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GENERAL AGREEMENT ON TARIFFS AND TRADE

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

Report of the Committee on Balance-of-Payments Restrictions

1. On 17-19 January 1972, this Committee entered into a consultation with the Republic of South Africa which the Council had initiated under the provisions of Article XII:4(a) on the action that South Africa had taken in November 1971 to impose new restrictions on imports and to reinvoke the provisions of Article XII for the justification of these new, as well as its existing, restrictions. For reasons stated in the concluding paragraph of the Committee's report on that discussion (BOP/R/59), the Committee proposed that the Council keep the matter under review and arrange for the Committee to resume the consultation before mid-1972. These proposals were approved by the Council (see C/M/76).

2. It may be recalled that at the January meeting, while members of the Committee questioned the need for South Africa to maintain the new restrictions or to invoke Article XII, the South Africa delegation took the position that the actual incidence of the restrictions could not be evalued until after the April/May issue of import permits and that his Government would be unable to respond to a judgement by the CONTRACTING PARTIES on the country's balance-of-payments position and prospects until a sufficient period of time had elapsed since the realignment of currencies.

3. When it reconvened on 21-22 June 1972, the Committee had before it the following documentation to serve as a basis for discussion:

(a) a statement by the South African Government on the present position of South Africa's balance-of-payments and monetary reserves, on recent internal measures to stabilize the economy and on other developments in the South African economy (BOP/125 and Corr.1);

(b) a list of products which had been freed from licensing control early in June 1972 (BOP/125/Add.1);

(c) a supplementary background paper supplied by the International Monetary Fund on recent economic developments in South Africa dated May 1972.

Consultation with the International Monetary Fund

4. In continuation of the related consultation under Article XV:2, the representative of the Fund took part in the meeting and made the following statement:

"The Fund invites the attention of the CONTRACTING PARTIES to the Supplementary Background Material dated May 24, 1972.

"In 1971, ~~despite a slower~~ pace of activity and easing pressures on the labor market, wages and prices continued to rise rapidly and the current account deficit remained exceptionally large. At R 1,005 million (or SDR 1,407 million) the deficit was some R 160 million larger than in 1970, and equal to about 7 per cent of GDP at current prices. The increase in the value of imports, which had been rather more moderate in the first half of 1971, became quite rapid again in the second half, in part reflecting anticipatory purchases caused by uncertainties in the international currency markets after August 15, 1971, and fears of a tightening of import controls. Because of weak markets for wool, diamond, and nonferrous metals, the growth in merchandise exports was only 4 per cent in 1971; but the value of "net gold output" was nearly 10 per cent larger than in 1970, owing to substantial price increases in the private gold market. Despite a substantial further net inflow of capital, particularly in the first half of the year, the official reserves fell sharply during 1971. At the end of November 1971, they stood at SDR 667 million representing about two months' imports.

"In November 1971, the South African authorities decided to arrest a further deterioration in the balance of payments by tightening quantitative import restrictions. On December 21, 1971, in the context of the general currency realignment, the rand was devalued from R 25 to R 28.5 per ounce of fine gold i.e., a devaluation of 12.3 per cent.

"In early 1972, the current account deficit of the balance of payments declined. While imports were marginally lower, export earnings rose, mainly because of improving demand and rising prices for sugar, wool and diamonds. Gold prices on the private market have risen sharply. There has also been a large inflow of private capital in early 1972 and official reserves have been on an upward trend since end-December. By end-May 1972 they amounted to SDR 911 million, including the allocation of SDR 34 million on January 1, 1972.

"South Africa has recently relaxed some of the restrictive measures imposed in November 1971. The Fund welcomes this action and believes that the recent balance of payments and reserves developments should allow South Africa to take further steps to eliminate the remaining measures taken in November 1971 to intensify import restrictions, and to resume the process of further liberalization."

