

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

BOP/R/59
26 January 1972

Limited Distribution

REPORT ON THE CONSULTATION WITH SOUTH AFRICA UNDER ARTICLE XII:4(a)

Submitted by the Committee on Balance-of-Payments Restrictions

1. By letter dated 26 November 1971, the Government of South Africa informed the CONTRACTING PARTIES of its intention to invoke Article XII of GATT and to intensify its remaining import restrictions as a means of safeguarding the country's external financial position and balance of payments. The South African Government indicated that it would be prepared to consult with the CONTRACTING PARTIES as necessary.
2. In accordance with the established procedures (see BISD, Ninth Supplement, pages 18 and 19) and in the light of discussions on this matter at the Council on 12 January (C/M/75), the Committee has consulted with South Africa under the provisions of paragraph 4(a) of Article XII. The consultation took place on 17, 18 and 19 January 1972. The Committee had before it a basic document supplied by the South African authorities (BOP/121) and material supplied by the International Monetary Fund, including two papers on economic developments in South Africa dated 28 June 1971 and 21 December 1971.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of paragraph 2 of Article XV, the International Monetary Fund was invited to consult with the CONTRACTING PARTIES in connexion with the action taken by South Africa. The representative of the Fund participated in the consultation and on the invitation of the Committee made a statement as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of July 16, 1971 taken at the conclusion of its most recent Article XIV consultation with South Africa, as well as to the paper on South Africa - Recent Economic Developments dated June 28, 1971 and the Supplementary Background Material dated December 22, 1971.

"Owing to the increasing pressure of domestic demand, the value of imports rose by 14 per cent in 1969 and by 20 per cent in 1970. The value of total merchandise exports showed a small decline in both years due mainly to poor crops in 1969 and to weak demand for wool and diamonds in 1970. The value of "net gold output" was moderately higher in each of these two years than in 1968. The current account of the balance of payments which had shown a surplus in 1968 registered deficits of \$367 million in 1969 and of \$1,103 million in 1970. The impact of these deficits on reserves, however, was moderated by a substantial net capital inflow.

"During the course of 1971, imports have continued to rise rapidly partly due to anticipatory purchases of foreign goods which probably to some extent reflected uncertainties in the international currency market after August 15, 1971 and expectations of tightening of import controls. The pressure of demand, although high in the first half of the year, has eased in recent months and the growth of output has moderated substantially. Exports have continued to decline in the course of 1971 despite some increase in "net gold output". Thus, the current account deficit has continued to widen.

"After August 16, 1971 the rand was pegged to the US dollar, thus providing some net effective devaluation to South Africa. But the international monetary situation since August 15, has given rise to adverse leads and lags and to a reduction in the net inflow of capital. Official reserves of South Africa, which stood at \$1,011 million at the end of 1970, fell further to \$666 million by the end of November 1971. At this level, South Africa's official reserves were equivalent to about two months' imports.

"The South African authorities believed that under the circumstances prevailing in late November 1971 a further general intensification of contractionary monetary and fiscal policies was inappropriate as it could have caused severe unemployment, and they therefore decided to provide additional safeguards for the balance of payments in the form of import restrictions.

"The South African authorities devalued the rand from R 25 per ounce of fine gold to R 28.5 per ounce of fine gold on December 21, 1971. This move should cause a substantial effective devaluation of the South African rand vis-à-vis its main trading partners and thus strengthen the balance of payments. It is realized that it may take some time before the turnaround in the current account materializes. However, the general realignment of currencies offers the prospect of an early positive effect on capital inflows. The Fund hopes that a strengthening balance of payments will soon enable the South African authorities to remove the restrictions recently applied and to resume the process of further liberalization."

Opening statement by the representative of South Africa

4. In his opening statement, the full text of which is reproduced in Annex E to this report, the representative of South Africa described the circumstances which had led to his Government's decision to impose new restrictions last November and, in that connexion, to reinvoke the provisions of Article XII. He drew attention to the persistent and sizable decline in the South African monetary reserves since the beginning of 1970. The deterioration in the current account had mainly reflected the effects of inflationary tendencies against which various fiscal and monetary measures had indeed been taken. Despite the decline in reserves, the liberal import policy introduced early in 1970 had been maintained. The current

account deficit mainly reflected a rising demand for imports, as well as some decline in exports. Contrary to the trend of previous years in which the current account deficit was partly offset by an inflow of capital, the rate of capital inflow declined substantially during the second half of 1971. Generally, South Africa's balance of payments had been in deficit consistently since the second quarter of 1969. In the view of the South African authorities, the basic reason was the excessive private consumption expenditure. Efforts had therefore been made to curb this tendency by the application of disinflationary monetary, fiscal and other measures. These corrective measures would normally have been sufficiently effective to achieve the desired purposes had it not been for the unexpected developments in international financial relations since mid-August 1971.

5. Developments in the international monetary arrangements, since May 1971, had had the effect of aggravating South Africa's difficulties by way of inducing unfavourable leads and lags in international payments as well as speculative imports. The combined effects of the growth of imports, leads and lags affecting reserves, and the declining confidence in the South African currency had compelled the South African Government to take immediate action to safeguard the balance of payments.

6. Since the intensification of restrictions in November 1971, another measure had been taken in December in the form of a devaluation by 12.28 per cent of the rand, mainly aimed at restoring external equilibrium in the balance of payments on a long-term basis.

7. In conclusion, the representative of South Africa stressed the very serious nature of South Africa's present balance-of-payments difficulties and expressed the hope that the intensification of import restrictions, together with the devaluation of the rand on 21 December 1971, would steadily improve South Africa's current account balance although this might take some time. The South African Government intended to keep under review the reserve position and the possibility of removing the newly imposed import restrictions. He assured the Committee that the import restrictions would be relaxed and removed as soon as it became clear that a definite improvement in the balance of payments and the reserve position had set in.

