

INTERNATIONAL MONETARY FUND



Staff Country Reports

July 1996

IMF Staff Country Report No. 96/64

South Africa—Selected Economic Issues

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INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Selected Economic Issues

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Approved by the African Department

May 8, 1996

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South Africa: Basic Data

Area	1.2 million square kilometers
Population (1995)	41.2 million
Population growth rate (1995)	2.0 percent
Employment in the nonagricultural sector	5.2 million

IMF Position (April 30, 1996)

Quota	SDR 1,365.4 million
Funding holdings of rand	SDR 1,979.77 million
Holdings of SDRs	SDR 9.75 million
Exchange rate	US\$ 1 = R 4.34

	1995	1991	1992	1993	1994	1995
	In millions of rand at current prices	(Percentage change at constant prices)				
<u>National accounts</u>						
Private consumption	294,895	-0.5	-1.4	0.3	3.1	4.9
Public consumption	99,284	2.3	1.5	2.9	4.2	0.3
Gross fixed investment	81,791	-7.4	-5.3	-2.8	8.7	10.4
Total domestic demand 1/	487,873	-0.6	-1.1	1.2	5.9	5.9
Exports of goods and services	117,868	-0.1	1.1	6.0	0.3	8.1
Imports of goods and services	119,688	2.1	5.3	7.0	16.1	17.1
Gross domestic product	484,621	-1.0	-2.2	1.3	2.7	3.3
<u>Prices and wages</u>						
Consumer prices, annual average		15.3	13.9	9.7	9.0	8.6
GDP deflator		13.5	12.4	11.1	9.5	8.7
Remuneration per worker 2/		16.1	15.2	10.5	12.2	...
		(In billions of U.S. dollars)				
<u>Balance of payments</u>						
Merchandise exports (non-gold)	16.2	17.2	17.3	18.3	22.3	
Gold exports	7.1	6.4	6.8	6.4	5.6	
Merchandise imports	17.2	18.2	18.3	21.5	27.1	
Services and transfers, net	-3.9	-4.0	-4.0	-3.8	-4.2	
Current account balance	2.2	1.4	1.8	-0.6	-3.5	
(In percent of GDP)	2.0	1.2	1.5	-0.5	-2.6	
Long-term capital, net	-0.6	-0.5	-0.1	1.0	3.5	
Short-term capital, net 3/	-0.2	-0.8	-4.5	0.5	2.5	
Capital account balance	-0.8	-1.3	-4.6	1.5	6.0	
Gross official reserves	2.9	3.0	2.7	3.1	4.3	
In months of imports	1.3	1.2	1.0	1.0	1.2	
Net official reserves	2.9	2.7	0.3	0.9	3.5	
In months of imports	1.3	1.1	0.1	0.3	1.0	
		(In billions of rand)				
<u>Government finances</u> 4/						
Revenue	78.8	84.1	98.3	112.4	128.5	
Expenditures	91.8	111.6	122.1	137.6	155.9	
Balance	-13.0	-27.5	-23.8	-25.2	-27.5	
(In percent of GDP)	-4.1	-7.9	-6.0	-5.7	-5.5	
		(Annual percentage change)				
<u>Monetary aggregates</u> (end-period)						
Broad money	12.3	8.0	7.0	15.7	15.1	
Bank credit to private sector	14.5	8.7	9.7	17.0	17.5	

Sources: Data provided by the South African authorities; IMF, International Financial Statistics; and staff estimates.

1/ Excludes statistical discrepancy.

2/ Nonagricultural sector.

3/ Includes errors and omissions of current as well as capital account.

4/ Fiscal year beginning April 1.

I. Recent Economic Developments

In 1995, South Africa grew by 3.3 percent, the third consecutive year of economic growth, and it is expected to grow between 3 1/2 and 4 percent in 1996. Private fixed investment rose strongly, inflation fell, and the renewed access to international private capital markets has accommodated an increase in international reserves, several measures of liberalization of controls on capital flows--most notably the removal of controls on non-residents when the financial rand mechanism was abolished--and the emergence of a current account deficit. And though private nonagricultural employment stopped falling in mid-1994, it barely grew since then, despite the most favorable macroeconomic conditions in many years, implying yet further increases in open unemployment.

The success of the political transition has far exceeded expectations, in large part because the Government of National Unity acted swiftly to address the negative investor sentiment prevailing prior to the national elections in 1994. Its initiatives encompassed the development of a consensual style of decision-making and commitments to a set of prudent financial and structural policies. These included a program of progressive fiscal deficit reduction, the constitutional guarantee of the independence of the Reserve Bank, a program of trade liberalization under the Uruguay Round, measures to begin to address the many social backlogs, reform of labor legislation to reduce tensions in industrial relations, and commitments to a progressive elimination of capital controls.

The impact of these broad-ranging actions was evident in the strong recovery of investor confidence during 1994 and 1995, which was achieved notwithstanding the contagion from the Mexican crisis after December 1994. But the depreciation of the rand after mid-February 1996 serves to emphasize that a number of challenges remain.

This paper discusses a number of issues related to these challenges. Some aspects of the unemployment problem are addressed as part of the review of economic developments in the remainder of this chapter. 1/ Subsequent chapters focus on the implications for policy of the steps taken in 1994 and 1995 to establish an outward-oriented economy, after many years of effective autarky. Chapter II discusses the recent experience of capital flows into and out of South Africa, while Chapters III and IV focus on trade policy. Chapter V considers some implications for fiscal policy of the renewed access to international private capital markets, and discusses the potential role of fiscal policy in efforts to strengthen the long-run growth and employment performance of the economy in this context. Chapter VI discusses narrow monetary aggregates in light of concerns that capital inflows may be

1/ Labor market issues are discussed further in "South Africa--Selected Economic Issues," IMF Staff Country Report No. 95/21, March 1995.

altering the behavior of M3 and bank credit to the private sector, the principal indicators used currently to assess the monetary stance. Chapter VII focuses on tax policy issues relating to South Africa's principal export sector, the mining industry, reexamining the issues involved in a context of an outward-oriented growth strategy.

1. Real sector developments

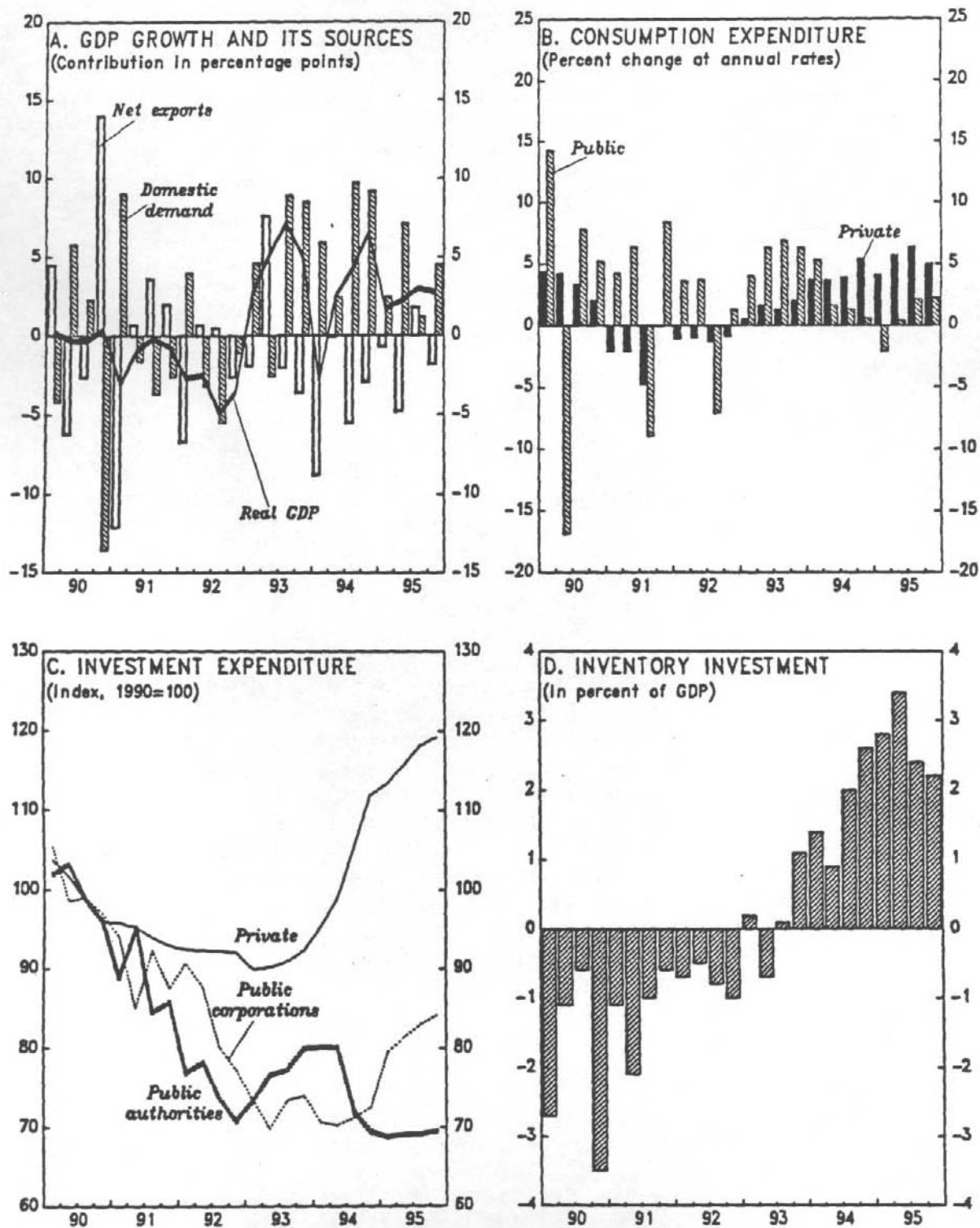
The recovery in economic activity, which had started in 1993, continued through 1995. GDP at market prices grew by 3.3 percent, despite a sharp decline in drought-affected agricultural production and a poor performance by the mining sector (Appendix Table 1 and Chart 1). The major contribution to growth continued to come from domestic demand, rather than net exports, and in particular from private consumption and private fixed investment. Private consumption expenditure continued on a strong upward trend, rising by 4.9 percent in 1995. All the major categories of consumer expenditure grew robustly, but expenditure on durable goods rose particularly vigorously, increasing by 19.4 percent (Appendix Table 4). Public consumption, in contrast, grew by a modest 0.3 percent in 1995.

Gross fixed investment rose rapidly throughout 1995, led by the private sector (Appendix Table 2). The latter grew by 13.3 percent in 1995, and was particularly robust in the manufacturing sector, where it rose by 21.3 percent; net fixed investment in the manufacturing sector increased by almost 50 percent. Unlike 1993 and 1994, when the growth in manufacturing fixed investment had come mainly from large mineral-beneficiation projects, ^{1/} the growth in 1995 was broadly based, particularly in the second half of the year. Gross fixed investment by public corporations continued on an upward trend, largely because of an increase in investment by Eskom, the electricity utility, but the increase in gross fixed investment was not sufficient to prevent a further decline in the fixed capital stock of the public corporations. Investment by public authorities ^{2/} continued on a downward trend in 1995. Since 1990, gross fixed investment by public authorities has declined by over 30 percent with gross fixed investment by general government falling by 15 percent, and that by public business enterprises by around 60 percent. Net fixed investment for the whole economy (at constant prices) increased from 2.6 percent of GDP

^{1/} Investment in a number of large mineral-beneficiation projects, including Columbus (stainless steel), Alusaf (aluminum), Namakwa Sands (titanium), and Saldhana Steel, was eligible for incentives provided in Section 37e of the Income Tax Act. The incentives are provided in the form of an accelerated depreciation allowance which can be used against profits unrelated to the project or transferred to other corporations. Projects were given a two-year implementation period from the date the incentive was authorized. The section 37e scheme was terminated in 1993.

^{2/} General government plus four official business enterprises (Community Development Fund, Government Motor Transport Trading, Government Printing Works, National Housing Fund).

CHART 1
SOUTH AFRICA
EXPENDITURE ON GDP, 1990-95
(Seasonally adjusted, at 1990 prices)



Source: South African Reserve Bank, Quarterly Bulletin.

in 1994 to 3.8 percent of GDP in 1995. The recovery in net investment has been broad based across the economy, with only agriculture, mining, and electricity continuing to show substantial negative net investment.

Inventory accumulation, which had made a substantial contribution to growth of GDP in 1993 and 1994, slowed in the second half of 1995 (Appendix Table 1 and Chart 1). Inventory accumulation in real terms was still running at about 2.3 percent of GDP in the second half of 1995, but this was below the peak levels of close to 3 percent of GDP in the first half of 1995.

As a result, gross fixed investment rose by almost one percentage point to 16.9 percent of GDP in 1995 (Appendix Table 3). Including inventory accumulation, total gross investment increased from 17.7 percent of GDP in 1994 to 19.3 percent in 1995.

Domestic saving dropped from 17.2 percent of GDP to 16.7 percent of GDP, despite a decline in government dissaving, as household saving fell for the second consecutive year, from 6.0 percent of GDP in 1994 to 4.8 percent in 1995, given that the rapid growth in consumption expenditure outstripped growth in personal disposable income; corporate saving remained relatively unchanged, dropping slightly from 15.2 percent of GDP in 1994 to 15.0 percent in 1995. The contribution of foreign saving to the financing of domestic expenditure increased sharply in 1995 from 0.5 percent of GDP in 1994 to 2.6 percent in 1995.

On the supply side, economic activity was dominated by the contrasting fortunes of the primary and nonprimary sectors of the economy (Appendix Table 5). As noted above, value added in the agriculture sector was adversely affected by drought conditions in the summer growing season, and declined by 15 percent in real terms. The mining sector also performed poorly with value added declining by 3.6 percent (Appendix Table 6). Gold production was adversely affected by a fall in productivity ^{1/} and a decline in the availability of higher grade ores; both contributed to a substantial decline in the average grade of ore milled. Diamond production was also affected by labor unrest, but these problems were compounded by difficulties in the international market for diamonds associated with an increase in the sale of diamonds outside of the cartel organized by the De Beers Central Selling Organization. ^{2/}

^{1/} The decline in productivity has been attributed to a combination of an increase in the number of public holidays and labor unrest in the mines. Gold mines sought to maintain milling volumes despite a decline in the volume of ore mined, hence the decline in the average grade of ore milled.

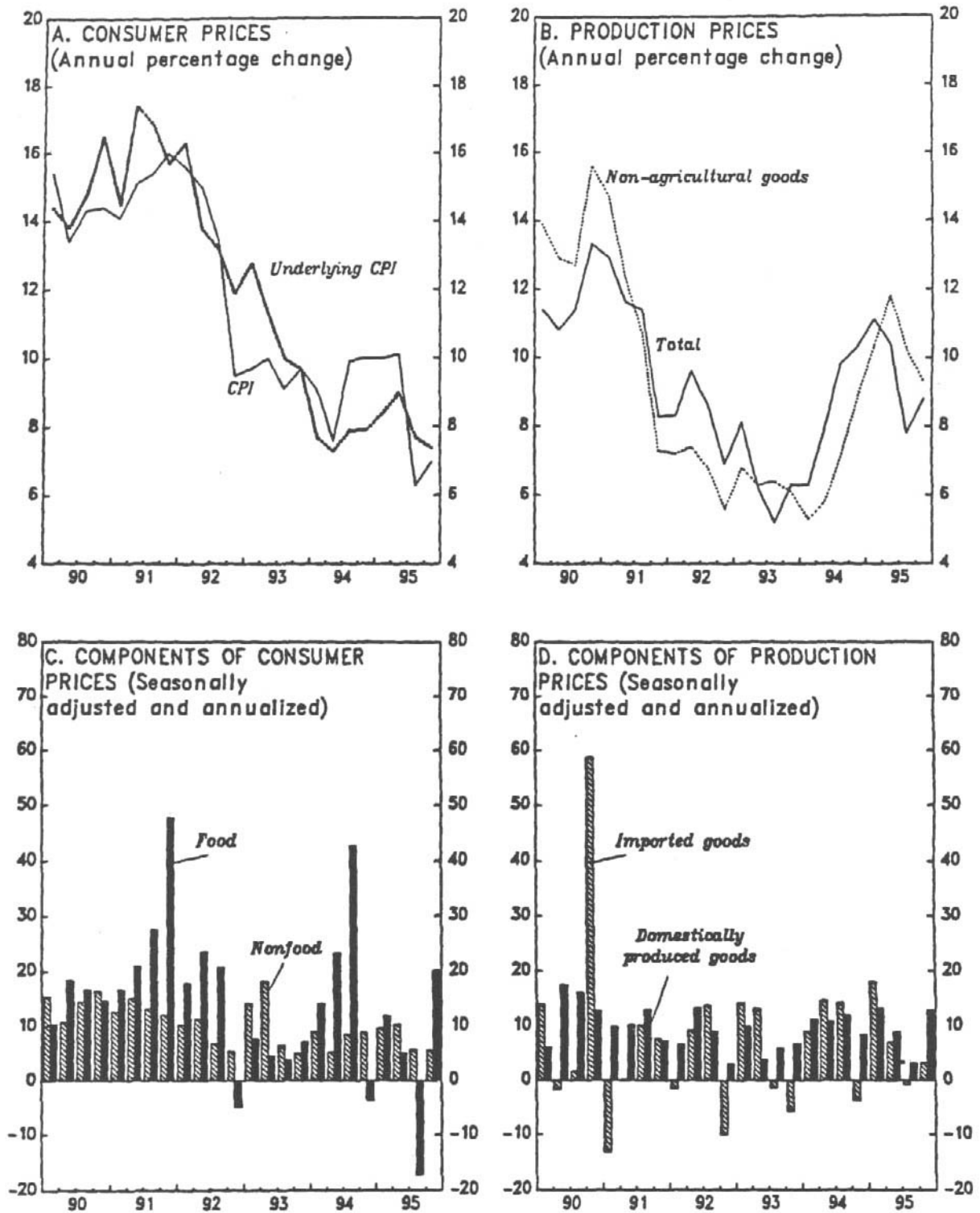
^{2/} On February 23, 1996, Russia and De Beers (a South African concern) signed a memorandum of understanding committing the two sides to a three-year marketing agreement. The agreement should limit the volume of diamond sales outside of the Central Selling Organization.

In contrast, the performance of the nonprimary sectors was much stronger: value added increased by 4.7 percent in 1995, compared to 2.5 percent in 1994, with industry growing by 6.4 percent and services by 3.6 percent. Growth in industry was particularly strong in the first three quarters of the year, averaging more than 7 percent on an annualized basis, but fell sharply in the fourth quarter because of a decline in value added in the manufacturing sector. Manufacturing production, as opposed to value added, had been subdued for most of the second half of 1995 (Appendix Table 7). Sales and new orders appear to have remained firm, but there was a substantial decline in unfilled orders in the first half of the year, suggesting that a backlog of deliveries had been cleared. Early indications suggest that manufacturing production rebounded at the start of 1996. The service sector grew strongly throughout the year, particularly private sector services. Wholesale and retail trade recovered from a relatively poor first quarter, and grew at a rate of 8-9 percent subsequently. Similarly, the transport sector performed well as did the financial service sector. Growth in general government was very modest, averaging less than 1 percent on an annualized basis.

The upward trend in both producer and consumer prices, which had been a source of some concern in the early part of 1995, was reversed decisively in the second half of 1995 (Appendix Table 10 and Chart 2). The 12-month rate of increase of producer prices declined from 11.1 percent at the end of the first quarter to 8.8 percent by end-1995, and that of consumer prices declined from 10.0 percent to 7.0 percent over the same period. As discussed below, the tightening of financial policies from the third quarter of 1994 to the middle of 1995 played an important role in the improvement of investor sentiment in the second half of 1995, which underpinned the strength of the rand, and contributed significantly to the deceleration in the rate of inflation in the second half of 1995.

The decline in the rate of inflation reflected a sharp fall in the rate of food price increases in the second half of 1995, as a result not only of climatic factors--the drought-depressed meat prices and a mild winter moderated the rate of price increases for fruit and vegetables--but also a number of policy changes. The latter included most notably a reduction of import tariffs on agricultural products, especially meat, and the introduction of agricultural marketing reforms which served to enhance price flexibility (see Chapter III). The decline in food prices provides only a partial explanation of the deceleration of inflation in the second half of 1995, as both the SARB measure for the underlying rate of consumer price inflation and the rate of increase in producer prices (excluding agro-based products) also declined sharply in the second half of 1995. The fall in the underlying rate of inflation was closely linked to downward pressure on prices of imported goods brought about by a combination of a stable rand in the second half of 1995 and lower tariffs (see Chapter III). Prices of imported goods, which were essentially flat in the second half of the year also put downward pressure on domestically produced goods.

CHART 2
SOUTH AFRICA
CONSUMER AND PRODUCTION PRICES, 1990-1995
(End period)



Source: South African Reserve Bank, Quarterly Bulletin.