Statement by the representative of South Africa

5. At the resumption of the consultation on 21 June 1972, the leader of the South African delegation made a statement in which he recalled the events which had led to the November action and the institution of this consultation in January; described the latest developments in the South African economy and balance of payments, and analyzed the factors behind these developments; outlined the liberalization measures taken since January, and stated the South African Government's present position on the use of import restrictions in relation of the provisions of Article XII of the General Agreement. The complete text of the statement is reproduced in the Annex to this report. The main points made therein are as follows:

(a) during the first quarter of 1972, imports remained approximately at the same level as in the previous quarter in spite of the new restrictions; exports improved somewhat; the current account deficit was reduced significantly but remained considerable;

(b) during the same period, the net inflow of capital declined further, resulting in a very moderate increase in reserves despite the diminution of the current account deficit;

(c) the absence of change in the level of imports showed that the new restrictions played a very minor rôle in improving the balance of payments and reserves situation;

(d) the increase in the value of exports partly reflected the adjustment of exchange rates and was partly attributable to exceptionally favourable market conditions. The larger capital inflow also reflected a series of fortuitous factors. Some of these special factors resonsible for the improvement of the balance of payments were non-recurrent, while some others might not continue;

(e) a 10 per cent issue of licences was made for general merchandise and clothing, and 15 per cent for textile piece goods. In general, permits for other goods subject to licence continued to be issued freely; twenty-six commodity groups were restored to the licence-free list from which they had been taken off last November.

6. In conclusion, the South African representative stated that his Government was fully conscious of its obligations under GATT and was anxious to fulfil its obligations at the earliest possible date. In view of the admittedly improving balance-of-payments position, steps had already been taken to ease the restrictions. Experience had taught the South African Government that a "stop-go" import control policy would benefit neither foreign exporters nor the South African economy. It was considered essential that a firm foundation for the balance of payments should be established before consideration could be given to the elimination of the import controls which were being used more as a precautionary device than an instrument to curtail imports.

Balance-of-payments position and prospects

7. Members of the Committee recalled that at its January meeting the Committee had generally conceded that the combination of internal and external economic circumstances prevailing in mid-November last year had called for action at that time by the South African Governmentto redress external disequilibrium, but believed that the devaluation of the rand in the context of the general alignment of currencies last December would have beneficial effects on South Africa's balance of payments, on the current account as well as on the capital account. Their view that South Africa's difficulties were of a transient nature had now proven to be correct. The rise in exports had been remarkable and the resumption of capital inflow and the decline in current account deficit were both significant of a turn-round of the trend. As regards the South African representative's caution against over optimism, the stress that he had laid on the rôle played by special factors in the recent improvement and his concern about uncertainties, the Committee considered that these should be viewed in perspective against other positive factors which could be expected to add momentum to the improvement. The markets for South Africa's traditional exports, such as diamonds, sugar and wool, appeared to be strong; there appeared to be no reason to fear that capital inflow into South Africa would not attain its usual magnitude. The unfavourable leads and lags in external payments, which had been invoked by the South African delegation as one of the factors accentuating the pressures on the balance of payments, must have been reversed after the realignment of currencies.

8. The South African representative stated that he readily conceded that the South African balance-of-payments and reserve position had improved since the introduction of the intensified import restrictions on 25 November 1971 and the subsequent devaluation of the rand. He pointed out, however, that this improvement had occurred at a time when the low growth rate of the economy and, more particularly, that of the industrial sector, had not yet improved despite the stimulating measures introduced by his Government towards the end of March 1972. He said that indications were that industrial output had remained stagnant during the first two quarters of 1972, as compared with the position in the last quarter of 1971. Surplus capacity in the manufacturing industry was increasing and there was a renewed downturn in fixed investment in this sector. From this, it could reasonably be assumed that the balance of payments and reserve position would not have improved to the extent indicated by recent figures if there had been a noticeable increase in the growth rate of the economy, as any such development would have led to a material increase in South Africa's import expenditures.