Balance-of-payments position and prospects

8. On the basis of the written material and statements mentioned above as well as data on the South African balance of payments shown in Annex III to this report, the Committee examined with the representative of South Africa the factual evolution of the various sectors of South Africa's balance of payments, as well as the underlying causes of the movements. In the course of the discussion the South African representative stated that his Government considered the restrictions to be justified under the provisions of both sub-paragraph (i) and (ii) of paragraph 2(a) of Article XII.

9. Some members of the Committee observed that the payment leads and lags which, according to the South African delegation, had served, at least in the short run, to aggravate the balance-of-payments difficulties and the speculative purchases and import stock-piling in anticipation of import restrictions were both presumably non-recurrent factors. They expressed the view that their effects should not be given undue weight in the formulation of import policies for the medium or longer term. Inasmuch as they had been taken as significant factors justifying the imposition of import restrictions in 1971, the disappearance of these phenomena following the re-establishment of currency stability should ipso facto strengthen the case for liberalization.

10. Members of the Committee invited comments from the South African delegation on the estimated current account and balance-of-payments prospects for the current year, taking into account the estimated effects of the new quantitative restrictions on imports and the direct and indirect influences of the changes in exchange rates on the various sectors of the balance of payments. The representative of South Africa informed the Committee that between March 1970 and June 1971 total imports had risen consistently, from an annual rate of R 2.2 billion to R 3.2 billion, and that the restrictions introduced in November 1971 were aimed at achieving a reduction of total imports in 1972 by some R 500 million from the 1971 level of nearly R 3,000 million to a level of approximately R 2,500 million. Owing to various uncertainties and many of the flexible elements in the import control system, there could be no assurance, however, that this target would necessarily be achieved. On the basis of annual rates for the third quarter of 1971, the fulfilment of this aim would still leave a current account deficit of more than R 300 million.

11. As regards the devaluation of the rand, undertaken in December 1971, the representative of South Africa expressed the view that, while this could be expected to contribute to South Africa's external equilibrium in the long run, its immediate or short-term impacts on the South African balance of payments were not necessarily positive. Domestic prices of many essential supplies of foreign origin were naturally raised, with obvious effects on production costs and the pressures of inflation. Possibilities of taking advantage of the changed currency values to expand exports were limited in the case of South Africa, whose exports consisted mostly of agricultural products and raw or semi-processed products of the mining industry. Agricultural production, particularly because of climatic and soil conditions, could hardly be increased at will; and increased mineral exports could not be achieved in the short term because of the non-availability of adequate transport and harbour facilities as well as the fact that the prices of mineral products were generally determined by factors of international demand and competition. South Africa's exports of manufactured goods were relatively low and had been declining. These exports could not be increased until capacity in the industrial sector had been expanded. Furthermore, the devaluation implied increased burdens for South Africa in terms of local currency and export proceeds on account of the heavy existing foreign currency obligations relating to service expenditures such as those on shipping and insurance and debt servicing.

12. Members of the Committee expressed the view that the South African overall trade and financial situation should benefit considerably from the recent settlement in the international monetary field and the ending of the recent uncertainties. Moreover, they drew attention to the magnitude of total effective devaluation of the rand in relation to the currencies of other important trading nations that had resulted from the general realignment, and expressed the view that this could not but have a considerable strengthening effect on South Africa's competitive position, especially in exports and should also restrain South Africa's recent excessive import demand.

13. Members of the Committee noted that South Africa's balance of payments over the years seemed to display a rather volatile character, susceptible to wide fluctuations rather than any tendency of gradual deterioration; the balance-of-payments table contained in Annex III, moreover, showed that a gradual improvement in the current account had occurred in each of the first three quarters of 1971. This would seem to point to the inappropriateness of the new trade restrictions as the principal remedy. In addition, the currency realignment seemed likely to encourage the inflow of capital into South Africa. Note was also taken of the admission by the South African representative that the devaluation would benefit South Africa with regard to the proceeds from her gold sales abroad.

14. Members of the Committee, other than South Africa, generally felt that whatever the merits might have been with regard to the introduction of the additional trade restrictions in November 1971, these considerations had since then been largely invalidated by the exchange rates realignment in December. The devaluation of the rand had been adopted as a measure to redress a fundamental disequilibrium. The Fund had pointed out that devaluation of the rand should result in a substantial effective devaluation which should strengthen South Africa's balance of payments and, on the basis of this assumption had expressed the hope that these would soon enable South Africa to remove the recently applied import restrictions and to resume the process of further liberalization. Some members not only shared this hope, but moreover, urged South Africa to do so promptly.

15. Members of the Committee welcomed the South African representative's statement that his Government firmly intended to relax and eventually to remove the import restrictions. Some members pointed out, however, that it would be over-cautious on the part of South Africa if it considered, as the South African representative had indicated in his opening statement, that the restrictions would not be relaxed unless and until a definite improvement in the current account of the balance of payments and reserves position had clearly set in. The South African representative assured the Committee that his Government had no desire to retain the restrictions longer than necessary and was therefore keeping the balance-of-payments position under constant review and that the decision to apply new restrictions was totally unrelated to the Article XXVIII negotiations which South Africa had initiated and were not intended to afford any protection to domestic industry.