More generally, however, the anti-inflationary monetary stance in recent years has clearly achieved a significant degree of success: the underlying rate of inflation has been reduced from around 17 percent in 1991 to 7-8 percent by late 1995 and wage settlements have moderated significantly in nominal terms (Appendix Table 9). Between 1990 and 1994, the 12-month rate of growth of remuneration per worker in the private sector declined from 17 percent to around 10 percent.

Despite the moderation of nominal private sector wage growth in recent years, average remuneration in the private sector increased by 4.6 percent in real terms between 1990 and 1994. As most wage settlements in 1995 reflected the acceleration of inflation that had taken place through May 1995, and did not anticipate the substantial decline in the rate of inflation in the second half of the year, real wages are likely to have increased further in 1995. The impact of this increase in real wages on unit labor costs since 1990 has been partly offset by higher labor productivity, albeit at the cost of a substantial loss of employment. Nevertheless competitiveness has continued to deteriorate since 1990 (Chart 3): the ratio of export prices to private sector unit labor costs declined further, as did the ratio of manufacturing prices to manufacturing labor costs.

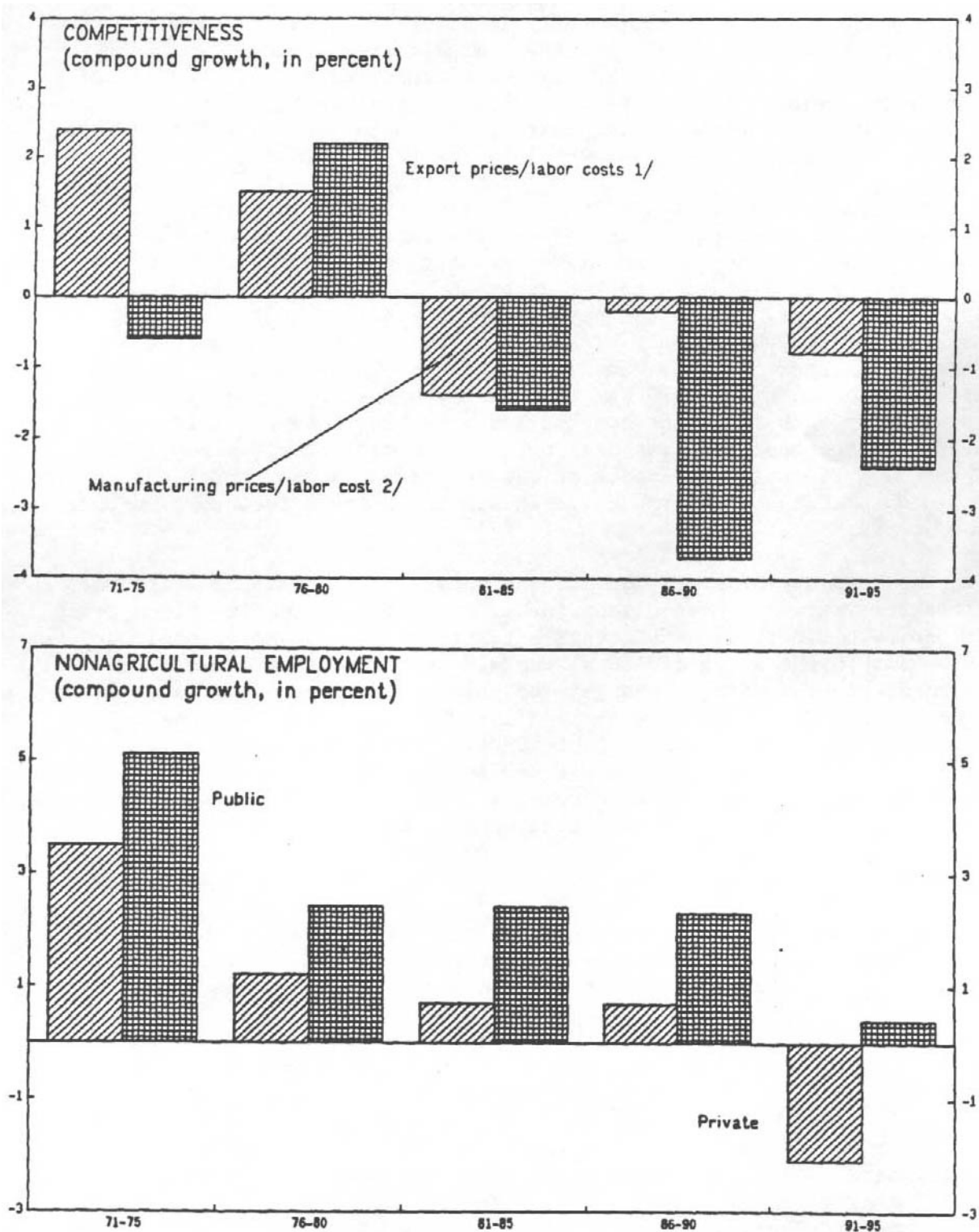
The response of employment to the upturn in economic activity in the last three years has been disappointing (Appendix Table 8). Since reaching its nadir in mid-1994, a full year after the start of the economic recovery, employment in the nonagricultural private sector has increased by about 1 percent, representing a net gain of only 30,800 jobs. The modest increase in employment levels must be set against the substantial decline in employment during the recession of 1990-92. Since 1990, employment in the nonagricultural private sector has declined by some 10 percent; employment by public authorities increased somewhat, but overall employment has fallen by more than 6.3 percent, a net loss of some 350,000 jobs.

These trends in employment occur in a context where unemployment is very high. The October Household Survey (OHS) of 1994--which provides the official measure of unemployment--estimates open unemployment at 32 percent of the labor force and indicates that most of the unemployed--4 million--were black people among whom the unemployment rate was more than 40 percent.

A number of insights into the composition and roots of the unemployment problem and its links to the problem of competitiveness may be derived from the survey results (see Box 1). Half the unemployed black people live in the rural areas, half of them are below 30 years old, 70 percent of them have never worked, and almost all have less than full secondary education (to standard 10). In contrast unemployment of skilled workers across all racial categories was found to be low and consistent with frictional unemployment. These findings are suggestive on a number of counts:

- the fact that such a large percentage of the unemployed are young people with limited educational attainment who have never worked suggests a

CHART 3
SOUTH AFRICA
COMPETITIVENESS AND EMPLOYMENT, 1971-95



Sources: South African Reserve Bank, Quarterly Bulletin.

1/ Nongold export prices divided by unit labor costs in nonagricultural sector.

2/ Manufacturing prices divided by unit labor costs in the manufacturing sector.

Box 1. South Africa: The Composition of Unemployment

The October Household Survey (OHS) of 1994 provides high-quality evidence of the composition and level of unemployment and is used as the official measure of unemployment. A household survey, rather than evidence from registered unemployed persons, is used for this purpose because few of the unemployed register. Field work for the survey was undertaken from the second week of September to end-October 1994. The 1995 results are not expected until mid-1996.

The survey defines the employed as those over 15 years old who, during the week prior to the survey, worked for five or more hours for a wage, profit, or family gain in cash or kind--a very comprehensive definition including many underemployed people and those engaged in informal sector activities. According to the so-called expanded definition, the labor force includes the unemployed who want work, even if they take no action to seek it. This definition is appropriate in South Africa--and is the ILO standard--because job scarcity rather than voluntary unemployment often accounts for nonjob search, but unemployment is also reported excluding these nonsearchers.

The survey has two biases: mining hostels were underenumerated, because security risks prevented full access by enumerators, as were the many new "informal settlements" outside main towns that have developed since 1991. These cancel out: the first exaggerates unemployment while the second understates it, to roughly the same degree. The unemployment rates by age are staff estimates based on data on the age structure of the labor force from the 1991 census.

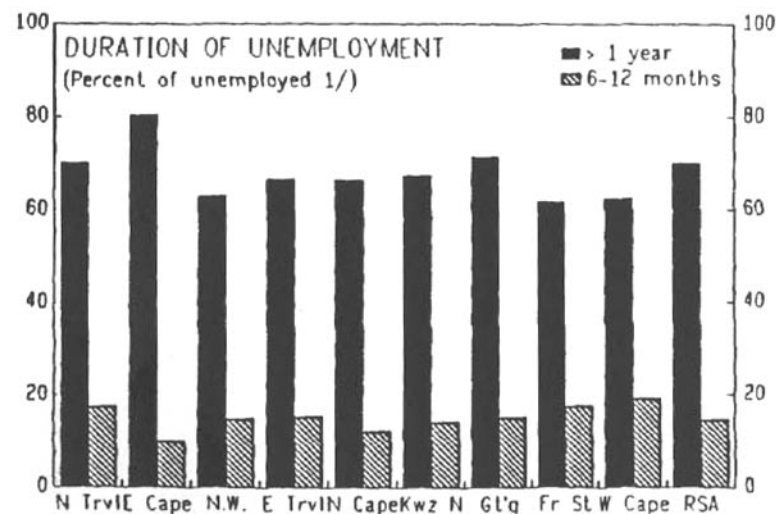
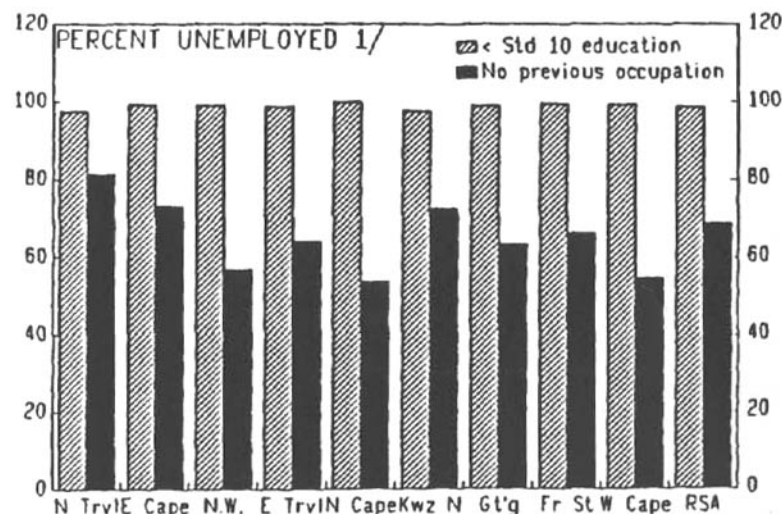
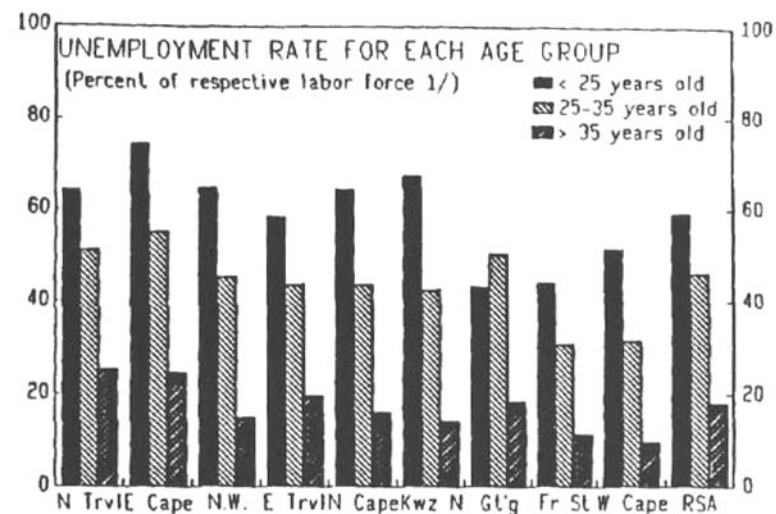
Key Results

Open unemployment amounted to 32 percent of the labor force, some 4.6 million people in October 1994. Unemployment of skilled workers is low and consistent with frictional unemployment. Most of the unemployed (4 million) were black people, among whom unemployment was more than 40 percent (see Chart 4). Half of these live in rural areas.

Half of the black people unemployed were below 30 years old, almost all had less than full secondary education (to Standard 10), almost 70 percent had never worked, and a similar proportion had been unemployed in excess of a year. In only two regions--Gauteng and the Free State--were unemployment rates among young black people (less than 25 years old) less than 50 percent, and black unemployment rates decline steeply with age across the country. There is substantial regional variation in unemployment, even among those more than 25 years old, and unemployment rates are higher for women than for men.

High youth unemployment, and its long average duration, may account for the crime rate. It also may explain how the long-term unemployed survive in the absence of official benefits, since these unemployed are disproportionately young and are generally supported by their families.

CHART 4
SOUTH AFRICA
COMPOSITION OF UNEMPLOYMENT OF BLACK PEOPLE, 1994



Source: October Household Survey 1994; and staff estimates.
1/ Including those wanting work but not actively seeking it.
2/ Excluding those not actively seeking work.

special problem at entry level into the workforce for unskilled workers. In particular, it indicates that the vast majority of young people are handicapped not only by the very limited skills they have to offer but also by inflexibilities in the price at which they can offer their labor services.

- the fact that so many of the unemployed live in the rural areas suggests that there are special problems in the rural labor market that are impeding the employment of a substantial proportion of the rural labor force. As the wage-setting mechanisms in the rural labor market are relatively flexible, the problems are likely to extend beyond the functioning of the labor market.

- the evidence that unemployment of skilled workers is relatively limited, and appears to be frictional, suggests that the markets for skilled labor clear. However, direct firm-level evidence from studies such as the Monitor Study indicates that skill-intensive sectors--principally manufacturing--are uncompetitive, and hence fare poorly in export markets. The absence of structural unemployment of skilled labor would tend to rule out the obvious explanation, namely that these firms are uncompetitive because union pressures are inflating wages above a market clearing level. This suggests that the appropriate question is why do skilled labor markets clear at wage levels which render the employers of skilled labor internationally uncompetitive? Two factors present themselves: (i) constraints on the supply of skilled labor as a result of inadequate education and training, and (ii) protection from international competition, which enables domestic firms to survive in the domestic market with inflated cost structures, but which impedes them from competing abroad and therefore impedes their growth (see Chapter III).

The OHS not only illustrates the sheer scale of the unemployment problem, and consequently the need for decisive action to address it, but also suggests that the roots of the problem are multifaceted and will need to be addressed at a number of levels if a coherent strategy to address the unemployment problem is to succeed.

2. The public finances

a. Recent developments

Central government finances, which deteriorated in 1992/93, improved significantly in 1993/94 and only gradually thereafter. 1/ The deficit rose from 4.1 percent of GDP in 1991/92 to 7.9 percent of GDP in 1992/93, before declining to 6 percent in 1993/94 and to 5.7 percent in 1994/95 and to 5.5 percent in 1995/96 (Appendix Table 11). 2/ The 1996/97 budget targets a further decline to 5.1 percent of GDP.

Revenue (excluding extraordinary revenue) varied by little more than 1 percentage point of GDP between 1991/92 and 1995/96, reaching 25.4 percent of GDP in 1995/96 (Chart 5 and Appendix Tables 12 and 13). Total income tax collections were fairly steady throughout the period at about 13.5 percent of GDP, as corporate tax receipts drifted downward from 4.4 percent of GDP in 1991/92 to 3.5 percent in 1995/96, personal income taxes rose from 9.4 percent of GDP in 1991/92 to 10.2 percent in 1995/96. The drop in corporate tax receipts was virtually the result of a decline in tax collections from nonmining companies. Both a prolonged recession and cuts in the corporate tax rate from 48 percent to 40 percent in 1993/94 and to 35 percent in 1994/95 contributed to this outturn. The tax cuts were only partly offset by the introduction of the secondary tax on companies (STC, a tax on distributed dividends); the initial rate of the STC was set at 15 percent in 1993/94 and subsequently raised in 1994/95 to 25 percent. In contrast to corporate tax performance, individual income tax collections rose largely because of inflation-induced bracket creep.

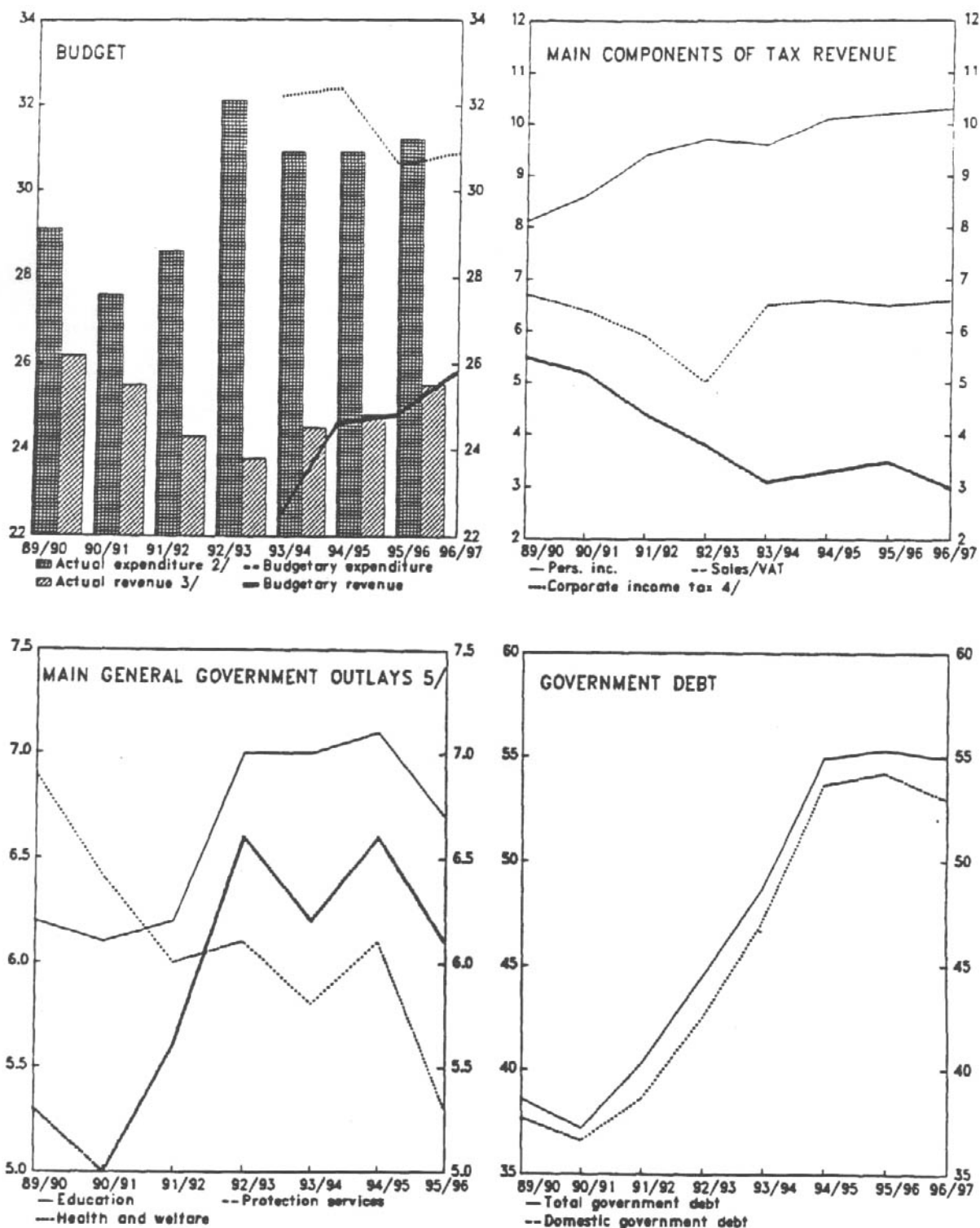
As regards indirect taxes, the replacement of the general sales tax with the VAT at a rate of 10 percent in September 1991 caused a decline in revenue from 5.9 percent of GDP in 1991/92 to 5 percent in 1992/93; however, this decline was more than reversed when the VAT rate was raised to 14 percent in 1993/94, and collections reached 6.5 percent of GDP. VAT revenue remained around this level through 1995/96. Excise duty revenue

1/ The fiscal year begins April 1. The 1994/95 budget introduced a major change in methodology regarding the treatment of the former homelands (the TVBC states), which also led to revisions of historical statistics on central government revenue, expenditure, and overall balances. Tax revenue previously diverted to the former homelands is now included in the revenue data of the new National Revenue Account and the expenditure which that revenue financed now appears as a transfer to a lower tier of government. Moreover, homeland expenditure previously financed by overdraft facilities now appear as a transfer from the central government budget.

2/ These data include extraordinary revenue, mainly proceeds from sales of the strategic oil reserves. Data excluding these receipts are reported in Appendix Table 11).

CHART 5

SOUTH AFRICA
GOVERNMENT FINANCES, 1989/90-1996/97 1/



Sources: Dept. of Finance; SARB; and Fund staff estimates.

1/ Fiscal year ending March 31. Data for 1995/96 is preliminary; and budgetary figures are given for 1996/97. All data is in percent of GDP.

2/ Central government expenditure, excluding extraordinary transfers to capitalize the civil service pension funds and the gold and foreign exchange stabilization fund.

3/ Central government only; excludes extraordinary capital revenue.

4/ Includes secondary tax on corporations.

5/ Data for 1995/96 comes from the 1995/96 budget.