9. Members of the Committee recalled the promptitude with which the South African Government had initiated action in accordance with the relevant GATT provisions when it decided last November to impose new restrictions to meet the imminent threat that it considered its monetary reserves faced at that time. In light of the requirements of Article XII many members could not understand why South Africa had not removed those restrictions and had not disinvoked Article XII when those imminent threats were clearly no longer present. As the South African Government was aware, the use of import restrictions by contracting parties for balance-of-payments purposes was governed by specific criteria which were as set forth in paragraph 2 of Article XII. Based on those criteria, there were no longer any balance-of-payments grounds for the maintenance of restrictions by South Africa.

10. In reply to these statements, the South African representative stressed that there were a number of special factors, many of them of a non-recurrent nature, which had contributed substantially to the recent improvement of South Africa's balance of payments. He reminded the Committee that during the January 1972 consultations members of the Committee had observed 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" (BOP/R/59, paragraph 13), and emphasized that his country was only just emerging from a balance-of-payments crisis of extreme severity. South Africa needed a transitional period to enable it to achieve a meaningful and sustained improvement in the balance of payments, as otherwise it would merely run the risk of an early renewed deterioration in its external financial position which would call for the re-imposition of restrictions on imports. The South African Government felt that such an improvement in the balance of payments should take the form of a significant and sustained increase in exports of raw and semi-processed mineral products. This would require heavy capital investments in rail transport and harbour facilities, involving at the same time a substantial increase in imports with a consequent drain on the country's foreign reserves.

11. Many members of the Committee stated that they were particularly disturbed by the South African representative's earlier statement that a "firm foundation" for the balance of payments must be established before consideration could be given to the removal of import controls and the arguments now put forward by him had reinforced their concern. The position taken by South Africa directly contradicted the GATT criteria of Article XII and, if accepted, could lead to a proliferation of import restrictions in a multitude of the world's trading nations. The Fund's findings quoted in paragraph 3 above could in no sense be taken to indicate that South Africa's monetary reserves at present faced any imminent threat of a serious decline that called for import restrictions to forestall or to stop.

Trade effects of the restrictions

12. Some members of the Committee expressed the view that, considering the substantial improvement in the balance of payments and the increase in reserves in the first quarter of this year, it was also disappointing to learn that the second issue of 1972 import permits had been so meagre, especially as the Committee had been told to look forward to this instalment as an evidence of the resumption of liberalization. The partial removal of the November restrictions would also appear to be insignificant.

13. The South African representative stated that some of these comments seemed to reflect a lack of acquaintance with the South African import control system. The effective area of the South African import restrictions was confined to consumer goods, since this was the only sector that could be effectively curtailed in an effort to save foreign expenditure. In respect of all other categories of imports, the intensified restrictions imposed in November 1971 were being applied in a most liberal manner, because these goods are essential and could not be curtailed without damage to the economy.

14. The South African representative quoted official statistics (adjusted on a seasonally annual basis) of monthly imports since the intensification of the import restrictions, to show that, in value terms, South Africa's imports had declined only marginally despite the application of the intensified restrictions. The decline in the volume of imports had been caused by the increased cost of imports in terms of the devalued national currency.

15. Members of the Committee called attention to the effects of South Africa's restrictions on the trade and economic interests of their respective countries, in most cases with reference to their traditional trade ties with South Africa which could be undermined by the restrictions, or to the high level of, or increases in, their own imports from South Africa. The observer representing Norway, in particular, pointed out that since the introduction of the new restrictions in November, Norwegian exports to South Africa had fallen by as much as 42 per cent. Most of Norway's major exports, such as canned fish, aluminium and certain other metals and machinery, were on the restrictions list but none happened to be included in the 2 June liberalized list. The serious decline in the export of canned fish to South Africa, for which the latter was the fourth largest market, was particularly felt by the industry and had caused serious hardship. These representatives pointed out that the stand they took was not only based on a concern for the integrity of GATT and the general interest of the contracting parties, but also because of the harm that the restrictions could have or already had on their exports. The representative of South Africa stated that he had taken due note of the representations.