Alternative measures to restore equilibrium

16. For this part of the discussion, the South African delegation supplied the Committee with a written statement containing more up-to-date and detailed information and comments on the fiscal, monetary and other measures taken by the South African authorities in the past few years to restore equilibrium. This statement is reproduced in Annex II to the present report. Briefly, the monetary measures included: successive increases in bank rates, interest rates on long-term government stock and deposit and lending rates of banks and building societies; increases in the minimum liquidity ratios for commercial banks and other financial institutions; and the setting of ceilings for banking institutions' discounts and advances and on investments in the private sector. A deflationary fiscal policy had been initiated in 1966, involving increased indirect taxes as well as higher direct taxation on individuals and companies. In the 1969/70 budget South Africa's tax structure had been reformed, a selective sales duty had been imposed and personal income taxes on individuals had been reduced. A surcharge on normal income tax introduced in the 1969/70 budget had been increased in the 1971/72 budget. Indirect taxes (sales and excise duties) had been increased on several occasions. A loan levy on the income tax had been increased and dividend receipts were specially taxed. The Government had endeavoured to limit its own expenditure to the fullest extent possible. Besides credit restriction direct curbs had been placed on the demand for goods and services and savings had been promoted. The Government had attempted to keep price increases within reasonable limits through tightening hire-purchase conditions, price and rent controls, etc. Measures had also been taken to increase the production of goods and services by means of investment allowances, training facilities, immigration policies, decentralization of industries and the creation of a Productivity Advisory Council and of an Export Advisory Council.

17. In reply to questions, the representative of South Africa stated that his Government was aware of the inflationary effects of the devaluation and of the intensification of import restrictions. While domestic fiscal and monetary restraints had, thus far, been relied upon for the reduction of total demand, the use of additional measures of this nature had been found unfeasible last November in view of the low rate of growth and of investment and the general business pessimism. He added that direct price controls, to be effective, would have to cover an extremely wide range of commodities. They had not been resorted to in South Africa because they were considered to be both administratively difficult to introduce and ineffective in anything but the very short run. Price control imposed on a few selected commodities had, however, been extended to a number of products where exploitation blamed on devaluation had been proved. It was believed that the high cost of money would be a more suitable instrument to limit stock-piling and price increases. It would not be legally possible to freeze wages and salaries in South Africa owing to the existence of a large number of labour contracts containing provisions for the automatic revision of wages at regular intervals taking into account the rise in prices. Greater reliance was, in fact, placed on voluntary restraints and co-operation between the government and industry.

18. Members of the Committee, other than South Africa, referred to the continued rapid rise of South African governmental expenditures as well as rather large wage increases. They expressed the view that the South African decision with respect to internal economic policies appeared to shift a disproportionate share of the burden of adjustment on to South Africa's trading partners.

19. As regards alternative measures with a trade effect that might have been used instead of the intensified quantitative restrictions, the representative of South Africa explained that the use of an import deposit scheme had been considered but rejected because of the high cost both for imports and for the administration. Given the credit control measures and the high interest rates prevailing on the South African financial market, an import deposit scheme would have inevitably raised the prices of imported goods. An import surcharge was also considered likely to have a severe inflationary effect and would cause complications notably in South Africa's relations with her Customs Union partners. Unilateral devaluation was rejected due to the uncertain international monetary conditions at that time and also because the authorities were of the opinion that, with a general realignment of the currencies in sight, confidence in the rand would not have been re-established. The decision of last November to import new import restrictions had been taken only after a review of all these alternative measures.

20. The representative of South Africa added that his country's previous domestic policies had imposed a heavy burden on the producing sector of the economy. This had caused some dislocations, particularly in the manufacturing and the mining sectors, and had reduced the rate of growth of the gross national product to an unsatisfactory low level. Since about the middle of 1971 there had been a cooling down of the economy and, in dealing with the balance-of-payments difficulties, his authorities had had to avoid measures which would have jeopardized economic growth.

System and methods of restriction

21. The Committee took note of the fairly extensive information on this subject contained in the documentation before it. The opportunity was taken by members of the Committee to seek clarification from the South African delegation on points relating to the practical administration of the restrictions and to present views on various problems created for exporters in their countries by the restrictions, particularly by the intensification of November 1971. In response to various questions, the representative of South Africa stated that:

- (a) there were provisions in the import control system to enable the entry of new traders;
- (b) each import permit being valid for a variety of products, an importer had a wide choice of products to import within the limit of his allocation; there could be no danger of any permit being too small to be of practical value or uneconomic for import purposes;

- (c) the provision for waiving the cash penalty on imports effected beyond the reduced permit limit had been made in order to enable special consideration to be given in special circumstances;
- (d) applications for import permits by end-users were considered individually on their merit; this system was designed to enable industrial and other users of equipment or other essential goods to make direct purchases from abroad without the intermediary of merchants;
- (e) for import control purposes, goods were classified into the three categories according to their essentiality;
- (f) it had been the established practice for the South African authorities to allocate licences in three instalments each year;
- (g) when introducing the new restrictions in November, provision had been made for the exemption of goods dispatched on or before 25 November. On the other hand, any later shipments would be entitled to entry under a 1972 permit as from 1 March. It was hoped that this provision would mitigate any hardship with which exporters in supplying countries might have been faced;
- (h) the South African authorities would be prepared to give special consideration to cases of particular difficulty, for example where goods had been subject to a firm order placed prior to the imposition of the new restrictions;
- (i) it was confirmed that the holder of a 1971 permit whose value had been halved in the context of the November measures would be allowed to import under the cancelled portion subject to the payment of a penalty;
- (j) import permits were allocated among importers on the basis of past performance in a representative period, and not on a first-come-first-served basis;
- (k) it was purely for administrative reasons that 1969 imports had been used as the basis for the issue of 1972 permits, the South African administration not yet being in possession of the 1970 trade returns.

22. The representative of South Africa stated that the South African import control system involved no discrimination among sources of supply, except for the exemptions granted to certain countries in Southern Africa, in most cases in the context of a Customs Union. With regard to the exemptions granted to countries not members of the Customs Union, some members reserved their position with respect to the relationship between this practice and the provisions of Article XIII of the General Agreement.

