GENERAL AGREEMENT

ON TARIFFS AND TRADE

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Committee on Balance-of-Payments Purposes

1993 CONSULTATION WITH THE REPUBLIC OF SOUTH AFRICA

Basic Document for the consultation[1]

Brief History

1. On 1 September 1985 South Africa had to introduce a temporary standstill in the repayment of certain categories of foreign debt, mainly short-term bank debt. The liquidity problem (in the form of short-term capital outflow) resulting from the unilateral and adverse actions by certain foreign banks, necessitated a range of measures to protect the country's foreign reserves and, in general, the balance of payments.

2. With effect of 23 September 1985 South Africa introduced a surcharge of 10 per cent on all imported goods that were not bound in terms of GATT. In South Africa's communication to GATT the reason was clearly stated, namely "...to forestall the imminent threat of a serious decline in South Africa's monetary reserves" . This step represented the reintroduction of a measure that had been introduced and repealed twice during the previous eight years (30/3/1977 - 27/3/1980 and 11/2/1982 - 29/11/1983; see Table 1).

Table 1
Summarized history of import surcharge

Date	Nature of Goods	Surcharge Rate	Reference
30 March 1977	All imported goods	15%	Budget Speech
30 March 1978	All imported goods	12.5%	Budget Speech
29 March 1979	All imported goods	7.5%	Government Gazette (GG no. 6372)
27 March 1980		Abolished	GG 6904
11 February 1982	All imported goods	10%	Budget Speech
26 November 1982	All imported goods	7.5%	GG 8459
25 February 1983	All imported goods	5%	GG8561
29 November 1983		Abolished	GG 8992
23 September 1985	All imported goods not bound under GATT	10%	GG9948

[1]Material provided by the authorities of South Africa.

Developments since introduction

3. Subsequently a number of adjustments were made, the nature of which is presented in Table 2.

Table 2
Differential import surcharge : August 1988 and beyond

	15 August 1988 to 15 March 1990 GG 11464	15 March 1990 to 21 March 1991 GG 12346	21 March 1991 to date GG 13988	Revenue contribution by different components in 1992/93
"Luxury" goods [1]	60%	40%	40%	11.2%
"White" goods [2]	20%	15%	15%	29.3%
Capital goods	15%	10%	5%	59.5%
Intermediary goods	10%	7½	5%	59.5%

1 Eg. video cassette recorders and cameras
2 Eg. consumer goods such as refrigerators and stoves

The most important changes since the introduction on 23 September 1985 were:

(a) Certain imported goods bound under GATT became subject to import surcharge as from 15 August 1988.

(b) The introduction of differentiated rates to approximate a balance between the balance-of-payments effect and the necessity in production of imports. On this basis four basic categories, each with a different general rate, was introduced. Rates differ within each category as well.

(c) As part of agreements with certain countries that lifted trade sanctions against South Africa, surcharge was abolished on a country basis in respect of Hungary (1990), Poland (1991), Czechoslovakia and Romania (1992).

4. The South African Government has committed itself to phasing out the import surcharge. Table 2 indicates the progress in this regard. The rates have already been reduced to the following levels:

- " luxury" goods: 40 per cent
- " white" goods: 15 per cent
- capital goods: 5 per cent
- intermediary goods: 5 per cent

5. The current interruption in the process of phasing-out of the surcharge is basically due to balance-of-payments considerations. To put this in proper perspective, it is necessary to give an exposition of recent and envisaged balance-of-payments developments.

Balance-of-Payments and foreign reserves position

6. Table 3 gives an indication of the annual surplus of the current account of the balance of payments for each year since 1985, together with the annual outflow of foreign capital - the combined

result of debt, within and outside of the debt standstill arrangements, or so-called "net", and other capital movements - as well as the year-end level of gross gold and other foreign exchange reserves. Table 4 depicts the movement in reserves on a monthly basis since January 1992, indicating the recent drop in reserves.

Table 3
Selected balance-of-payments statistics, 1985-1992
(R billion)

	1985	1986	1987	1988	1989	1990	1991	1992
Current Account Surplus	5,1	6,1	6,0	2,7	3,1	5,8	7,4	4,3
Capital Outflow								
Long-term	-0,5	-3.2	-1,7	-1,2	-1,2	-1,9	-2,7	-1,5
Short-term	-7,8	-1,9	-1,2	-5,0	-3,1	-0,9	-3,3	-5,0
Total	-8,3	-5,1	-2,9	-6,2	-4,3	-2,8	-6,0	-6,5
Gross gold and other foreign reserves (as at 31 December)	5,9	5,7	7,9	6,7	6,9	7,2	9,8	11,2

Table 4
Gross gold and other foreign reserves
(R billion)

		Changes during period	Amount as at end of period
1992	January	-	11,0
	February	0,9	11,9
	March	-0,4	11,6
	April	-0,3	11,2
	May	0,6	11,9
	June	-0,1	11,8
	July	0,9	12,7
	August	0,5	13,2
	September	-0,7	12,5
	October	0,2	12,7
	November	-0,4	12,3
	December	-1,1	11,2
1993	January	-0,4	10,8
	February	-0,1	10,7
	March	-0,8	9,5

