PO-CH/NL/0237 PT A

Part A.

CONFIDENTIAL

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Begins: 5/8/87.
Ends: 17/10/88.

PO -CH /NL/0237

PART A

Chancellor's (Lawson) Papers:

THE SOUTH AFRICAN ECONOMY AND THEIR RELATIONSHIP WITH THE INTERNATIONAL FINANCIAL COMMUNITY

Disposal Directions: 25 Years

21/9/95.

PO -CH /NL/0237
PART A

GRS 501

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FM CAPE TOWN
TO PRIORITY F C O
TELNO 348
OF 051615

Z AUGUST 1987

INFO PRIORITY JOHANNESBURG, UKDEL IMF WASHINGTON

SOUTH AFRICAN ECONOMY

1. WHEN I SAW STALS, SECRETARY TO THE TREASURY, TODAY HE SAID PRIVATELY THAT HE DOUBTED WHETHER THE SOUTH AFRICAN ECONOMY WOULD MEET THE OFFICIAL FORECAST OF 3 PERCENT REAL GROWTH THIS YEAR. HE EXPECTED GROWTH TO BE BETWEEN 2 AND 3 PERCENT. BECAUSE OF THE EXCHANGE CONTROL REGULATIONS AND THE STRENGTH OF THE GOLD PRICE, THERE WAS A GREAT DEAL OF MONEY AROUND ON THE JOHANNESBURG STOCK EXCHANGE TO BUY OUT COMPANIES WHICH WANTED TO DISINVEST (THOUGH THERE ARE PARTICULAR COMPLICATIONS IN THE CASE OF STANDARD CHARTERED (SEE MIPT, NOT TO ALL), OR FOR TAKEOVER PURPOSES. BUT FIXED CAPITAL INVESTMENT HAD DECLINED OVER THE PAST FOUR YEARS AND WAS ONLY NOW BEGINNING TO RECOVER VERY SLOWLY. THE ECONOMIC UP-TURN SO FAR WAS RELATIVELY WEAK, THOUGH HE EXPECTED GROWTH TO CONTINUE THROUGH NEXT YEAR.

2. STALS EXPECTED THERE TO BE AN R 7 BILLION SURPLUS ON THE TRADE ACCOUNT THIS YEAR (THE SAME AS IN 1986). SINCE THE CAPITAL OUTFLOW WOULD BE LOWER, THIS COULD RESULT IN A R 2 BILLION INCREASE IN THE RESERVES (AS AGAINST AN R 1 BILLION INCREASE LAST YEAR). IF THE RECOVERY STRENGTHENED , THIS WOULD SUCK IN IMPORTS, AND THERE COULD BE A MUCH TIGHTER BALANCE OF PAYMENTS POSITION TWO YEARS OR SO DOWN THE TRACK. AT THE MOMENT, HOWEVER, THE WORRY WAS RATHER THAT THE ECONOMY WAS NOT YET MOVING AHEAD STRONGLY ENOUGH. OBVIOUSLY THE SURGE IN THE PRICE OF GOLD WAS A MAJOR POSITIVE FACTOR (DOLLARS 10 ON THE GOLD PRICE OVER A FULL YEAR MEANS A DOLLARS 200 MILLION BENEFIT TO THE BALANCE OF PAYMENTS). STALS ACKNOWLEDGED THAT FINANCING R 1 BILLION WORTH OF CURRENT GOVERNMENT EXPENDITURE FROM FOREIGN FUNDS CAUGHT IN THE NET HAD ITS HAZARDS, BUT SAID THAT OTHERWISE THE GOVERNMENT COULD NOT SUBSTANTIALLY INCREASE SPENDING ON BLACK EDUCATION PROGRAMMES, AS IT IS PLANNING TO DO.

CONFIDENTIAL

/3.

3. STALS ACKNOWLEDGED THAT THE PRIVATISATION PROPOSALS JUST PUT FORWARD (ON WHICH WE SHALL BE REPORTING IN MORE DETAIL) ARE PRETTY MODEST IN SCOPE. WHAT IS ENVISAGED IS THE PRIVATISATION OF PERIPHERAL ACTIVITIES OF THE MAJOR STATE CORPORATIONS E.G. SOUTH AFRICAN AIRWAYS. THIS WOULD CERTAINLY NOT AMOUNT TO A FUNDAMENTAL SHIFT FROM THE PUBLIC TO THE PRIVATE SECTOR OF THE KIND THE ROVERNMENT HAD UNDERTAKEN IN BRITAIN. THERE WAS VASTLY MORE SCOPE FOR PROGRESS IN THE FIELD OF DEREGULATION AND STALS WAS IMPATIENT ABOUT THE SNAIL'S PACE AT WHICH THIS IS PROCEEDING, PARTLY AS A RESULT OF THE ENTRENCHED RESISTANCE OF THE AFRIKANER BUREAUCRACY AND PARTLY BECAUSE MANY OF THESE REGULATIONS ARE INTEGRAL TO THE APARTHEID SYSTEM. AS A RESULT OF THE HOMELANDS POLICY, AND THE CONTINUED ATTEMPT TO DEAL SEPARATELY WITH BLACK , WHITE AND COLOURED EDUCATION, THERE ARE ELEVEN SEPARATE EDUCATION DEPARTMENTS HERE, AND THE SOUTH AFRICAN TREASURY IS FINDING IT AN ALMOST IMPOSSIBLE TASK TO ALLOCATE RESOURCES BETWEEN THEM.

4. FCO PLEASE PASS TO MOUNTFIELD (TREASURY) MAYES (BANK OF ENGLAND) AND TITCHENER (DTI).

RENWICK

YYYY

CFPOAN 1297

FINANCIAL
SAFD.

COPIES TO:
MOUNTFIELD HM. TRSY
MAYES BANK OF ENGLAND
TITCHENER DTI

CONFIDENTIAL

4372/036

MP

FINANCIAL SECRETARY TO THE TREASURY

FROM: **N M DAWSON**
DATE: **29 October 1987**

MR MATTHEWS

cc: PS/Chancellor
PS/Sir P Middleton

MEETING WITH THE SOUTH AFRICAN DEPUTY FINANCE MINISTER

The Financial Secretary has received the attached letter from the South African Embassy.

2. I would be grateful for advice on whether the Financial Secretary should meet with Mr Durr by Monday 2 November please.

N M DAWSON
Diary Secretary

TEL 01-930 4488

TELEGR.: OPPOSITELY LONDON WC2

Verw:
Ref: B7/9/21/2

SUID-AFRIKAANSE AMBASSADE
SOUTH AFRICAN EMBASSY
TRAFALGAR SQUARE
LONDON,
WC2N 5DP

27 October 1987

Mr Nigel Dawson
Financial Secretary's Office
H M Treasury
Parliament Street
LONDON
SWIT 3AJ

Dear Mr Dawson

As I mentioned in our telephone conversation today, Mr Kent Durr South Africa's Deputy Minister of Finance will be in London in November and would like to pay a courtesy call on the Financial Secretary, Mr Norman Lamont.

Mr Durr will be available during the morning and afternoon of Thursday 12 November and the morning of Friday 13 November. As other appointments for Mr Durr need to be made around this particular one an early reply would be appreciated.

Your assistance is greatly appreciated.

Yours sincerely

C C Edwards (Miss)
SECRETARY OF EMBASSY

055531
MDHIAN 7102

RESTRICTED
FM CAPE TOWN EMBASSY
TO IMMEDIATE FCO
TELNO 23
OF 091645Z FEBRUARY 1988
INFO PRIORITY JOHANNESBURG, BANK OF ENGLAND, HM TREASURY, DTI

SOUTH AFRICAN ECONOMY

SUMMARY

1. THE FINANCE MINISTER ANNOUNCED THAT REAL GROWTH IN GDP IN 1987 WAS 2.6 PER CENT. THE TRADE SURPLUS FOR 1987 WAS RAND 14 BILLION. THE PAYMENTS SURPLUS RAND 6 BILLION. THE RESERVES INCREASED TO RAND 8 BILLION. GROWTH OF APPROXIMATELY 3 PER CENT IS EXPECTED IN 1988.

DETAIL

2. THE FINANCE MINISTER HAS ANNOUNCED THAT THE LATEST GOVERNMENT ESTIMATES ARE THAT REAL GROWTH IN GDP WAS 2.6 PER CENT LAST YEAR. THIS COULD STILL BE SUBJECT TO SOME CORRECTION WHEN THE FINAL FIGURES BECOME AVAILABLE. BAREND DU PLESSIS POINTED OUT THAT PART OF THIS GROWTH WAS ATTRIBUTABLE TO THE INCREASE IN PUBLIC EXPENDITURE . (IT ALSO WAS STIMULATED IN PART BY NEGATIVE REAL INTEREST RATES).

3. THE TRADE SURPLUS FOR 1987 WAS RAND 13.98 BILLION (THE TRADE SURPLUS LAST YEAR WAS RAND 15.3 BILLION). THE PAYMENTS SURPLUS BEFORE REPAYMENT OF DEBT WAS ABOUT RAND 6 BILLION. THE RESERVES INCREASED FROM RAND 5.7 BILLION AT THE END OF 1986 TO RAND 8 BILLION.

4. THE TREASURY SECRETARY , STALS , TOLD ME LAST NIGHT THAT THE BUDGETED DEFICIT OF RAND 8.5 BILLION (4.7 PER CENT OF GDP) FOR FISCAL YEAR 1987-88 IS LIKELY TO BE EXCEEDED BY RAND ONE AND HALF TO 2 BILLION. THIS IS LESS THAN CURRENTLY EXPECTED BY THE FINANCIAL MARKETS. BUT IT HAS STRENGTHENED THE DETERMINATION OF THE FINANCE MINISTRY TO CONTAIN FURTHER GROWTH IN PUBLIC EXPENDITURE AND HELPED THEM TO PUSH THROUGH THE CABINET THE PAY FREEZE FOR THE PUBLIC SERVICE ANNOUNCED LAST WEEK BY PRESIDENT BOTHA.

5. ALTHOUGH THE RECOVERY IS GATHERING MOMENTUM, STALS DOES NOT EXPECT GROWTH TO BE HIGHER THAT 3 PER CENT THIS YEAR IN PART

BECAUSE AGRICULTURAL PRODUCTION IS AGAIN LIKELY TO BE AFFECTED BY ADVERSE WEATHER CONDITIONS IN THE PAST FEW WEEKS. THE RECOVERY IN THE MANUFACTURING SECTOR IS MUCH STRONGER. THE RECOVERY IS MORE BROADLY BASED AND IS BEING LED BY THE PRIVATE SECTOR. PRIVATE FIXED CAPITAL INVESTMENT HAS INCREASED THOUGH TOTAL FIXED INVESTMENT HAS NOT AS GOVERNMENT CAPITAL SPENDING HAS CONTINUED TO FALL.

6. STALS EXPECTS A FURTHER SUBSTANTIAL TRADE SURPLUS THIS YEAR, WITH A BALANCE OF PAYMENTS SURPLUS OF ABOUT RAND 4 BILLION. THIS SHOULD COVER COMFORTABLY FURTHER DEBT REPAYMENTS. ONLY ABOUT US DOLLARS 500 MILLION OR RAND ONE BILLION ARE DUE TO BE REPAID FROM FUNDS WITHIN THE NET IN 1988. STALS EXPECTS, THEREFORE, SOME FURTHER INCREASE IN THE RESERVES BY THE END OF THE YEAR. HE ADDED THAT THE US BANKS IN PARTICULAR WERE SHOWING INCREASED INTEREST IN THE CONVERSION OF FUNDS WITHIN THE NET INTO TEN YEAR ''EXIT BONDS'' . PERMISSION SO FAR HAD BEEN GIVEN BY THE RESERVE BANK FOR ABOUT US DOLLARS ONE AND A HALF BILLION TO BE CONVERTED IN THIS WAY.

7. I ASKED STALS AT WHAT POINT HE EXPECTED THE BALANCE OF PAYMENTS TO BECOME A SERIOUS CONSTRAINT. CURRENTLY HE BELIEVES THAT THIS IS UNLIKELY TO BE MUCH OF A FACTOR BEFORE LATE 1989. IF GROWTH STARTED TO SUCK IN IMPORTS AT A RATE THAT THREATENED THE BALANCE OF PAYMENTS, THE GOVERNMENT WOULD RESPOND BY RAISING INTEREST RATES, AND THEY ARE LIKELY TO RISE ANYWAY. THE DEBT STANDSTILL IS THOUGHT LIKELY TO BE CARRIED FORWARD ON TERMS SIMILIAR TO THOSE AT PRESENT IN FORCE WHEN IT FALLS FOR RENEWAL IN 1990.

8. THE FINANCIAL RAND, MEANWHILE, HAS RISEN TO US DOLLARS 0.36, REDUCING SIGNIFICANTLY THE DISCOUNT AGAINST THE COMMERCIAL RAND. THE ECONOMY WILL REMAIN VULNERABLE TO OSCILLATIONS IN THE GOLD PRICE. SOUTH AFRICAN GOLD PRODUCTION HAS FALLEN FROM 683 TONS IN 1984 TO 605 TONS IN 1987, WHILE PRODUCTION OUTSIDE SOUTH AFRICA HAS BEEN INCREASING. THIS LOSS IN VOLUME HAS BEEN MORE THAN OFF-SET BY THE HIGHER GOLD PRICE.

