.

"The policies adopted by the South African authorities to redress the external position and contain inflation include a credit policy aimed at containing the annual growth in net domestic credit to 11 per cent (in the year to June 1977) and a fiscal program which contains the annual growth in government credit to 12 per cent. Also, the Government intends to work toward a continuation of voluntary arrangements to moderate wage and price increases and to continue quantitative ceilings on the growth of bank credit to the private sector. In order to help bolster confidence in the rand and to facilitate the refinancing of the short and medium-term official borrowing which would fall due in the second half of 1976, the authorities introduced, in August, an import deposit scheme under which a 20 per cent deposit of the f.o.b. value of most imports is required at the time of customs clearance. The scheme is likely to have a sharp short-term effect on imports and liquidity which would be reversed when the scheme is removed.

"As already mentioned, on August 6, 1976 the Fund granted South Africa a stand-by arrangement. In the context of this arrangement the South African authorities indicated their intention to terminate the import deposit scheme as soon as circumstances permit, and in any event not later than February 2, 1977. The Fund staff will review the import deposit requirement in the context of South Africa's balance of payments situation in the course of the next consultation discussions scheduled to take place early next year.

"The Fund believes that the imposition of the import deposit requirement was, under the circumstances, warranted as a short-term measure to prevent a further deterioration in the balance of payments position. It is too early to assess the effectiveness of the policy measures undertaken in August 1976; however, in view of the continuing reserve losses in the past few months, the instability of the gold price, and the sharp reduction in capital inflow, it may be necessary for South Africa to adjust its current account position more rapidly and thus perhaps to modify economic policies further than was thought necessary at the time when the financial program was drawn up."

Opening statement by the representative of South Africa

4. In his opening statement, the text of which is annexed to this report, the representative of South Africa pointed out that his Government was not invoking the provisions of Article XII. He explained that the import deposit scheme introduced on 2 August 1976 consisted of the payment of a 20 per cent deposit of the f.o.b. price of all imports not specifically exempted. The deposit was kept by the South African Reserve Bank and was repaid to the importer, without interest, not later than six months. The importers were authorized to borrow abroad to finance the deposit. It was estimated that about 35 to 40 per cent of total imports were exempted from the deposit requirement. The scheme was introduced to arrest an untenable decline in South Africa's total net gold and foreign exchange reserves which was caused by adverse developments in the world economy, the sharp decline in the price of gold, the inflationary impact of increased government expenditure and large capital outlays for infrastructure projects by public corporations, and a decline in the net inflow of foreign capital. The scheme was also introduced to react to expectations in the private sector of a further devaluation or an intensification of import restrictions, which had led to an accumulation of inventories and unfavourable leads and lags in foreign payments and receipts. The representative of South Africa further explained that the scheme had to be seen as part of a package of measures, which included fiscal and monetary measures, and that it had been planned for a six-month period His Government was still optimistic that this time-limit would be realized. The South African representative concluded his statement by expressing the conviction that, among the policy alternatives available to South Africa, the one chosen had the least disruptive effect on international trade.

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

5. In reply to questions regarding the prospects for the current account the South African representative stated that the current account deficit had increased from R 771 million in the first half of 1975 to R 845 million in the second half and R 1,108 million in the first half of 1976. The preliminary figures for the third quarter of 1976 indicated a slight improvement in the current account situation and further improvements were expected. During the coming twelve-month period a 20 per cent increase of exports was projected on the assumption that the prices of exported minerals would improve, that there would be some increase in the volume of exports, and that receipts from gold sales remained stable.

6. As to the effect of the deposit scheme on imports, the South African representative said that it was difficult to distinguish the consequences of the scheme from those of the other measures the Government had taken to improve the balance-of-payments situation. However it was expected that imports would decline by 3 to 4 per cent in value terms during the next twelve months; in volume terms the decline would be even steeper. Provided there were also some improvements in the services account, the overall current account deficit would then decline to about R 750 million during the twelve-month period ending in mid-1977.

7. Asked to comment on the prospects for the overall balance-of-payments situation the South African representative said that the most recent statistics available justified some optimism. Gold and foreign exchange reserves had increased by over R 60 million during the past two months. The domestic policy measures introduced in August 1975 were beginning to show results. The liquid asset requirements of banks were now at the highest level in the history of South Africa and a ceiling on the increase of private sector lending by banks of ½ per cent per month was in operation. Deficit spending had been substantially reduced and some backflow of funds from the Government could now reasonably be expected. As a consequence the increase in the supply of money and quasi-money had been kept to an annual rate of 13 per cent during the first eight months of the year, which compared to rates of 22 per cent in 1974 and 18 per cent in 1975. The target for the next twelve months was 12 per cent. These various restrictive policy measures had reduced the rate of GDP growth from 7 per cent in 1974 to 2½ per cent in 1975 and zero per cent in the first half of 1976.