7. There are a number of reasons for the recent adverse trend in foreign reserves. On the current account of the balance of payments, the surplus declined from a record high of R7,4 billion in 1991 to R4,3 billion in 1992. This decline was mainly the result of the effect of the drought, although lower gold exports - due to lower prices and volumes - and smaller service receipts also contributed to the smaller surplus on current account. Preliminary figures for the first quarter of 1993 indicate that the surplus deteriorated substantially further. Contrary to normal patterns, this weakening in the current account occurred at a time when the economic performance actually worsened, thus raising concern about a much earlier-than-usual balance-of-payments constraint during the next economic upswing, especially if the recent unfavourable developments on the capital account should persist. It has to be emphasized that South Africa's debt repayment obligations and the need to build-up a moderate level of foreign reserves, require that a significant current account surplus (of at least R5 billion) be maintained. This is therefore regarded as an average reference figure for assessing balance-of-payments difficulties as far as the current account is concerned.

8. The suspension of the process of political negotiations and the Boipatong event in June 1992 sparked off a dramatic weakening in the capital account of the balance of payments. In the first quarter of 1992 a small net outflow of capital not related to reserves was recorded. This was followed by much higher outflows in especially the second and fourth quarters, with the total outflow for the year amounting to R6,5 billion. Of this amount, R5,3 billion took the form of short-term capital (including errors and omissions). This large outflow can be attributed mainly to unfavourable leads and lags in foreign payments and receipts, the outflow of capital in terms of forward cover transactions following the strengthening of the US-dollar and year-end adjustments in foreign organizations' balance sheets. This trend was continued in the first quarter of 1993.

9. As a consequence of the decline in the current-account surplus and the considerable weakening of the capital account of the balance of payments, the country's net gold and foreign reserves dropped by R3,7 billion during the second half of 1992. This represents a clear turn-about, since reserves had increased by R6,1 billion from June 1989 to June 1992. The situation deteriorated further during the first quarter of 1993, with the Reserve Bank's net reserves falling by a further R2,9 billion. The Bank's gross reserves also fell by R1,6 billion during the first quarter, with the drop of R0,8 billion in March reducing the level to R7,5 billion, or 35 per cent below the August 1992 figure. In April an increase of R0,6 billion was recorded.

10. At the end of February 1993 the country's gross gold and foreign reserves amounted to R10,7 billion, compared to R13,2 billion at the end of August 1992. Over this period the import cover fell from an equivalence of 9 week's import of goods and services, to less than seven weeks.

11. The need of caution regarding the balance of payments stems from three factors. Firstly, 1993 is the last year of South Africa's Third Interim Foreign Debt Arrangements with its foreign creditor banks. In terms of this arrangement an estimated R1,3 billion of foreign debt will be repaid during 1993. Together with debt repayment outside the "net", the total net capital outflow can amount to R15 billion. Although clarity should be obtained soon on the outcome of the current negotiations regarding the repayment of the estimated January 1994 foreign debt figure of about R5 billion in the in the "net", repayment in the absence of any significant capital inflow will continue to represent a particular balance-of-payments constraint. Secondly, as might be expected, the process of political transition and constitutional negotiations entails a degree of instability which, together with the occurrence of violence, creates uncertainty that enhances the risk of capital outflows and delays the normalization of the country's international financial relations, which is necessary for foreign loans. Thirdly, an

economic upswing that leads to an early rise in imports, will add to the vulnerability of the balance of payments, even if the current account remains in considerable surplus.

Future prospects and conditions for full removal of import surcharge

12. Following Government's publication of a discussion document on economic restructuring goals and policy implications (under the title "Normative Economic Model"), a formal process has started of consensus-seeking regarding an appropriate strategy of economic restructuring. Already there are wide recognition and support of the urgency for improving the country's international competitiveness. International experience suggests that the judicious rationalization of and reduction in the import tariff structure should be an important instrument in this respect. Such a strategy has no room for a discriminatory and distortionary surcharge on imports, provided the phasing-out is synchronized with and justified by balance-of-payments developments.

13. Assuming a relatively normal crop, latest projections for 1993 point to an economic growth rate of, at best, 0.5 per cent in real terms. This will be accompanied by an estimated current account surplus that will be less than the projected long-term capital outflow. Under these circumstances there would be no room for any relaxation of the import surcharge, less so for as long as or insofar as sanctions regarding foreign loans to and investment in South Africa remain in force in certain countries and South Africa's access to IMF facilities has not been resolved beyond any doubt. On the contrary, much skill will actually be required to avoid further restrictive policy measures during the course of 1993 to safeguard the balance of payments.

14. The earliest next opportunity for a full reappraisal of the prospects for an early reduction or even total phasing-out of the surcharge would probably not be before the middle of 1994. By then there may be much greater clarity on the timing and strength of the country's next economic upswing (to be substantially influenced by the extent of economic recovery in OECD countries), the precise arrangements with foreign creditor banks, the process of political development and the nature of economic restructuring. Should these developments hold the prospect of an early melioration of the balance-of-payments constraint, in support of a sustainable economic growth phase of some significance, the abolition of the surcharge may become feasible. In quantitative terms, an economic growth rate of between 1 and 2 per cent for 1994, coupled with a current account surplus of at least R5 billion, are regarded as prudent reference figures, i.e. assuming that no new foreign loans of any significant magnitude become available.

15. For the above reasons, it is, for the time being, regarded as essential for South Africa to continue levying an import surcharge.