(including the fuel tax) held basically steady throughout the period 1991/92-1995/96, despite the strong increase in consumption in 1995/96. The weak performance in 1995/96 is likely to have reflected a rise in evasion. 1/ Customs duty revenue (excluding import surcharges which were eliminated over the period 1994/95-1995/96) was flat between 1991/92 and 1994/95, as the effect of growing imports was offset by lower tariffs, but rose 27 percent in 1995/96 in line with the sharp rise in imports.

Central government expenditure rose by 3.5 percentage points of GDP between 1991/92 and 1992/93, but fell by more than a percentage point to around 31 percent of GDP in 1993/94 and remained at that level in the following two years (Appendix Table 11).

The decline in expenditure of general government since 1992/93 was concentrated in the wage bill and in subsidies to business, and occurred despite higher interest outlays and a rise in capital expenditure (Appendix Table 14).

Between 1991/92 and 1994/95, general government (national and provincial governments) expenditure on protection services was kept virtually stable at about 6 percent of GDP. 2/ Spending on social services was boosted by over 1.5 percentage points of GDP between 1991/92 and 1992/93 and thereafter remained roughly constant as a proportion of GDP. In contrast, spending on economic services was reduced by 1.3 percentage points of GDP between 1991/92 and 1994/95 (Appendix Tables 15 and 16). General government spending in 1995/96 is estimated to have remained at about its 1994/95 level of 32.5 percent of GDP. 3/

The increase in capital spending in 1995/96 reflects in part an improved delivery rate in expenditure under the Reconstruction and Development Program (RDP). The RDP fund is designed to allow rapid mobilization of resources for special initiatives to redress inherited inequities. The fund is financed by an equivalent reduction of planned allocations to spending departments and is to increase by R 2.5 billion in each budget through 1998/99. In 1994/95 the turnover of funds was quite slow and it is estimated that more than half of the funds were rolled over into 1995/96. While 1995/96 saw a further rollover of funds (of R 1-2 billion) out of the R 5 billion (or 1 percent of GDP), the rate of expenditure take-up increased substantially, and outlays under the RDP were estimated at 0.6-0.8 percent of GDP in 1995/96.

1/ The revenue services have experienced a shortage in staff in recent years following implementation in 1994 of a voluntary retirement program.

2/ Defense expenditure has fallen by over 1 percentage point of GDP since the beginning of the decade to under 3 percent of GDP by 1994/95, but much of these savings has been diverted to internal protection services, mainly the police.

3/ No breakdown is available for 1995/96 on the composition of the functional classification of expenditure.

The Central Government's debt-to-GDP ratio, which stood at 37.2 percent at the end of 1990/91, rose to 55.3 percent at the end of 1995/96. Part of the increase in debt reflects transactions that were not included in above-the-line deficits. 1/ These transactions, as identified from financing data compiled by the Reserve Bank (Appendix Table 17), are: (a) the losses associated with the provision of forward cover for foreign borrowing by the Reserve Bank on behalf of the government; 2/ (b) transfers to cover the actuarial underfunding of state pension funds which totaled R 10.3 billion between 1991/92 and 1993/94; 3/ (c) government securities issued at coupon rates below market interest rates that result in a discount on government paper. As debt statistics are compiled at book values, the practice of discounting amplifies the stock of outstanding debt; and (d) the assumption of debts of the former homelands, which resulted from overdraft facilities and were guaranteed by the Central Government and amounted to R 13 billion by the end of 1995 (Appendix Table 18).

b. 1996/97 budget

On March 13, 1996, the budget for fiscal year 1996/97 was presented to Parliament. The budget envisages a decline in the overall deficit from 5.5 percent of GDP in 1995/96 to 5.1 percent. 4/ To meet this target, the budget includes a combination of higher revenue and lower expenditure. Revenue (excluding extraordinary revenue) is projected to rise slightly from 25.4 percent of GDP to 25.5 percent, while outlays are projected to decline from 31.2 percent of GDP to 30.9 percent. As capital outlays are budgeted to decline somewhat, government dissaving (including extraordinary receipts) is projected to decline from 2.9 percent of GDP in 1995/96 to 2.7 percent in 1996/97.

1/ Over the period March 1991 to March 1996, the debt of Central Government increased by just under R 180 billion (including debts incurred by the former homelands). Of this increase, about R 26.2 billion represented the effect of below-the-line (off-budget) transactions.

2/ Following the realization of losses, the Government regularizes its position with the Reserve Bank by issuing zero coupon bonds. This transfer is shown below the line in the fiscal accounts as adding to the Government's borrowing requirement, but it does not appear above the line in the fiscal accounts. The transfer has the effect of reducing the balance in the Gold and Foreign Exchange Contingency Reserve Account, which had increased with the realization of the losses, and therefore does not affect the stock of government debt because this stock is inclusive of the balance in that account (Appendix Table 18).

3/ As of March 31, 1996, actuarial underfunding of state pension funds is estimated at 30 percent of contingent government liabilities (excluding those of the Reserve Bank), roughly 7 percent of GDP in 1995/96.

4/ At the time the budget was presented, the outturn for 1995/96 was provisionally estimated at 6 percent of GDP. These data include extraordinary receipts. Data excluding these receipts are reported in Appendix Table 11.

Financing of the deficit is to be done almost wholly through the issue of government securities in the domestic market. The Government intends to continue to issue debt at a discount, as well as zero-coupon instruments. The net issue of securities resulting from the budget should lead to a slight decline in the overall government debt-to-GDP ratio from 55.3 percent in 1995/96 to 54.9 percent in 1996/97; however, this does not reflect potential off-budget increases in debt owing to the further assumption of the debt balances of the former homelands.

The main measures on the revenue side include: a temporary 17 percent tax on the monthly gross interest and net rental income of retirement funds (estimated yield 0.5 percent of GDP); tax administration improvements as a result of improved cross-checking capabilities and tighter enforcement of rules barring tax avoidance schemes, owing to the merger of the Inland and Customs Revenue Services to form the South African Revenue Service, that are projected to yield 0.3 percent of GDP (equivalent to a 1 percent increase in revenue from income and value-added taxes); hikes in specific excise taxes, stamp duties, and the fuel levy that are projected to yield an additional 0.2 percent of GDP. The VAT rate was maintained at 14 percent, exemptions for fee-based financial services (effective October 1, 1996) and gambling were removed; the net yield will be small, however, as the broadening of the VAT base was done concurrent with the elimination of the financial services levy.

Income tax regulations were changed to correct for past bracket creep and are expected to yield a revenue loss of 0.4 percent of GDP. In addition, the minimum taxable income threshold was raised, the number of tax brackets was lowered from 10 to 8, and the maximum tax bracket was increased from R 80,000 to R 100,000 (with an unchanged 45 percent marginal tax). The secondary tax on companies was halved to 12.5 percent, effectively reducing corporate income tax rate from 48 to 42 percent, but no revenue loss is expected because this tax has been increasingly avoided through the payment of dividends in scrips. The corporate income tax rate was maintained at 35 percent. Other measures that cut tax rates include the halving to 0.5 percent of the marketable securities tax and the stamp duty on securities that are estimated to yield a loss of revenue of 0.2 percent of GDP.

The revenue projection excludes dividend payments from state enterprises that last year amounted to 0.1 percent of GDP, but the authorities intend to establish a formal dividend policy with respect to the state enterprises to replace the current ad hoc approach. The budget also includes strategic oil stockpile sales of 0.3 percent of GDP, compared with 0.2 percent of GDP last year.

On the expenditure side, the wage bill is expected to rise 13.2 percent reflecting wage increases and costs associated with voluntary retirement packages in accordance with the civil service reform established in March 1996 (see below). Interest payments are expected to rise to more than 6 percent of GDP, compared with 5.8 percent in 1995/96. Capital expenditure

is projected to decline marginally in 1996/97 from 2.6 percent of GDP in 1995/96 to 2.4 percent of GDP. Real expenditure increases are planned in education and police services, and that on health is to remain in line with the 1995/96 outturn. Despite a cut in direct funding in the 1996/97 budget, nominal housing outlays could rise by up to 24 percent, if the carryover of funds from previous allocations and new allocations of RDP grants is used. In contrast, real expenditure cuts are planned in defense and export subsidy programs. Defense spending is projected to decline to less than 2 percent of GDP in 1996/97, compared with just under 3 percent of GDP in 1995/96. The 1996/97 budget cuts led to cancellation of almost all arms acquisition programs and a 50 percent cut in the Special Defense Account (arms production subsidy).

On March 8, 1996 an agreement was reached within the Chamber of Public Service Bargaining Council on a three-year adjustment package. The agreement addresses only one element of a civil service reform--namely, the restructuring of salary scales and grades and the identification of funds for increased salaries. Agreements remain to be finalized on downsizing and a voluntary severance package, and on a restructuring of pension benefits. The agreement of March 8 calls for additional funds for salary improvements of R 7.4 billion, as contained in the 1996/97 budget, and R 6.5 billion in both 1997/98 and 1998/99. Furthermore, the agreement allows for budgetary savings from downsizing to fund additional salary hikes of the order of R 1.1 billion in 1996/97 and R 4.8 billion in both 1997/98 and 1998/99. These increases imply that the wage bill will rise 13.2 percent in 1996/97, 10.1 percent in 1997/98, and 9.2 percent in 1998/99. Assuming a continuation of nominal GDP growth at present rates over this period, the wage bill would remain around its 1995/96 level of 11.3 percent of GDP in 1996/97 and 1997/98 before declining slightly in 1998/99 to 11.1 percent of GDP.

With respect to downsizing, the intention is to reduce staff positions by 300,000 (out of 1.2 million public sector employees) over three years. Regarding pension benefits, the terms of reference for an agreement on reform is shaped around early retirement, enhancing resignation benefits, the transfer of accrued interests, dormant member benefits, and final salary definition.

c. Poverty alleviation and social programs

Poverty alleviation, mainly directed at the black population, is the most pressing problem facing South Africa. The Department of Welfare is undertaking a five-year plan that will combine public and private financing options to alleviate poverty and end racial and gender discrimination in the provision of social services. The social welfare delivery system will be restructured, with less emphasis on specialized services, and with a focus on community development. At present, nongovernmental agencies do the bulk of the delivery of welfare services, but these agencies lack sufficient resources to do the necessary work. Also, plans are being drawn up to eliminate the substantial waste and fraud in the social security system.

The objective is to set up a National Social Grants Registry, first by concentrating on new registrants and then moving to the private and civil service pension funds to complete the Registry. The ultimate aim is to move to an AFIS system (fingerprint system) to reduce fraud.

Also, there is an imbalance within social services provision where 61 percent of the beneficiaries are the elderly, 23 percent disabled, and 16 percent children and families. Moreover, programs for the elderly are quite generous (R 11,000-22,000 per person per annum). Social security assistance (old-age and veterans' pensions, disability grants, child and family maintenance grants, foster-parent grants, and relief aid) made up 88 percent of the 1995/96 budget for social services, while welfare assistance (elderly care, child and family welfare, probation services, drug rehabilitation, community centers, and population development) and capital expenditure amounted to 8 and 4 percent, respectively.

The bias toward social security in large part reflects that parity in social grants among the races as required by the new constitution has been implemented; however, there is not yet parity in maintenance grants. At present, maintenance grant payouts cover relatively few eligible black people. If all eligible black people were to apply, the cost could rise by R 15 billion (3 percent of GDP).

Progress in implementing programs in each of the critical social sectors--health, education, and housing--has been slow. The housing program aimed at eventually benefitting up to 300,000 families a year (consisting of a one-time subsidy scheme and mortgage indemnities against political risk to facilitate private sector financing) is barely underway. Progress in health is difficult to judge at this stage. The Government introduced free health care for pregnant women and for children under six years, but the health strategy remains to be fully developed. Education reform is a national imperative, but progress will depend, among other things, on decisions about sharing the various areas of responsibility between national and provincial levels of government.

d. Fiscal policy reform

In December 1995 the Smith Commission published its recommendations for improving the efficiency and equity of the present system of retirement arrangements. The Committee's reform proposals aim at promoting saving, lowering the burden on the public sector finances, and improving the coverage for poor and informal sectors. The major recommendations include periodic means and eligibility testing to ensure that the state old-age pension is being properly targeted to the poorest sectors; raising the effective retirement age of women (currently at 60 years) by paying a higher pension for those who delay retirement; establishing open funds to allow for small enterprise and informal sector worker participation; allowing pension fund portability; and reducing penalties for the early withdrawal of assets. The Commission calls for modifying public sector pension plans to bring them in line with those in the private sector. At present, the replacement ratio

is equal to $1/42$ of the final salary for each year of service in the public sector, compared with a ratio of $1/48$ of the average of the last two years of salary in the private sector; public sector lump-sum gratuities are more generous than in the private sector; and retrenchment benefits in the public sector are 5 times the annual salary, compared with a factor of 1.5 in the private sector (for those with more than 10 years experience). To promote labor mobility, the Commission recommends that civil servants leaving voluntarily be offered the option to transfer to a private fund the full actuarial interest of their accrued pension rights. Finally, the Commission suggests that new state employees be enrolled in a defined contribution scheme, allowing the current defined benefit system to contract over time.

In the area of relations between the various levels of government, Parliament is considering legislation (Provincial Governments Borrowing Act) to define the borrowing rights of provincial governments, and the Financial and Fiscal Commission (FFC) is formulating recommendations for the new constitution regarding revenue sharing and expenditure responsibilities among national, provincial, and local levels of government. Regarding the Provincial Borrowing Bill, the latest draft would forbid provinces from borrowing to finance current expenditure (with the exception of bridge financing). Borrowing for capital expenditure must meet the approval of the Loan Coordinating Committee (LCC) which the Minister of Finance chairs. Moreover, a province's borrowing (including borrowing through provincial enterprises or development corporations) would be capped by a formula that would limit annual gross interest payments (including all forms of finance charges and deferred interest) to less than a given percentage of current revenue. Also, national guarantees on provincial borrowing will require a national Exchequer Act.

The FFC is looking into how resources should be shared between the central and the provincial governments and among the provinces, given the interim constitutional requirements that the provinces receive an equitable share of the personal income tax, VAT, national fuel levy, and national transfer taxes collected within their borders, and that the provision of health, education, housing, and welfare services be in the domain of the provinces. Further recommendations are to be made on the allocation of resources between provincial and local governments. The FFC calls for a freeze in real terms on resources for the national government for 3 years, with all remaining resources going to the provinces (based on the assumption that the demand for services under provincial authority will grow with the population), while many services provided at the national level (e.g., defense) will not. With respect to the division of resources among provinces, the FFC calls for the allocation of resources to be based on provincial populations (with greater weights for rural residents) and on estimated education and primary health needs within each province. To avoid harsh adjustment costs, the formula would be phased in over 5 years.

In June 1994, an independent tax commission was appointed (the Katz Commission) to conduct a review of selected aspects of South Africa's tax structure and, in particular, to provide recommendations for tax changes.

To date, the Commission has made three reports in these matters (November 1994, June 1995, and November 1995), with a fourth report to be issued in 1996. 1/

As regards the personal income tax, recommendations to eliminate the discriminatory tax treatment based on gender and marital status and child rebates were implemented in the 1995/96 budget. The Commission has also called for reducing the number of brackets from 10 to 5, instituting a flat rate of 9 percent on annual taxable income up to R 30,000 and maintaining the maximum marginal rate of 45 percent on incomes above R 150,000. The fourth interim report is to make proposals regarding base broadening through limiting or removing deductions and exemptions, indexation of tax brackets, and the taxation of fringe benefits.

With respect to corporate taxation, the Commission recommended that the secondary tax on companies (STC) be retained for now but at a reduced rate; this was implemented in the 1996/97 budget. Also, the Commission has called for the eventual replacement of the STC by a full or partial imputation system and the implementation of a presumptive tax on company gross assets.

Regarding VAT reform, the Commission has called for a new study to assess whether the base can be broadened by narrowing zero ratings and eliminating exemptions, and whether there is scope for a rate hike. The recommendation that the VAT be applied to all fee-based financial services was adopted in the 1996/97 budget.

The third interim report called for the taxation of retirement income, both as it accrues and upon withdrawal. The Commission supports the equal tax treatment of discretionary and contractual saving and proposes to bias the taxation of retirement income toward encouraging annuities and discouraging lump-sum withdrawals (the Commission's views are that retirees spend the resources from lump-sum withdrawals too fast and, disproportionately, end up in their later years on public rolls). Finally, the Commission calls for equal tax treatment of public and private pension funds.

The Commission has identified considerable scope for strengthening tax administration. The Government is presently moving forward on several proposals including the modernization of computer facilities, improved tax assessment and audit procedures, enhancing taxpayer education, and endowing the revenue service with more flexibility in respect of employment and wage policy.

e. Restructuring of State assets

The Government is in the early stages of formulating a program of State asset restructuring that would include, but not be limited to,

1/ For a description of the current tax system, see Annex I.

privatization. The program is aimed at imparting competitiveness in firms, promoting human resource development, widening share ownership, and stimulating entrepreneurship within the black community. Full implementation could take 5-6 years, but some enterprises are on a fast track for reform.

3. Monetary developments and policies

The prospect of rising inflation reemerged during 1994, after several years of falling, rates--both the 12-month consumer price index, and the measures of underlying inflation, which adjust for special factors such as tax changes and volatile elements in the index--began to rise (see Section 1 above). The primary source of the renewed pressures was the strength of domestic demand. Those prospects were reflected in rising market yields for both short- and long-term securities (Chart 6).

The monetary and credit aggregates reflected these developments. The 12-month growth rate of M3, which was 7 percent in December 1993, had risen to 15.7 percent in December 1994, well in excess of the upper guideline range of 9 percent for 1994. The trend growth in narrow money, in particular notes and coin in circulation outside the banking system, also accelerated from less than 10 percent at end-1993 to some 16 percent at end-1994. ^{1/} Over the same period, the 12-month growth rate of bank credit to the private sector rose from 9.7 percent to 17 percent, with demand for bank credit by households (notably mortgage finance) and corporates (to fund investment and inventory accumulation) rising equiproportionately.

In light of these developments--as well as the need to support the liberalization of foreign exchange controls on nonresidents, to respond to the fallout from the Mexican crisis of December 1994, and to strengthen sentiment towards the rand--a number of steps were taken to tighten monetary policy from mid-1994 onwards:

- the bank rate was increased in three steps from 12 percent in September 1994 to 15 percent in June 1995 (see Chart 6);

- ambitious guidelines were set for the growth in M3 in 1995--6 to 10 percent--in order to signal the authorities' commitment to combatting the inflationary pressures;

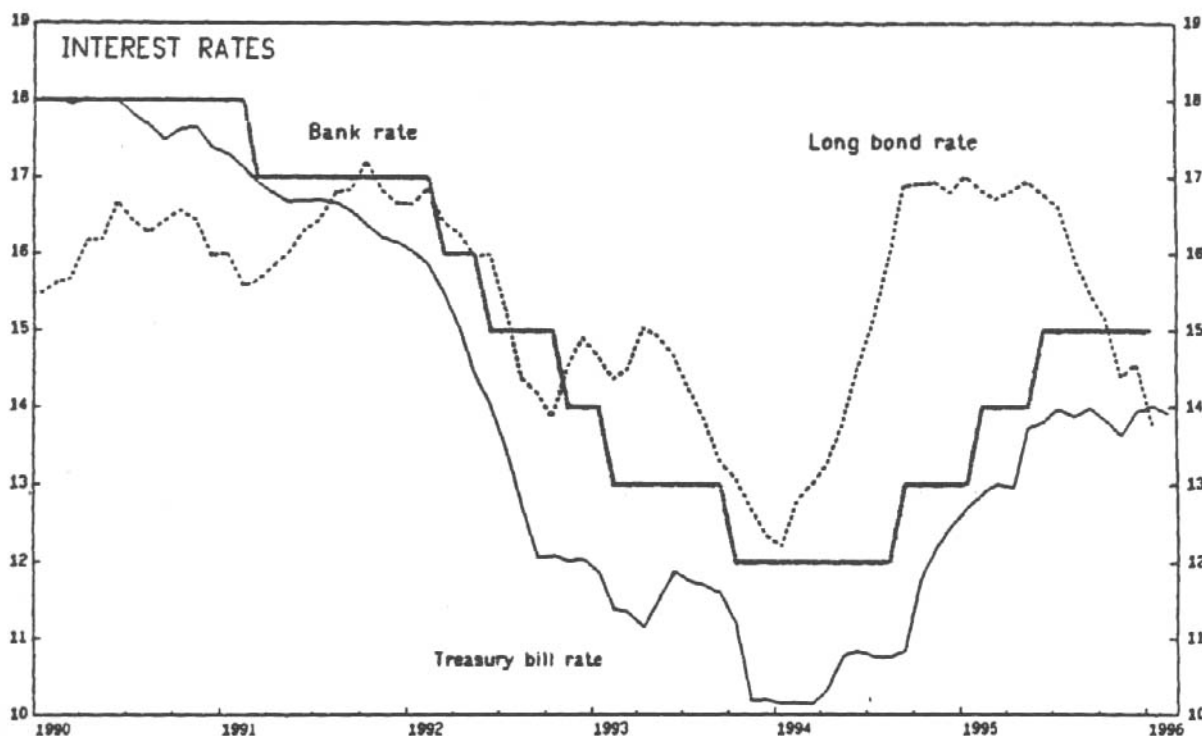
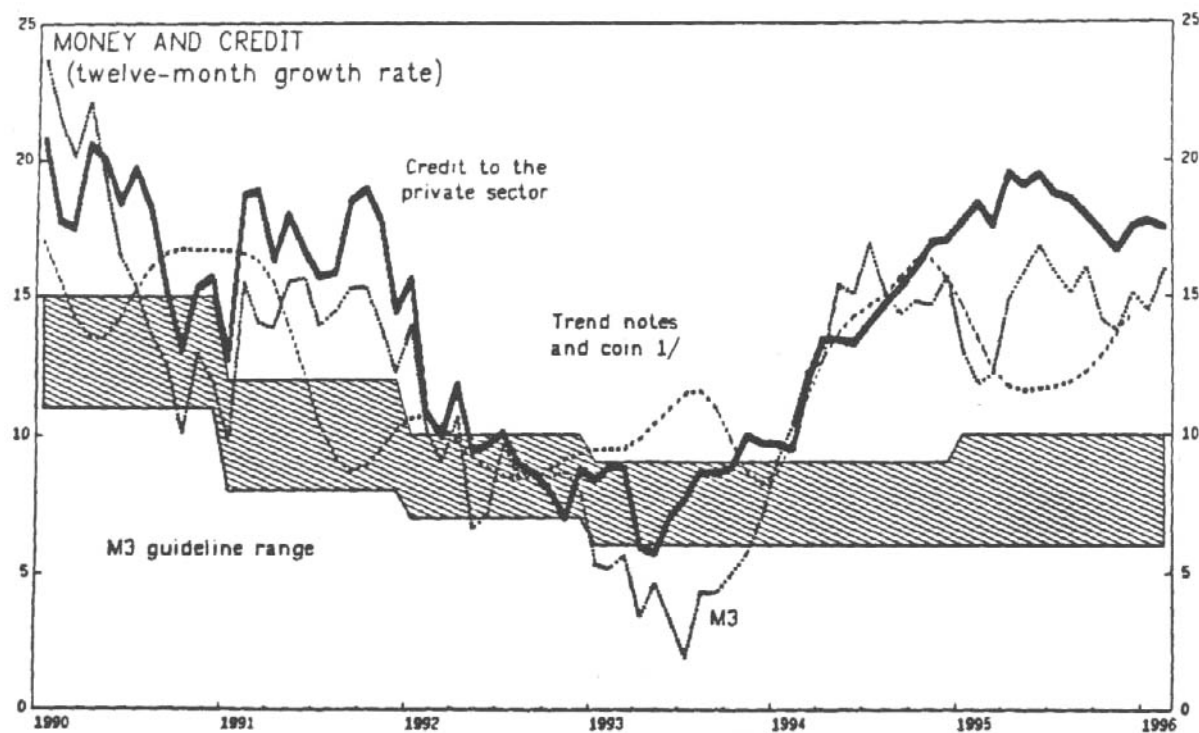
- these were supplemented by bank-by-bank guidelines on the growth of credit to the private sector of 10 percent for 1995;

- the minimum cash reserve requirement on nonreserve liabilities was raised from 1 to 2 percent in February 1995.