8. In reply to a question regarding the composition of the foreign debt, the representative of South Africa said that the proportion of short-term debts had increased in line with the world-wide tendency towards shorter maturities.

9. In response to queries on inflation rates, the causes of inflation and the extension of voluntary wage/price arrangements, the representative of South Africa replied that the seasonally adjusted increase in the consumer price index had declined for six consecutive quarters until the first quarter of 1976, accelerated to 13.3 per cent per annum in the second quarter and then declined again to 10.8 per cent per annum in the third quarter of 1976. In recent months, inflation rates had slightly risen again mainly because of increases in administered prices (steel, electricity, railways). The Government had introduced in October 1975 voluntary arrangements to moderate wage and price increases and it was working towards a continuation of these arrangements. He added that the economy was suffering from a cost-push rather than a demand-pull inflation.

10. Members of the Committee expressed their concern about the inflationary impact of South Africa's budget deficits. One member of the Committee pointed out that the budget for 1976/77 also provided for a deficit and that the tax increases on which it was based were apparently insufficient. The South African representative explained in reply that the budget for the fiscal year 1975/76, though on the whole balanced, initially had an expansionary effect since the sharp tax increases on the basis of which it was drawn up, went into effect only later in the year. Early in the fiscal year the credits from the Reserve Bank to the Government therefore increased, but the flow of funds was now expected to reverse. It was the intention of the Government to continue its restrictive budgetary policies in the fiscal year 1976/77.

11. Some members of the Committee wanted to know whether the South African Government pursued policies to stimulate mineral exports. The representative of South Africa said that the principal means by which his Government promoted sales of minerals abroad was the improvement of the infrastructure. For example, two new harbours were being built, one north of Durban which would facilitate coal exports and another north of Cape Town for the export of iron ore.

12. Members of the Committee asked whether South Africa envisaged additional measures to reduce government spending and to deflate the economy without resorting to further trade restrictions. In reply the representative of South Africa expressed his conviction that the policies applied at present were showing results and that it would not seem necessary to introduce new restrictive measures, either in the area of fiscal and monetary policies or in the field of foreign trade.

13. One member of the Committee, pointing to a recent weakening of the net capital inflow, asked for indications on South Africa's future foreign borrowing requirements. The representative of South Africa replied that the expected current account deficit of R 750 million during the twelve-month period ending mid-1977 was expected to be covered by a net foreign capital inflow. In view of the net capital inflow of R 634 million during the first half of this year, this estimate seemed reasonable.

II. System and methods of the restrictions and effects of the restrictions

14. Several members of the Committee observed that South Africa had a restrictive system of import licensing and that, though it no longer invoked Article XII only some 25 per cent of imports had been made without permit in 1975. During the same period about 60 per cent of imports could enter only under permit but subject to automatic licensing for bona fide merchants and manufacturers, 6 per cent of imports were subject to global quotas and 9 per cent to a régime of specific licensing. The deposit scheme which was expected to cover about 60 per cent of imports, was in addition to these restrictions and to import duties some of which were fairly high. As a consequence some products were now subject to quotas, tariffs and the deposit requirement. The Committee members wondered why this accumulation of import controls was considered necessary and what purpose the deposit requirement served in cases of imports subject to quota limitations. They also expressed their hope that the import licensing system would be liberalized. The South African representative stated in response that the different types of controls served different purposes. The deposit scheme was general in application; the level of the deposit requirement was uniform and hence did not vary with the tariff level or any licensing requirements. It served mainly balance-of-payments, not protective purposes. The deposit requirement was much easier to introduce and to remove than tariffs or quantitative restrictions and it therefore suited the temporary character of the problems it sought to overcome, among them the increase in imports prompted by the expectation of a further devaluation or intensification of import restrictions. The South African representative added that, although his country had continuously worked towards the removal of import restrictions, a further relaxation of import restrictions would be difficult while the present balance-of-payments problems lasted.