Effects of the restrictions

23. Commenting on the South African practice of not issuing the major portion of the import permit until a fairly late date during each licensing year, some members of the Committee expressed the view that the uncertainty it caused to exporters would seem to place an additional obstacle to trade beyond the limit permitted under Article XII. In response to this comment, the South African representative explained that since the restrictions were intended to safeguard the balance of payments, the issue of permits had to be done in the light of changes in foreign exchange receipts and disbursements. Imports of essential products had been fairly stable over the years and most of these products were in the licence-free category or in the quota categories, under which importers could confidently expect to receive their total entitlement. Consequently, the element of uncertainty was limited. In reply to a question concerning the procedure applied to the import of equipment for new industries or for the expansion of existing industries, which appeared to be particularly severe, the representative of South Africa stated that equipment for new enterprises was indeed subject to individual licensing but this was in no sense synonymous with severe restriction, licences being given freely whenever a new industrial enterprise was considered justified and desirable for the economy.

24. As regards the "severity" of the November measures, the representative of South Africa further explained that when the new restrictions were being considered in November 1971, there existed in fact R 900 million worth of unused import permits, valid for shipments up to March 1972. These in themselves amounted to approximately four months of imports and would normally be added to the new import permits issued in October for use as from 1 January 1972. However, to lessen the combined pressure of these entitlements on the balance of payments, the authorities had decided to halve the value of the old permits and postponed the validity of the new permits until 1 March. The halving of the 1971 permits represented an attempt, along with the transfer of certain products from the "free" to the quota category, to reduce existing entitlements but these measures were accompanied by various facilities having the effect of alleviating their restrictive impact; goods despatched before the cut or covered by firm orders or contracts were exempted; imports beyond the reduced permit limits were admitted subject to the payment of a penalty which was in no way prohibitive in relation to the high profit margins on imported goods. The value of permits that were thus reinstated in December 1971 alone amounted to R 120 million. Owing to the availability of ample stocks, the effects of these measures on the domestic market would hardly be felt, even if there had been no alleviating facilities such as those mentioned above.

25. The representative of the United Kingdom speaking for Hong Kong, drew attention to the serious effects which the restrictions would have particularly on the exports of Hong Kong, since they were aimed mainly at reduction of import of less essential goods and since Hong Kong's exports contained a high proportion of consumer goods which might be classed as less essential. He observed that

the restrictions also aimed at achieving maximum import substitution; in this context he suggested with particular reference to exports of clothing which in 1970 had accounted for over one third of Hong Kong's total exports to South Africa, that when the immediate balance-of-payments difficulties had been overcome, pressure could develop on the South African authorities to retain some restrictions in order to maintain protection of domestic manufacture which had thereby been enabled to expand.

* * *

On the basis of the information supplied by the International Monetary Fund and by the South African authorities, and in the light of the discussion:

- (a) the Committee, having examined South Africa's balance-of-payments situation and taking account of the combination of internal and external economic circumstances prevailing in mid-November 1971, generally agreed that this situation called for action at that time by the South African Government to redress external disequilibrium.
- (b) The Committee noted that, since the intensification of South Africa's import restrictions in November 1971, the South African authorities had devalued the rand in the context of the general realignment of currencies. While it was recognized that the beneficial effects of these developments on the current account of South Africa's balance of payments might not become immediately evident, notwithstanding South Africa's improved competitive position, an improvement in the capital account should result more quickly;
- (c) with regard to the intensified import restrictions, the Committee noted that some relaxation in respect of 1971 permits had already been introduced, but that the level of imports under 1972 permits would to a large extent depend on South Africa's decisions with regard to further permit issue to supplement the first issue of permits made at the end of 1971;
- (d) members of the Committee, other than South Africa, questioned the need to maintain the intensified import restrictions established in November 1971 which appeared to have been rendered excessive, if not redundant, by the subsequent currency realignment and the devaluation of the rand. Consequently, they urged the Government of South Africa to remove them rapidly.
- (e) The South African representative stated that, pending a decision by the South African authorities on the customary second issue of permits during April/May, it would be premature to pass judgment on the severity of the intensified restrictions and that until such time as more information was available on the evolution of South Africa's trade and balance of payments, the South African authorities would not be in a position to take a decision on the relaxation or removal of the new restrictions; and
- (f) in the circumstances, the Committee considered that the Council might wish to keep the matter under review and that the Committee should be instructed to reconvene before the middle of 1972 in order to continue the consultations.

ANNEX I

Opening Statement by the Representative of South Africa

The GATT secretariat has been provided with the background material for our consultations and I presume that the relevant paper as well as the documentation submitted by the International Monetary Fund have already been circulated and studied by the members of this Committee.

Permit me to supplement and up-date this material as far as possible. Perhaps we could start with a summary review of developments in the South African economy and South Africa's balance of payments during the past year or two.

Following upon the 1969 Article XIV consultations with the International Monetary Fund, and on the advice of the Fund itself, the South African Government informed the CONTRACTING PARTIES on 24 November 1969, that South Africa had decided to disinvoke GATT Article XII as justification for the application of its import restrictions. Immediately thereafter steps were taken by the South African Government to liberalize these import restrictions substantially. Full details of these major relaxations, which came into operation on 1 January 1970, were communicated to the CONTRACTING PARTIES at that time. Subsequently, earnest consideration was given to the further dismantling of South Africa's remaining restrictions. Satisfactory progress was achieved in this direction. I would like to invite the Committee's attention in this regard in particular to the import relaxations published in GATT document L/3563 of 18 August 1971.

Unfortunately the task of the South African Government was rendered extremely difficult by the continuing and at times sharp decline of the country's gold and foreign exchange reserves, a process which continued almost uninterruptedly since January 1970. The magnitude of this decline of the reserves was without precedent in South African history. In fact, Mr. Chairman, the gold and foreign reserves of the South African Reserve Bank declined by no less than 68 per cent from a high of R 1.175 million in April 1969 to a low of R 375 million in December last.