^{1/} The growth rate of the trend corrects for the high volatility in the monthly data in the series for notes and coin in circulation outside the banking system.

CHART 6

SOUTH AFRICA
MONETARY INDICATORS AND INTEREST RATES, 1990-96



Sources: South African Reserve Bank; and IMF, International Financial Statistics.

1/ Trend notes and coin in circulation outside the banking system.

This monetary policy stance was one of the factors underlying an improvement in investor sentiment towards the rand that occurred during 1995. But the speed and strength of the turnaround in sentiment that occurred complicated the monetary objectives of the authorities. On the one hand, it increased downward pressure on inflation through a strengthened currency; on the other, it further compromised external competitiveness. In recognition of the inherent conflict between these twin policy goals, the authorities stemmed the upward pressure on the rand exchange rate by reducing the net forward open position of the South African Reserve Bank. But to the extent that this was accomplished by an increase in net international reserves (which rose from some R 1 billion in mid-1994 to over R 15 billion by end-1995), this represented an injection of domestic liquidity and thus complicated monetary management.

A number of steps were taken to sterilize the monetary consequences of the inflow arising from the accumulation of international reserves. These included sales of government securities held by the SARB--holdings of which fell from some R 9 billion in late 1994 to a little under R 5 billion by end-1995--as well as an increase in government deposits held with the SARB from R 3.9 billion in July 1995 to R 7.9 billion at end-1995. The impact of these steps on market rates was muted somewhat because the banks' holdings of paper eligible for rediscount at the SARB rose considerably through 1995, from some R 15 billion in mid-1994 to R 22 billion by end-1995, diminishing their need to adjust their deposit and lending rates despite the increased rediscounting with the SARB.

Despite these difficulties, the thrust of the policy was maintained, but its impact on the broader monetary aggregates and on credit expansion became apparent only by mid-1995. The 12-month growth rate of M3 peaked at a little under 17 percent in June 1995, and fell to 15.1 percent by end-December 1995. The 12-month rate of growth of credit to the private sector also peaked in June 1995, at 19.5 percent, and fell to 17.5 percent at end-December 1995. In both cases, the quarter on quarter seasonally adjusted growth rates also peaked in June 1995, but the subsequent decline has been more marked for M3 than for credit to the private sector. Nevertheless, the slowdown in the growth of both aggregates has perhaps been surprisingly limited given the increases in interest rates after mid-1994, even allowing for the long lags involved. By end-1995, both the guidelines for M3 and those for bank credit to the private sector had been exceeded by large margins.

Trend 12-month growth in notes and coin in circulation outside the banking system fell earlier than that of M3 or that of credit to the private sector. Thus, it may have responded more rapidly to the increase in interest rates than either of these other aggregates, and may have constituted an early indication of the fall in the underlying consumer prices

index that occurred later in the year. ^{1/} However, the trend in this narrow aggregate began to accelerate again towards end-1995, recording a 12-month growth rate of a little under 15 percent in December 1995.

The rapid growth of the monetary and credit aggregates through 1995 occurred against a backdrop of high real interest rates--deflated by past inflation--and sharp deceleration in both the consumer prices inflation and in underlying inflation towards year-end. Markets responded favorably to these developments as inflation expectations implicit in long yield differentials with foreign financial assets fell from some 10 percent in early 1995 to some 8 percent by the end of the year.

From mid-February 1996, sentiment was unsettled by a number of rumors in the market, particularly concerning policy on exchange control liberalization (Chapter II). Markets' expectations of inflation as implicit in interest rate differentials increased somewhat notwithstanding a further increase in the bank rate to 16 percent in late April 1996. However, since the bulk of the adjustment to the change in market sentiment occurred through the depreciation of the rand, the direct short-run impact on domestic money market conditions was not substantial.

4. Land reform

Land reform efforts include a land restitution scheme as well as a land redistribution program. The issue of restitution for those dispossessed of their land under apartheid is being addressed by the Lands Court. No cases have yet been adjudicated, but 6,000 claims have been lodged. Calculations of the compensation liability--to be carried by the Government--are not yet available.

The land redistribution program is a market-based program, essentially increasing access to the market for the poorest. The plan includes a flat-rate grant of R 15,000 per household (which, if taken, eliminates the household from eligibility for a similar housing subsidy). To augment the grant element, the Strauss Commission is preparing recommendations to revamp rural financing. As concerns commercial farming areas, the Labor Tenants Bill is now being discussed in Parliament. The bill seeks to protect the rights of existing tenants and provides them the right to buy the land they live on "for fair value", through a negotiated agreement with the existing owner. In addition, land initiatives are being prepared for the development of urban housing that would be eligible under the housing subsidy scheme. Gauteng province has already identified 5 suitable areas.

^{1/} The leading indicator properties of this aggregate are discussed in Chapter VI.

5. The external sector

The external current account balance turned from a surplus of 1.5 percent of GDP in 1993 to a deficit--the first since 1984--of 0.5 percent in 1994. This shift largely reflected an increase in imports of 16.2 percent in volume terms as economic activity accelerated, and export growth lagged behind (Appendix Tables 23-26). A substantial increase was registered in the imports of capital goods, mainly machinery and electrical equipment, chemical products, textiles, and transport goods, as the investment gained momentum in the latter part of the year. The imports of intermediate and consumer goods grew more moderately. The strengthening of the rand in the second half of the year may have also contributed to the rapid import growth.

The volume of non-gold exports expanded at about 4 percent during 1994. Gold exports contracted by 6.2 percent in U.S. dollar terms, notwithstanding an increase in the average price of gold from US\$360 in 1993 to US\$384 in 1994, due to a sharp decline in production. The services and transfers balance improved by 0.3 percent of GDP as large increases in tourism receipts, interest earnings, and dividends and profits from abroad offset higher freight and other transportation costs and a decline in private transfers (Appendix Table 27).

The current account deficit widened further in 1995 to 2.6 percent of GDP, notwithstanding an increase in the volume of non-gold exports by almost 15 percent. The volume of imports grew by 17 percent, reflecting the continued rapid growth in aggregate demand and progress in the liberalization of trade (see Chapter 3). Nonetheless, the pace of import growth on a quarter by quarter basis moderated through 1995, and import volumes fell in the fourth quarter. As in 1994, the growth of imports was especially pronounced in machinery and electrical equipment, vehicle and transport equipment, and mineral products, suggesting that investment continued to be the main factor behind the rapid import growth.

The expansion of nongold exports in the second half of 1994 continued into the first quarter in 1995 despite weak growth in agricultural exports due to poor weather conditions, but moderated over the subsequent three quarters. The moderation may have reflected domestic capacity constraints and the real appreciation of the rand, from the second quarter of 1995 onwards. Net gold exports remained relatively depressed in 1995 declining by a further 13 percent in U.S. dollar terms as production difficulties continued and international prices remained stable. The deficit on the services account widened by about 0.3 percent of GDP, primarily due to higher payments on freight and merchandise insurance on imports and interest payments on sharply rising foreign debt. These higher payments were partly offset by a further increase in tourist receipts.

The capital account turned around in mid-1994, following the election of the Government of National Unity, registering a surplus for the first time since 1984. Total flows in 1994 amounted to US\$1.5 billion

(notwithstanding "unrecorded" outflows in the first half of the year of US\$0.9 billion) compared to a deficit of US\$4.6 billion in 1993. The inflows reflected growing confidence in the South African economy and the rand, with the abatement in political uncertainty and the strengthening of economic performance (Appendix Table 28). ^{1/} A substantial portion of the flows was short-term, with the major recipient being the banking sector as banks took advantage of the renewed access and favorable cost of borrowing abroad. The other short-term flows mainly comprised trade finance, mirroring the rapid growth of imports.

Long-term flows in 1994 were dominated by the public sector with the successful placement of a global bond issue equivalent to US\$750 million in December 1994 and some net borrowing by public corporations. The global bond issue followed, and was facilitated by, the grading of South Africa's sovereign debt by Moody's in October 1994 as investment grade. The Nippon Investor Service also gave this debt an investment grade rating, but Standard and Poor's rated it below investment grade although with a positive outlook. Other long-term inflows financed capital imports of several large investment projects and net purchases of securities and equity on the Johannesburg Stock Exchange.

Notwithstanding the general slowdown in inflows to emerging markets in the months following the currency crisis in Mexico, the capital account continued to strengthen through 1995, and net capital inflows increased to US\$6 billion. The flows were more long-term in nature and more concentrated in the private sector: private long-term inflows rose from US\$218 million in 1994 to US\$2 billion in 1995. This increase reflected several factors: a substantial jump in the participation of nonresidents in the securities and equities markets following the abolition of the financial rand in March 1995; a large use of syndicated bank borrowing by South African commercial banks and corporations; a large number of issues of Euro commercial paper by banks; and placement abroad of equity and convertible bond issues by corporations. The public sector continued to import capital at about the same pace as in 1994, mainly in the form of a US\$346 million government bond placement in the Japanese Samurai market in May 1995, and borrowing by parastatals through further placements in the Samurai market and the contracting of syndicated bank loans.

Developments in early 1996 have been mixed. The Government successfully placed a £ 100 million bond issue with a 10-year maturity in late January, with a spread of 190 basis points above the equivalent British government bond. Also, capital inflows appeared to have continued at a fairly rapid pace through January and the first half of February.

In line with the rapid increase of capital inflows, South Africa's foreign debt (net of rand-denominated debt) increased from US\$16.7 billion in 1993 to US\$18.6 billion in 1994 and to US\$20.7 billion by end-June 1995

^{1/} See Chapter II for a detailed discussion of capital flows.

(this compares with US\$23.7 billion at end-1985, the year in which the debt standstill was declared) (Appendix Table 29). Within the total, public sector debt declined from US\$9.2 billion at end-1993 to US\$8.2 billion by mid-June 1995, while private debt surged from US\$7.5 billion to US\$12.4 billion over the same period. The term structure has improved substantially with the share of short-term debt in total debt declining from 51 percent at end-1993 to about 41 percent by end-June 1995. The rand denominated debt held by nonresidents is estimated to have increased by US\$0.4 billion through 1994, to US\$9.2 billion (more recent data are not available).

The surge in capital inflows in the latter half of 1994 and through 1995 was more than sufficient to finance the current account deficit and supported a substantial increase in the country's net foreign reserves. ^{1/} During this period the SARB fully repaid all its reserve-related external liabilities (US\$2.6 billion) (Appendix Table 30). The reserve position of the SARB began to improve in the third quarter of 1994, after a loss of reserves of US\$2.4 billion in 1993, and further decline in the first half of 1994 such that the net reserves of the SARB were negative through the second and beginning of the third quarter in 1994. However, with the strengthening in the capital account, the SARB had accumulated net reserves of US\$0.9 billion by end-1994 and a further US\$2.5 billion in 1995 to a total of US\$3.5 billion (R 13 billion). The reserve position weakened in the first quarter of 1996 in line with the SARB's intervention to maintain orderly market conditions following the attacks on the rand beginning in mid-February. By end-March, net reserves declined to US\$2.9 billion (R 11.2 billion).

The large inflow of capital in 1995, which supported the stability of the rand through most of 1995 (see below), together with the general strengthening of sentiment about South Africa's prospects, facilitated the SARB decision to substantially reduce its role in the forward market. The SARB abolished the requirements for exporters to obtain forward cover, limited its participation in short-term cover to financial transactions, and began to progressively reduce the subsidy on short-term borrowing. Nevertheless, the SARB continued to be active in contracts with maturities longer than 12 months. As a result, the net oversold short-term position of the SARB declined by US\$5.7 billion between March and November 1995, and the total net open forward position fell to US\$6.8 billion by mid-February 1996. However, as a result of the support provided by the SARB to the rand, the net open forward position rose to US\$8.2 billion at end-February.

There was significant progress in the relaxation of capital controls on both residents and nonresidents in 1995 and early 1996, of which the most notable was the elimination of the financial rand on March 13, 1995. The authorities had identified specific conditions necessary for abolition to proceed, namely the successful return to international bond markets, the

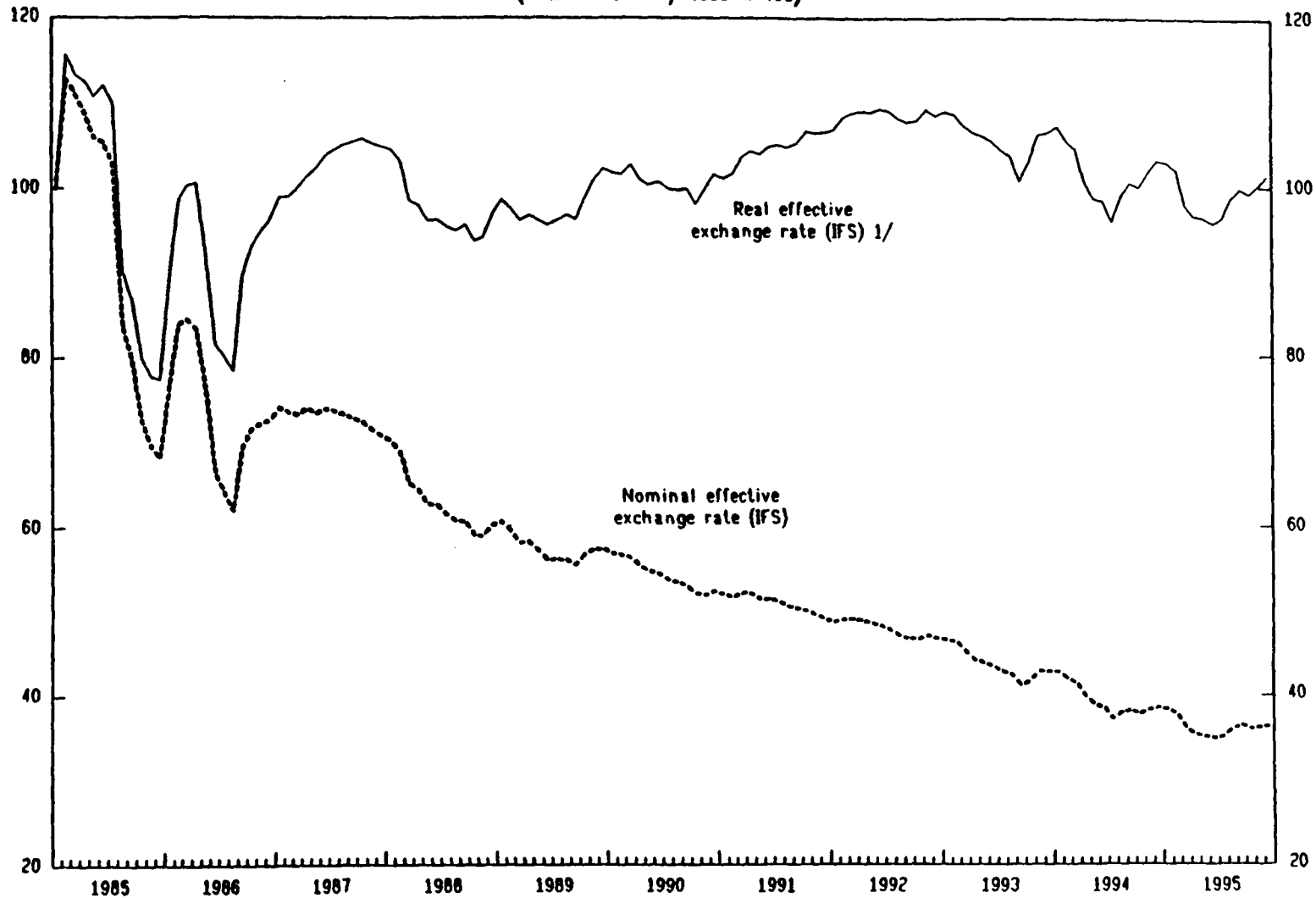
^{1/} Net foreign reserves include the CCFF purchase from the Fund in December 1993 as a liability.

narrowing of the financial rand discount to below 10 percent, a decrease in financial rand deposits held in the banking system, and a comfortable reserve position. The first two of these conditions were met: as noted above, the global bond was successfully issued in December 1994; and the discount on the financial rand narrowed to below 10 percent in the three weeks leading to its dismantling and was as low as 3.6 per cent on the actual day. However, financial rand deposits remained broadly constant and the level of international reserves, while strengthening significantly beginning mid-1994, remained relatively modest, covering less than a month of imports. Nonetheless, the abolition of the financial rand proceeded smoothly with no disturbance to the exchange rate.

Capital controls on residents were partially relaxed in mid-July with the announcement that insurance companies, pension funds, and unit trusts would be allowed to undertake foreign investments by way of swap arrangements with foreign investors. These transactions permitted South African institutional investors to diversify their portfolio abroad without loss of foreign exchange reserves. By March 1996, transactions equivalent to R 11 billion were approved. Further relaxation of controls was also signaled with the permission by these institutional investors to take up 10 percent of the Sterling bond issue in late January 1996.

The nominal effective exchange rate depreciated by 10 percent in 1994 and a further 10 percent by May 1995, leading to a cumulative real depreciation of 10 percent from December 1993 (Appendix Table 31 and Chart 7). The rand remained stable in U.S. dollar terms through mid-February 1996, appreciating in real effective terms by 8 percent. At that time, prompted by unfounded rumors about the President's health and an imminent capital liberalization for residents, the rand came under attack. Spurred by further concerns about the President's health, the expectation of a wholesale removal of capital controls on residents, and uncertainty regarding economic policy following the resignation of the Minister of Finance, the rand declined from R 3.64 per U.S. dollar in mid-February to R 4.43 per U.S. dollar by April 26, 1996.

CHART 7
SOUTH AFRICA
EXCHANGE RATES, 1985-95
(Indices January 1985 = 100)



Source: IMF, International Financial Statistics.

1/ Based on relative consumer prices using the Commercial Rand exchange rate.

II. Capital Flows: Recent Developments and Policy Challenges

1. Introduction

One of the most striking changes in the economic situation of South Africa has been a dramatic shift in capital flows between mid-1994 and early 1996. Following the reduction of political uncertainty with the election of the Government of National Unity in April 1994, and the continuation of the economic recovery that began in 1993, confidence in South Africa's prospects strengthened. By the end of 1994, the capital account registered a net surplus for the first time since 1984. After a temporary slowdown in early 1995, following the Mexican crisis, capital flows resumed and total inflows for the year reached nearly R 22 billion (US\$6 billion).