9. AVERAGE WAGE SETTLEMENTS FOR UNIONISED WORKERS ARE ESTIMATED TO HAVE REACHED 18 PER CENT IN 1987 (THREE POINTS HIGHER THAN INFLATION). A RESULT OF THE INCREASED MILITANCY OF THE BLACK TRADE UNIONS, MORE DAYS WERE LOST THROUGH STRIKE ACTION LAST YEAR THAN IN THE WHOLE OF THE PRECEDING SEVEN YEARS.

10. THE BUSINESS COMMUNITY HAVE WELCOMED P W BOTHA'S STATEMENT

ON ECONOMIC POLICY, BUT DOUBTS ABOUT THE GOVERNMENT'S COMMITMENT TO ANY VERY RADICAL POLICY ON PRIVATISATION HAVE BEEN CONFIRMED BY A STATEMENT BY THE DEPUTY FINANCE MINISTER THAT THE GOVERNMENT INTENDS TO RETAIN A 51 PER CENT HOLDING IN THE MAJOR CORPORATIONS LISTED AS POTENTIAL CANDIDATES FOR PRIVATISATION.

11. F C O PLEASE PASS TO TREASURY, MAYES (BANK OF ENGLAND) AND MUIR (DTI).

RENWICK

YYYY

<u>DISTRIBUTION</u> 175

<u>MAIN</u> 175

FINANCIAL SAFD

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MDLIAN 5302

CONFIDENTIAL
FM CAPE TOWN EMBASSY
TO PRIORITY FCO
TELNO 104
OF 241600Z MARCH 1988
INFO PRIORITY JOHANNESBURG, BANK OF ENGLAND, HM TREASURY, DTI, ECGD

MY TELNO 97 : SOUTH AFRICAN ECONOMY

1. I HAD A TALK TODAY WITH STALS, DIRECTOR-GENERAL FOR FINANCE, ABOUT THE PROSPECTS FOR THE SOUTH AFRICAN ECONOMY.

2. STALS SAID THAT THE BUDGET WAS INTENDED TO BE MILDLY DEFLATIONARY . THE LATEST RETURNS SHOWED THAT GROWTH IN THE FOURTH QUARTER HAD PROCEEDED AT AN ANNUALISED RATE OF 4.8 PER CENT. THIS WAS UNSUSTAINABLE . THE FINANCE MINISTRY WERE PLANNING FOR 2.5 PER CENT GROWTH THIS YEAR,IE THE SAME AS LAST YEAR. THIS, IN STALS' VIEW, SHOULD BE SUSTAINABLE. THERE WERE OBVIOUS DIFFICULTIES IN ATTEMPTING TO FINE TUNE THE ECONOMY. BUT STALS FELT THAT THE BUDGET AND THE PRESIDENT'S STATEMENT AT THE OPENING OF PARLIAMENT REPRESENTED A CONSIDERABLE VICTORY FOR THE FINANCE MINISTRY. HE HAD BEEN INVITED BY THE PRESIDENT TO GIVE A PRESENTATION TO THE CABINET, IN WHICH HE HAD MADE CLEAR THAT GOVERNMENT BORROWING MUST BE REDUCED AS A PER CENTAGE OF GNP. THE GOVERNMENT COULD NOT GO ON SPENDING MORE IN REAL TERMS AND THIS WAS NOT NECESSARY IN A PERIOD WHEN PRIVATE FIXED CAPITAL INVESTMENT WAS PICKING UP. PRIORITY HAD PERFORCE TO BE GIVEN TO SPENDING ON DEFENCE AND SECURITY, AND BLACK EDUCATION AND HOUSING. OTHER PARTS OF THE BUDGET WOULD BE SUBJECTED TO A CONTINUING SQUEEZE.

3. I SAID THAT BOTH THE FINANCE MINISTER AND THE RESERVE BANK GOVERNOR HAD EMPHASISED TO ME THE NARROW MARGINS WITHIN WHICH THE SOUTH AFRICAN GOVERNMENT HAD TO OPERATE, WITH PARTICULAR REFERENCE TO BALANCE OF PAYMENTS CONSTRAINTS. HOW DID STALS SEE THE PROSPECTS ? STALS SAID THAT THE SAG WERE BUDGETING FOR A RAND 3 BILLION SURPLUS THIS YEAR, FOLLOWING THE RAND 6.2 BILLION SURPLUS IN 1987. THIS WAS IN LINE WITH THE PROJECTIONS HE HAD GIVEN TO THE OVERSEAS BANKS WHEN THE DEBT STAND-STILL HAD BEEN NEGOTIATED, IE A DOLLAR 3 BILLION SURPLUS IN 1987 , FALLING TO DOLLARS 1. 5 BILLION THIS YEAR AND ZERO NEXT YEAR. THE OUTSTANDING DEBT WITHIN THE NET WAS DOLLARS 10 BILLION . OF THAT DOLLARS 500 MILLION FELL TO BE REPAID THIS YEAR, WITH A SMALLER AMOUNT NEXT YEAR. IF NONE OF THE DEBT OUTSIDE THE NET WAS ROLLED FORWARD (INCLUDING TRADE CREDITS ETC) SOUTH AFRICA WOULD HAVE A TOTAL EXPOSURE THIS YEAR OF

DOLLARS 2 BILLION . BUT THE SAG EXPECTED NEW TRADE CREDITS TO BE ROUGHLY EQUAL TO THOSE FALLING DUE FOR REPAYMENT. THEY HAD INCREASED THEIR RESERVES AND HE FELT REASONABLY CONFIDENT ABOUT THE POSITION NEXT YEAR. BUT SOUTH AFRICANS IMPORTERS WOULD HAVE TO CHANGE THEIR METHOD OF FINANCING. IN THE PRESENT PHASE OF THE GROWTH CYCLE THEY HAD BEEN BORROWING DIRECT FROM THE BANKS AND PAYING CASH FOR IMPORT ORDERS. THE BANKS WERE NOW ADVISING THEM TO RELY MORE ON OVERSEAS TRADE CREDITS. AS THE BANKS HAD BEEN AWASH WITH CREDIT, THEY HAD ALSO HAD GONE IN FOR QUITE AGGRESSIVE FINANCING OF EXPORTS. MORE OF THAT CREDIT WAS GOING TO HAVE TO BE MADE AVAILABLE BY FOREIGN BANKS AS SOUTH AFRICA MOVED OUT OF THE PHASE OF NEGATIVE REAL INTEREST RATES.

4. STALS SAID THAT HE AND HIS COLLEAGUES HAD NOT REALLY BEGUN TO THINK ABOUT THE NEXT RE-SCHEDULING AGREEMENT. BUT HE WOULD BE GIVING A BRIEFING ON THE SOUTH AFRICAN ECONOMY AND BALANCE OF PAYMENTS POSITION TO MILBURN (NATWEST) AND HIS COMMITTEE IN THE SECOND HALF OF MAY. ATTEMPTING TO ACHIEVE SUSTAINED ECONOMIC GROWTH WITH NO NET INFLOW OF NEW INVESTMENT WAS AN EXTREMELY

DIFFICULT TASK. BUT SOUTH AFRICA NEEDED CONTINUING ACCESS TO TRADE CREDITS AND WAS DETERMINED TO HONOUR ITS DEBTS. THEY WERE CONFIDENT OF THEIR ABILITY TO DO SO. NEARLY DOLLARS 2 BILLION OF THE FUNDS WITHIN THE ''NET'' HAD BEEN CONVERTED INTO EXIT BONDS,SOME MOSSEL BAY FINANCING WAS GOING TO BE ARRANGED IN THIS WAY.

5. I SAID TO STALS THAT ONE MINISTER (THOUGH I DID NOT NAME HIM, THIS WAS KENT DURR) HAD SPOKEN TO ME OF THE POSSIBLE EVENTUAL IMPOSITION OF IMPORT CONTROLS . STALS SAID THAT HE AND HIS MINISTER WERE TOTALLY OPPOSED TO THIS. IMPORT CONTROLS REQUIRED A BUREAUCRACY OF 800 PEOPLE. 40 PER CENT OF SOUTH AFRICAN IMPORTS WERE OF CAPITAL GOODS, A FURTHER 40 PER CENT OF INTERMEDIATE GOODS REQUIRING FURTHER PROCESSING HERE (EG VEHICLE COMPONENTS) AND ONLY 20 PER CENT OF STRAIGHTFORWARD CONSUMER GOODS. THE REAL VOLATILITY LAY IN THE DEMAND FOR CAPITAL GOODS AS THE RECOVERY CONTINUED. INEVITABLY THERE WOULD BE SOME FURTHER DEPRECIATION OF THE RAND , THOUGH THE GOVERNENT WAS DETERMINED TO LIMIT THIS AND INTENSIFY THE FIGHT AGAINST INFLATION.

6. ON REFORM OF THE TAX SYSTEM, STALS SAID THAT THE SHIFT NEXT YEAR FROM THE GENERAL SALES TAX TO VAT WOULD PREVENT FURTHER EROSION OF THE TAX BASE. VAT WOULD HAVE TO BE LEVIED ON ALL FOOD STUFFS (AT PRESENT IT IS LEVIED ONLY ON TINNED FOODS). IT WOULD

BE SET AT THE SAME RATE AS GST (CURRENTLY 12 PER CENT). THE GOVERNMENT WOULD HAVE LIKED TO EXEMPT CAPITAL GOODS FROM VAT , BUT FOUND THAT IT WOULD BE TOO EXPENSIVE TO DO SO. THEY WERE LIKELY, HOWEVER, TO SET THE VAT EXEMPTION AT A RATE SUBSTANTIALLY HIGHER THAN THE RAND 25,000 PER ANNUM RECOMMENDED BY THE MARGO COMMISSION. STALS THOUGHT THAT THE RATE SHOULD BE SET CLOSER TO RAND 100,000 A YEAR . THIS WAS NECESSARY TO ENCOURAGE THE DEVELOPENT OF THE INFORMAL SECTOR, WHICH WAS UNDER-MEASURED IN ITS CONTRIBUTION TO THE ECONOMY, AND TO EXEMPT SMALL FARMERS.

7. ON PRIVATISATION, STALS SAID THAT SOME CABINET MINISTERS NAIVELY WERE ALREADY MAKING PLANS TO SPEND THE PROCEEDS. IN FACT THERE WOULD BE VERY FEW PROCEEDS IN THE FIRST YEAR. THE GOVERNMENT , DELIBERATELY, HAD SET NO FIGURE IN THE BUDGET. SOME SMALL OPERATIONS, INCLUDING THE MINT, WOULD BE PRIVATISED THIS YEAR. BUT THE YIELD WOULD BE ONLY RAND 2-300 MILLION AND THE PROCEEDS WOULD NOT GO TOWARDS CURRENT EXPENDITURE. DEPARTMENTS WHICH HAD PUT IN ADDITIONAL BIDS WERE BEING TOLD THAT THEY HAD TO FIND CORRESPONDING SAVINGS. THE GOVERNMENT HAD TAKEN NO DECISIONS AT THIS STAGE ON WHAT IT WAS GOING TO DO ABOUT ESCOM, ISCOR AND THE TRANSPORT SERVICES. A LEADING MERCHANT BANKER FROM THE FINANZBANK WAS BEING APPOINTED TO ASSIST DAWIE DE VILLERS WITH PRIVATISATION. THE PROGRAMME WAS NOT A SOLUTION TO SOUTH AFRICA'S BUDGETARY PROBLEMS. THE ONLY SOLUTION WAS TO KEEP EXPENDITURE IN CHECK.

8. ON THE DEFICIT BEFORE BORROWING, STALS SAID THAT THE GOVERNMENT HAD NOT ISSUED ANY NEW BONDS IN THE PAST THREE MONTHS. THEY ANTICIPATED , THEREFORE, A STRONG DEMAND FOR THE NEW ISSUES. ALTHOUGH THE DEFICIT WAS STILL TOO HIGH AS A PERCENTAGE OF GDP (THE INTENTION IS TO BRING IT DOWN PROGRESSIVELY TO 3 PER CENT) THERE SHOULD BE NO DIFFICULTY IN FINANCING IT THIS YEAR. HE HOPED THAT IT WOULD BE POSSIBLE TO LIMIT THE PIC FUNDS FOR THE PURPOSE TO SIGNIFICANTLY LESS THAN THE MAXIMUM ENVISAGED (RAND 2 BILLION)

9. FINALLY , STALS ADDED HIS CONGRATULATIONS ON THE BUDGET IN THE UNITED KINGDOM.

10. FCO PLEASE PASS TO HM TREASURY, MAYES(BANK OF ENGLAND), ECGD AND OT4 (DTI)

RENWICK

020761
MDLIAN 5302

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DISTRIBUTION 169

MAIN 163

MONETARY
SAFD
CAFD

ADDITIONAL 6

HM TSY
MR MAYES BANK/ENG
ECGD
DTI/OT4 VIC ST
MUIR (AUS DTI)
MR WICKS NO 10 DOWNING ST

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030440
MDLIAN 8480

Ch.
NB 'X' (para 7).