Inflationary pressures, which had been evident in the South African economy already prior to 1969, and which continued during that year, became more intense during 1970, but showed a definite and welcome decline during the second quarter of 1971. The economic situation in 1970 was characterized by a reasonably satisfactory rate of growth (5.1 per cent in real terms); by shortage of skilled labour, capital, certain raw materials and basic services; by sharp increases in consumption expenditure; by strong upward pressures on wages, prices and interest rates; and by successive large deficits in the current account of the balance of payments.

In order to curtail the excessive increase in private consumption expenditure, the Government announced the introduction of more stringent hire-purchase and credit restrictions in October 1970. In the case of certain durable consumer goods such

as furniture and household appliances, these restrictions had such a severe effect on sales that moderate relaxations of the intensified hire purchase restrictions had to be introduced in November 1970 and again in February 1971. At the same time the Minister of Finance announced on 10 February 1971 increases in sales duties on a wide range of goods as an additional disinflationary measure. Meanwhile credit ceilings, which had applied to certain discounts, advances and investments of banking institutions for a number of years, continued to be strictly enforced and, more recently, the South African Government took positive steps to reduce the rate of increase in public expenditure. Government departments were requested to curtail consumption expenditure as far as possible and, on a selective basis, also capital outlays.

Despite the persistent decline on the country's gold and foreign exchange reserves throughout 1970, the South African Government nonetheless regarded the level of these reserves as still adequate to enable it to maintain the liberal import control policies introduced early in 1970 and to allow a large and growing flow of imports to assist in filling the gap between domestic production and demand. The result of this policy was a decline of the excess liquidity which had prevailed in both the banking and private sectors. This, in turn, enabled the monetary authorities by the end of 1970 to influence and channel monetary and banking developments much more effectively than previously in the desired direction.

During 1970 a record deficit of R 843 million (that is, approximately \$1.2 billion) was recorded in the current account of the balance of payments. The position deteriorated further during the first quarter of 1971 when the current account deficit reached a seasonally adjusted annual rate of R 1.254 million. The second quarter saw an improvement in the rate of deficit to R 881 million while a further slight improvement was experienced during the third quarter of 1971.

The extent of this adverse balance can be largely ascribed to the trend in imports. Merchandise imports rose from R 2.148 million in 1969 to R 2.579 million in 1970. On a quarterly seasonally adjusted basis, a peak annual rate of R 2.917 million was reached in the fourth quarter of 1970. For the first quarter of 1971 the figure was unchanged at R 2.917 million but it declined to R 2.800 million in the second quarter before rising slightly in the third quarter. The buoyant demand for imports in 1970 and 1971 may be ascribed mainly to a strongly rising trend in domestic demand, coupled with fears of a possible tightening of import control and general uncertainties in the international monetary field which induced importers to build up large inventories. The moderate decline of imports in the second quarter of 1971 reflected a somewhat lower rate of increase in total domestic demand.

Merchandise exports declined from R 1.513 million in 1968 to R 1.486 million in 1969 and to R 1.420 million in 1970. The seasonally adjusted annual level of exports reached a low of R 1.300 million in the first quarter of 1971, rising to R 1.575 million in the second quarter and again declining in the third quarter to R 1.533 million. The downward tendency in exports in 1970 and up to the end of the first quarter of 1971 can be ascribed mainly to a decline in world prices and, consequently, in South African export earnings from diamonds, wool and fresh and

preserved fruits, while the increase in exports in the second quarter of 1971 was due mainly to increased foreign sales of maize and diamonds.

Promotion of exports is an important objective of Government economic policy, and the Government is concerned at the sluggishness and lack of vitality in this component of the balance of payments. Early in 1971 a reconstituted Export Advisory Council was established in an attempt to allow the private sector to play a more active and effective rôle in the formulation of Government policies relating to the promotion of exports. Moreover, in August 1971, the Government appointed a Commission of Enquiry to investigate all aspects of South Africa's export trade. This Commission is due to submit its first interim report at an early date. Vigorous efforts are being made to encourage manufacturers and other producers to export a larger proportion of their output on a continuous basis.

The net value of gold output declined from R 847 million in 1969 to R 837 million in 1970 before rising on a seasonally adjusted annual basis to R 848 million in the first quarter of 1971, R 902 million in the second quarter and R 929 million in the third quarter. These increases in gold production earnings were entirely due to the higher gold price obtained on the free market.

Other items in the current account were comparatively stable throughout 1970/71.

Turning to the capital account, members of the Committee are no doubt aware of the fact that the adverse balance on current account was partly offset by a record inflow of capital, which amounted to R 557 million in 1970 and reached an annual rate of R 689 million during the first three quarters of 1971. It should be noted, however, that this rate of inflow declined from R 217 million in the first quarter of 1971 to only R 117 million in the third quarter.

Due to exceptionally high imports it soon became clear, however, that even the record capital inflows were insufficient to prevent a sharp decline in South Africa's gold and foreign exchange reserves. The total gold and foreign reserves stood at a month-end peak of R 1.235 million in March 1969. By the time South Africa had decided to disinvoke Article XII towards the end of 1969, they were down to about R 1.070 million, and by the end of October 1971, had fallen to a level of R 601 million which, under the conditions prevailing in South Africa, must be regarded as a dangerously low level. It is barely enough to pay for approximately two months' imports at the then existing annual rate. After the end of October, the South African Reserve Bank's share of these reserves declined by a further R 85 million from R 460 million to R 375 million on 17 December but, following on the devaluation of the Rand, these reserves rose to R 495 million on 7 January 1972. However, of the increase of R 120 million between the latter two dates some R 55 million was accounted for by valuation adjustments following the parity change of the Rand, and R 28 million by South Africa's share of the additional Special Drawing Rights allocated by the International Monetary Fund on 1 January 1972.