Substantial capital inflows are likely to have a major impact on South Africa's growth potential as they raise the availability of saving and hence investment and growth. But such flows may be volatile, as has been evidenced in a number of emerging markets in the recent past, and in South Africa in early 1996. In mid-February, the rand came under significant pressure as a result of unfounded rumors about the President's health and an imminent removal of capital controls on residents. There was also uncertainty regarding the future course of policies following the resignation of the Minister of Finance in late March 1996. As a result, by end-April the rand had depreciated by about 16 percent since mid-February.

This chapter examines the factors that have contributed to the surge in capital inflows, and describes how the nature of these flows has evolved. The chapter then briefly discusses the factors that contributed to the currency attacks in early 1996 and examines the broad implications of the capital inflows for macroeconomic policy in the specific context of South Africa, including the effects of volatility of these flows.

2. Capital flows: recent developments

a. Developments prior to 1994

During the period 1970-85, South Africa relied heavily on foreign saving, equivalent to an average of about 2 percent of GDP a year (Table 1 and Chart 8). However, with the intensification of political problems, the imposition of financial sanctions, and the debt standstill in 1985, ^{1/} the situation was reversed, and South Africa became a net exporter of capital. This involved a substantial depreciation of the currency in the period through 1989; the maintenance of restrained demand-management policies, with

^{1/} In September 1985, South Africa imposed a moratorium ("standstill") on repayments of private debt to foreign commercial banks and, subsequently, negotiated with creditor banks a series of interim agreements providing for repayment of principal.

Table 1. South Africa: Capital Inflows and Macroeconomic Balances
(In percent of GDP)

	Average 1970-84	Average 1985-93	1994	1995
Capital inflows	1.8	-2.5	1.2	4.5
Current account balance	-2.2	2.5	-0.5	-2.6
Consumption	70.4	76.1	81.4	81.4
Private	56.5	57.2	60.2	60.9
Public	13.9	18.9	21.2	20.5
Investment	26.8	19.1	16.0	16.9
Central Government balance (deficit before borrowing) 1/	-3.8	-4.6	-6.0	-5.7
<u>Memorandum items</u>				
Real GDP growth	3.0	0.6	2.7	3.3
Inflation (annual average)	11.5	14.6	9.0	8.6
CPI - REER 2/	1.6 3/	-1.8	-4.1	-2.3
Debt/GDP ratio (end of period) 4/	29.6	27.7	22.9	...

Source: South African Reserve Bank, Quarterly Bulletin, and the International Monetary Fund, International Financial Statistics.

1/ Fiscal year ending March 31.

2/ A negative sign indicates a depreciation.

3/ 1979-84.

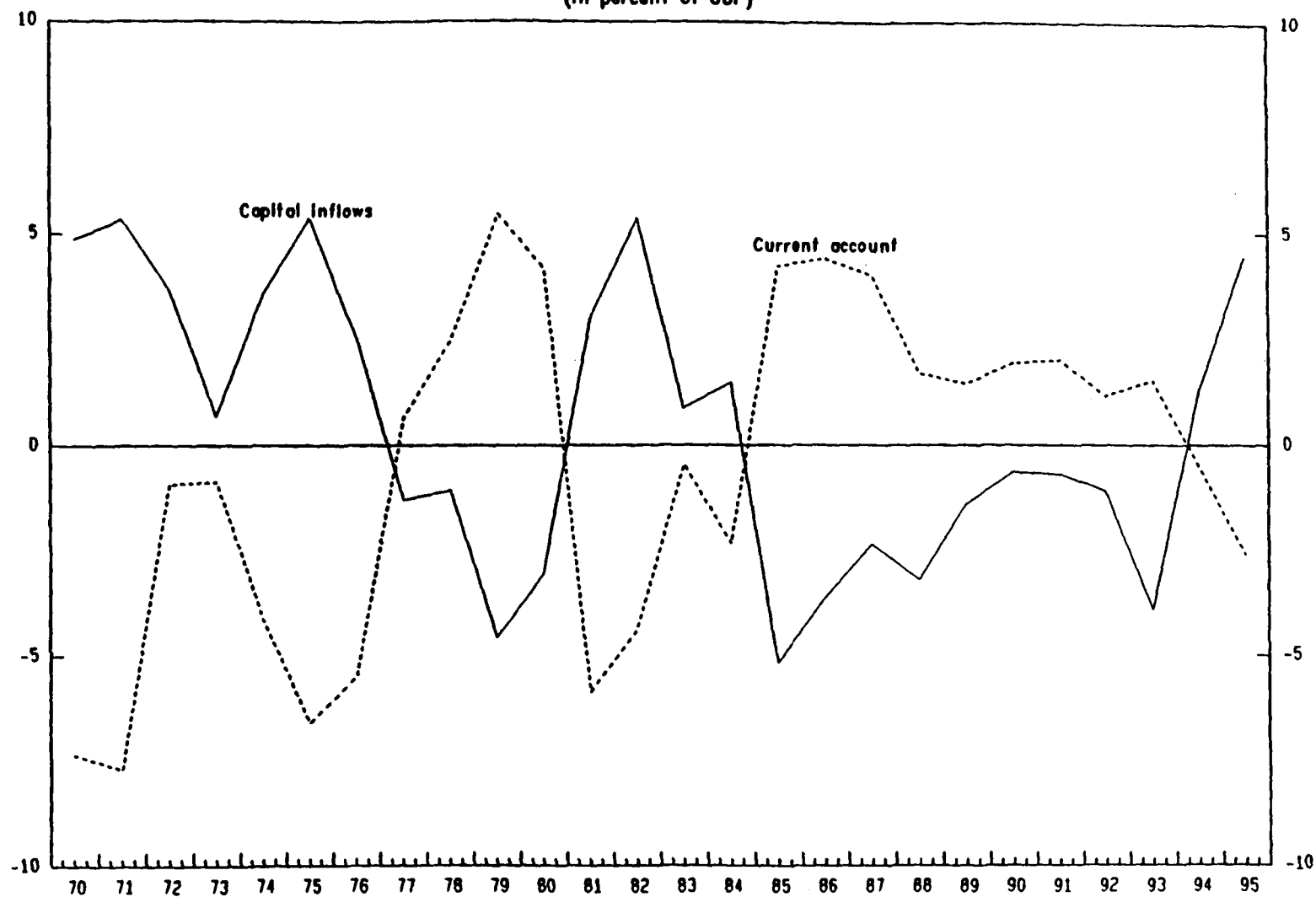
4/ Including debt denominated in rand.

CHAPT 8

SOUTH AFRICA

CURRENT AND CAPITAL ACCOUNT BALANCES

(In percent of GDP)



Source: South African Reserve Bank.

growth of real domestic demand during 1985-92 limited to 1 percent a year; the intensification of trade protection; and a tightening of capital controls. In response to these policies, the current account balance shifted to a surplus that averaged about 2.5 percent of GDP a year during 1985-93.

Notwithstanding the moratorium on bank lending to South Africa, some private borrowers regained access to international capital markets after 1990. In 1991-92, the Government and major public enterprises also returned to the capital markets with the placement of bonds (Table 2). However, these flows were offset by pronounced private outflows as political uncertainty intensified in the wake of the breakdown in constitutional talks in May 1992. Moreover, debt under the first interim arrangement following the debt standstill began to be amortized and margins offered to South African borrowers doubled to 3 percentage points. As a result, many borrowers elected not to roll over their debts, and thus led to net outflows of capital of R 3.7 billion in 1992 and R 15 billion in 1993 (Tables 3 and 4).

b. Developments in 1994-95

International confidence in South Africa's prospects gradually improved during 1994 with the decline of political uncertainty following the elections and the continued strengthening in domestic market conditions--real economic growth doubled to 2.7 percent, investment expanded by nearly 9 percent in real terms, and inflation decelerated to 9 percent. Two other factors also facilitated South Africa's access to the international capital markets. First, the conclusion of the 1994 Debt Arrangements normalizing the debt to bank creditors which remained under the standstill. Second, South Africa's sovereign debt was rated investment grade by Moody's (Baa3) in October 1994 and by the Nippon Investor Services (BBB); Standard and Poor's rated this debt at below investment grade, BB, but with a positive outlook.

Net inflows amounted to R 5.2 billion (US\$1.5 billion) in 1994, despite the continuation of substantial unrecorded outflows in the first half of the year (estimated at about R 3.1 billion) and the repayment of external long-term debt of R 5.9 billion. The inflows were primarily short-term, with the major recipient being the financial sector, as banks took advantage of the renewed access and favorable cost of borrowing to contract significant sums in the form of short-term lines of credit. This general trend was mitigated somewhat by the practice of some foreign banks of reducing their outstanding claims on South Africa at the end of their financial year. Other short-term inflows reflected increased trade finance available directly to firms, largely mirroring the strong growth of imports.

Long-term flows were dominated by the public sector with the successful placement of a global bond issue equivalent to US\$750 million (R 2.7 billion) in December 1994, as well as net borrowing by public

Table 2. Bonds Issued by the Central Government and Public Companies
From 1/01/90 to 2/29/96

(In millions of U.S. dollars)

Date	Issuer	Currency	Amount	Coupon Rate	Maturity
09/19/91	Republic of South Africa	DM	239.1	10.5	5 years
1/20/92	Republic of South Africa	ECU	314.9	10.375	5 years
2/07/92	Development Bank of Southern Africa	DM	125.5	10.0	6 years
3/24/92	Electricity Supply Commission	DM	179.6	10.0	5 years
4/08/92	Industrial Development Corporation	DM	30.8	10.0	5 years
12/07/94	Republic of South Africa	US\$	750.0	9.6	5 years
05/16/95	Republic of South Africa	Yen	346.0	5.0	5 years
10/17/95	Escom	Yen	198.6	3.1	5 years
12/01/95	Transnet Ltd.	Yen	197.3	3.0	5.5 years
01/23/96	Republic of South Africa	Stg	151.1	9.4	10 years

Source: International Financing Review, Euroweek, Financial Times, and staff estimates.

Table 3. South Africa: Net Capital Movements, 1993-95

(In millions of rand)

	1992 Total	1993 Total	1994 Total	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1995 Total
Long-term capital	-1,511	-272	3,503	577	3,706	2,754	5,480	12,517
Public sector	3,142	-2,886	4,102	-383	1,258	1,091	2,072	4,038
General government	2,122	168	3,521	-35	1,471	16	156	1,608
Public companies	1,020	-3,054	581	-348	-213	1,075	1,916	2,430
Nonbank private sector	3,964	2,675	755	1,090	1,855	1,998	2,210	7,153
Net purchase of securities	-2,271	2,809	391	625	1,816	1,425	1,012	4,878
Loans	-1,747	-562	-354	-22	-39	650	1,198	1,787
Other	54	428	738	487	78	-77	--	488
Banking sector	-689	-61	-1,374	-130	593	-335	1,198	1,326
Short-term capital	2,504	-5,081	4,942	3,320	1,119	-1,062	3,179	6,556
Public sector	-39	553	1,891	192	-1,817	-45	114	-1,556
General government	--	475	1,720	160	-1,880	0	0	-1,720
Public companies	-39	78	171	32	63	-45	114	164
Nonbank private sector	-763	-2,325	-363	1,302	-1,362	-1,957	1,135	-882
Trade finance	-544	-424	1,048	1,334	-1,382	-1,864	619	-1,293
Other	-219	-1,901	-1,411	-32	20	-93	516	411
Banking sector	3,306	-3,309	3,414	1,826	4,298	940	1,930	8,994
Errors and omissions	-4,666	-9,668	-3,093	1,584	204	2,109	-1,236	2,661
Net capital movements	-3,673	-15,021	5,352	5,481	5,029	3,801	7,423	21,734

Source: South African Reserve Bank and staff estimates.

Table 4. South Africa: Net Capital Movements, 1990-95

(In millions of dollars)

	1990	1991	1992	1993	1994	1995
Long-term capital	-39	-627	-530	-83	988	3,452
Public sector	197	381	1,102	-885	1,157	1,113
General government	538	422	744	51	993	443
Public companies	-340	-42	-357	-936	164	670
Nonbank private sector	-251	-962	-1,390	820	219	1,972
Net purchase of securities	-636	-843	-796	861	110	1,345
Loans	29	-194	-613	-172	-100	493
Other	356	75	19	131	208	135
Banking sector	14	-45	-242	-19	-387	366
Short-term capital	-541	664	878	-1,557	1,394	1,808
Public sector	17	-151	-14	169	533	-429
General government	90	-29	--	146	485	-474
Public companies	-82	-122	-13	24	48	45
Nonbank private sector	-804	-134	-268	-713	-102	-243
Trade finance	-148	198	-191	-130	296	-357
Other	-656	-333	-77	-583	-398	113
Banking sector	247	949	1,159	-1,014	963	2,480
Errors and omissions	-105	-818	-1,636	-2,963	-872	734
Net capital movements	-685	-780	-1,288	-4,604	1,309	5,993

Source: South African Reserve Bank and staff calculations.

corporations. 1/ In addition, nonresidents extended loans to the large capital projects in progress, 2/ and purchased securities on the Johannesburg Stock Exchange (JSE) equivalent to R 1.2 billion on a net basis. These purchases were made through the financial-rand mechanism 3/ and therefore did not affect the foreign reserves of the country, but served to reduce the discount on the financial rand.

Despite a slowdown associated with the Mexican crisis in early 1995, capital inflows rose to R 21.7 billion (US\$6 billion) in 1995, reflecting continued growing confidence in the rand. This strengthening in sentiment was particularly evident in the narrowing of the spread between yields on South Africa's global bond and the equivalent U.S. Treasury paper, and in the spread between the long bond yield with the U.S. (Charts 9 and 10). The former--having increased following the Mexican crisis to about 250 basis points by mid-year--declined to 210-220 basis points in the latter part of 1995, 4/ and fell below the spread at the time of issue--193 basis points --in early January 1996. In addition, South Africa's weight in emerging market indexes increased: in June 1995, it achieved the largest weighing in the IFC's index and the second largest in Morgan Stanley's index.

The improved sentiment was also reflected in the development of a Euro-rand market beginning in September 1995 (Box 2), which indirectly contributed to the inflow of capital. There was also a further upgrading of South Africa's credit rating in November 1995 by Standard and Poor's and Moody's. However, the firmest evidence of the turnaround in sentiment toward the rand was the sharp decline in the net open forward position of the South Africa Reserve Bank (SARB), which fell to less than US\$7 billion in mid-February 1996 without any substantive disturbances to exchange or interest rates.

Long-term borrowing by the public sector continued at about the same magnitude as in 1994, about R 4 billion, reflecting the Government's placement of bonds equivalent to US\$346 million in the Japanese Samurai market in May 1995, and two subsequent placements by parastatals also in the Samurai market amounting to the equivalent of about US\$400 million. The parastatals also made increased use of syndicated bank loans throughout the year, at maturities ranging between 3 years and 5 years and interest margins generally less than 100 basis points.

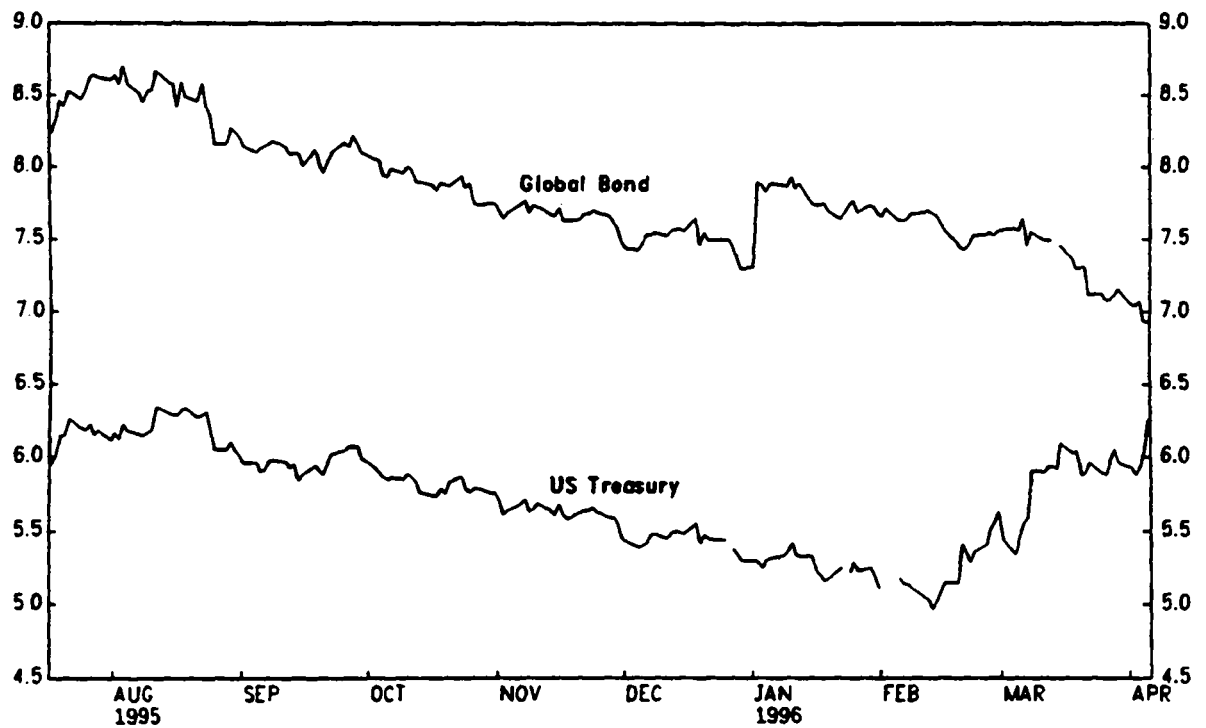
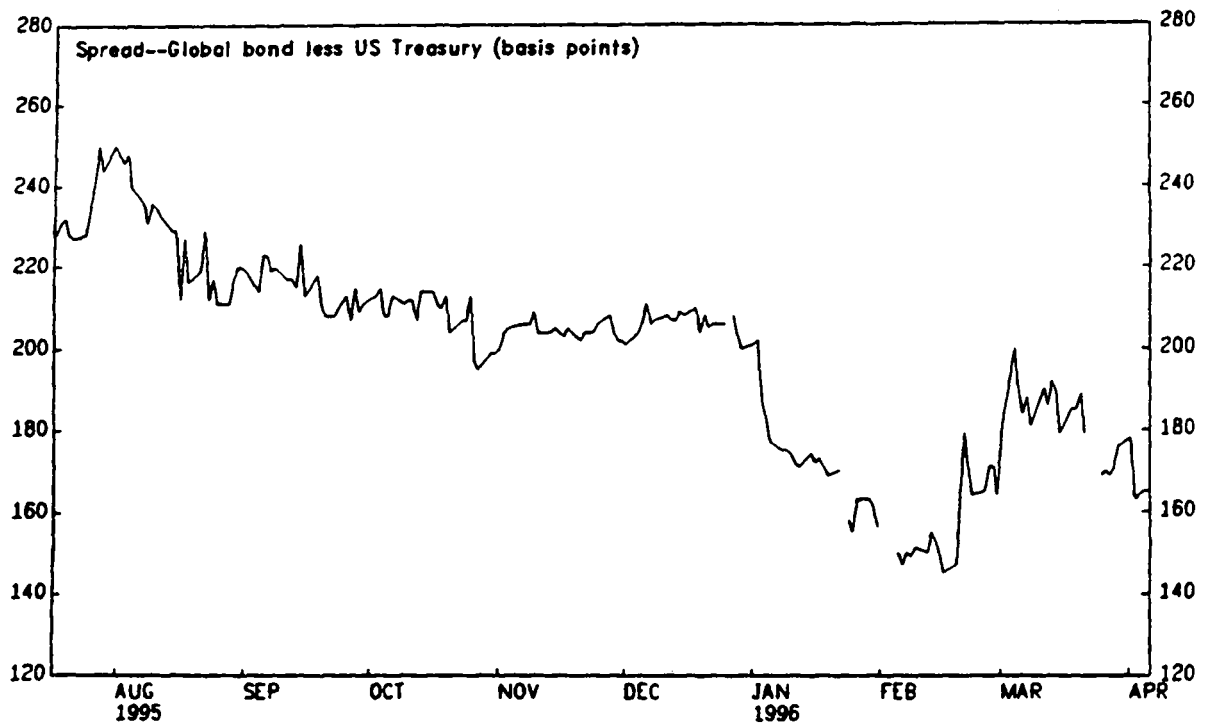
1/ The global bond issue was intended to establish a benchmark for other South African borrowers.

2/ These were primarily mineral-processing projects, including Alusaf (aluminum) and Columbus (stainless-steel).

3/ The financial rand was a separate currency maintained for nonresident capital transactions which was freely traded in South Africa, generally at a substantial discount from the regular rand.