CONFIDENTIAL
FM CAPE TOWN EMBASSY
TO PRIORITY FCO
TELNO 177
OF 181303Z MAY 1988
INFO PRIORITY WASHINGTON

SOUTH AFRICA : MEETING WITH THE MINISTER OF FINANCE

1. WHEN I CALLED ON BAREND DU PLESSIS, THE MINISTER OF FINANCE, I ASKED HIM ABOUT PROSPECTS FOR THE SOUTH AFRICAN ECONOMY AND THE BALANCE OF PAYMENTS FOR THE REST OF THE YEAR.

2. DU PLESSIS SAID THAT SOUTH AFRICA WAS IN A SITUATION IN WHICH IT COULD NOT AFFORD TO AIM FOR MORE THAN 2.5 PER CENT GROWTH IN GDP. THERE WAS NO ACCESS TO WORLD BANK FINANCE OR IMF CREDITS AND NO EXTERNAL INVESTMENT FLOWS. THIS LEFT HIM AND THE FINANCIAL AUTHORITIES WITH VERY NARROW MARGINS IN WHICH TO OPERATE. THE RECENT INCREASE IN INTEREST RATES AND RESTRICTIONS IN CREDIT WERE INTENDED TO COOL OFF THE CONSUMER -LED BOOM WHICH WAS PROCEEDING AT AN UNSUSTAINABLE RATE. IF THAT PROVED INADEQUATE, HE WANTED THE RESERVE BANK FURTHER TO RESTRICT THE FLOW OF PAPER TO AN EXTENT WHICH WOULD OBLIGE THE BANKS THEMSELVES TO FURTHER INCREASE INTEREST RATES. THE RAND WOULD HAVE TO BE ALLOWED TO WEAKEN AGAINST OTHER CURRENCIES TO MAKE IMPORTS MORE EXPENSIVE. IT SHOULD BE POSSIBLE TO MAINTAIN A SMALL BALANCE OF PAYMENTS SURPLUS THIS YEAR. THE POSITION NEXT YEAR WOULD BE VERY TIGHT BUT, HE BELIEVED, MANAGEABLE PROVIDED GROWTH, AND WITH IT THE PROPENSITY TO IMPORT, WAS HELD WITHIN THESE BOUNDS.

3. I SAID THAT WE ATTACHED GREAT IMPORTANCE TO THE BATTLE HE, THE GOVERNOR OF THE RESERVE BANK AND THE TREASURY SECRETARY WERE FIGHTING AGAINST THE DRIFT TOWARDS A SIEGE ECONOMY. WE HAD PROTESTED ABOUT THE FEBRUARY MEASURES AGAINST BLACK ORGANISATIONS BOTH BECAUSE WE BELIEVED THAT THEY WERE WRONG IN PRINCIPLE AND BECAUSE WE WERE CERTAIN THAT THEY WOULD INCREASE THE SANCTIONS AND DISINVESTMENT PRESSURES AT A TIME WHEN SOUTH AFRICA COULD LEAST AFFORD IT. THOSE EXPECTATIONS HAD BEEN REALISED. WE UNDERSTOOD THAT IN THE CALCULATIONS THE SOUTH AFRICAN GOVERNMENT HAD TO GIVE GREAT WEIGHT TO SECURITY CONSIDERATIONS. BUT WE FELT THAT THIS WAS BEING DONE AT THE EXPENSE OF THEIR INTERNATIONAL RELATIONS AND ECONOMIC PROSPECTS. THE SITUATION HAD BEEN DIFFERENT IN MANY RESPECTS IN RHODESIA BUT IT WAS, POTENTIALLY AT LEAST, SIMILAR IN THIS RESPECT THERE THE MILITARY AND POLICE HAD ENDED UP GOBBLING UP ALL THE

RESOURCES. THAT WAS A RECIPE FOR DISASTER IN THE LONGER TERM.

4. BAREND DU PLESSIS SAID THAT HE WAS CONCERNED ABOUT THIS. HE WAS DETERMINED TO PRESERVE SOUTH AFRICA'S FINANCIAL CONTACTS WITH THE REST OF THE WORLD. ANY MOVE TOWARDS A SIEGE ECONOMY WOULD LEAD TO THE DENIAL OF TRADE CREDITS , WITH A FURTHER NEGATIVE IMPACT ON GROWTH. A HIGH PROPORTION OF SOUTH AFRICAN IMPORTS CONSISTED OF CAPITAL AND INTERMEDIATE GOODS. IF MILITARY SPENDING INCREASED, THAT WOULD IMPOSE FURTHER CONSTRAINTS ON SOCIAL EXPENDITURE, WHICH WAS CRUCIAL FOR THE FUTURE. HE HAD TO FIND MORE RESOURCES FOR THAT PURPOSE. FOR MY PRIVATE INFORMATION, HE WAS TRYING TO PERSUADE THE STATE PRESIDENT THAT SOUTH AFRICA SHOULD SELL OFF PART OF ITS HUGE OIL STOCKPILE. THIS WAS IMMOBILISING BILLIONS OF RANDS TO NO GOOD EFFECT. HE WAS BEING OPPOSED BY THE MILITARY, BUT INTENDED TO PURSUE THIS BATTLE WITH THEM.

5. IF AS A RESULT OF DEVELOPMENTS WITHIN THE COUNTRY OR EXTERNAL ACTIONS SOUTH AFRICA WAS PUSHED INTO A STATE OF SIEGE, THAT WOULD END UP WITH THE MILITARY EFFECTIVELY IN CONTROL. HE WAS WORRIED ABOUT THE US SANCTIONS LEGISLATION FROM THIS POINT OF VIEW. IF CONGRESS THIS YEAR OR A DEMOCRATIC ADMINISTRATION NEXT YEAR PUSHED THROUGH DRACONIAN LEGISLATION OF THIS KIND, THAT WOULD GIVE A FURTHER BOOST TO THE RIGHT WING HERE. IT ALSO WOULD DIMINISH THE INFLUENCE OF THOSE WITHIN THE GOVERNMENT WHO WISHED TO PURSUE MORE ENLIGHTENED POLICIES AND TO WORK FOR PROGRESSIVE REFORM.

6. I SAID THAT , AS YOU AND THE PRIME MINISTER HAD MADE CLEAR, WE REMAINED FIRMLY OPPOSED TO PUNITIVE ECONOMIC ACTIONS. BUT APART FROM SUSTAINING OUR OWN POSITION , WE HAD ALSO TO SEEK TO INFLUENCE OTHERS. THE FEBRUARY MEASURES HAD INCREASED THE PRESSURES ON THE OIL COMPANIES. IF WITHIN THE NEXT FEW YEARS THE OIL COMPANIES DISINVESTED , THE CONSEQUENCES WOULD BE DISASTROUS FOR CONFIDENCE IN THE ECONOMY BOTH WITHIN SOUTH AFRICA AND OUTSIDE. WE WERE GOING TO HAVE TO EXPRESS OUR OWN CONCERN IN WASHINGTON ON ASPECTS OF THE DRAFT LEGISLATION. WE ALSO WERE GOING TO HAVE TO TRY TO INFLUENCE WHATEVER ADMINISTRATION TOOK OVER IN THE NEW YEAR. TO HAVE ANY HOPE OF DOING SO WE NEEDED, AT THE MOMENT, THE AVOIDANCE OF FURTHER MISTAKES BY THE SOUTH AFRICAN GOVERNMENT AND THE RE-AFFIRMATION OF THE COMMITMENT TO REFORM. ONE SERIOUS AND AVOIDABLE MISTAKE WOULD BE TO PASS THE PROPOSED LEGISLATION ON FOREIGN FUNDING IN ITS PRESENT FORM.

7. DU PLESSIS SAID THAT HE WAS GRATEFUL FOR THE ATTITUDE WE HAD ADOPTED. THE COUNTRY WAS AT SOMETHING OF A TURNING POINT. IF

FURTHER PUNITIVE MEASURES WERE ADOPTED IN WASHINGTON HE FEARED FOR THE INTERNAL POLITICAL CONSEQUENCES HERE. HE WOULD BE ATTENDING THE IMF MEETINGS IN THE AUTUMN AND THEREAFTER, WOULD BE PASSING THROUGH LONDON. HE HOPED THAT THIS WOULD AFFORD AN OPPORTUNITY TO TALK TO YOU AND THE CHANCELLOR. |X

RENWICK

YYYY

DISTRIBUTION 176

MAIN 176

FINANCIAL SAFD

NNNN

35/1 aef2/ln.8.23.5

CONFIDENTIAL

FROM: MRS S THOMSON

DATE: 26 MAY 1988

PS/ECONOMIC SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
Mr Anson
Mr Monck
Mr Mountfield
Mr Turnbull
Mr Edwards
Mr M L Williams
Mr Bottrill
Mr Call

COAL IMPORTS - SOUTH AFRICA

I attach a copy of letter dated 6 May from the Minister for Trade to the Minister of State at the Foreign and Commonwealth Office and the reply, which came from the Foreign Secretary on 19th May. You will see that the Minister for Trade thinks it possible that German determination to resist an EC ban on imports of South African coal may be faltering. He therefore wishes to convey privately to the Portuguese our support for their continued opposition to an EC ban on coal. He also indicates that even if the Portuguese also withdraw their opposition we should veto an EC ban.

2. In his reply the Foreign Secretary says it is unlikely that the Germans will drop their opposition to the ban, but that if they do the UK is bound by the terms of the Marlborough House Resolution and should neither talk to the Portuguese nor veto the ban.

3. The DTI letter was copied here to the Financial Secretary, and we made no comment. The action proposed was in line with our general policy of opposition to sanctions against South Africa which might provoke a destabilising response and of encouraging free trade. The Foreign Secretary's reply is a firm restatement of the position taken in August 1986. Nothing has happened since then to change the balance of the arguments: should the Treasury join in, and, if so, with what object in mind?

4. In 1986 South African exports of coal represented 7% of all South African exports, and half went to the EC. Assessments made then of the impact of such a ban assumed that the US and Japan would also ban South African coal - the impact on jobs would then be a loss of 33,000 - 43,000 jobs out of a total coal workforce of 98,000. These figures are, however, likely to be substantially overestimated. In practice South African coal has found a ready market in a number of countries in the Far East, albeit at a small discount on world prices. An EC ban is unlikely to have much impact either on South African exports or on world coal prices (direct imports into the UK of South African coal are unlikely in any event, even if the domestic market is liberalised; no coal user will want to risk the possible union reaction). It is similarly unlikely that an EC ban on South African coal imports would be very damaging to the South African coal industry. It has long been signalled. On balance it will probably provoke some retaliatory action, but it is not likely that this would be disproportionate - the likeliest reaction would be a selective ban on exports to the EC of some strategic metals.

5. As the FCO seem confident that German opposition will be maintained any Treasury contribution to the debate now would be premature. The Treasury's interest is in encouraging free trade in coal and preventing sanctions which might provoke South Africa into taking retaliatory action damaging to UK interests. So far as we are concerned, the main interests are those of the UK banks with loans outstanding to South Africa and ECGD's outstanding guarantees. The total amounts at risk are \$3.7 bn for the banks and \$2.5 bn for ECGD. At first sight, an EC ban on coal imports, while not consonant with free trade, is not likely to be so damaging as to (for example) cause South Africa to cut itself off from the international financial community through a debt default, so neither of the above amounts seem seriously threatened. If the German opposition is withdrawn the Treasury would need new and compelling arguments against the present UK line. On balance, therefore, while watching the DTI/FCO debate with interest, we should not join in.

S y Thomson.

MRS S THOMSON

42/2.BTW.4372/31

FINANCIAL SECRETARY TO THE TREASURY

FROM: N M DAWSON
DATE: 6 June 1988

MR BENT

cc PS/Chancellor
Mr Moore
Mrs Brown
Mr Cropper
Mr Tyrie
Mr Call

MEETING WITH DR De VILLIERS: SOUTH AFRICAN MINISTER
10.30AM 22 JUNE

The Financial Secretary has agreed to see Dr De Villiers to discuss
... privatisation at 10.30am on Wednesday 22 June (letter attached).

2. I would be grateful if you could supply briefing by close of play Tuesday 21 June.

3. The Financial Secretary would also be grateful if you and Mr Call could be present at the meeting.

Nigel Dawson

NIGEL DAWSON
Diary Secretary

ENC

TEL.: 01-930 4488

TELEGR.: OPPOSITELY LONDON WC2

Verw:
Ref: 7/9/21/2

SUID-AFRIKAANSE AMBASSADE
SOUTH AFRICAN EMBASSY
TRAFALGAR SQUARE
LONDON,
WC2N 5DP

18 May 1988

Mr Nigel Dawson
Financial Secretary's Office
H.M. Treasury
Treasury Chambers
Parliament Street
LONDON SW1T 3AJ

Dear Mr Dawson,

Dr D.J. de Villiers, South Africa's Minister for Administration and Privatisation, will be visiting London from 21 - 23 June 1988. He would welcome the opportunity of a meeting with Mr Norman Lamont, Financial Secretary to the Treasury, during his visit.

It would accordingly be appreciated if you could indicate if an appointment could be made for Dr de Villiers to see Mr Lamont.

Kindly contact me on 930 4488 X138 in order to arrange a date and time.