16. Members of the Committee referred to press reports and statements, which they understood had been made by responsible Ministers of South Africa, that seemed to assure domestic industries that they would be duly protected against foreign competition and refered to the quantitative import restrictions as an instrument to afford such protection. Specifically, there seem to have been indications of an intention to deliberately retard liberalization, irrespective of balance-of-payments developments, so as not to disturb domestic production.

17. In reply to these fears, especially in so far as they related to the November 1971 restrictions, the South African representative stated that his Government had on several occasions made it clear that the restrictions introduced in November 1971 would be dismantled as soon as the balance-of-payments and reserve position had shown a sound improvement. Specifically he recalled that these restrictions were totally unrelated to the Article XXVIII negotiations which South Africa had initiated. He stated that the intensified restrictions of November had not had any stimulating effect on the gross value of manufacturing production while industrial investment had, in fact, declined since the introduction of these restrictions. He further stated that his Government understood the conclusions of the International Monetary Fund, with which his Government agreed, to mean that the Government could eliminate the November restrictions step by step. The Government had appointed a Committee, consisting of senior representatives of the public and private sectors, to enquire into South Africa's position in relation to the GATT provisions. As regards the remaining restrictions, other than the November

restrictions, the Government had ordered an urgent and thorough technical investigation to be made by the Board of Trade and Industries into the need for replacing by tariff protection the incidental protection afforded to domestic industries by import control, where it could be shown that such tariff protection was justified by economic circumstances. South Africa had always wanted to respect the rules of GATT and was currently considering policy adjustments designed to achieve better harmonization therewith. In the meantime, South Africa would continue to liberalize its import restrictions. It was not the South African Government's policy to use import control as an instrument for the purposes of continuing protection.

18. The Committee welcomed the assurance by the South African representative that the intensified import restrictions embodied no protective intention. In that context most members of the Committee pointed out that since, as was advanced by the South African representation, they exerted no incidental protective effect, the November restrictions could certainly be eliminated immediately without difficulty for the South African economy.

19. Some members referred to the exemption of certain countries from South Africa's restrictions, and recalled the position taken by the CONTRACTING PARTIES that import restrictions for balance-of-payments reasons should be applied consistently with the provisions of Articles XIII and XIV and, as stated in a report approved by the CONTRACTING PARTIES, that there was "nothing in the General Agreement, nor any prior waiver granted by the CONTRACTING PARTIES, which would justify or constitute a recognition by the CONTRACTING PARTIES that balance-of-payments quantitative restrictions may justifiably be applied in a discriminatory manner to encourage economic development" (BISD, 8th Supplement, page 159). They suggested this was an additional reason for the removal of restrictions originally imposed for balance-of-payments reasons.

Conclusions

20. Taking into account the statement of the International Monetary Fund representative quoted in paragraph 4 above, and in the light of the discussion, the Committee:

(a) recalled the view of members of the Committee at the time of the January 1972 consultations that the intensified import restrictions established in November 1971 appeared to have been rendered excessive if not redundant, by the subsequent currency realignment and the devaluation of the rand and that they had consequently urged the Government of South Africa to remove them rapidly;

(b) noted the substantial improvement in the South African balance-of-payments and reserve position which has occurred since the consultation in January 1972;

(c) took note of the view of the South African representative that the improvement of the South African balance-of-payments and reserve position had, to an important extent, been due to a simultaneous occurrence of a number of specially favourable factors, many of which were of a non-recurrent nature;

(d) took note of the liberalization measures announced by South Africa effective on 9 June 1972 as well as South Africa's concurrence with the statement of the International Monetary Fund that the recent balance-of-payments and reserves developments should allow South Africa to take further steps to eliminate the remaining measures taken in 1971 to intensify import restrictions and to resume the process of further liberalization;

(e) welcomed the assurances of the South African delegation that it was not the South African Government's policy to apply restrictions on imports, originally imposed for balance-of-payments reasons, for continuing protection of domestic industry; and

(f) expressed the view that the present balance-of-payments position of South Africa no longer justified recourse to Article XII of the General Agreement and urged South Africa to eliminate the intensified restrictions of November 1971 and to proceed promptly with further liberalization of import restrictions in effect prior to November 1971.[1]

[1] One member, whilst reserving his position, nevertheless felt that the situation warranted an early and substantial liberalization of the restrictions.