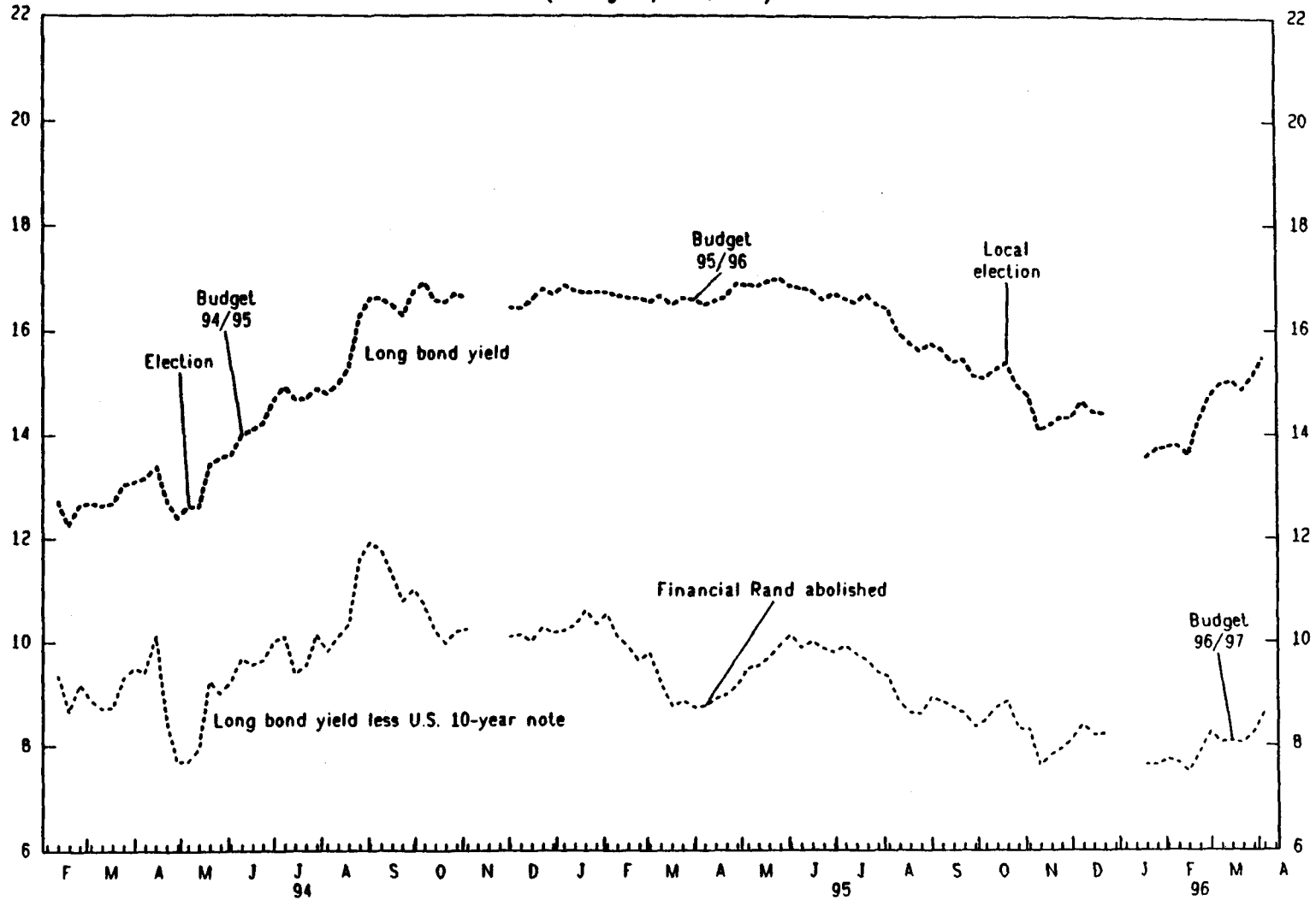
4/ Trading of the global bond during the first half of 1995 was sparse.

SOUTH AFRICA
GLOBAL BOND AND U.S. TREASURY RATES



Source: Bloomberg (U.S. Treasury: six percent maturing 10/15/99).

CHART 10
SOUTH AFRICA
LONG BOND YIELD SPREAD OVER U.S. RATE
(through April 4, 1996)



Source: Financial Times and Reuters.

Box 2: The Growth of the Eurorand Market

Beginning in September 1995, a series of rand-denominated bonds were issued in European market by non South African entities, including Merrill Lynch, EBRD, and the Government of Sweden. Total issues amounted to US\$1.8 billion at mid-February 1996 (Table 5). The coupon rate fell from 15 percent on the initial issues to as low as 13 percent on issues in late January and early February, reflecting the popularity of the issues, which were clearly supported by the continued stability of the rand. There has been only one issue since the pressures on the rand emerged in mid-February.

The market developed in response to demand by European retail investors for rand-denominated paper, who were either unwilling or unable to invest in the South African market. Some of the reasons for this retail demand for rand-denominated Eurobonds are the long settlement periods in South Africa; South African bonds are registered and not bearer bonds; and that bonds are not traded on the international exchanges such as Euroclear. These factors established arbitrage opportunities between the yield differentials on the Eurorand bonds and returns on rand paper in South Africa, and between yields on paper in major currencies, the Euro-rand yields and the forward market prices. And the rand-denominated Eurobond issues reflected both sets of arbitrage opportunities.

According to various sources, some of the issuers covered their rand exposure in private forward rand markets. The primary counterparts to these transactions were major South African entities which were covering new dollar-denominated liabilities. Other issuers used the proceeds to invest directly in South Africa's securities market, often simply using the proceeds of the issuer to purchase gifts, contributing directly to capital inflows.

Long-term flows to the private sector shifted sharply from a net outflow of R 600 million in 1994 to a net inflow of R 8.5 billion in 1995, reflecting a substantial increase in the participation of nonresidents in the securities market. Nonresident activity began to grow following the abolition of the financial rand in response to the relatively high yields. In the nine months to December 1995, net purchases of bonds on the JSE by nonresidents amounted to R 2.2 billion, compared with a net outflow in the first three months of the year of R 0.3 billion and net inflows of R 1.1 billion in 1994 (Table 5). Nonresident participation also grew rapidly in the secondary equity market, as total purchases rose from R 185 million in 1994 to R 4.8 billion in 1995.

Another important channel of long-term flows to the private sector was a significant expansion in syndicated bank borrowing by the South African banks and corporations. Whereas in 1994, only one commercial bank and one private corporation accessed this source (for short-term financing), in 1995, 15 such loans were made to commercial banks--with more than half of the loans at a 3-year maturity--and another 7 loans were made to corporations, the majority with medium-term maturities. At the same time, domestic banks started to issue Euro commercial paper, while South African corporations increased their placement of international equity and bond issues.

Commercial banks substantially raised their access to short-term capital, in large part to finance domestic credit expansion. Total short-term flows to the banking sector increased from R 3.4 billion in 1994 to R 9 billion in 1995. In contrast, the public sector and the private nonbank sector made net repayments equivalent to R 2.6 billion, largely reflecting a decline in trade-related liabilities, as importers made significantly less use of forward cover from abroad owing in part to the continued stability and growing confidence in the rand.

In its continuing effort to reestablish South Africa in the international capital markets the Government, in late January 1996, placed bonds amounting to £ 100 million (R 560 million), with a 10-year maturity. At the time of issue, the spread above the equivalent British government bond was 190 basis points, providing further evidence of improved investor rating of South Africa. This increase in confidence was also reflected by the fall in the spread between the yields on the South African global bond and the U.S. Treasury paper from 200-220 basis points to 160 basis points by end-January 1996 and to 140 basis points by mid-February; the spreads on long bond yields also fell during this period by approximately the same amount (Charts 9 and 10).

3. The currency attack

After nearly ten months of stability in its external value, fluctuating narrowly around R 3.64 per U.S. dollar, the rand came under substantial pressure in mid-February 1996, and fell during the subsequent weeks to R 4.32 per U.S. dollar by end-April (Charts 11 and 12), depreciating by

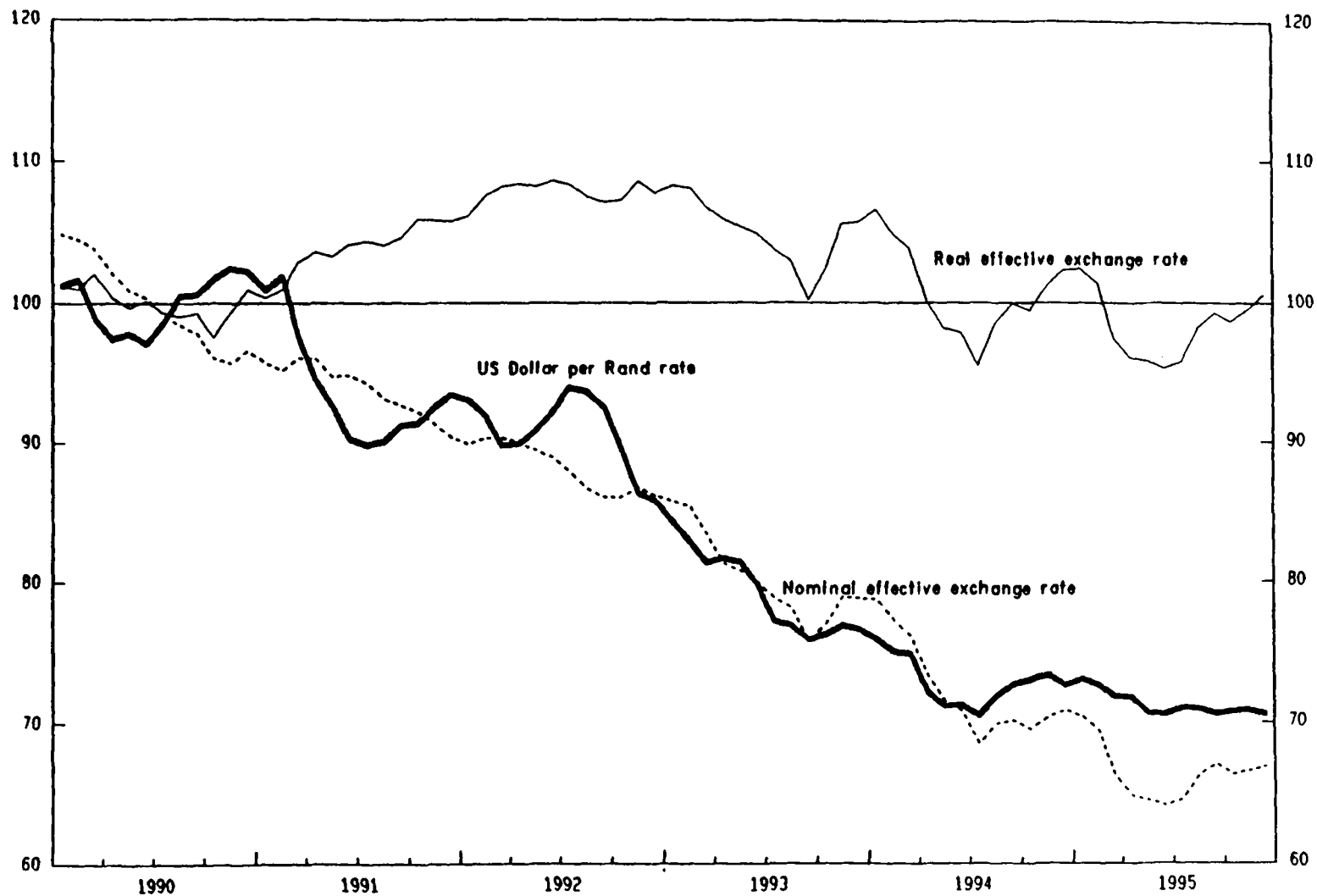
Table 5. Rand Bonds Issued in the Euromarket

(In millions of U.S. dollars)

Date	Issuer	Amount	Coupon rate	Maturity
09/12/95	Merrill Lynch & Co. Inc.	40.9	15.00	3 years
09/14/95	Deutsche Bank Finance NV	109.1	15.00	4 years
09/26/95	European Bank for Reconstruction and Development	68.5	14.75	3 years
09/27/95	Kingdom of Sweden	54.8	15.00	3 years
09/28/95	WestLB Finance (Curacao) NV	54.8	15.00	3 years
10/06/95	General Electric Capital Corp.	54.8	14.75	5 years
10/13/95	Bayerische Vereinsbank AG	68.3	14.50	4 years
10/16/95	ABN AMRO Bank NV	68.3	14.75	4 years
10/18/95	JP Morgan & Co. Inc.	68.3	14.50	2 years
11/24/95	Commerzbank Overseas Finance NV (Curacao)	68.5	14.00	5 years
11/27/95	WestLB Finance (Curacao) NV	43.8	14.00	5 years
12/01/95	Toyota Motor Credit Corp.	68.4	14.00	5 years
12/04/95	Daimler-Benz North America Corp.	68.2	14.00	5 years
12/05/95	Bayerische Vereinsbank Overseas Finance NV	68.2	14.00	1 year
12/06/95	Rabobank Nederland NV	68.2	14.25	5 years
12/14/95	ABN AMRO Bank NV	13.6	14.75	3 years
01/08/96	Bank Austria AG	68.9	13.25	1 year
01/10/96	European Bank for Reconstruction and Development	68.9	13.50	1 year
01/11/96	Deutsche Bank Finance NV	165.3	13.50	1 year
01/12/96	General Electric Capital Corp.	68.9	13.50	1 year
01/24/96	Inter-American Development Bank	68.6	13.00	5 years
01/25/96	Deutsche Finance (Netherlands) NV	68.6	13.00	5 years
02/06/96	International Finance Corp.	68.5	13.00	2 years
02/08/96	Bayerische Vereinsbank Overseas Finance NV	68.5	13.25	1 year
02/13/96	Rabobank Nederland NV	68.5	13.125	5 years
02/15/96	Nacional Financiera SNC (Grand Cayman)	68.5	17.00	3 years
04/11/96	Deutsche Finance (Netherlands) NV	12.2	13.00	4 years & 10 mos.
Total		1,782.1		

Source: Euromoney Bondware (c) Euromoney Publications plc (Data) - Computasoft Ltd. (Software) 1983-94.

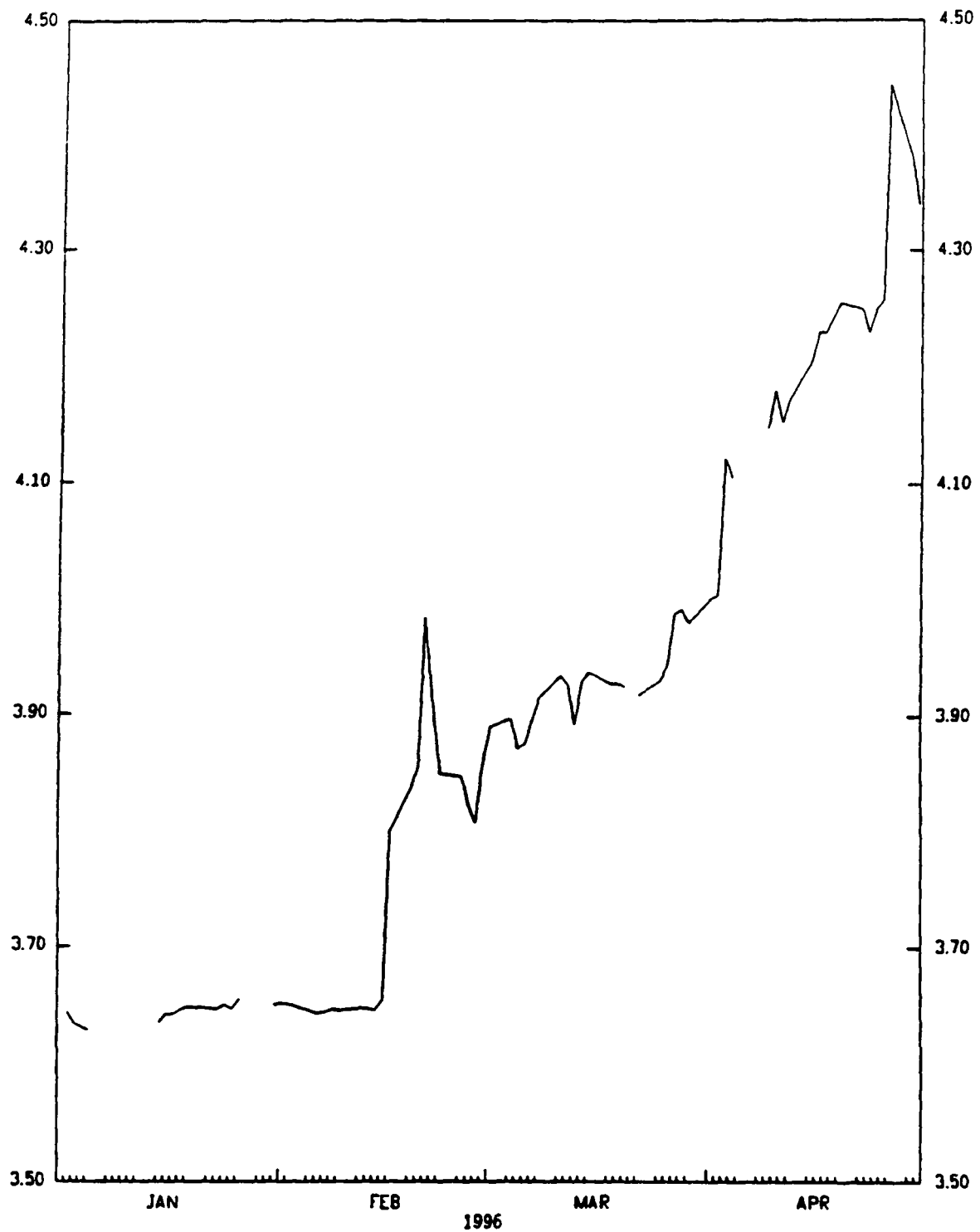
CHART 11
SOUTH AFRICA
EXCHANGE RATES, JANUARY 1990-JANUARY 1996



Sources: IMF's Informations Notices System and International Financial Statistics.

CHART 12

SOUTH AFRICA
SOUTH AFRICAN RAND PER U.S. DOLLAR RATE
January 1-April 30, 1996



Source: Financial Times and Reuters.

16 percent. The SARB intervened to "lean against the wind" and ensure orderly market conditions, selling the equivalent of R 5 billion in foreign exchange during that period.

Market reports indicated that the initial attack on the rand was sparked by rumors about the health of the President and about the imminent removal of all capital controls on residents. The rand fell further as a result of uncertainty prior to the announcement of the budget on March 13, 1996, and subsequently the resignation of the Minister of Finance at end-March. The rand declined even further through April due to uncertainty about the course of future policy, particularly regarding the removal of capital controls.

Another factor that may have contributed to the initial attack was the real appreciation of the rand in the preceding months (of about 7.7 percent in real effective terms between June 1995 and January 1996). Other explanations include the view that some investors interpreted the stability in the nominal exchange rate to mean that the SARB was targeting the rate which made it vulnerable to an attack. For instance, the Union Bank of Switzerland (UBS) published a report several days before the attack indicating that "the rand's trading range bears a strong resemblance to a currency moving within an exchange rate band," given that the fluctuation margin was about 1 percent in the past year. Others suggest the sharp increase in international long-term rates in February and the strengthening of the U.S. dollar vis-à-vis other currencies played a greater role; however, the impact of these elements on other emerging markets was only marginal and therefore cannot explain the extent of the attack on the rand (Chart 13).