South Africa's balance of payments has been in deficit every single quarter since the second quarter of 1969. The basic reason for this phenomenon has been the excessive domestic demand for consumer goods, capital goods and services. The authorities have endeavoured to curb this tendency by applying suitable monetary, fiscal and other measures. But the strength of domestic demand has proved to be much greater than was originally expected, and the corrective measures introduced were thus not as effective within a short period as had been hoped for.

There is nevertheless every reason to believe that, under normal conditions, it would have been possible for the South African Government to have solved the balance-of-payments problem by normal monetary and fiscal means without having to seek recourse to intensified import controls. However, international monetary and trade developments since the middle of 1971, over which South Africa had no control, had such an adverse effect on this slow recovery process that the South African authorities had no alternative but to intensify its import restrictions in an attempt to avert the serious and imminent threat to its exchange reserves. In this connexion I need only point out that uncertainties which encourage early imports and cause leads or early payments for such imports while at the same time discouraging exports and creating lags in the settlement of foreign indebtedness for exports can have a potentially disastrous short-term effect on the balance of payments of a country such as South Africa. This is, in fact, what happened in South Africa after 15 August 1971. Our foreign trade is such an important component of our national accounts that with an open economy and foreign trade amounting to some R 4.5 billion, it soon became evident that we would be caught in a whirlpool of growing imports, adverse leads and lags resulting in lower reserves and loss of confidence in the Rand, all pointing to the need for immediate action to safeguard the balance of payments.

In the light of these circumstances and after fully considering various corrective measures, the Government decided that the intensification of its import restrictions would be the least disruptive and quickest way of protecting the speedily worsening balance of payments.

Another important reason why South Africa was unable to solve its balance-of-payments problem by measures other than import control, was the fact that towards the end of 1971, the growth rate of the economy in real terms had declined to 4 per cent, surplus capacity had developed in certain industries while the pressure on labour and other factors of production had declined. There was, accordingly, a real danger of recessionary conditions developing in the economy if more severe fiscal and monetary measures had to be adopted to solve the balance-of-payments crisis.

In short, I can assure you that the South African Government was at all times fully aware of the deterioration in the balance of payments and took timeous and what it regarded as effective monetary and fiscal steps to avert a serious external financial crisis. Under normal conditions these steps would almost certainly have succeeded albeit taking some time, had it not been for the unexpected uncertainties in the international monetary and trade fields which came at a most unfortunate time for South Africa.

Following on the intensification of South Africa's import restrictions, a further supporting measure was decided upon on 21 December 1971, when the Rand was devalued by 12.28 per cent. In deciding to devalue the Rand by more than the United States dollar, the South African Government was, to a large extent, motivated by the need to bring about a long-term improvement in the balance of payments on current as well as on capital account.

In order to guard against the possibility that further inflationary pressures may be unleashed by the intensification of import controls and by devaluation, the Government has decided that the existing fiscal and monetary measures will for the time being be maintained. Price control is also being used to curb unjustifiable price increases.

In conclusion, I feel that I should stress again the very serious nature of the balance-of-payments problem with which South Africa was confronted at the time when it decided to intensify its import restrictions. It is our earnest hope that this step, as well as the additional measure of devaluation of the Rand which was taken on 21 December 1971, will steadily improve South Africa's balance of payments on current account. However, this improvement will necessarily take some time to materialize. Devaluation itself does not produce an immediate solution to our problems, hence we are obliged to support this measure by the retention of the intensified import restrictions which were introduced in November. The Government has, however, already indicated that the balance of payments and reserve position will be continually kept under review and that its new import restrictions will be progressively relaxed as and when it becomes clear that a definite improvement in the balance of payments and reserve position has set in.

ANNEX II

Measures to Restore Conditions of Equilibrium in the
Economy of the Republic of South Africa

Statement Supplied by the South African Government

During 1964 increased pressure was brought to bear on South Africa's available productive resources, which resulted in inflationary price increases and a deterioration of the current account of the balance of payments. Consequently, the monetary authorities in South Africa warned financial institutions in June 1964 to follow a careful credit policy. In 1965 the Government applied the first restrictive measures which were supplemented in 1966 and thereafter by a wide range of restrictive measures in an attempt to achieve a better balance between the supply of and demand for goods and services in the country.

The principal measures taken may be classified into the following broad categories:

Monetary measures

1. The bank rate was raised from 5 per cent to 6 per cent on 8 July 1966 in order to slow down the excessive rate of capital and consumption expenditure. In the light of the considerable improvement in economic conditions during the latter half of 1967 and in 1968, the bank rate was lowered somewhat to $5\frac{1}{2}$ per cent in August 1968. However, as a result of adverse developments thereafter, mainly due to uncertain international financial conditions, it was found necessary to increase the bank rate again to $6\frac{1}{2}$ per cent on 31 March 1971.
2. The yields on long-term government stock have been increased on various occasions, the latest upward adjustments being from 7 per cent to $7\frac{3}{4}$ per cent on 13 August 1970 and to $8\frac{1}{2}$ per cent on 31 March 1971.
3. The deposit and lending rates of banks and building societies have been adjusted upwards after these institutions had been released in August 1970, from the undertaking not to pay more than 7 per cent on deposits with a maturity of twelve months and longer.
4. On various occasions during 1965 the minimum liquidity ratios maintained by commercial banks in respect of short, medium and long-term liabilities to the public, and of liabilities under acceptances, were increased. In 1967 a start was made to also tighten the liquid asset requirements of merchant, hire-purchase, savings and general banks, while the liquid asset requirements of all types of banking institutions were placed on an equal footing in 1969. Thus the liquid asset requirements of commercial banks were, with effect from 21 April 1965, increased to 34, 24, 5 and 10 per cent in respect of their short, medium and long-term liabilities to the public and of liabilities under acceptances, respectively. In the case of merchant, hire-purchase, savings and general banks the respective

liquid asset requirements were increased to 34, 24, 5 and 10 per cent with effect from 21 August 1967. A number of upward adjustments in these ratios have been effected subsequently. As from 21 June 1969 the liquid asset requirements of all banking institutions stood at 48, 30, 5 and 10 per cent for short, medium and long-term liabilities and liabilities under acceptances, respectively. Thereafter, the ratio in respect of short-term liabilities was reduced from 48 per cent to 45 per cent with effect from 21 February 1970 and that in respect of medium-term liabilities from 30 per cent to 28 per cent with effect from 21 June 1970.