Yours sincerely,

C.C. EDWARDS (MISS)
SECRETARY OF EMBASSY

45 Great Peter Street
London SW1P 3LT
Telephone 01-222 5133

British Industry Committee on South Africa Limited

B I C S A

12/9/88

With Compliments

BICSA

British Industry Committee
on South Africa Limited

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45 Great Peter Street, London SW1P 3LT
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BICSA

British Industry Committee
on South Africa Limited

British Industry in South Africa

Fundamental Change

Apartheid is intolerable and there will be no real peace in South Africa until all people have secured human and political rights. The South African business community has been urging fundamental change on the government and has been supported in this by British business. The end of apartheid is inevitable; the only question is whether it comes about by negotiation or through increasing violence and bloodshed.

Involvement

More than 100 British companies have direct investment in South Africa with many more engaged in trade with that country. Total British investments represent a stake of £6,000 million and trade is worth nearly £4,000 million a year. Our estimate suggests that some 120,000 UK jobs are dependent on these activities. This represents an important stake in the future of South Africa which is only likely to be secured in the longer term if it is possible to emerge from the present impasse with amicable relations established with any post-apartheid government in the Republic.

Responsibility

British companies collectively have built up, over a century, more experience and knowledge of the country than those of any other nation. This history gives British companies a particular responsibility now when South Africa is approaching the edge of an abyss. It is a responsibility which embraces our South African partners and employees, black, coloured and white. Unless apartheid is ended soon South Africa could be plunged into even greater chaos. This would not only be a human tragedy and an appalling waste; it would wreck the South African economy, destroying the work of many decades and blighting the hopes of future economic advancement for the majority of South Africans.

Sanctions

The objectives are clear and shared generally, i.e. the abolition of apartheid and the establishing of a political and social order which ensures freedom for all the people of South Africa. The argument is about how best to achieve these objectives. In other words, what are the means most likely to be effective in persuading the Government of the sovereign state of South Africa to take the necessary action.

The imposition of punitive measures, even if they are universally observed and enforced, is likely to mean that some sections of the community in South Africa, including

NEI plc
Overseas Containers Limited
Pilkington Brothers plc
Reckitt and Colman plc
Renold plc
The Rio Tinto Zinc Corporation plc
Rowntree Mackintosh plc
Shell International Petroleum Co Ltd
Tioxide Group plc
United Transport International plc

BICSA

BICSA (British Industry Committee on South Africa) was created in January 1986 following discussions between the CBI and the United Kingdom South Africa Trade Association (UKSATA). Both organisations had concluded that the South African scene was changing so rapidly that specific and dedicated attention to it was needed if British industry's views and interests were to be adequately represented in contributing to peaceful progress in that country.

Whilst BICSA cannot claim to represent the views of all British companies involved in the South African economy, it can and does express the views and opinions of the great majority. BICSA speaks *only* for British industry and for no other organisation or authority.

The following companies subscribe to this statement:—

Associated British Ports Holdings plc
Babcock International plc
Barclays Bank plc
Beecham Group plc
Blue Circle Industries plc
The BOC Group plc
British and Commonwealth Shipping plc
The British Petroleum Co plc
The Burmah Oil Co plc
Cadbury Schweppes plc
Consolidated Gold Fields plc
Cookson Group plc
Delta Group plc
B. Elliott plc
Foseco Minsep plc
Gallaher Limited
Hall Engineering (Holdings) plc
Hanson Trust plc
Hill Samuel Group plc
ICI plc
Lopex plc
Mitchell Cotts plc

the government, could retreat in on themselves and become even more resistant to change. However, white opinion is not unanimous in support of the government's current unwillingness to embark upon significant political reform; and it is not inconceivable that increased international pressure and dialogue could play a significant role in support of those pressing for change within the country. What is certain is that the continued absence of political change will strengthen the calls for sanctions.

Hope for the future

Even at this late stage we have not given up hope that negotiations to end apartheid can be started. Ultimately peace and economic prosperity run together but political change and economic development do not always run in parallel.

Economic growth has undoubtedly been a force for social and political change in South Africa as elsewhere. Equally there can be no economic prosperity without political change and as Jan Steyn, the Chairman of the Urban Foundation has said, "only on the basis of a growing economy, in which the country is able to house its people, educate its youth and provide jobs for its growing population, can positive social political change be sustained over time". Mrs Helen Suzman, MP (Progressive Federal Party) has said "The best hope for reform in South Africa lies in economic advancement of the Blacks. American, British and other foreign firms should stay and exert pressure for change and implement enlightened employment codes". We will continue to try to meet that challenge.

British companies have not only contributed to economic growth but are making an important contribution to the welfare and advancement of their black and coloured workers. Many are closely involved in working to improve community life beyond the workplace. These activities range from housing and health care to agriculture and the development of Black business. A notable example is the field of education which has particularly suffered from neglect by the authorities over many years. Companies which have initiated or support education programmes recognise that the country's future economic welfare requires a much better educated and trained black population. Equally compelling is the fact that so few Africans are able to fulfil their educational potential without the help which companies can provide.

Skill training of Black employees is virtually universal. Some companies have their own numeracy and literacy programmes. Technical training is emphasised; and some of the larger companies have opened fully equipped government-registered apprentice schools or training centres. Still more can, and must, be done.

Conclusion

A number of modifications to apartheid have been undertaken in recent years. Some steps have been in response to the economic need for a more skilled and mobile labour force. However, the core of apartheid remains.

The immediate challenge is to bring about political change upon which long term prosperity can be founded. A number of British companies have been working directly for change, pressing the urgency of fundamental political and social reform, and using their influence as a significant presence in South Africa to create opportunities for dialogue between the various groups. Further, these companies recognise the continuing and increasing need of the Black communities for education and training.

We understand the frustrations which have led the Commonwealth and others to conclude that economic measures or sanctions are the only recourse left by which the rest of the world can bring pressure to bear on the South African government. BICSA understands the case for non economic measures that might express the world's deep abhorrence to what it sees in South Africa.

Table III

South African Visible Exports to the UK 1985

	£m
Crude materials, inedible, except fuel	372.1
Manufactured goods	327.1
Food and live animals chiefly for food	150.3
Machinery and transport equipment	57.9
Miscellaneous manufactured articles	33.5
Mineral fuels, lubricants and related materials	22.9
Chemical and related products	13.0
Others	13.1
Total	£989.9m

Source: UK Overseas Trade Statistics – SITC Classifications.

Table II

UK Visible Exports to South Africa in 1985

	£m
Machinery and transport equipment	479.4
Chemicals and related products	200.9
Manufactured goods	124.7
Miscellaneous manufactured articles	95.7
Beverages and tobacco	42.5
Commodities and transactions not classified elsewhere	26.3
Food and live animals chiefly for food	17.6
Crude materials, inedible, except fuels	12.9
Others	9.7
Total	£1,009.7m

Source: UK Overseas Trade Statistics – SITC Classifications.

We recognise that international pressures have strengthened internal developments bringing about change in South Africa and we are certainly not opposed to further pressures which support those working for non-violent change from within and which are aimed at ending apartheid. However, we believe that external pressures on the South African economy will not achieve their objective if they are designed in such a punitive way as to destroy the South African economy.

Appendix

UK Investment in S.A.

Almost 7% of all British overseas direct investment is in South Africa, the market value of which at May 1986 was estimated at about £2,700 million. There is also a substantial indirect (i.e. portfolio) investment, the market value of which is now probably about £3,300 million. £6,000 million of British investment money is therefore at stake.* British investment accounts for 40% to 45% of total foreign investment in South Africa.

South African Investment in the UK

The current market value of South African direct investment in Britain is estimated by BICSA to be about £700 million – perhaps 1.9% of all foreign direct investment in the United Kingdom.

Trade

Britain's total gross income from trade with South Africa is estimated by BICSA to be about £3,860 million per annum. The earnings from UK visible exports, currently running at an annual rate of approximately £1,010 million, provide substantial employment for British workers and the income received from 'invisible' earnings, i.e. investment income, insurance, services, profits, dividends, shipping etc., we estimate totals about £2,350 million per annum. In addition, an estimated £500 million per annum is earned on imports of South African diamonds and gold processed in the UK and then exported. Total two-way UK visible trade with South Africa for the year ended December 1985 was £2 billion. South African trade represents about 2% of British exports and 7% of South African exports.

*** Footnote**
These figures appear lower than those 5 years ago, partly as a result of investment withdrawal, but principally as a result of the difference in the exchange rate.

Table I

UK-South Africa Trade and Investment Statistics

UK Investment in South Africa	£m
Direct	2,700
Indirect	3,300
Total	6,000

This is 7% of all British overseas investment.
This is 40-45% of all foreign investment in South Africa.

UK/SA Trade	£m
Visible Exports from UK (year to 31.12.1985)	1,010
Estimated Gross Earnings from Invisible Trade (year to 31.12.1985)	2,350
Estimated Value of Re-Exports	500
Estimated Gross UK income from SA Trade (Visibles, Invisibles and Re-Exports)	3,860
Visible Imports from SA (year to 31.12.1985)	990

UK share of SA Import Market is *11.6%*
SA is *16th* most valuable UK Export Market (*2%* of total)
UK share of SA Exports is *7%*

SA Investment in the United Kingdom

Estimated at *£700m* – about *1.9%* of all foreign investment in UK.

SIR G HOWE'S LETTER OF 12/9

CONFIDENTIAL

12/9/88

Foreign and Commonwealth Office

London SW1A 2AH

CH/EXCHEQUER
REC. 12 SEP 1988
ACTION Mr BOTTRILL
COPIES TO EST, Sir P. MIDDLETON, Sir G. LITTLER, Sir T. BURNS, Mr LANKESTER, Mr MOUNTFIELD, Mr H.P. EVANS.

12/9

4878 SYLVIA THOMSON Now seeking

From the Secretary of State

Yes we are getting there: delay is due to the recent arriving late from FCO.

Dear Robin

You may know that our officials, together with the Treasury, DTI and ECGD, have been working on a paper about South Africa's relationship with the international financial community. We commissioned it to shadow the similarly named Commonwealth report published last month at the meeting in Toronto of the Commonwealth Committee of Foreign Ministers on Southern Africa (CCFM-SA); the UK is not, of course, a member of the CCFM-SA.

I enclose a copy of the final version of our paper. Although to some extent it duplicates the (much longer) Commonwealth report which is now freely available, I think it will be useful to have an agreed Bank/Whitehall assessment of the various financial sanctions proposed and the damage they would cause to British interests.

The Commonwealth report and the CCFM-SA's recommendations for further financial sanctions will be a live issue at least until the Commonwealth Heads of Government Meeting in Kuala Lumpur next year; and if Dukakis is elected President we can expect unwelcome US pressure well beyond 1989. Given the sensitivity of the whole subject of sanctions, particularly within the Commonwealth, you may like to see the short defensive briefing we have prepared (again, in consultation with

/your

Jonathan

Mr Bottrill chasing ECGD for some figures, will reply ASAP. Mike

The Rt Hon Robin Leigh-Pemberton

your people and others in Whitehall) on the CCFM-SA's 'decisions'. Of course, we do not need to say anything unless taxed with the Commonwealth recommendations, and at present we would not want to draw attention to them in any way. But it is as well to have to hand an agreed line to take for use if necessary; and indeed at some stage we may need to take a more active line. The Prime Minister saw a slightly earlier version of this material before she went to Australia.

I am copying this letter to Nigel Lawson and David Young.

GEOFFREY HOWE

COMMONWEALTH COMMITTEE OF FOREIGN MINISTERS ON SOUTHERN AFRICA

STATEMENT ON
SOUTH AFRICA'S RELATIONS WITH THE
INTERNATIONAL FINANCIAL SYSTEM

At its first meeting in Lusaka the Commonwealth Committee of Foreign Ministers agreed on the terms of reference for a study on South Africa's relationship with the international financial system with a view to exploring the possibilities of effective action against South Africa in this area. Ministers have now considered the study prepared by officials from Australia, Canada and India and agreed a number of measures designed to increase financial pressure on South Africa and to invite Commonwealth and other governments to consider their adoption and implementation.

The South African economy cannot grow fast enough to prevent unemployment from rising further without strong import growth and a collapse of the current account surpluses necessary to repay foreign debt. It cannot gain sufficient new sources of foreign exchange to break out of this trap because:

- foreign banks are uninterested in new lending;

- foreign trade credits provide only a short-term and one-off increase in foreign borrowing;

- many capital-exporting economies have banned new investment in South Africa;

- potential foreign investors are discouraged by the political uncertainties caused by apartheid, the associated poor economic outlook, and the economic uncertainties arising from disinvestment pressures and trade and financial sanctions;

- its key export - gold - faces increasing global supplies and uncertain price prospects; and

- it has limited opportunities to increase non-gold exports.

This study has arrived at a number of broad conclusions about financial sanctions:

- the refusal of banks to lend to South Africa has been the most significant sanction in restricting economic growth through forcing large capital account deficits to repay maturing loans, and requiring corresponding current account surpluses;

- trade sanctions and disinvestment pressures have played a supporting role, making it more difficult for South Africa to maintain the required current account surplus, and discouraging potential new foreign investment;

- an important consequence of disinvestment has been its contribution to the poor outlook for new direct investment in South Africa;

- South Africa cannot gain any external account relief from its relations with the Bank for International Settlements or the International Monetary Fund, because the Fund's Board is unlikely to approve a programme for South Africa and the BIS would only lend to bridge to an IMF programme; and, finally

- The maintenance and extension of financial sanctions would hobble South African economic growth and maintain the economic pressure on the South African Government to abandon apartheid.