Annex

OPENING STATEMENT BY THE LEADER
OF THE SOUTH AFRICAN DELEGATION

Members of the Committee are acquainted with the conditions that led to the decision of the South African Government in November last year to intensify import restrictions for balance-of-payments reasons and thus to reinvoke the provisions of Article XII of the General Agreement on Tariffs and Trade.

This step was deemed necessary to stop a serious decline in South Africa's already very low level of monetary reserves. The persistent decline in the country's reserves was caused mainly by a continuous rise in imports, which increased by more than 50 per cent since 1968, and which was partly financed by a strong inflow of foreign capital, to wit from R180 million during 1969 to R737 million for the whole of 1971. From the second quarter of 1971, however, a sharp decline in capital inflow was experienced.

South Africa's current account deficit, taken at a seasonally adjusted annual rate, amounted to more than R675 million in the fourth quarter of 1971, while the country's gold and foreign exchange reserves fell from a peak of more than R1,200 million in March 1969 to only R650 million in December 1971. Expressed in terms of monthly import commitments including freight and insurance payments, the country's level of gold and foreign exchange reserves reached the record low figure of 2.5 months' imports at the end of 1971.

After the general realignment of exchange rates and the devaluation of the rand in December 1971, consultations under Article XII were held with South Africa in January 1972. At this meeting we pointed out that it was too early to assess the impact of the realigned exchange rates and the ensuing international economic developments on South Africa's balance of payments. The Committee consequently decided to keep the matter open for further discussion when more concrete information on the developments in South Africa's balance of payments particularly during the first quarter of 1972 will be available. The relevant preliminary data have been furnished to the GATT secretariat and I trust that members of the Committee have had an opportunity of studying this.

More up-to-date data are provided in my statement.

The available information indicates that despite the intensification of import control, merchandise imports remained approximately the same during the first quarter of 1972 compared with the last quarter of 1971.

For the same period the current account deficit improved from R676 million to R493 million. This improvement was largely due to an increase in merchandise exports (which rose from R1,680 million to R1,793 million on a seasonally adjusted annual basis) and net gold output (increasing from R984 million to R1,073 million). Nevertheless the deficit of R493 million still represents nearly 30 per cent of South Africa's total merchandise imports. In fact, the largest deficit registered during the sixties amount to no more than R296 million.

During the first quarter of 1972 the net inflow of foreign capital continued to decline to R146 million, compared with R170 million during the fourth quarter of 1971. The net result was an improvement in South Africa's gold and foreign reserves of only R28 million, disregarding the SDR allocation of R28 million. However, including valuation adjustments following devaluation and the subsequent SDR allocation, South Africa's total gold and foreign exchange position improved from R651 million at the end of 1971 to R707 million at the end of March 1972, and to an estimated R808 million at the end of May. Since imports remained at approximately the same level throughout this period, despite the intensification of import control, it is clear that this measure played a very minor rôle in the improvement of the reserves.

If the above improvements in South Africa's reserves were to continue, further relaxations would be clearly indicated. There are, however, <u>special factors</u> affecting the balance-of-payments improvement thusfar which should be fully taken into account in this regard. These may be summarized as follows:

(i) <u>Exports</u>

In the first place, in judging the 7 per cent increase in the seasonally adjusted value of exports between the fourth quarter of 1971 and the first quarter of 1972, it should be borne in mind that South Africa's export earning in 1971 were actually lower than in 1968, whereas the increase in total world exports was of the order of 14 per cent per annum over the same period. Increased export earnings during the first quarter of 1972 also resulted from the higher rand earnings arising from the realignment of exchange rates in December last year.