15. The question was asked whether South Africa intended to phase out the deposit scheme as its balance-of-payments situation improved, for instance by reducing the deposit rate or the retention period. The South African representative replied that, as his Government planned to abolish the scheme completely at the end of the six-month period, no phasing out was presently being considered. Several members of the Committee also wondered whether the maximum retention period was applied to all products or whether there were exceptions. The reply was that the Reserve Bank had been given the right to reimburse the deposit before the lapse of six months solely for administrative reasons, namely to permit repayments to importers at weekly or bi-weekly intervals. In practice, the retention period was never shorter than five and a half months. One member of the Committee wished to know the criteria used to exempt products from the deposit scheme. The South African representative replied that goods imported for re-export or used in export commodities were exempted so as to avoid any adverse impact of the scheme on export performance. Certain capital goods were exempted for development reasons. Exemptions had also been granted for certain medical supplies to take into account public health considerations.

16. In response to questions regarding the effects of the scheme on domestic liquidity and foreign import financing, the representative of South Africa said that the deposits made since the introduction of the scheme on 2 August 1976 until 31 October 1976 amounted to R 40 million. There were no statistics available indicating the proportion of deposits financed from abroad. Several members of the Committee expressed their concern that the scheme might lead to an upsurge in liquidity when the deposits were reimbursed and they asked what policy measure the South African Government intended to take to counteract the adverse liquidity impact of the scheme's termination. The South African representative replied that his Government had so far no specific plans to this effect. Presumably restrictive monetary measures, such as increases in the bank's liquid asset requirements, would be taken. The extent to which such counter-measures were necessary depended on the overall situation of the economy.

17. One member of the Committee wanted to know the circumstances under which the deposit scheme would be terminated. The South African representative replied that it was not possible to give a precise, quantitative answer to this question. The decision to terminate the scheme would depend mainly on the prevailing trends in the economy and not on the attainment of specific policy targets. Satisfactory trends as to the current account, domestic liquidity and the foreign reserves would be the main considerations.

Conclusions

18. The Committee examined the temporary Import Deposit Scheme introduced by South Africa on 2 August 1976. The Committee reiterated its view that adjustment of balance-of-payments disequilibria through trade measures should be avoided, especially in times when there was danger of chain reactions.

19. The Committee noted that the deposit scheme was non-discriminatory and had been introduced as a short-term measure for balance-of-payments reasons, mainly to further reduce domestic liquidity and to contain the increase in speculative imports. It further noted that the South African Government had also taken domestic fiscal and monetary measures to restore equilibrium. The import deposit was in addition to the system of quantitative restrictions maintained by South Africa.

20. The Committee welcomed the statement by the representative of South Africa that it was his authorities' intention to terminate the Import Deposit Scheme after six months' operation namely, on 2 February 1977 and that no further trade restrictive measures were contemplated at the present time. The Committee noting that the Deposit Scheme had no termination date expressed the hope that the South African authorities would terminate the deposit in the very near future.

21. The Committee agreed that South Africa's Import Deposit Scheme, applied on a temporary basis, was not more restrictive than an application of the provisions of Article XII of the General Agreement. Noting that South Africa was not invoking the provisions of Article XII, the Committee agreed that this conclusion was without prejudice to the rights and obligations of contracting parties under the General Agreement.

ANNEX

Opening Statement by the Representative of South Africa

For many years it has been this Committee's task to conduct annual or bi-annual consultations with contracting parties invoking the provisions of Article XII or Article XVIII of the General Agreement concerning restrictions applied by them to safeguard their external financial positions.

Despite the fact that South Africa has not invoked the provisions of either of the aforementioned articles, my delegation today finds itself in a position where it must consult with the Committee about the temporary import deposit scheme introduced by South Africa on 2 August 1976.

The situation is unusual. It will be recalled, in this connexion, that similar schemes applied by countries not invoking the above-mentioned Articles were in the past dealt with in special working parties.

There is nothing novel about South Africa's import deposit scheme. Details were circulated to the contracting parties in document L/4386. The scheme is similar in most respects to schemes introduced by other contracting parties in previous years. Some of these schemes are still in operation today. Our scheme, in particular, is an integral part of a series of monetary and fiscal measures which were progressively made more restrictive since the second half of 1975. The intention was to arrest an untenable decline in South Africa's total net gold and foreign exchange reserves.

Basically, the scheme amounts to the payment of a 20 per cent deposit of the free-on-board price of imports, except those which are specifically exempted. The deposit is payable when the goods are cleared through customs and the amounts collected are transferred to the South African Reserve Bank. The latter will repay the deposits, without interest, to the importers not later than six months after the date of payment to the Controller of Customs and Excise. In view of the restrictive domestic monetary policy, exchange control authority was granted to all importers to borrow funds abroad to finance the compulsory deposits.