Ministerial Decisions

(a) Increased Restrictions on New Lending and New Investment

At present, all Commonwealth countries except the UK have imposed a ban (either voluntary or mandatory) on new lending, other than short-term trade credits, and on new investments. This could be extended to include new trade credits. A global ban on trade credits would have a very serious effect on South Africa's external accounts.

Ministers have agreed to ask financial institutions operating in their countries to ensure that there is no expansion in trade financing. South Africa should know that this source of funding can no longer be tapped as a balance of payments cushion.

(b) Provisioning Requirements

Ministers have agreed to ask national bank regulatory authorities to ensure that their loan loss provisioning requirements are rigorously applied with respect to South African risk. Ministers expect that South African country risk will be treated no more favourably than that of heavily indebted countries.

(c) Existing Loans

Banks whose loans are subject to the South African moratorium and interim rescheduling have no option but to retain their exposure in South Africa or to sell it at a discount to other banks. However, the type of rescheduling accepted by the bank can have a significant effect on the constraints faced by economic policy-makers in South Africa. Ministers agreed to ask banks in their countries to press for rescheduling arrangements which do not extend beyond one year at a time.

(d) Ban on Official Export Credit Insurance

Ministers agreed to press for an international ban on insurance cover by official export credit agencies for loans to South Africa.

(e) Internationalisation of Lending Restrictions

The financial pressures on South Africa would be very much greater if more countries followed the Commonwealth's lead in restricting new lending to South Africa. The Commonwealth has already asked others to adopt its approach with some success to date. These efforts will be further intensified through bilateral contacts and in international fora.

Anti-apartheid and other non-governmental organisations can bring pressure to bear on institutions with which they deal. They are becoming more active in several countries. These groups could learn much from the success of established groups in other countries. Ministers agreed to facilitate the flow of such information.

Commonwealth Secretariat
Royal York Hotel, Toronto
3 August 1988

OFFICIALS' REPORT

CONFIDENTIAL

12/9/88.

SOUTH AFRICA'S RELATIONSHIP WITH

THE INTERNATIONAL FINANCIAL COMMUNITY

A paper produced by the Bank cf England, FCO, DTI, ECGD and HMT.

CONFIDENTIAL

TABLE OF CONTENTS

SOUTH AFRICA'S RELATIONSHIP WITH THE INTERNATIONAL FINANCIAL COMMUNITY

1: FOREIGN LENDING TO SOUTH AFRICA

A. The 1985 Debt Standstill

1 South Africa's total external debt nearly quadrupled between 1980 and 1984, measured in national currency terms. By end-August 1985, the total external debt had reached $24bn. Although not overburdened with debt in absolute terms, the South African authorities had entered into gold swaps and borrowed on the international capital markets; the main debt burden, however, arose from heavy bank lending to South African banks, much of which was passed on in the form of domestic currency lending. At the same time, market sentiment had been hardening against the Republic, as a result of which borrowings from international banks were on ever-shorter naturities.

2 In the early part of 1985, a handful of US banks announced at different times withdrawals from South African business - culminating in Chase Manhattan's decision at the end of July 1985 not to renew loans to the South African private sector. At about the same time, the imposition of the state of emergency and threatened and actual sanctions activity in the US and France further undermined international financial confidence in South Africa. By the end of August 1985, it became evident that the crisis caused by the flight from South African assets (both in the Johannesburg Stock Exchange (JSE) and in the interbank market) and the fall in the value of the rand (which fell from $0.52 on 20 July to under $0.33 at one point on 27 August) demanded immediate action.

3 On 27 August, the authorities announced a package of measures which included closing the JSE, suspending all foreign exchange

dealing until 2 September, re-introducing the financial rand* and declaring a moratorium on certain categories of foreign debt, covering about 57% (or $13.6bn) of the total. Debt subject to the standstill (within 'the net') included $8.8bn borrowed by South Africa's banking sector and some of the debts owed by the South African public and non-bank private sectors. Debt exempt from the standstill included:

a) bearer bonds and notes issued by the public sector;

b) debts guaranteed by foreign governments through export guarantee schemes;

c) debts owed to international organisations (eg the IMF);

d) loans to the South African Reserve Bank (SARB);

e) private credits on trade delivered after 1 January 1985.

All debt in these categories has continued to be serviced normally.

B. The First and Second Interim Arrangements

4 An arrangement between the South Africans (represented by the Standstill Coordinating Committee (SCC)) and the creditor banks, who held over 70% of restricted debt, was finally reached in February 1986. This was regarded as an interim arrangement, not a formal rescheduling and covered debts maturing up to 30 June 1987, on which 5% of principal (as well as full interest) was repaid. It was a unilateral arrangement, imposed by the South Africans; the

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* South Africa operates a dual exchange rate: the financial rand is used for the repatriation of the proceeds of disinvestment and for new direct foreign investment, the commercial exchange rate, which is substantially higher, is used for all other transactions.

standstill has remained in force since the 1985 crisis and there has been little negotiation between creditor and debtor. As a result, the banks' initial worries over burden sharing - the decision to exclude official debts from the moratorium concerned a number of banks who would have wished to go down the route of equal misery for all - have not become a central issue of the debate.

5 Creditors were given the option to convert blocked debts into three-year loans, which would then be removed from the 'net' of blocked debts. It is reported that initially most banks did not go along with this option, partly because it was hoped that, as the debt crisis had been presented as a short-term problem, South Africa would very quickly put forward proposals for a more speedy release of blocked debt. As it became clear that South Africa was not regaining financial normality (which would presuppose an early release of funds) more banks took up the loan option; it is said that over $500 million of blocked debt maturing before 1 July 1987 was converted during the life of the first interim arrangement and thus removed from the 'net'.

6 On the expiry of the first interim arrangement, some $10 billion of debt would have become immediately repayable - clearly impossible for the South Africans to finance. Therefore some form of follow-on arrangement was inevitable and was drawn up in the first half of 1987.

7 The new arrangement ("the second interim arrangement") was described as an extension of the first interim arrangement; again it was not a formal rescheduling. It runs from 1 July 1987 to 30 June 1990 (ie three years) and covers all blocked debts falling due between 28 August 1985 and 30 June 1990. The arrangement allows for further limited release of blocked funds (about $1.4 billion in total, to be repaid over three years). Creditors have the option to convert blocked debt into long-term loans (for a minimum of 10 years). An option permitting the conversion of blocked debts into equity has also become operational and some banks have shown interest.

C. Structure of South Africa's External Indebtedness

8 The most complete analysis of South African external debt is that produced in the aftermath of the debt standstill. At end August 1985:

South African Borrower	Amount ($bn)	Comments
Public Sector	8.6	Includes $2.9 billion of debts guaranteed by foreign governments and/or any agencies of foreign governments, and $3.0 billion of bearer bonds.
SARB	1.4	All owed to overseas commercial banks.
Private Banking Sector	8.8	Includes on-lending to public and private non-banking sector.
Private non-Bank Sector	4.9	Includes $2.8 billion of private trade finance.
TOTAL	23.7	

D. The Present State of South African Borrowing

9 Since the events of 1985, external sentiment has altered to such an extent that South Africa has been turned into a net exporter of capital. South Africa's access to new foreign capital is now severely restricted and the authorities are acutely aware that they have no access to IMF or other international contingency funds. The 1985 withdrawal of credit lines was perhaps more 'effective' than the many formal sanctions imposed on the Republic. Without a major change of sentiment, South Africa's ability to borrow from banks

will continue to be very restricted, although some loans have recently been obtained, mainly from banks with no existing exposure to South Africa.

E. Sources of Funds Categorised by External Creditor

10 (i) Since the introduction of the standstill, South Africa has not placed any public or private bond issues abroad. The South Africans have recently been exploring the scope for issuing gold backed bonds or investing in an issue of zero coupon bonds; but two possible sources (of zero coupon bonds), the US Treasury and the BIS, have both turned down the South African request.

(ii) The banks: at end December 1987, banks in the BIS area had gross assets of $15.8 billion owed by South Africa. UK banks are very cautious towards South Africa and only small volumes of new lending are being made available, but generally only within existing limits. Some European banks seem to take a more positive attitude towards South Africa. There have been reports of some German and Swiss banks being prepared to lend. Japanese banks are also reported to have resumed some lending (probably via third parties). US banks: all new public and private lending to South Africa was banned by Congress in October 1986*. Exceptions were made for various forms of humanitarian lending, rescheduling of debt and short-term credit. Despite this ban, one or two loopholes appear to have remained, particularly as regards foreign affiliates of US banks, and the proposed Dellums/Wolpe Bill would bar lending undertaken through foreign affiliates and would also bar short-term credit. In any case, over the last two or three years, most major US bank holding companies have said that they will not make new loans to South Africa both for ethical reasons and because of credit quality concerns. These statements followed an extensive campaign by shareholder and other pressure groups.

How much is blocked

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* Even non-US banks with operations in the US who have increased exposure in South Africa have been or have expected to be penalised by US legislation.

(iii) Private Trade Credits: partly reflecting the lower levels of imports between 1985 and mid-1987, but also the low level of domestic interest rates, (which encouraged a shift in trade financing to local sources), South Africa's access to private trade credit lines has diminished. Recently, there have been a series of calls by the South African authorities urging importers and exporters to look for new external trade credits, to offset a decline in the current account surplus. As domestic interest rates rise, there is expected to be more incentive to look for external credits, which still appear to be available. However, there is evidence that in some instances, South Africa's name is becoming unacceptable; in some cases the confirmation of letters of credit has to be routed through banks in third countries to avoid the South African name, a service which is expensive for the South Africans.

(iv) Export Credit Agencies (ECAs): South African borrowers still face little difficulty in obtaining guaranteed credits for project related imports. It is expected that the position will remain easy as major projects (eg Mossel Bay) progress; competition for this business is keen and longer terms appear to be on offer. Nevertheless, most ECAs are sensitive about support for exports to South Africa. The figures in the following table may not be totally accurate; even so it is quite clear that 3 ECAs (ECGD, Hermes and Coface) have over 80% of the exposure on South Africa.

South Africa: Export Credit Agency Exposure

ECA	CURRENT COVER POSITION*	EXPOSURE 30.11.85 ($mn)	EXPOSURE 31.12.87+ ($mn)	OFFERS 31.12.87 @ ($mn)
HERMES (West Germany)	Short and medium term cover subject to max contract size and 5 year risk horizon for medium			

* Source: Berne Union Quarterly Return

Source: EGC Paper (EG/86/2) of 17 January 86. Exposure is defined as firm commitments of short and medium cover (principal and interest)

+ Source: Berne Union Quarterly Return. Exposure is define as above

@ Source: Berne Union Quarterly Return.

	term. (Most recent reports indicate that Hermes is becoming less accommodating)	1,998	3,304	147
ECGD (UK)	Open for short term cover; case by case for medium term cover subject to limit on total commitments	2,768	2,771	382
COFACE (France)	Open for short term cover; case by case for medium term	1,934	1,754	191
EID/MITI (Japan)	Case by case for short and medium term cover	392	507	
GERG (Switzerland)	Open for short term cover; medium term on case by case	313	402	548
OND (Belgium)	Short and medium term cover subject to limit on total commitments	71	58	26
OEKB (Austria)	Short term cover only	40	26	4
CESCE (Spain)	Open for short term cover; medium term subject to limits on total commitments	1	20	
ZCIC (Zimbabwe)	Open for short term; medium term on case by case		16	

SACE (Italy)	Short term cover for private sector only	58	16
EXIMBANK (USA)	Off cover	18	0.8
EDC (Canada)	Off cover	10	0

F. Prospects for debt servicing

11 During the life of the second interim arrangement, forecast surplus on the current account (and the relatively healthy state of the reserves) should be sufficient to fund expected capital outflows (including repayments of debts both inside and outside the 'net'). Beyond 1990, the balance of payments position is forecast to be far less favourable. By the end of the second interim agreement the bunching of debt repayments outside the 'net' in H2 1990 and 1991 and the restricted access to new foreign capital mean that South Africa is facing an increasingly intractable debt problem.

12 Although the South Africans are proud of their achievements in scrupulously meeting debt obligations outside the standstill 'net', even to creditors from whom new money is not available, and remain committed to the debt agreements, the uncertain prospects of continued repayments (at least, in their present form) beyond 1990 has raised the question of whether the authorities may unilaterally reduce or repudiate debt servicing liabilities (say by differentiating between various categories of creditor bank - with lowest priority accorded to US banks), or place restrictions on remittances of royalties and dividends. Indications are, nevertheless, that the South Africans will be willing in a third interim arrangement to continue repaying banking debt at about a rate of 1½% each six months.

13 The level of South Africa's indebtedness is low by any standards for a developing country, at 37% GDP at the end of 1986. Annual debt service, at 21% of exports of goods and services, is also very small. The authorities do not want to see total external

debt decline beyond current levels, which implies that the Republic is still looking towards buoyant inflows of ECA and private trade credits. The authorities do not intend to do anything to jeopardise their access to these types of credit. However, should the external environment alter to the extent that these credits were severely restricted or even not available, the South Africans would have little to lose by widening the extent of the debt standstill. There is a powerful domestic lobby within South Africa which resents the heavy drain on resources that 'empty' debt servicing represents.