5. Since 1966 quantitative restrictions (ceilings) have been introduced and maintained on monetary banking institutions' discounts and advances to and investments with the private sector. Since June 1970 the ceilings of the monetary banks in respect of discounts and advances have been kept at 118 per cent of the levels at which they stood on 31 March 1965, while their investment ceilings have been fixed at 115 per cent of the March 1968 levels with effect from February 1970.

Ceilings were also imposed on non-monetary banks in August 1970 at a level of 105 per cent of their discounts and advances, as well as investments, as at the end of June 1970.

Since the beginning of 1971 all banking institutions which exceeded their stipulated ceilings had to maintain additional interest-free cash balances with the South African Reserve Bank pending their compliance with the prescribed credit ceilings.

Certain concessions to exceed the ceilings were granted from time to time in respect of the extension of credit for agricultural and industrial purposes, as well as to small and new undertakings.

6. Since May 1968 monetary banking institutions had to maintain supplementary reserve balances with the South African Reserve Bank. In addition to the basic reserve requirement of 8 per cent prescribed by the Banks Act, monetary banking institutions were, with effect from 21 May 1968, required to keep with the Reserve Bank an additional reserve balance equal to 12 per cent of the increase in their short-term liabilities to the public since 31 March 1968, as well as a balance, equal to 20 per cent of that increase, with the National Finance Corporation. The additional reserve requirement of 12 per cent with the Reserve Bank was reduced to 7 per cent in August 1969, while that of 20 per cent with the National Finance Corporation was increased to 25 per cent.

Fiscal measures

1. In general, it may be said that, since 1966, the Government has pursued a deflationary policy in the light of the circumstances prevailing at the time of the submission of the various national budgets.

2. The budget for 1966/67 (April-March) as well as that for 1967/68 was, for example, used to combat inflationary tendencies in the South African economy. These budgets contained measures which varied from increased indirect taxes on items such as alcoholic beverages, cigarettes, tobacco, motor-cars, petrol and imported luxury goods, to higher direct taxation of individuals and companies. At the same time, various measures were announced with a view to encouraging savings.
3. In the 1969/70 budget, South Africa's tax structure was reformed in so far as the indirect tax basis was widened through the imposition of a selective sales duty on a wide range of commodities, while the rate and the progression of direct taxes on individuals, especially those in the middle and higher income groups, were reduced. In this way it was, inter alia, attempted to eliminate the detrimental effect which the former relatively sharp progression in the scale of taxation had on the rate of savings generally.
4. A surcharge of 5 per cent on normal income tax had been introduced in the 1969/70 budget and it was increased to 10 per cent in the 1971/72 budget.
5. Indirect taxes were also increased on several occasions. For example, the sales duty was increased in respect of various commodities in August 1970 and again in February 1971. Furthermore, the excise duty on certain motor cars was increased on 1 January 1971 and the duties on petrol, alcoholic beverages, cigarettes, cigars and tobacco in March 1971.
6. A loan levy of 5 per cent of the basic tax on individuals, which had been introduced in the 1969/70 budget, was supplemented by an additional levy of 5 per cent in the 1970/71 budget. This levy was increased on a sliding scale to a maximum of 20 per cent in the 1971/72 budget. In addition, a loan levy of 2.5 per cent on companies, excluding gold and diamond mining companies, which had been introduced in the 1970/71 budget, was increased to 7.5 per cent in the 1971/72 budget. At the same time a new loan levy of 7.5 per cent on the dividend receipts of companies was also introduced.
7. The Government continually endeavours to limit its own expenditure to the minimum level which is essential for the provision of basic services and to finance its expenditure programmes as far as possible from non-inflationary sources. It was also recently announced that the Government had accepted a recommendation of the Commission of Inquiry into Fiscal and Monetary Policy to appoint a special Cabinet Committee for Finance under the chairmanship of the Minister of Finance to attain a larger measure of central direction, priority determination and co-ordination in respect of expenditure incurred by all bodies in the public sector.
8. The State's own savings media, such as the issue of Treasury and Jubilee bonds, were supplemented in June 1971 when subscription lists were opened for a new tax-free Premium Bond of seven years.

9. In order to enable the authorities to finance their expenditure in a non-inflationary manner, the Minister of Finance announced measures in September 1971 in terms of which certain financial institutions, such as pension funds and insurance companies, are to hold a larger share of their prescribed investments in government stock.