In deciding on the level of the import deposit, the South African authorities considered various percentages up to a maximum of 50 per cent. In the final analysis, however, it was decided to keep the level of the import deposit as well as the extent of the exemptions that had, inevitably, to be made, as low as possible. It was felt that such an approach would yield the most effective results, would have the least harmful effects on South Africa's trading partners, and would

be the most appropriate in the light of other policy measures employed in the domestic economy. It would, furthermore, exclude the possibility of discrimination between the products of the various supplier countries.

Separate import figures for the goods exempted from the import deposit requirement are not readily available. But it is estimated, on the basis of the import figures for 1975, that the exemptions will apply to between 35 and 40 per cent of South Africa's total imports.

The economic developments which gave rise to the scheme were outlined in detail in our basic document. This was circulated under number L/4386. I feel, therefore, that it would suffice if I merely summarized the reasons why the South African authorities found it necessary to introduce the scheme:

(a) Contrary to earlier predictions, the 1973-75 world-wide recession was the longest and deepest recession since the great depression of the 1930's. South Africa's initial reaction to the adverse development in the country's balance of payments as a result of the recession in the economies of its major trading partners was to raise short-term foreign loans to finance the widening gap. As it became evident that the recession would be deeper and of longer duration than initially expected, and that a recovery in commodity prices and therefore in South Africa's exports and terms of trade would be delayed until well into 1976, my authorities switched the emphasis in their economic policy to more restrictive monetary and fiscal measures. This change in emphasis was adopted despite a sharp decline in the real rate of growth in the domestic economy.

(b) The sharp decline in the price of gold after August 1975 substantially reduced South Africa's foreign earnings from the sale of gold. At this juncture, the Rand was devalued by 17.9 per cent and various exchange control measures were adjusted to encourage the inflow of foreign capital into the country.

(c) Substantial increases occurred in central government expenditure during the last half of 1975 and the first half of 1976. The expansionary effects on the economy resulted in increased imports. A severely restrictive budget was therefore introduced for the current fiscal year.

(d) Large capital outlays by certain public corporations on infra-structural projects which were, in some cases, commenced a few years earlier, contributed to excessive spending by the public sector as a whole.

(e) New expectations in the first half of 1976 of either a further devaluation of the Rand or the intensification of quantitative import controls, or both, not only led to an accumulation of inventories but also to the development of new unfavourable leads and lags in foreign payments and receipts.

(f) Recently, i.e. since the second quarter of 1976, a decline occurred in the net inflow of foreign capital.

The import deposit scheme should not be seen in isolation. On the contrary, it is only part of a package of measures designed to arrest South Africa's rapidly deteriorating balance-of-payments position. We believe that the fiscal and monetary measures introduced since 1975, together with a very conservative budget for the financial year 1976/77, will attain the desired objectives. It was necessary to introduce the temporary import deposit scheme to strengthen these measures and to expedite expected developments in the South African economy which will ultimately improve the balance-of-payments situation. These measures are explained in detail in the documentation before the Committee and my delegation is ready to elaborate on any of the measures, should members of the Committee so wish.

The import deposit scheme is temporary. For this reason, no date has been set for its termination. In fact, Mr. Chairman, when the imposition of the scheme was considered in June/July of this year, it was felt that it would not be necessary to maintain it for longer than six months. We are still optimistic that this hypothetical time-limit will be realized. Unfortunately, I am not in a position to give an undertaking to this effect. But I can assure you that the measures will under no circumstances be retained longer than necessary. They will be abolished as soon as the balance-of-payments position will so permit.

Mr. Chairman, we are convinced, that the developments outlined in our basic document provide ample justification for the action taken to safeguard South Africa's balance of payments. With the deficit on current account assuming dimensions which, in the second quarter of 1976, clearly were untenable for a country in South Africa's stage of economic development, further action could not be delayed.

Various options were open and were considered. A further devaluation of the Rand was ruled out because the 17.9 per cent devaluation of 22 September 1975 had not had the desired effect on the economy, particularly in stimulating exports. A further possibility was to invoke the provisions of Article XII and to tighten remaining import restrictions. However, this also was ruled out because it was felt that measures of a temporary nature were called for and that it would not be in the interest of South Africa's trading partners to impose additional quantitative restrictions.

It is for these reasons that the South African Government introduced a temporary import deposit scheme which, it is convinced, will have the least disruptive effect on international trade. We believe, therefore, that the scheme is necessary, and not unduly restrictive on trade.