G. Default by South Africa

Effect on UK banks?

(i) Effect on US banks

14 At end-1987, 184 major US banks were owed a total of $2.9 billion by South African borrowers, after adjustments for guarantees and external borrowings. Of this total, $2.2 billion was owed to nine money centre banks. This comprises 0.3% of those nine banks' total assets and 4.2% of their total capital. The largest creditor is Citicorp, which has $800 million in loans outstanding, but this represents just 3% of its capital. The money centre banks' exposure to South Africa is 14% of the size of their exposure to Brazil, which suspended interest payments last year, and if a 10% interest rate is assumed on the debt then a South African default would reduce US money centre bank holding companies' return on equity by 0.8% per annum. While obviously this would be unpleasant for the companies involved, it would not cause them any significant difficulties.

(ii) Effect on ECAs

15 Any default would have a relatively insignificant impact on all but 5 ECAs (ECGD, HERMES, COFACE, EID/MITI and GERG). In particular Eximbank's low exposure would not be a deterrent to US action which might precipitate a crisis. The impact on ECGD of a complete default would however be quite serious.

(iii) ECGD

16 ECGD supports about 50% of visible UK exports to South Africa (excluding the oil sector). It is doubtful whether many UK companies would wish to take the risk of exporting to South Africa on medium term credit without ECGD support. The withdrawal of ECGD cover for medium term credits would therefore put at risk the major part of UK exports of capital goods and equipment to this important market. Recently, UK firms have secured substantial contracts in the Mossel Bay project and stand to win further orders. UK firms are also well placed to win other major public sector contracts over the next year or so.

17 Total ECGD exposure on South Africa amounts to some £1.6 billion representing over 5% of ECGD exposure worldwide. About £1.5 bn of this exposure is on medium term business, mainly with the public sector (principally with ESCOM, the electricity parastatal). Repayments under these medium term commitments extend beyond the end of the century; about £140 million is due for repayment in 1989, declining gradually to about £120 million by 1993. If ECGD cover were to be withdrawn as part of a general application of sanctions, the danger is that the South African Government would cease paying its existing debts. ECGD would consequently have to pay claims to its policy holders in excess of £140 million per annum, with no prospect of negotiating a debt restructuring agreement. This would have a cumulatively severe effect on ECGD's overall financial performance, and thus on the PSBR: ECGD's peak borrowing from the Exchequer would go up from an estimated £3.9 billion to £5.5 billion, forcing a capital reconstruction of ECGD.

18 There are no legislative procedures involved in stopping ECGD cover. But over the years Ministers have given assurances to the House that the availability of ECGD cover would be governed by commercial not political considerations. For this reason withdrawal would be likely to attract severe criticism from Parliament as well as UK industry.

II: SOUTH AFRICA'S EXTERNAL ASSETS AND RELATIONSHIPS WITH OVERSEAS FINANCIAL INSTITUTIONS

A. South African assets held abroad

19 The level of South Africa's external assets is far outstripped by its liabilities. In 1986 (latest data) external assets, at $14.7 billion, were less than half of total external liabilities (at $32.9 billion). Nevertheless, since the debt crisis in 1985, the level of external assets has been increasing; on a geographical basis the two most important centres where assets are held are the EEC and the Americas; the third most important area is black Africa (see Table I), but this probably represents largely illiquid balance of payments loans to African countries and other debts due from them. Pressure from anti-apartheid lobbies and governments has, on occasions, forced South Africa not to invest (mainly private investment) in a particular country eg Australia. US legislation does not at the moment prohibit South African investment in the US.

B. External assets of the South African Reserve Bank (SARB) (Gold and foreign exchange reserves)

20 At 31 March 1987, the SARB had external assets (foreign exchange) of $1.1 billion, of which $1.0 billion was held with foreign banks ($0.2 billion on current account, $0.8 billion on deposit). In addition, South Africa had $1.2 billion gold reserves. Against this, the SARB had external liabilities (in the form of foreign commercial borrowing) of $0.8 billion. Since then, the SARB's holdings of foreign exchange have dropped (by end May 1988, to $0.6 billion), a reaction usually seen when the balance of payments is under pressure.

21 The SARB are worried over the possibility that the foreign exchange assets could be impounded. The SARB now consider London to be the safest repository for foreign exchange holdings - safer even than Switzerland.

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TABLE 1

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FOREIGN ASSETS HELD BY SOUTH AFRICA

	1980	1981	1982	1983	1984	1985	1986	
Direct investment								
Banking sector	181	85	49	132	51	58	91	
Non-bank private sector	5,541	5,624	6,287	6,065	6,461	6,435	7,587	
TOTAL	5,772	5,709	6,336	6,197	6,512	6,504	7,678	
Non-direct investment								
Public sector	1,700	1,478	1,517	1,589	1,162	1,071	1,549	(Largely international organisations)
Banking sector (includes reserves)	7,956	4,760	4,442	4,281	2,857	2,482	2,748	
Non-bank private	2,528	2,112	1,999	1,984	1,870	1,776	2,773	
TOTAL	12,184	8,360	7,958	7,854	5,889	5,329	7,030	
TOTAL FOREIGN ASSETS	17,905	14,069	14,294	14,051	12,402	11,832	14,708	

1986: Assets: Area Split

		EEC Countries	Rest of Europe	N & S America	Africa	Asia	Oceania	Int Organisations	Other
		5,125	471	4,073	1,615	515	30	1,104	1,176
(Memo items: foreign liabilities)	(32932)	(16,365)	(3,624)	(8,827)	(576)	(1,376)	(229)	(1,532)	(402)

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C. Relationships with other central banks

22 Central banks are understandably cautious when discussing links with South Africa (and would presumably be unhappy for their South African links to be publicised). Even so, it is known that the central banks of Malawi, Swaziland, Lesotho and Botswana (amongst black African countries) and the central banks of Taiwan, France and the UK maintain open links with South Africa, (as does the BIS). The central banks of Zimbabwe, Zambia and Zaire and, doubtless, other central banks also have banking and personal relationships with the SARB. Nevertheless, there have been reports that some central banks (eg Canada) are now less willing eg to receive guests from the SARB.

23 Based on the Bank of England's relations with the SARB (and, more generally, with South Africa) typical central bank contacts could be expected to include:

(i) Central bank/central bank contacts

a) maintenance of cash accounts, securities accounts and Treasury Bill (or equivalent) accounts on behalf of the SARB; maintenance (by the SARB) of reciprocal accounts.

b) dealing in gold and foreign exchange on behalf of the SARB, or, in the cases of Malawi, Lesotho and Swaziland, by SARB;

c) exchange of information, exchange of appropriate technology (eg security information, computer technology); in Malawi's case, the SARB provide technical assistance;

d) bilateral (personal) contacts;

e) for Lesotho and Swaziland, extremely close liaison on currency and exchange control matters, and reserve management.

(ii) Central bank/South African banks

a) banking supervision of branches of South African banks operating abroad.

(iii) Central bank/South Africa

a) payment of dividends and redemption proceeds on government securities owned by South African residents;

b) payments of pensions to South African residents;

c) ad hoc queries (eg exchange control queries).

D. Relations with IFIs

24 At the end of 1986, South African assets held with international organisations totalled $1.1 billion. Although South Africa's role in several international bodies has been curtailed, the Republic remains a member of a range of international organisations including GATT, the World Bank (IBRD), the International Monetary Fund (IMF), International Finance Corporation (IFC) and the International Development Association (IDA).

(i) IMF

25 South Africa has no Board representation (it was previously linked with Australia and New Zealand) but maintains a permanent representative in Washington. South Africa last applied to use Fund resources in November 1982 when a SBA and CFF were agreed. (These facilities have now been fully repaid.) At the IMF Board discussion, South Africa's application was opposed by several of the LDC constituencies. Minutes of the Board meeting leaked and the substance of the discussion appeared in the New York Times; several letters expressing concern about the IMF loans were received in Whitehall.

26 Should South Africa apply in the future for Fund facilities (and in the view of the IMF mission leader, a clear balance of payment need has now emerged), uniformity of treatment is a basic tenet of IMF policy and the Republic could not be barred from access to Fund resources on political grounds alone. Nevertheless, a future request could be expected to encounter resistance from the

United States who command just over 19% of the total votes. US reservations would probably be centred on the 1983 IMF Act which stipulates that the US Executive Director must oppose IMF lending to any member practising apartheid on the grounds that the severe constraints on labour and capital mobility resulting from apartheid run counter to the objectives of the IMF. This argument might well find support from those countries which are already applying some form of commercial sanctions on South Africa. But since the Act also incorporates a measure of flexibility, it is possible that the US position could soften, depending on the prevailing political climate in the US and the South African authorities' willingness to implement the required structural changes.

27 Given South Africa's quota of SDR 916 million, it would be entitled to an annual theoretical maximum access limit of SDR 824 million (90% of quota) and a cumulative limit of SDR 3,664 million (400% of quota). An approach to the IMF would inevitably act as a focus for adverse attention and hostile lobbying both within the Board and in member countries. At present the South African authorities are reluctant to borrow from the Fund, partly since this would be unlikely to generate additional external finance from private creditors but mainly because they do not wish to risk raising the temperature of public discussion of South African financial affairs. A highly politicised discussion in the IMF Board could, for instance, fuel demands for South Africa's expulsion from the IMF. Absence of an IMF programme would make it very difficult for the Paris Club to reschedule South African debt to ECAs; this is believed to be one reason why they were excluded from the moratorium.

(ii) <u>IBRD</u>

28 South Africa is a member of the IBRD, with 1.01% of total votes. It has no Board representation, as it did not participate in 1986 election of Executive Directors. It has no loans outstanding to the IBRD, though its GNP per capita is $1,800, (1986 US$) and the IBRD graduation level is $3,010 (1986 US$). However, IBRD creditworthiness is not assessed on GNP per capita grounds alone.

29 The World Bank's Articles state that the World Bank should not interfere in the political affairs of any member, and that only economic, ie not political, considerations shall influence IBRD decisions. The UK's own policy towards IBRD lending is to consider each case on its technical merits alone, regardless of the political complexion of the borrower.

30 South Africa would dearly like to borrow from the World Bank to finance the "third world" part of its economy and the development of its black population. It is delighted to have been associated with the World Bank-supported Highlands Water Scheme in Lesotho which has involved co-financing and guarantees from South African banks and special facilities within the Common (Rand) Monetary Area and standstill arrangements.

(iii) African Development Bank

31 South Africa is not a member of the AfDB, which has no relations with South Africa at all, as far as we are aware, although it may have some connection through the Highlands Water Scheme.

III: FOREIGN INVESTMENT IN SOUTH AFRICA

A. Introduction and background

32 The facts on foreign investment in South Africa are difficult to come by and even more difficult to quantify. But some general trends are reasonably clear:

a) the UK is the largest foreign investor in South Africa. The most recent official estimate (end 1984) of UK direct investment was £2,725 million.

b) considerable foreign, particularly US, disinvestment has taken place since about 1984.

c) the global emphasis of UK investment has, in recent years, moved to North America and the EEC and away from the old Dominions and Colonies.

33. After the Sharpeville killings in 1960, anti-Apartheid groups in Europe began to focus their attention on companies with interests in South Africa as well as the South African Government. The then Labour Government induced UK companies to abide by a voluntary Code of Conduct as an EC instrument in 1977. Similar pressures persuaded US companies to adopt parallel principles. The EC Code and (US) Sullivan Principles provided an early defence for western companies to argue that they were a force for good in South Africa.

34. But by the late 1970s European and American companies found themselves under pressure from other African countries, from their own trade unions, from their shareholders, and from their domestic customers. While South Africa boomed when much of the rest of the world was in recession in the early 1980s, western companies were content to benefit from their investments in the Republic. But when the downturn came in South Africa, some companies began to look critically at their investment there.

B. Scale of Disinvestment

35 It is hard to gauge the extent of disinvestment from South Africa with any precision. "International Business In South Africa 1988" by the Investor Responsibility Research Center Inc lists 84 non-US companies which have "severed their direct investment ties to South Africa" since 1 January 1984 (list at Annex A); a further 20 are shown as "year of disinvestment unknown". The same publication lists some 1250 subsidiaries and affiliates of international companies with direct investment in South Africa. EC commercial counsellors in their 35th report (7023/88) estimate that 140 US companies have left South Africa since 1984, accounting for over a third of the total US companies at that date. They include some of the largest such as Eastman Kodak, Coca Cola, Exxon, General Motors and IBM.

36 It is frequently suggested that many companies, particularly American ones, have exaggerated their claims of disinvestment. Companies have shown considerable ingenuity in the attempt to give this impression, by exercising various options such as buy back, transfer to offshore and name changes. Some commentators have suggested that many American companies are using the political excuse for a commercial decision. With the Rand depreciating considerably against the $, South African subsidiaries of US companies were simply not paying their way in many instances. But by presenting the disinvestment as a political decision, some firms were able to earn goodwill from their domestic customers. The US General Accounting Office Report "South Africa: Trends in Trade, Lending and Investment" of April 1988 analyses the principal methods of withdrawal as being: (1) closing down the operation, (2) selling the company to local management, (3) selling the company to a South African company, (4) selling the company to a non-South African company, and (5) transferring the company assets to a trust fund. Case studies of US firms in each of the 5 categories showed that 40% of companies' black employees were likely to be worse off after disinvestment; in another 40%, it was difficult to judge; in only 20% of cases was there likely to be no difference.