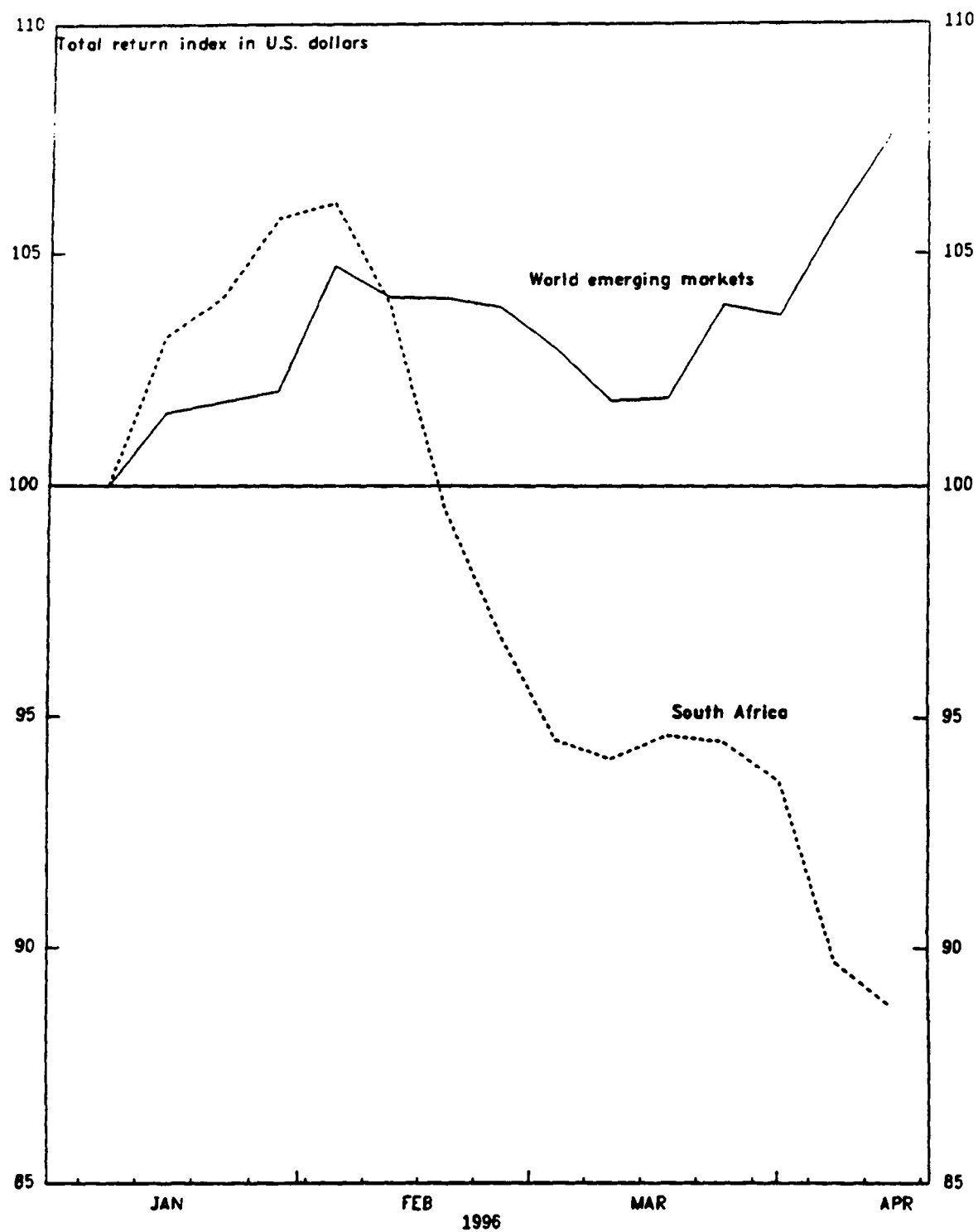
While all the factors that triggered the attacks cannot be identified with certainty, few observers have argued that the attacks were based on fundamental macro-imbalances such as those that triggered the Mexican crisis. ^{1/} South Africa's external current account position had deteriorated to 2.6 percent of GDP in 1995, but a continuation of deficits of this order of magnitude was regarded by most observers to be readily financeable; in contrast, Mexico's external current account deficit was nearly 8 percent of GDP in 1994. Moreover, South Africa's external debt is rather modest by world standards, and even though a significant proportion of the flows were short-term, there was a determined effort (particularly if the SARB is included) to reduce short-term exposure. But perhaps more importantly, all other macro variables in South Africa were moving in the right direction.

Other recent episodes of sudden reversals in capital flows were the result of the contagion effect of the Mexico crisis. They mainly reflected

^{1/} A discussion of this episode can be found in the "Factors Behind the Financial Crisis in Mexico," Annex I, May 1995, World Economic Outlook, IMF.

CHART 13

SOUTH AFRICA
DEVELOPMENT IN SOUTH AFRICA AND WORLD EMERGING MARKETS
(Jan 5=100)



Source: IFC's emerging markets database.

investors' uncertainty regarding the authorities' commitment to an officially fixed exchange rate. However, it is worth noting that the degree to which countries were affected and how fast the flows resumed, reflected how far advanced they were in their adjustment efforts to begin with, notwithstanding the substantial tightening of financial policies by the majority of the affected countries. ^{1/}

4. Policy Challenges

The renewed access for South African borrowers to international capital markets and the abolition of exchange controls on nonresidents in March 1995 described above are substantive structural changes to the economy.

The volume of foreign saving available has increased--accommodating larger current account deficits--and the way in which external developments impinge on the domestic macroeconomic balance has changed. In particular, these flows now affect the domestic balance directly through the capital account of the balance of payments, and are no longer merely reflected in movements in the financial rand discount. Moreover, with the removal of exchange controls on nonresidents, domestic real interest rates are no longer independent of foreign rates.

The additional access to foreign saving has relieved one of the constraints on higher growth, namely the difficulties of financing the associated current account deficits. This may alter the "business cycle" behavior of the economy, as the downturns in the past decade have often been directly related to the early emergence of a binding external financing constraint. However, the external financing constraint has not vanished; rather the challenge is to ensure that the greater inflows are absorbed efficiently, with a key test being the extent to which they finance additional private fixed investment. On that measure, South Africa performed well in 1995, with a large portion of the current account deficit induced by rapid growth in private investment.

At the same time, the recent experience in South Africa has underscored the importance of appropriate policies to deal with capital inflows as well as with the volatility of these flows. In response to the capital inflows in the second half of 1994 and in 1995, the authorities remained broadly on track in their efforts to reduce the fiscal deficit, allowed a limited appreciation of the rand, implemented a sterilized intervention in the spot market, and reduced the net oversold forward position of the SARB. As a result the rand appreciated 7.7 percent in real effective terms from May 1995 through January 1996, net reserves increased from about zero in mid-1994 to US\$3.5 billion by end-1995, and the net open forward position declined rapidly, as noted above. At the same time, the authorities removed capital controls on nonresidents and relaxed controls on residents. The

^{1/} See Chapter III, May 1995, World Economic Outlook; and Chapter I, October 1995, World Economic Outlook, IMF.

sterilization of the intervention on the spot market appears to have been effective as the rate of inflation decelerated to below 7 percent by end-1995. In sum, the direction of policies was appropriate and their achievement significant.

However, these policies were not sufficient to avert the deterioration in the sentiment toward the rand--and the associated capital outflows in recent months. This rapid swing underscores that one of the primary features of recent developments is the volatility of such sentiment. Thus, an identification of the source of the volatility in sentiment is necessary. In part, it derives from the fact that the foreign exchange market in South Africa is--by international standards--relatively small. International developments also have played some part in it--notably the marked recovery in market sentiment toward emerging markets in mid-1995, and the impact of the swings in U.S. dollar interest rates in early 1996--but domestic developments have been the prime cause of the volatility.

Even though the swings in market perceptions concerning South Africa appear overdone in hindsight, they would seem to be directly traced to changing perceptions of the prospective stance of policies:

- pessimism ahead of the 1994 election primarily reflected concerns that the transition might fail and concerns with the stance of policies likely to be adopted by the Government of National Unity following the election;

- the turn in sentiment after the election and the associated capital inflows primarily reflected the political consensus that emerged, and the elaboration and pursuit by the Government of cautious financial policies, backed by structural reform, including the announcement of medium-term fiscal targets and the commitment to phased trade and exchange control liberalization;

- but sentiment turned again after mid-February 1996 as uncertainty over the policy stance reemerged--notably concerning the authorities' stance on the abolition of exchange controls on residents, and toward the underlying structural problems of slow growth and unemployment. These uncertainties were compounded by the resignation of the Minister of Finance.

The recent volatility in market perceptions of South Africa suggests that in a context where the domestic macroeconomic balance is directly linked to external developments--particularly on the capital account of the balance of payments--the authorities should be guided by three concerns: the need to implement financial and structural policies that strengthen market confidence; the need to ensure that their commitment to persist with such policies does not come to be called into question; and the need to ensure that markets are confident that the policies will be adjusted appropriately in the face of unexpected developments.

If uncertainties in these areas are not addressed, the benefits for growth of an easing of the external financing constraint since the early 1990s would be lost as a result of the associated increase in the country risk premium, and thus higher domestic interest rates.

III. Recent Developments in Trade Policy

1. Introduction

South Africa's trade policy has long been inward-oriented reflecting, among other objectives, the promotion of industrialization through import substitution. The trade system was uniquely complex, opaque, frequently altered--all of which placed a heavy burden upon the customs services administering it--and exhibited a high degree of dispersion of protection across firms and industries. Notwithstanding a number of partial reforms to the regime in the past two decades, its essential nature remained unchanged.

In 1994, South Africa embarked on a new and comprehensive trade reform under the auspices of the Uruguay Round and the World Trade Organization (WTO). This chapter provides an overview and initial assessment of this effort. It notes that some elements of the reform--notably concerning agriculture--predated the commitments to the WTO; that the reform process is still at a relatively early stage; that some detailed information on the reforms implemented is not yet available; and that important aspects about the future implementation of the trade reform process remain unclear. It suggests that while the effort thus far represents a substantial improvement on the pre-existing situation--and will require a significant adjustment for affected firms--there may be much to gain from a further strengthening of the trade reform process in order to diminish the output and employment adjustment costs.

2. The trade regime prior to 1994

South Africa's trade regime prior to 1994 was highly protective, employing a variety of instruments such as tariffs, formula duties (see below), direct controls, and import surcharges. The anti-export bias inherent in this protective regime was offset in part by export subsidies and duty drawbacks and rebates. Manufacturing was protected primarily by means of tariffs while the agricultural sector was protected with a variety of instruments including tariffs and direct quantitative restrictions (QRs). The mining sector was largely unprotected. For details, see Belli et al. (1993), and GATT (1993).

The tariff structure in industrial products was complex and subject to frequent changes. Ad valorem tariffs were highly dispersed, and exhibited escalation, i.e., with the exception of capital goods, the rate of tariff increased with the degree of processing. According to the IDC, the weighted average import duty in 1994 was 11 percent on capital goods, 8 percent on intermediate goods, and 34 percent on final consumption goods. The maximum tariff rate of 1,389 percent was applied to certain textile products, and 17 individual tariff lines had tariffs in excess of 80 percent. But at the same time, a large number of tariff lines were zero-rated.

Formula duties, which applied principally to agricultural commodities, were designed to maintain domestic prices above set floors, and were automatically adjusted with changes in international reference prices to achieve this goal. ^{1/} Their original justification was to combat dumping. However, both the tariff rates and the floor prices targeted by the formula duties were frequently altered, often in response to ad hoc requests by domestic producers.

Import surcharges were introduced as part of the response to emerging balance of payments constraints in 1985. The rates of surcharge were changed on several occasions, but at end-1993, were 5 percent on intermediate and capital goods, 15 percent on motor vehicles, and 40 percent on home electronics and luxury products. In 1990, 60 percent of tariff lines were subject to import surcharges.

These surcharges compounded the escalation inherent in the tariff structures and the combined effect of all the instruments of trade protection was to give rise to high rates of effective protection for domestic production of final goods: the World Bank estimated that the average rate of effective protection in manufacturing was some 30 percent in the early 1990s. ^{2/}

This pattern of protection had a number of effects:

- it raised the rates of remuneration of factors employed intensively in the protected sectors, notably those of skilled labor;
- it raised the capital intensity of the domestic economy by encouraging the production of capital-intensive final goods; and
- it impeded the growth of nontraditional exports by weakening the international cost-competitiveness of these products.

In agriculture, both imports and exports of most products were controlled through some 20 marketing boards. E.g., the maize board obliged producers to market their product through the board, and fixed producer prices based on production costs for each season; in some cases, these prices were well in excess of international market prices. The Department of Agriculture issued import and export permits of major products under the Marketing Act, which entitled the Minister to determine the total maximum quantity of trade. For agricultural products not protected by QRs, formula or specific duties were often applied.

^{1/} While the definition of the reference price left room for discretion, in practice, the price of an American or European product was widely used.

^{2/} See Belli et al. (1993).

The main export subsidy, the General Export Incentive Scheme (GEIS), was introduced in 1990. 1/ The GEIS aimed at mitigating anti-export bias that resulted from the high level of import protection, and at increasing the share of higher value-added manufactures in total exports. The GEIS provided a tax-free subsidy to exporters based on export turnover, the degree of processing, and the local content of exported products. 2/ The subsidy under the GEIS amounted to approximately R 2 billion in 1995/96.

3. Trade reform commitments under the Uruguay Round of the GATT/WTO

The 1994 trade reform initiative under the Uruguay Round of the GATT/WTO was based on the work of the IDC, the Department of Trade and Industry (DTI), and the Board on Tariffs and Trade (BTT). Following negotiations with external parties and the affected domestic producers, the Government's final offer was accepted by other countries participating in the Uruguay Round. These countries also accepted South African eligibility under the Generalized System of Preferences (GSP), despite its WTO classification as a developed country, which usually excludes such preferences.

The industrial offer comprised the following commitments:

- all QRs and formula duties would be tariffied to equivalent ad valorem rates;
- 98 percent of all tariff lines would be subject to tariff bindings with effect from 1999, up from 55 percent in 1993;
- the average of all bound tariff rates would fall by 1/3 over 5 years;
- tariff rates would be standardized at six levels (0, 5, 10, 15, 20, and 30 percent), except for "sensitive" industries: clothing, textiles, and motor vehicles. The maximum tariff rates would be lowered to 45 percent

1/ Prior to 1990 there were four types of export subsidy: (i) an input compensation, whereby exporters could receive half the cost of protection afforded to imported inputs; (ii) a value-added compensation, whereby exporters could receive 10 percent of the value added of export sales; (iii) a marketing development scheme; and (iv) a marketing allowance provided under the Income Tax Act. The GEIS replaced the first two.

2/ The GEIS stipulated that for manufactures to be eligible for a tax-free cash payment or a promissory note, the local content had to be at least 35 percent.

for clothing and textiles and to 50 percent for motor vehicles over eight years; 1/

- the number of tariff lines, some 12,000, would be reduced by 15 percent at the outset, and by at least a further 30 percent to the six-digit Harmonized Code level by the end of 1999;

- rebates and the duty drawback schemes would be retained.

The agricultural offer, which also covered processed agricultural products, such as canned foods, beverages, and cigarettes, included the following commitments:

- tariffication of all QRs to equivalent ad valorem rates;

- a reduction in the average level of these tariffs of 36 percent over six years;

- a 21 percent decrease in subsidies, weighted by export volume.

The WTO rules allow signatory countries to use anti-dumping, countervailing, and safeguard duties only against abnormal competition, i.e., "the result of Government intervention which distorts cost and price structures, or of an imbalance between supply and demand which results in abnormally high or abnormally low prices." 2/ The South African anti-dumping legislation is currently under review.

Detailed schedules--defining how tariffs will be reduced over time--had been worked out for most of the individual tariff lines by early 1996, but these are not formally part of the offer to the WTO, which only specifies formal commitments applicable from 1999 onward. Thus, alterations can be made to these time schedules--and even to the tariff rates applying after 1999 if these adjustments are consistent with the bound rates--without reference to the other parties to the Uruguay Round agreement. It is envisaged that a number of reasons might be advanced for such alterations, including claims of dumping, and economic difficulties in individual sectors, and even sometimes difficulties faced by individual firms; such requests for alterations will be assessed on a case-by-case basis. In the event that these adjustments imply that the formal commitments to the WTO are breached, there is provision for other countries to lodge formal challenges at the WTO, and these are subject to reviews by that body.

1/ Motor vehicle imports comprised 14 percent of total imports in 1994, while textiles comprised 4 percent of total imports, with leather products, footwear, and clothing comprising 1 percent, 1 percent, and 0.5 percent, respectively.

2/ See Green Paper on Customs Tariff Policy with regard to Agricultural Products, 1996, p. 20.

These aspects of the commitments to the WTO underscore the considerable degree of discretion retained by the authorities concerning the pace and extent of trade liberalization, within the formal offers made by the South African authorities to the WTO, and motivate a discussion of progress thus far.

4. Trade reform during 1994-1996

a. Import surcharges

The Government began dismantling the system of import surcharges in 1994, removing the 5 percent surcharge on intermediate and capital goods in June and the 15 percent surcharge on motor vehicles in September. It subsequently abolished the 40 percent surcharge on home electronics and luxury products in October 1995. No import surcharges remain in effect.

b. Customs duties in the nonagricultural sector

A large number of changes to the tariffs on nonagricultural commodities have occurred in 1994 and 1996. A summary of these changes--insofar as they concern ad valorem tariff rates--is shown on the first six columns of Tables 6 and 7. These show the import weighted average tariff rates, excluding lines on which the tariff is zero, and the portion of imported commodities, under each category, that enters free of duty. A striking feature of the developments shown is the large number of categories for which average tariff rates have risen between 1994 and 1995: the weighted average tariff rates on lines with tariffs exceeding zero rose in 9 out of 30 categories between 1994 and 1995, and a similar pattern can be seen in final goods, where average tariff rates rose in 15 of the 34 categories. No such increases occurred in the capital goods categories. Tariff rates on some 580 individual tariff lines (out of some 7,000 lines for industrial products) were raised in 1995, many on lines applicable to relatively large volumes of imports.

In some of these cases, these increases in tariff rates were offset by increases in the share of lines on which tariffs were reduced to zero. In addition, the increases may have reflected the elimination of QRs, formula duties, and import surcharges and therefore do not necessarily imply increases in protection. While detailed information is not yet available to determine the extent to which such steps rationalizing the protective regime account for the frequency of the tariff increases, it is the impression of officials that they explain many of the increases. It is also notable that no such increases are anticipated for 1996, but this is subject to review during the year.

Overall, however, the import-weighted average tariff rate for the whole manufacturing industry dropped from 15 percent in 1994 to 12 percent in 1995

Table 6. South Africa: Trade Reform--Intermediate and Capital Industrial Goods

	Average tariff exclud. zero-rated tariffs 1/			Share of goods at zero tariff			Av. tariff targets 1/ 2/ WTO Own.		
	1994	1995	1996	1994	1995	1996	1995	2004	2004
Intermediate goods									
Salt, sulphur, earths and stone	13	19	16	77	79	81	4	1	1
Ores, slag, and ash	0	0	0	100	100	100	0	0	0
Inorganic chemicals	11	11	11	55	73	73	3	9	3
Organic chemicals	15	11	11	53	91	91	1	10	1
Fertilizers	13	0	0	0	100	100	0	11	0
Tanning or dyeing extracts	19	21	19	58	90	89	2	8	1
Essential oils and resinoids	17	16	16	29	50	50	8	12	7
Albuminoidal substances	0	5	5	97	99	99	0	11	0
Explosives, pyrotechnic products	8	15	14	25	80	79	3	14	3
Miscellaneous chemical products	14	13	13	57	92	92	1	8	1
Raw hides, skins, and leather	20	18	16	45	50	50	9	15	5
Wood and articles of wood	18	18	18	39	78	83	4	11	3
Cork and articles of cork	0	0	0	100	100	100	0	10	0
Pulp of wood	0	0	0	100	100	100	0	5	0
Wool, and woven fabrics	23	38	36	52	53	53	18	14	9
Cotton	35	37	34	0	0	0	37	22	18
Other vegetable textile fibres	10	10	10	10	10	10	9	25	9
Man made filaments	33	41	38	0	0	0	41	23	20
Man made staple fibres	42	42	39	36	36	36	27	16	14
Wadding, felt and nonwovens, ropes	13	14	14	0	0	7	14	20	13
Stone artefacts	16	18	16	38	50	44	9	10	7
Iron and Steel	6	5	5	17	40	40	3	10	3
Copper and articles thereof	14	12	12	50	67	67	4	15	3
Nickel and articles thereof	0	0	0	100	100	100	0	12	0
Aluminium and articles thereof	26	15	13	27	33	31	10	15	4
Lead and articles thereof	0	0	0	100	100	100	0	7	0
Zinc and articles thereof	0	0	0	100	100	100	0	10	0
Tin and articles thereof	0	0	0	100	100	100	0	6	0
Other base metals	0	0	0	100	100	100	0	5	0
Miscellaneous base metal products	17	18	17	6	11	6	16	22	15
Import weighted average	16	16	15	46	67	67	7	12	4
Capital Goods									
Boilers, machinery	20	18	17	75	89	88	2	8	1
Electrical equipment	15	15	9	47	53	56	7	18	5
Railway or tramway locomotives	0	0	0	100	100	100	0	9	0
Vehicles	54	45	43	6	7	7	42	40	28
Aircraft	0	0	0	100	100	100	0	2	0
Ships and boats	25	22	19	84	86	84	3	2	2
Import weighted average	27	23	21	51	59	60	13	18	9

Source: Industrial Development Corporation.

1/ Weights are shares in 1994 imports.

2/ Including zero-rated tariff lines.