It is well-known, too, that the composition of South Africa's export trade is such that our export earnings are highly dependent on internal climatic conditions and overseas economic trends, factors which are difficult to anticipate or project. Judging by past experience the export earnings of minerals, raw materials and agricultural products are subject to wide fluctuations while net gold output now also depends on the behaviour of the price of metal on the private market. It would therefore be prudent to establish at least a sustained upward trend in export earnings over a longer period before considering the drastic relaxation in import control measures.

(ii) Capital inflows

Whereas the net capital inflow and transfers accounted for less than 4 per cent of South Africa's capacity to import from 1962 to 1966, these sources accounted for more than 19 per cent of the country's capacity to import during the past five years. As indicated previously, the total net capital inflow declined from R170 million in the last quarter of 1971 to R146 million in the first quarter of 1972. Moreover, the composition of the capital inflow also changed significantly between these two latter periods. In the last quarter of 1971, the central government and the banking sector were net borrowers abroad to the extent of R129 million, but in the first quarter of 1972, their net borrowing from foreign sources declined to only R6 million. In the case of the private sector, on the other hand, the net capital inflow increased from only R41 million in the fourth quarter of 1971 to about R140 million in the first quarter of 1972. It is also significant that R62 million of this latter amount represented an inflow of capital arising from purchases by foreigners of securities listed on the Johannesburg Stock Exchange, compared with an inflow of capital for this purpose amounting to R90 million during the year 1971 as a whole. A further R19 million of this private capital inflow represented foreign loans by public corporations and local authorities. Indications are that these types of capital also largely accounted for the continued rise in the reserves in April and May 1972. Unfortunately foreign capital inflows are subject to wide fluctuations and do not constitute a reasonably stable source of financing foreign current account commitments.

The South African Government recently announced the issue of a second round of import permits for the three main classes of consumer goods, namely

(i) for general merchandise

a further allocation of 10 per cent on 1969 imports which, together with the first issue of 20 per cent made in December 1971, will bring the allocation in respect of these goods to 30 per cent of 1969 imports.

(ii) for textile piece goods for sale in shops

a further allocation of 15 per cent on 1969 imports which, together with the first issue of 20 per cent made in December 1971, will bring the allocation in respect of these goods to 35 per cent of 1969 imports; and

(iii) for clothing

a further allocation of 10 per cent on 1969 imports which, together with the first issue of 15 per cent made in December 1971, will bring the allocation in respect of these goods to 25 per cent of 1969 imports.

The policy, and therefore the permit issues, in respect of all other commodity groups which are subject to control, are of course being maintained and are therefore not affected by the Government's recent announcement. This means that, in general terms, permits are issued either freely on application by end-users of the commodity groups subject to the procedure of end-user permit issues, or freely on application to allow importers to maintain stocks ranging from four to nine months' normal consumption, depending on the nature of each commodity group.

The Government has also decided to transfer back to the permit free list twenty-six commodity groups which were removed from that list in November 1971.

In conclusion, I should like to stress that the South African authorities are fully conscious of their international obligations under GATT and are desirous of complying with these obligations at the earliest possible date. South Africa admits that its balance of payments is improving. In view of this improvement and the more favourable outlook for the immediate future, steps have recently been taken to ease the import restrictions - which have in any case been leniently applied.

In viewing the more recent developments in the South African balance of payments and the consequent steps that have been taken to liberalize the import control measures which were imposed last November, I wish to direct the attention of the Committee to the various special factors which have contributed towards this improvement in the balance of payments. From past experience the South African authorities realize that a stop-go import control policy would benefit neither countries exporting to South Africa nor the South African economy. It is, therefore, essential that a firm foundation for the balance of payments should be established before consideration could be given to the elimination of import control. The South African Government is prepared to relax from time to time, as has already been done, the import restrictions in conjunction with developments in the balance of payments, although I wish to stress that these restrictions serve more as a precautionary device than as an instrument to curtail imports.