Other measures to combat inflation

In addition to the measures which are directly aimed at restricting credit facilities and curbing the demand for goods and services and promoting savings, the Government has also introduced other measures which are designed to keep price increases within reasonable limits. These measures include the following:

1. In the light of the relatively high level of South Africa's foreign exchange reserves the Government had been able to progressively relax the country's remaining import restrictions since 1967. In this manner the local supply of goods and services had been supplemented and the inflationary pressure on the available productive resources in the country had been considerably relieved. Unfortunately developments in the international monetary sphere, particularly since 1969, and the consequent substantial deterioration in the country's balance-of-payments position have forced the Government to tighten import control again on 24 November 1971.
2. In October 1970 new or more stringent conditions of sale were prescribed in respect of a wide range of durable consumer goods in order to curb excessive spending on these goods.
3. Action has also been taken under the Price Control Act to prevent unjustifiable price increases.
4. The Government applies the Regulation of Monopolistic Conditions Act to maintain healthy competitive conditions in the economy (for example, the abolition of resale price maintenance in 1969) and to eliminate restrictive trade practices, such as conditional selling to and the unreasonable withholding of supplies from merchants, which may keep prices artificially high.
5. Various measures have been taken to keep housing costs within reasonable limits. These measures include, inter alia, the introduction of building and rent control; special concessions in respect of tax-free investments with building societies in order to keep interest rates on housing loans at the lowest possible levels and to make available more funds for the erection of housing accommodation; the introduction of an interest rate subsidy on housing loans not exceeding R 12,000; and implementation of the recommendations of the Niemand Commission of Inquiry in an effort to restrain the rising costs of building stands.

Measures designed to raise the production of goods and services

With a view to increasing the production of goods and services in South Africa the Government has introduced the following measures:

1. A system of investment allowances was re-instituted in August 1970 for a period of three years in order to stimulate fixed investment in the manufacturing industry.
2. To help alleviate the shortage of skilled manpower, the training facilities for technical, vocational and higher education have been expanded, while the training system for apprentices has been improved.
3. The better utilization of the available manpower has been investigated by a Committee of the Economic Advisory Council of the Prime Minister and the Government has associated itself with the recommendations of the Committee in so far as matters of policy are concerned.
4. The Government has also accepted a purposeful policy of immigration in order to attract skilled workers from foreign countries and in this manner to supplement the trained labour force in South Africa.
5. The Government pursues a progressive policy of decentralization of industries and the development of border areas and Bantu Homelands in an effort to also expand production in the less-developed areas of the country. In addition, steps have been taken to achieve still higher results with the policy by effecting certain changes in the application thereof, as set out in the White Paper on the Report by the Inter-Departmental Committee on the Decentralization of Industries (June 1971).
6. The infra-structure of the country has been and is being expanded substantially as a means of facilitating the increased production of goods and services.
7. The Productivity Advisory Council was appointed in 1968 to promote the general level of productivity in the country.
8. The measures which have been introduced to increase savings are not only designed to curb the excessive consumer demand, but also to mobilize more funds for productive investment.

Export promotion

The Government also attaches great importance to the promotion of South Africa's export trade. Thus the export trade promotional services offered by the Government have not only been strengthened considerably during the past few years, but a new system of aid to exporters has been introduced following an announcement in this respect in the budget statement on 12 August 1970.

In addition, an Export Advisory Council was established in 1971 to coordinate the export promotional efforts of the Government and private sectors. Furthermore, a Commission of Inquiry into the Export Trade of South Africa was appointed in August 1971 to investigate and report on all matters relating to the country's export trade.

ANNEX III

Balance of Payments 1970-1971

Quarterly Figures Supplied by the S. African Delegation

(R millions)

	1970					1971				
	I	II	III	IV	1970	I	II	III	IV	1971
CURRENT ACCOUNT										
Merchandise exports, f.o.b.	355	588	337	340	1,420	834	389	398		
Net gold output	192	214	217	214	837	205	227	234		
Service receipts	126	139	152	163	560	133	142	146		
Merchandise imports, f.o.b.	-581	-643	-653	-702	-2,579	-737	-711	-721		
Service payments	-228	-264	-297	-341	-1,130	-245	-297	-276		
Total goods and services (net receipts +)	-136	-166	-264	-326	- 892	-310	-250	-219		
Transfers (net receipts +)	10	15	14	10	49	13	14	14		
Balance on current account	-126	-151	-250	-316	- 843	-297	-236	-205		
CAPITAL MOVEMENTS										
Private sector	60	108	88	197	453	182	165	108		
Long-term	63	74	33	156	326	114	72	87		
Short-term	- 12	53	28	20	89	29	87	5		
Errors and unrecorded transactions	9	- 19	27	21	38	39	6	18		
Central government and banking sector	17	32	35	20	104	35	18	9		
Long-term	25	17	31	30	103	23	26	23		
Short-term	- 8	15	4	- 10	1	12	- 8	- 14		
Total capital movements (net inflow +)	77	140	123	217	557	217	183	117		
CHANGE IN GOLD AND FOREIGN RESERVES AS A RESULT OF:										
Balance of payments transactions	- 49	- 11	-127	- 99	- 286	- 80	- 53	- 88		
SDR allocations and valuation adjustments	24	-	-	-	24	15	2	-		
Total change in gold and foreign reserves	- 25	- 11	-127	- 99	- 262	- 65	- 51	- 88		

Seasonally Adjusted Balance of
Payments on Current Account
Quarterly Figures at an Annual Rate
(R millions)

	1970					1971				
	I	II	III	IV	1970	I	II	III	IV	1971
Merchandise exports, f.o.b.	1,381	1,569	1,294	1,436	1,420	1,300	1,575	1,533		
Net gold output	794	848	864	842	837	848	902	929		
Service receipts	540	574	563	563	560	565	590	623		
Merchandise imports, f.o.b.	-2,502	-2,530	-2,567	-2,917	-2,579	-2,917	-2,800	-2,835		
Service payments	-1,041	-1,064	-1,248	-1,167	-1,130	-1,107	-1,197	-1,160		
Total goods and services (net receipts +)	- 628	- 603	-1,094	-1,243	- 892	-1,311	- 930	- 910		
Transfers (net receipts +)	48	55	46	47	49	57	49	46		
Balance on current account	- 580	- 548	-1,048	-1,196	- 843	-1,254	- 881	- 864		