37 The costs to UK companies of disinvestment has varied.

Generally they have not been great (notable exceptions being Barclays and Leyland) and not of the same order as forced disinvestments in the past (eg UK companies' asset sales in the USA to finance the World Wars). The controlled pace and timing have contributed to lessening the impact. All companies claimed disinvestment to be for commercial reasons: some failed to maintain competitiveness and were contracting their operations worldwide (eg the Rover Group); some had urgent requirements to raise capital (eg Standard Chartered); some judged profits elsewhere were suffering (Barclays); some took advantage of reorganisation of their subsidiaries to claim disinvestment; and some may well simply have believed that better rates of return could be realised elsewhere. The total number of UK disinvesting companies is reckoned by the Embassy in Pretoria to be just under 30. Some UK firms which have maintained their investment in South Africa have made it clear that HMG's continued support for a normal trading and economic relationship with the Republic has been a major factor in their decision to stay. Remittance of disinvestment proceeds from South Africa is limited by the dual Rand system, which obviously acts as a disincentive to disinvest.

C. New Investment

38 Both the EC and the Commonwealth agreed in 1986 on a ban on new investment. The UK implemented both under a "voluntary ban" (which allowed considerable exceptions) agreed with other EC member states. Few companies have made their intentions to invest public. Details of the overall picture are at Annex B which shows continued, but declining, total net investment up until 1986, the last year for which figures are available. Annex B also reveals that UK investment in South Africa appears to have been fairly profitable, with 3.6% of total UK direct investment overseas yielding 5% of net earnings on overseas direct investment. In financial terms, annual net UK direct investment in South African manufacturing industry has declined from about £70 million in 1984 to £21 million in 1986. In that year there was net disinvestment in the mechanical engineering and electrical engineering sectors. Financial services, including banking, was the most prominent non-manufacturing sector to show disinvestment and new figures will show the effect of the departure

of Barclays and Standard Chartered. Future trends are likely to show a continued gradual trend towards reduced UK investment in South Africa.

39 If current draft legislation in the US (the Dellums/Wolpe Bill) is enacted US firms will be forced to disinvest. Mobil has threatened to sue the US Government with the 5th Amendment which provides that "Private property (shall not) be taken for public use without compensation." The extraterritorial reach of the Bill and a general'domino' effect could cause considerable acceleration in disinvestment of non-American companies also. Fortunately, it seems unlikely that the legislation will be enacted under the current Administration but new legislation from the next Administration cannot be discounted. US local authorities can also force UK companies to choose between investing in the US or in South Africa.

D. South African Investment in the UK

40 Although not by choice, South Africa is currently a net exporter of capital. The book value of South African investment in the UK at the end of 1984 in the order of 15% of UK investment in the Republic. Although there was a net disinvestment of £9 million in 1986, more recent reports indicate planned or actual acquisitions in the UK by major South African companies such as Liberty Life and Rembrandt. Such acquisitions are treated on their merits by the DTI just as those of any other major trading partner.

E. Arguments against disinvestment

41 Disinvestment (like investment - despite the voluntary ban) is properly left to market forces and the commercial judgement of individual companies. The effects of disinvestment and political pressure are almost entirely negative and include the following:

a) They encourage those who wish to play politics with international trade and investment. (South Africa today, Chile, Libya etc tomorrow.)

b) The local South African employees of all races are likely to be worse off. Blacks do not benefit from the EC Code of Conduct if the company is no longer EC owned.

c) White South Africans will lose further contacts with the outside world and be driven towards the laager.

d) Disinvesting companies can lose large sums of money (eg Barclays) when South African companies acquire their interests. The individual losses would be likely to be greater if disinvestment accelerated.

e) The strengthened South African companies provide increased competition to UK companies elsewhere in Africa (eg First National Bank is competing hard with Barclays in Southern Africa outside RSA).

f) UK and foreign firms are generally enlightened influences in South Africa.

INTERNATIONAL COMPANIES THAT HAVE SEVERED THEIR DIRECT INVESTMENT TIES TO SOUTH AFRICA

Since Jan. 1, 1984

Akzo N.V.#, The Netherlands
Alfa-Laval AB, Sweden
Allied Colloids Group P.L.C., United Kingdom
Armstrong Equipment P.L.C., United Kingdom
Associated British Foods P.L.C., United Kingdom
Banco Di Roma, Italy
Barclays Bank P.L.C., United Kingdom
Henry Barrett Group P.L.C.+, United Kingdom
N.V. Bekaert S.A.+, Belgium
H.P. Bulmer Holdings P.L.C.#, United Kingdom
CAP Group P.L.C.#, United Kingdom
CCL Systems Ltd., United Kingdom
Cable & Wireless Ltd., United Kingdom
The Colonial Mutual Life Assurance Society Ltd., Australia
Compagnie Financière Alcatel, France
Concrete Utilities Ltd., United Kingdom
Crown House P.L.C., United Kingdom
Dresdner Bank AG, Federal Republic of Germany
Durr GmbH, Federal Republic of Germany
Elders IXL Ltd., Australia
Elders Keep Ltd. (formerly Keep Bros. Ltd.), United Kingdom
Elkem A/S, Norway
Ellerman Lines P.L.C., United Kingdom
Esselte AB, Sweden
Eugen Lutz GmbH & Co., Maschinenfabrik, Federal Republic of Germany
Exchem P.L.C., United Kingdom
Fisker & Nielsen A/S, Denmark
Thomas French & Sons P.L.C., United Kingdom
N.V. Gemeenschappelijk Bezit Vrg+, The Netherlands
Grasso's Koninklijke Maschinenfabrieken N.V., The Netherlands
The Hongkong and Shanghai Banking Corp., Hong Kong
Hoover P.L.C., United Kingdom
Illingworth, Morris P.L.C., United Kingdom
Imperial Continental Gas Association, United Kingdom
Inchcape P.L.C.#, United Kingdom

+ a plus indicates that the company told IRRC that it retains non-equity ties to South Africa that are described in Section III.

a pound indicates that the company told IRRC that it does not retain non-equity ties to South Africa.

(Companies without a plus (+) or a pound (#) may or may not have non-equity ties to South Africa.)

EXTRACT FROM "INTERNATIONAL BUSINESS IN SOUTH AFRICA 1988
INVESTOR RESPONSIBILITY RESEARCH CENTER INC.

Interfina AG+, Switzerland
The International Thomson Organisation P.L.C.#, United Kingdom
Jardine Matheson Holdings Ltd., Hong Kong
Kalamazoo P.L.C.+, United Kingdom
M.F. Kent & Co. Ltd.#, Ireland
LTG Lufttechnische GmbH#, Federal Republic of Germany
Legal & General International Ltd.#, United Kingdom
MK Electric Group P.L.C., United Kingdom
Manders (Holdings) P.L.C., United Kingdom
Marshalls Halifax P.L.C., United Kingdom
Alfred McAlpine P.L.C., United Kingdom
McKechnie P.L.C., United Kingdom
Meggitt Holdings P.L.C.#, United Kingdom
Monier Ltd.+, Australia
John Mowlem & Co. P.L.C.# (owner of SGB Group P.L.C.), United Kingdom
Nicholas Kiwi Australasia Ltd., Australia
Océ-van der Grinten N.V.+, The Netherlands
Otavi Minen AG+, Federal Republic of Germany
Pernod Ricard, France
Petrofina S.A., Belgium
Peugeot S.A., France
Pioneer Concrete Services Ltd., Australia
Plastic Omnium Cie., France
The Prestige Group P.L.C., United Kingdom
Rank Xerox Ltd.+, United Kingdom
Repco Corp. Ltd., Australia
The Rover Group P.L.C., United Kingdom
Sanderson Murray & Elder (Holdings) P.L.C.#, United Kingdom
Adolf Saurer AG, Switzerland
Schneider S.A., France
Sears Holdings Ltd., United Kingdom
Simon Engineering P.L.C., United Kingdom
Skandinavisk Holding A/S, Denmark
Smiths Industries P.L.C., United Kingdom
Société Nationale Elf Aquitaine, France
Spie Batignolles, France
Standard Chartered P.L.C.#, United Kingdom
Staveley Industries P.L.C., United Kingdom
Stewart Wrightson Ltd., United Kingdom
Stiebel Eltron International GmbH, Federal Republic of Germany
Swedish Match AB, Sweden
Taprogge Gesellschaft mbH+, Federal Republic of Germany

+ a plus indicates that the company told IRRC that it retains non-equity ties to South Africa that are described in Section III.

a pound indicates that the company told IRRC that it does not retain non-equity ties to South Africa.

(Companies without a plus (+) or a pound (#) may or may not have non-equity ties to South Africa.)

Thomson S.A., France
Trusthouse Forte P.L.C., United Kingdom
Tubemakers of Australia Ltd., Australia
United Wire Group P.L.C., United Kingdom
Valor P.L.C.#, United Kingdom
S.G. Warburg Group P.L.C., United Kingdom

Year of Disinvestment Unknown

Ateliers de Constructions Electr. de Charleroi S.A. (ACEC)+, Belgium
BM Group P.L.C., United Kingdom
Beheer Maatschappij Buisleeuw B.V., The Netherlands
Biocon Biochemicals Ltd., Ireland
British Vita P.L.C.+, United Kingdom
James Hardie Industries Ltd., Australia
Dr. Johannes Heidenhain GmbH+, Federal Republic of Germany
A. Johnson & Co. HAB, Sweden
Kymmene Corp., Finland
Laser Lab Ltd., Australia
Lastek N.V., Belgium
The Peninsular & Oriental Steam Navigation Co., United Kingdom
Schauenburg GmbH, Federal Republic of Germany
W. & W. Schenk GmbH & Co. KG, Federal Republic of Germany
Stal-Astra GmbH+, Federal Republic of Germany
Szerelmey (International) Ltd., United Kingdom
Vandeputte Fils et Cie. S.A.#, France
Wagner International AG, Switzerland
Thomas Walker P.L.C., United Kingdom
Williams Holdings P.L.C.#, United Kingdom

+ a plus indicates that the company told IRRC that it retains non-equity ties to South Africa that are described in Section III.

a pound indicates that the company told IRRC that it does not retain non-equity ties to South Africa.

(Companies without a plus (+) or a pound (#) may or may not have non-equity ties to South Africa.)

SOUTH AFRICA : DIRECT INVESTMENT TRENDS

The overall picture

The figure on UK direct investment in South Africa in recent years are

£m

	1984	1985	1986
Unremitted profits	180	174	73
Acquisitions of share and loan capital	6	22	16
less Disposals of share and loan capital	42	8	46
Net change in Intercompany and branch/head office accounts	-24	12	43
Total net investment	120	199	86

The low figure for net investment in 1986 resulted from a fall in profits which reduced the amounts available for re-investment. Net disinvestment in share and loan capital of £30 million in 1986 was offset by an outflow of £43 million through inter-company and branch head office accounts. More details of these figures are given in Table 1 (attached).

A sectoral analysis of direct investment

Net UK direct investment in South Africa manufacturing industry has declined from about £70 million in 1984 to £21 million in 1986. In 1986 there was net disinvestment in the mechanical engineering and electrical engineering sectors. Amonst the sectors of non-manufacturing, financial services (which includes banking) was the most prominent. More recent figures, when these become available, are likely to show the effects of disinvestment by Barclays and Standard Chartered. A more detailed breakdown of UK direct investment and earnings is given in Tables 2A and 2B.

Importance of UK investment in South Africa

At end 1984, the book value of UK direct investment in South Africa was £2725 million. This yielded net earnings in 1984 of £393 million. In terms of proportions, these amounts represented 3.6 per cent of the total book value of UK direct investment overseas and 5.0 per cent of net earnings on overseas direct investment. However in recent years, UK companies have greatly increased their overseas direct investments, principally in North America and in the other developed countries. In consequence, the importance of UK direct investment in South Africa will have declined. Net earnings from UK direct investment in South Africa in 1987 are unlikely to exceed £200 million, less than 2 per cent of total net earnings on our foreign direct investments. This figure would be well below our direct investment earnings from the rest of Africa. Should the US take a firmer anti-South Africa stance, the increase in UK direct investment in the US would mean that UK companies might find it more difficult to take a line on investment in South Africa different from that of US companies.

Other points

(i) This Section collects details of overseas payments and receipts on royalties. In 1986, the UK companies received £15 million from South African companies for royalties. There were no royalty payments to South African companies.

(ii) Figures published in the Survey of Current Business show the US direct investment position in South Africa as follows:

	US direct investment position	US $ Million
end - 84	1440	
" - 85	1154	
" - 86	1143	

Information for 1987 will be published in August in the SCB.

(iii) At end -84 South African companies had £372 million invested in UK companies. These investments yielded net earnings of £24 million in 1984, £21 million in 1985 and £29 million in 1986. Information on direct investment flows from South Africa in 1985 is disclosive, but in 1986 there was a net disinvestment of £9 million.

S2C

June 1988

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TABLE 1

TABLE 3.5 Net earnings and investment analysed by components and by area and country, 1984 - 1986

£ million

		NET EARNINGS: Overseas Subsidiaries and Associates		NET EARNINGS: Branches Overseas	NET EARNINGS: Total Net Earnings (1)	NET INVESTMENT: Overseas Subsidiaries and Associates		
		UK companies share of overseas companies net profits (3)	Interest received by UK companies (4)	Net profits (3)		UK companies share of overseas companies net profits (3)	Less Dividends received by UK companies (4)	Unremitted profits
South Africa	84	385	5	3	393	385	205	180
	85	356	4	2	362	356	182	174
	86	313	5	3	320	313	239	73

NET INVESTMENT			Branches Overseas	Total Net Investment (2)	
acquisition of overseas companies share and loan capital	disposal of overseas companies share and loan capital	increase in amounts due to UK parent on inter-company account	increase in indebted-ness to UK parent on branch head office account		
6	42	-28	4	120	84
22	8	20	-8	199	85
16	46	40	3	86	86

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utward Direct Investment

ABLE 3.3 Net investment analysed by industrial activity of overseas affiliate and by area and main country, 1984-1986
(Net investment includes unremitted profits)

£ million

		Metal manufacture	Chemicals	Mechanical Eng	Electrical Eng	Transport Equip	Food drink tobacco	Paper	Other manufacture	Total manufacture
South Africa	84	2	11	5	-8	-7	..	..	60	71
	85	-	7	7	-9	5	..	..	47	59
	86	2	14	-17	-4	3	8	1	13	21

Agriculture	Energy	Construction	Distribution	Transport	Financial services	Other services	Total non-manufacture	Total all industries	
..	..	-5	-31	8	98	8	49	120	84
..	58	-	7	-3	70	..	141	199	85
..	..	-	1	5	81	..	65	86	86

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TABLE 2B

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Outward Direct Investment

TABLE 3.4 Net earnings analysed by industrial activity of overseas affiliate and by area and main country, 1984 - 1986
(Net investment includes unremitted profits)

£ million

		Metal manufacture	Chemicals	Mechanical Eng	Electrical Eng	Transport Equip	Food drink tobacco	Paper	Other manufacture	Total manufacture
South Africa	84	2	46	16	14	..	..	1	88	177
	85	6	38	8	8	-	5	-	66	130
	86	8	55	-2	5	3	8	2	64	145

Agriculture	Energy	Construction	Distribution	Transport	Financial services	Other services	Total non-manufacture	Total all industries	
..	..	-2	13	4	137	21	216	393	84
..	..	4	28	4	92	12	232	362	85
..	..	5	20	4	109	9	175	320	86

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IV: THE ROLE OF GOLD

A. Gold in South Africa's Economy

42 The discovery of gold in South Africa in 1886 triggered off a gold rush transforming the country into a major industrial and trading nation, with the gold mining houses providing the main impetus for industrial and commercial development. Gold continues to dominate the South African economy. The major mining houses (eg Anglo American, Barlow Rand) have interests which span the entire economic spectrum. In 1986, South Africa produced 632 tonnes of gold, accounting for 11.9% of GDP; gold export earnings totalled $7.3 bn, 40% of total export earnings.

43 Gold mining is a labour intensive industry which in 1986 employed 551,100 workers (11% of total non-agricultural employment) of which about 200,000 are from neighbouring countries (and on whose remittances several of South Africa's neighbours are dependent).

44 South Africa is predominant in the West's gold trade; in 1987, South Africa ranked first of the world's gold producers, accounting for about 44% of the non-communist production. South Africa's gold trade enables the Republic to maintain links openly with several countries: the UK, Switzerland, West Germany, the US, Hong Kong and Japan are all important gold trading centres.

B. Gold and Sanctions

45 South Africa's dependence on gold has prompted several sanctions campaigners to suggest schemes to disrupt South Africa's gold trade, on the basis that this would break the Republic's economy far more quickly than any other sanction. Proposals to hit South African gold earnings generally fall into one of four main categories:

(i) disrupting the South African mining industry, through taking action against companies involved in the South African gold mining industry;

(ii) disrupting the supplies of South African gold reaching the world markets;

(iii) switching gold purchases to non-South African gold suppliers; (Proposals in this category often include suggestions that gold held in national reserves should be released so that the price of gold in the short term would not be affected.)

(iv) action to depress the world gold price;

46 Nevertheless, most commentators are aware that the difficulties involved in promoting measures of this type are enormous, generally because of the difficulty of achieving the level of international co-operation which would be necessary to make any impact on South Africa's gold trade. None of these measures would be cost-free to the country or group of countries imposing the sanction. Unlike other sanctions, most of these schemes are designed as short-term actions, to be unwound at a later date; often, the 'reversal mechanism' has not been adequately thought through. As yet, none of these gold schemes has been adopted, although bans on the import or sale of South African gold coins are fairly widespread. There are also signs of some resistance to gold bars of South African origin amongst official holders in some of the Scandinavian countries.

47 Factors which argue against imposing gold related sanctions include:

(i) Disrupting companies; could easily rebound onto other gold producing countries given the international links of the main South African mining companies;

(ii) It is physically difficulty to halt or disrupt supplies of South African gold; by-and-large most countries have not been prepared, say, to sever air links with South Africa. Gold is a relatively anonymous commodity and its origins are easily concealed through remelting. It is also relatively easy to smuggle gold. Thus a ban on South African bars will probably merely result in the opening up of some small price differential being equal to the cost of melting South African bars in order to cast them in another form. Any physical interruption to gold supplies from South Africa might lead to a boost for the gold price which would benefit not only South Africa but also the USSR amongst others. It might also provoke South Africa to retaliate by withholding supplies of platinum.

(iii) It has been suggested that a ban on all newly-mined South African gold could be introduced, whilst simultaneously releasing gold from national reserves to make up the shortfall, ie changing the suppliers of gold. To instigate this plan would require the co-operation of and trust between non-Commonwealth countries. The nine biggest holders of official gold are the US, the IMF, West Germany, the European Monetary Fund, Switzerland, France, Italy, Holland and Belgium. Other arguments against this scheme include the difficulty in policing the ban on South African gold (see ii) and the difficulties in co-ordinating the release of gold onto the world market. The end result could be a major disruption to the world gold markets coupled with a rapid growth in the supplies of gold (as South African gold makes its way covertly onto the world's markets).

(iv) Schemes to depress the gold price (through enforced gold sales) have received wide publicity. Again any action would require a high level of international co-operation and trust, and be undertaken primarily by non-Commonwealth countries. There would also be many losers - including financial institutions using gold as collateral (gold loans, gold swaps etc), non-South African gold producers and countries with small reserves held in the form of gold. The international monetary system would be badly affected. The policy would be particularly difficult to reverse, and would set a dangerous precedent for manipulating the price of a commodity for political ends.

DEFENSIVE NOTE

Richardson.

Revive Misc 118 in Nov/Dec.

ANNEX A

CCFM-SA RECOMMENDATIONS FOR FURTHER FINANCIAL SANCTIONS: BACKGROUND AND DEFENSIVE LINE TO TAKE

a) Increased Restrictions on New Lending and New Investment

At present, all Commonwealth countries except the UK have imposed a ban (either voluntary or mandatory) on new lending, other than short-term trade credits, and on new investments. This could be extended to include new trade credits. A global ban on trade credits would have a very serious effect on South Africa's external accounts.

Commonwealth Ministers at Toronto agreed to ask financial institutions operating in their countries to ensure that there is no expansion in trade financing. South Africa should know that this source of funding can no longer be tapped as a balance of payments cushion.

UK line to take (If raised)

- Not our practice to instruct banks and private entities in this manner.

- South Africa's access to new foreign capital is already restricted. Further action to withhold credit might prompt default, which would damage creditors and the international financial system.

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b) Provisioning Requirements

Commonwealth Ministers agreed to ask national bank regulatory authorities to ensure that their loan loss provisioning requirements are rigorously applied with respect to South African risk. They expect that South African country risk will be treated no more favourably than that of heavily indebted countries.

<u>UK line to take</u> (If raised)

- Such requirements a matter for the Bank of England; the requirements are kept under review.

c) Existing Loans

Banks whose loans are subject to the South African moratorium and interim rescheduling have no option but to retain their exposure in South Africa or to sell it at a discount to other banks. However, the type of rescheduling accepted by the bank can have a significant effect on the constraints faced by economic policy-makers in South Africa.

Commonwealth Ministers agreed to ask banks in their countries to press for rescheduling arrangements which do not extend beyond one year at a time.

<u>UK line to take</u> (If raised)

- Could increase risk of South African default.

d) Ban on Official Export Credit Insurance

Commonwealth Ministers agreed to press for an international ban on insurance cover by official export credit agencies for loans to South Africa.

UK line to take (If raised)

- ECGD is a statutory body; availability of credit is governed by commercial judgements.

e) **Internationalisation of Lending Restrictions**

The financial pressures on South Africa would be very much greater if more countries followed the Commonwealth's lead in restricting new lending to South Africa. The Commonwealth had already asked others to adopt its approach with some success to date. At Toronto Ministers agreed that these efforts should be further intensified through bilateral contacts and in international fora.

Anti-apartheid and other non-governmental organisations can bring pressure to bear on institutions with which they deal. They are becoming more active in several countries. These groups could learn more from the success of established groups in other countries. Commonwealth Ministers agreed to facilitate the flow of such information.

UK line to take (If raised)

- Inappropriate to introduce political considerations into decisions which should be made on commercial grounds alone.

- As study recognises, "there is little that governments can properly do to encourage the spread and development of such movements in other countries".

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FROM: A R H BOTTRILL
DATE: 10 October 1988

PS/CHANCELLOR

Ch/ Content to write as proposed?

OK -

cc Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Lankester
Mr Mountfield
Mr H P Evans

SOUTH AFRICA'S RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY

The Foreign Secretary circulated with his letter of 12 September a copy of the report prepared by Treasury, Bank of England, DTI and ECGD officials on South Africa's relationship with the international financial community. This was to shadow the Commonwealth report published in August, and the Foreign Secretary attached some defensive briefing prepared to counter the Commonwealth proposals.

2. Treasury officials saw an earlier version of the line proposed by the FCO, and suggested detailed amendments. The final version is satisfactory stressing as it does that commercial banks' attitude to South Africa is for their own decision. Provisioning requirements are a matter for the Bank of England which keeps them under review. ECGD's provision of credit is defended as being governed by commercial judgements. We can recommend the Chancellor to endorse these at least for the present.

3. The prospects for the South African economy, however, have deteriorated. It is caught in a spiral of balance of payments constraint and slow domestic growth. The latest IMF report suggests that South Africa's current surplus will fall from \$3 billion last year to less than \$1 billion in 1988. The staff recommend tighter fiscal policy to contain real domestic demand while stressing the importance of maintaining external competitiveness if debt service obligations are to be met.

4. The difficult medium-term outlook suggests that we may need to review again our approach to South Africa and in particular the provision of ECGD cover. The market limit was revised down from

£1.8 billion to £1.4 billion in early 1986. This was in line with the recommendation of the MISC 118 report. Cover is currently close to the market limit. ECGD is to produce a new market review later this month.

5. We may also need to review our approach more generally after the US Presidential election - particularly if Mr Dukakis wins. The Foreign Office would support the reconvening of MISC 118 in November/December for this purpose. The next major Commonwealth discussion will be at next year's CHOGM in Kuala Lumpur.

6. I attach a draft reply for the Chancellor to send to the Foreign Secretary.

A R H BOTTRILL

aef2.cj/bottrill/minute/south./af2.

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Pse type final.

DRAFT REPLY TO FOREIGN SECRETARY

SOUTH AFRICA'S RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY

Thank you for sending me a copy of your letter of 12 September to Robin Leigh-Pemberton. I agree with the line you propose to take in response to any questions on the report by the Commonwealth Committee of Foreign Ministers on Southern Africa.

2. The economic situation in South Africa, however, gives increasing cause for concern and it is doubtful whether the balance of payments performance will be sufficiently strong to sustain both the continued servicing of official debt and an orderly renegotiation of commercial banks' claims in 1990.

3. In these circumstances I suggest that officials need to keep developments - particularly of ECGD credits - under close review. It may be sensible to look afresh at these issues once the results of the US Presidential election are known and ahead of next year's meeting of Commonwealth Heads of Government.

4. I am copying this to David Young and Robin Leigh-Pemberton.

NL

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cc Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Lankester
Mr Mountfield
Mr Bottrill
Mr H P Evans

PMP

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

FOREIGN SECRETARY

SOUTH AFRICA'S RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY

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The economic situation in South Africa, however, gives increasing cause for concern and it is doubtful whether the balance of payments performance will be sufficiently strong to sustain both the continued servicing of official debt and an orderly renegotiation of commercial banks' claims in 1990.

In these circumstances I suggest that officials need to keep developments - particularly of ECGD credits - under close review. It may be sensible to look afresh at these issues once the results of the US Presidential election are known and ahead of next year's meeting of Commonwealth Heads of Government.

I am copying this to David Young and Robin Leigh-Pemberton.

NL

N.L.

17 October 1988