Table 7. South Africa: Trade reform -- Industrial Final goods

	Average tariff exclud. zero-rated tariffs 1/ 1994 1995 1996			Share of goods at zero tariff 1994 1995 1996			Av. tariff targets 1/ 2/ WTO Own. 1995 2004 2004		
	1994	1995	1996	1994	1995	1996	1995	2004	2004
Final goods									
Pharmaceutical products	25	24	23	88	100	100	0	13	0
Soap, organic surface-active agents.	17	19	19	12	16	16	16	14	15
Photographic or cinematic goods.	11	13	13	64	77	77	3	13	3
Plastics, and plastic products.	21	16	15	48	50	47	8	17	7
Rubber, and rubber products.	22	18	17	32	33	35	12	20	9
Articles of leather.	21	28	28	0	0	0	28	29	28
Furskins and articles of fur.	15	17	17	0	6	6	16	17	16
Manufactures of straw.	16	20	20	6	10	10	18	20	18
Paper and paperboard products.	11	11	11	9	18	18	9	7	5
Printed books, newspapers, pictures.	18	17	16	83	88	88	2	3	2
Silk	23	0	0	0	100	100	0	0	0
Carpets.	29	29	29	0	0	0	29	30	29
Special woven fabrics.	19	44	41	11	11	12	39	26	19
Treated textile fabrics.	24	28	27	38	39	37	17	25	13
Knitted or crocheted fabrics.	33	45	42	0	0	0	45	25	22
Clothing, knitted or crocheted.	84	90	83	0	0	0	90	45	40
Clothing, not knitted or crocheted.	84	90	83	0	0	0	90	46	40
Used textiles and clothing.	37	41	39	0	0	0	41	32	26
Footwear.	41	43	40	2	2	2	42	29	29
Headgear.	21	27	27	14	15	15	23	29	23
Umbrellas, walking sticks.	26	25	25	0	0	0	25	25	25
Prepared feathers and down.	13	20	20	15	30	30	14	25	14
Ceramic products.	17	27	26	41	41	42	16	15	13
Glass and glassware.	12	11	11	25	27	36	8	17	6
Precious and semi-precious stones.	16	20	20	94	100	100	0	0	0
Articles of Iron and steel.	13	13	12	31	38	42	8	18	6
Tools, cutlery.	20	20	19	50	65	63	7	20	7
Photographic and optical equipment.	26	21	19	92	100	100	0	10	0
Clocks and timepieces.	0	0	0	100	100	100	0	10	0
Musical instruments.	0	0	0	100	100	100	0	5	0
Furniture and bedding.	22	22	22	23	32	36	15	22	13
Toys and sports equipment.	19	25	25	0	92	92	2	29	2
Miscellaneous manufactured articles.	21	20	19	19	55	53	9	18	8
Artworks.	0	0	0	100	100	100	0	0	0
Import weighted average	22	21	20	29	34	34	10	15	7

Source: Industrial Development Corporation.

1/ Weights are shares in 1994 imports.

2/ Including zero-rated tariff lines.

and to 11 percent in 1996. 1/ Nevertheless, the sectoral variation remained high, and the degree of tariff escalation was not substantially altered by the tariff reforms. The major contributor to reducing that escalation was the elimination of the import surcharges.

c. Sensitive industries

Within the confines of the offer to the WTO, the Government developed a plan for restructuring the textile and clothing industries in 1995, reflecting policy recommendations listed in the "Swart Report" issued by the BTT. The plan accelerated the process of tariff reduction-envisaged in the "Swart" report-by shortening the program period from ten years to eight years.

The program specifies progressive tariff reductions over the 8-year period from 90 percent to 40 percent for clothing, from 55 percent to 30 percent for household textiles, from 42 percent to 22 percent for fabrics, from 30 percent to 15 percent for yarn, and from 24 percent to 7.5 percent for polyester fiber. As with other non-agricultural tariff lines, weighted average tariffs for some groups of textile or textile-related items rose between 1994 and 1995, and some are scheduled to do so again in 1996, but a number of tariff reductions were also implemented. Specific duties will be abolished by the end of 1998, with a possible extension of one year in exceptional cases. All duty drawbacks and rebates will be phased out by the end of 2004.

Trade reform in the motor vehicle industry was introduced in September 1995 under two separate development programs: one for medium and heavy commercial vehicles, and the other for motor cars and light commercial vehicles. The implementation of these programs is to be completed by 2000 and 2002, respectively. In September 1995, these two programs eliminated the previous local content regulations aimed at protecting local component manufacturers, and reduced import duties on completely built-up vehicles (CBUs) and components. In contrast, however, the Government introduced an import-export trade balance rebate system to promote domestic production of parts in the motor vehicle industry. 2/

In the case of cars and light commercial vehicles, the Government lowered tariff rates for CBUs from 115 percent in September 1994 to 65 percent in September 1995 and further to 61 percent in January 1996. These tariffs are to be lowered to 40 percent by January 2002, according to a pre-announced schedule (Table 8). Over the same period, tariff rates for components were reduced from 50 percent to 49 percent, and then to

1/ These figures do not include import surcharges.

2/ The rebate permits the duty-free importation of vehicles and components equal to the local content value of motor vehicles and components exported. The rebate is transferable. In some cases the rebate induced a domestic producer to export components in exchange for imports of CBUs.

Table 8. South Africa: Timetable for Tariff Reduction
in the Motor Vehicle Industry
(cars and light commercial vehicles)

Year	Import Duty	
	Built-up Vehicles	Components
September 1995	65.0	49.0
January 1996	61.0	46.0
January 1997	57.5	43.0
January 1998	54.0	40.0
January 1999	50.5	37.5
January 2000	47.0	35.0
January 2001	43.5	32.5
January 2002	40.0	30.0

Source: "Motor Industry Development Programs," National Association of Automobile Manufacturers of South Africa.

46 percent. They will be lowered to 30 percent by 2002. In addition, the duty-free allowance granted to motor vehicle manufacturers on import components was reduced from 35 percent of wholesale turnover to 27 percent in 1995.

For medium and heavy commercial vehicles, the tariff rates on CBUs were reduced from 75 percent in September 1994 to 40 percent in September 1995, and to 36 percent in January 1996; they will be lowered gradually to 20 percent by January 2000. The tariff rates on components (e.g., engines, transmissions, drive axles, and tires) dropped from 30 percent in September 1995 to 27.5 percent in January 1996, and will be reduced gradually to 15 percent by 2000. Other components will be duty-free by 2000.

d. Agricultural trade reform

The restructuring of agricultural marketing has made significant progress in 1993-94. This included a shift from systems of surplus removal at floor prices to complete domestic deregulation. In addition, the Government has taken numerous steps to transform the 15 agricultural control boards, and abolished six of them in 1993-94. ^{1/} The Government also launched a large-scale conversion of import controls to ad valorem duties in

^{1/} The Banana Board was abolished in March 1993; the Chicory, Dried Beans, and Rooibos Tea Boards in September 1993; the Potato Board in December 1993; and the Mohair Board in January 1994.

1994, and this process is scheduled to be completed by the end of 1996. It is not known at this stage the extent to which this conversion has yielded tariffs which are below, equivalent to, or above the tariff equivalents of the instruments they replaced, but in none of the categories of agricultural commodities did import weighted average tariff rates rise between 1994 and 1995.

The Meat Board has deregulated auctions and allowed new entry of abattoir firms since 1992. In 1994, the surplus removal operations were stopped, and since then private meat markets have been developed. In addition, the centralized auction system was privatized so that farmers are now allowed to bring their cattle to the auction of their choice as well as market on a private contract basis with dealers. Also in 1994, QRs were replaced by tariffs (R 1.75 per kilogram) though evasion continues to be a problem. 1/

Since May 1995, the marketing system for maize products--which account for 44 percent of all cultivated area and 40 percent of the value of all crops in recent years--has been largely liberalized. Previously, the Maize Board had the sole marketing right of maize products, and maintained prices significantly above world levels. Exports were subsidized with the funds obtained from the difference between domestic consumer and producer prices. The new marketing scheme is based on free market determination of domestic prices, while a surplus removal scheme continues to be operated by the Maize Board as the buyer of last resort. Under the new system, quantitative import controls were removed and the imports of maize products were freed. The operations of the Maize Board are self-financed.

e. Export subsidies

In 1995 the Government initiated the three-year process to eliminate the GEIS, as envisaged under the commitments to the WTO. In June 1995 the GEIS benefits became taxable and the Government reduced the number of export categories eligible for the subsidy and cut the level of the subsidy. 2/ In March 1996, the Government announced its decision to accelerate a phasing out schedule of the GEIS: the GEIS subsidy for processed products was cut

1/ At a price of R 5 per kilogram, this specific duty would imply a tariff of 35 percent. The evasion takes place, inter alia, by qualifying meat products as processed meat products.

2/ Under the GEIS, exports were categorized into four types depending on the degree of processing: (a) primary products (e.g., logs, mineral products), (b) beneficiated primary products (e.g., saw logs, billets), (c) material intensive products (e.g., planed planks, sheet metals), and (d) manufactured products (e.g., furniture, steel cabinets). The higher the level of processing, the larger the subsidies became. In April 1995, the Government abolished GEIS benefits on products listed in category (a) and reduced subsidies for products in category (c) by reclassifying them as category (b).

from 14 percent of the export value to 12 percent in April, and is scheduled to decline further to 6 percent in July; the GEIS subsidy for raw materials was cut from 3 percent of the export value to 2 percent in April and is scheduled to be phased out in July.

The Government has expressed its intention to utilize fiscal savings obtained from the phasing out of the GEIS to reinforce supply-side measures and develop alternative, WTO-consistent export promotion measures. As part of this, the Export Marketing Assistance scheme was extended further to small, medium, and micro enterprises (SMMEs) in 1995. The Government also extended export credit assurance and guarantees to financial institutions against potential losses resulting from the nonpayment of loans made to exporters who default or experience insolvency.

f. Trade reform and macroeconomic developments in 1994-95

Firm evidence on the contribution of the reforms to the major macroeconomic developments during 1994-95--rapid private investment and import growth alongside stagnant employment (see Chapter I)--is not yet available.

It may have some role in stimulating imports; the contribution is perhaps most apparent in the case of imports of motor vehicles. But other factors, including the rapid growth of inventories stimulated by strong domestic demand and the strength of the rand, appear to have been the primary causes of the rapid growth of import volumes in 1995.

While gross fixed investment may have been stimulated by the beneficial signal provided by trade reform, there is little evidence thus far that its sectoral composition closely reflects the anticipated pattern of protection implicit in the specific targets that the authorities have set themselves.

The reduction in export subsidies, notably following the reforms to the GEIS, have not had an obvious effect on nongold exports, which have grown rapidly through 1995 especially to sub-Saharan Africa.

5. Future trade reform under the WTO

Central to assessing the impact of the commitments to the WTO is the extent to which the commitments will reinforce the authorities' own trade reform goals by requiring reductions in actual tariff rates.

Data presented in the last three columns of Tables 6 and 7 may form the basis of an initial assessment of this. These data show the weighted average tariff rates (including zero rated tariff lines) in 1995, those implicit in the WTO commitments, and those specified by the authorities as their own targets.

This shows that tariffs in 25 final goods categories, 25 intermediate goods categories, and all but one of the capital goods categories were

already below the WTO commitments in 1995. Although individual lines within each of these categories may have to fall to meet the WTO commitments, this is not necessary in a great many cases. In addition, the WTO commitments retain a degree of tariff escalation, implying a higher degree of effective protection for final goods than for intermediate goods.

However, as shown in the last columns of Tables 6 and 8, the authorities' own targeted tariff reductions are more ambitious--and sometimes considerably more ambitious--than those to which they are bound under the commitments to the WTO, and these are often below the tariff rates applied in 1995. But even the authorities' own target rates retain a degree of tariff escalation.

These aspects of the current program of trade reform--that actual tariffs do not have to fall from present levels in many cases to meet the WTO commitments, that the authorities are nevertheless targeting more ambitious goals for tariff reduction than obligated to under the terms of their WTO offer which will often require further actual tariff reductions, and that the authorities' own targets retain a degree of tariff escalation--convey mixed signals concerning the future path of trade reform. While the targets are a sign of the authorities' intention to open the economy to international trade, the fact remains that they leave considerable room to postpone downward adjustments or even raise tariffs, as well as to raise the ultimate targets for tariff rates.

This room for discretion introduces a degree of uncertainty over the paths that tariffs will actually take. Notwithstanding the authorities' repeated undertakings not to adjust the schedules or end-targets, the scope for such adjustments was illustrated by a decision in early 1996 to raise the import tariff on alumina in light of the circumstances of the single local supplier, albeit on condition that the supplier provides regular reports concerning measures it is taking to improve productivity.

Given that tariffs can be raised above the authorities' own targets, this gives rise to some uncertainty over the path of effective protection in individual industries. And because the authorities have not targeted an elimination of tariff escalation, an increase in the protection of final goods can be achieved by reducing tariffs on imported inputs faster than scheduled, while maintaining the scheduled reductions on final goods.

This room for discretion has important disadvantages because it increases the adjustment costs associated with the trade reform. It may encourage attempts in the private sector to reverse--or at least delay--the reform process. Such attempts may include more than straightforward lobbying against individual tariff reductions. They could also include resistance among both employers and employees to make the necessary adjustments. This will tend to increase the loss of employment during the implementation phase of the reform, and these losses may be used as a means of increasing pressure on the authorities to slow or reverse the process. Losses of employment from this source may be compounded by a "wait-and-see"

attitude by potential new investors, particularly those investing in outward-oriented activities--who would prefer to make new investments only once the "final" trade regime is in place. In turn, this slows the pace at which unemployed labor is absorbed into such activities.

In view of the output and employment costs arising from this degree of discretion, there may be considerable gains from efforts to pursue the overall strategy of trade reform while diminishing the degree of discretion in the process. This consideration forms part of the motivation for the discussion that follows in Chapter IV.

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IV. A Free Trade Arrangement with the European Union

1. Introduction

The European Union (EU) has recently offered South Africa a free trade area (FTA) arrangement, involving a reciprocal reduction in tariffs on "substantially all" bilateral trade. This chapter discusses the implications of the offer for trade policy, including its implications for exports to the EU, for South Africa's trade relations with the Southern African region, its implications for the budget, trade diversion, and for growth, and its implications for the program of import liberalization already underway under the auspices of the Uruguay Round (see Chapter III).

It suggests that the principal economic benefit to South Africa of the FTA is not the preferential access it provides for exporters to the EU market--useful though that is--but its potential role in strengthening the program of trade reform that is already underway. The implications of the FTA for the members of the Southern African Customs Union (SACU) are different from those for the members of the Southern African Development Community (SADC), and specific suggestions are offered to address the different issues raised in each case.

2. Background

The EU has traditionally been the largest market for South African exports. 1/ South Africa's nongold exports to the EU accounted for about 45 percent of total exports in the 1980s and early 1990s. Major products exported to the EU in 1994 included basic manufactures, foods and beverages, crude materials, and mineral fuels (Table 9). Similarly, over half of South Africa's imports originated in the EU in the 1980s and early 1990s. 2/ A half of total imports from the EU recorded in 1994 consisted of major machinery and transport equipment (Table 10).

Though the EU granted South Africa concessional access to its markets under the Generalized System of Tariff Preferences (GSP) in 1994, the concessions were more limited for agricultural than for manufactured products, reflecting the special concerns of EU agricultural interests. Nevertheless, in January 1995, eligibility of GSP benefits were extended for both industrial and agricultural products, raising the share of all South Africa's exports--including mineral products--that enter the EU markets duty-free to about 80 percent.

1/ By contrast, the share of EU exports to South Africa accounted for only 0.5 percent of total exports in 1994.

2/ However, the share of EU nongold imports from South Africa recorded only 0.4 percent of total imports in 1994.

Table 9. South Africa: Composition of Exports 1970-94 1/
(In Percent)

	1970-74	1975-79	1980-8	1985-89	1990-94
Total Exports					
Commodity					
Food and live animals	28.8	20.4	15.2	12.6	13.2
Beverages and tobacco	1.2	0.5	0.5	0.4	0.6
Crude materials excluding fuels	31.2	24.9	24.1	21.1	18.6
Mineral fuels etc.	1.6	5.5	12.5	13.0	13.1
Animal and vegetable oils, fat	0.7	0.5	0.3	0.2	0.2
Chemicals	2.8	4.7	7.0	6.2	5.5
Basic manufactures	29.0	36.5	31.6	40.2	38.2
Machinery, transport equipment	3.2	1.8	1.7	2.8	5.0
Miscellaneous manufactured goods	0.5	4.6	5.8	1.7	3.4
Goods not classified by kind	0.8	0.7	1.4	1.7	2.2
TOTAL	100.0	100.0	100.0	100.0	100.0
Exports to the EU					
Commodity					
Food and live animals	31.2	20.8	16.2	15.8	18.8
Beverages and tobacco	1.6	0.7	0.4	0.6	0.9
Crude materials excluding fuels	34.8	30.5	32.8	25.5	18.8
Mineral fuels etc.	1.8	6.6	17.7	16.9	17.2
Animal and vegetable oils, fat	0.9	0.5	0.2	0.1	0.0
Chemicals	1.5	4.9	7.4	5.5	3.8
Basic manufactures	24.8	32.9	20.5	30.2	29.3
Machinery, transport equipment	2.5	1.1	2.1	2.8	5.8
Miscellaneous manufactured goods	0.5	1.0	1.5	2.0	4.7
Goods not classified by kind	0.7	0.9	1.2	0.8	0.7
TOTAL	100.0	100.0	100.0	100.0	100.0
Share of exports to the EU in total exports					
Commodity					
Food and live animals	55.0	50.6	46.9	56.0	64.4
Beverages and tobacco	66.9	65.5	38.0	63.6	64.6
Crude materials excluding fuels	56.5	59.7	58.9	53.8	45.8
Mineral fuels etc.	55.2	57.1	62.0	57.3	59.2
Animal and vegetable oils, fat	59.3	41.5	26.0	17.2	6.3
Chemicals	26.4	48.1	46.6	40.3	31.1
Basic manufactures	43.1	44.3	28.1	33.5	34.7
Machinery, transport equipment	38.2	32.3	51.5	46.1	50.0
Miscellaneous manufactured goods	42.7	10.9	11.4	54.9	62.2
Goods not classified by kind	41.4	55.6	41.9	20.1	14.7
TOTAL	50.7	48.7	43.3	44.6	45.1

Source: TARS data base.

1/ Figures are averages.

Table 10. South Africa: Composition of Imports 1970-94 1/
(In Percent)

	1970-74	1975-79	1980-8	1985-89	1990-94
Total Imports					
Commodity					
Food and live animals	3.1	2.6	4.2	3.6	4.9
Beverages and tobacco	0.5	0.5	0.8	1.2	1.1
Crude materials excluding fuels	3.4	3.3	3.6	3.1	2.6
Mineral fuels etc.	1.4	2.6	1.6	1.0	0.8
Animal and vegetable oils, fat	0.5	0.5	0.6	0.8	0.8
Chemicals	9.7	10.8	10.6	14.5	14.0
Basic manufactures	20.1	15.2	13.5	13.1	14.8
Machinery, transport equipment	53.0	56.7	56.1	52.7	49.3
Miscellaneous manufactured goods	7.5	6.4	7.7	8.2	9.5
Goods not classified by kind	0.7	1.4	1.3	1.8	2.1
TOTAL	100.0	100.0	100.0	100.0	100.0
Imports from the EU					
Commodity					
Food and live animals	1.7	1.2	1.6	2.3	2.1
Beverages and tobacco	0.8	0.8	1.1	1.4	1.3
Crude materials excluding fuels	1.4	1.5	1.7	2.0	1.8
Mineral fuels etc.	0.8	0.9	0.7	0.7	0.6
Animal and vegetable oils, fat	0.1	0.1	0.2	0.2	0.2
Chemicals	10.6	12.2	12.5	16.4	16.8
Basic manufactures	18.8	14.3	13.5	13.8	15.2
Machinery, transport equipment	58.3	61.1	60.2	54.2	51.9
Miscellaneous manufactured goods	7.0	6.0	6.7	7.5	8.7
Goods not classified by kind	0.5	1.8	1.9	1.6	1.4
TOTAL	100.0	100.0	100.0	100.0	100.0
Share of imports from the EU in total imports					
Commodity					
Food and live animals	30.5	25.5	22.3	38.1	24.7
Beverages and tobacco	85.1	82.9	74.5	63.7	65.0
Crude materials excluding fuels	22.9	25.7	24.9	37.4	38.5
Mineral fuels etc.	36.4	19.1	26.8	47.9	41.0
Animal and vegetable oils, fat	13.4	13.9	15.3	16.1	16.9
Chemicals	60.6	63.5	61.4	64.3	64.4
Basic manufactures	52.2	52.8	52.5	60.4	55.6
Machinery, transport equipment	61.5	60.7	56.1	58.8	56.8
Miscellaneous manufactured goods	52.4	53.1	45.5	52.3	49.3
Goods not classified by kind	41.0	73.8	74.5	50.1	36.6
TOTAL	55.9	56.3	52.3	57.2	54.0

Source: TARS data base.

1/ Figures are averaged.

Following the EU's rejection of South Africa's request for eligibility under the Lomé Convention in June 1995, ^{1/} negotiations proceeded on two tracks: bilateral trade negotiations on the one hand, and partial accession to nontrade and aid protocols of the Lomé Convention on the other. In these discussions, South Africa has sought an agreement with the EU that would contain benefits similar to those of the trade charter of the Lomé Convention--complete access to GSP benefits--while the EU has offered a FTA. In March 1996, EU foreign ministers granted a formal mandate to the EU Commission to commence negotiations.

The mandate envisages that the FTA would be phased in gradually: the EU would reduce tariffs on eligible South African exports rapidly over some three years, while South Africa would lower its tariffs on eligible imports from the EU over 10 years, or 12 years in exceptional cases. Once fully phased in, it is envisaged that some 90 percent of total bilateral trade between South Africa and the EU would be free of all duties. The products to be excluded from the FTA (the remaining 10 percent of bilateral trade), and the precise phasing-down of tariffs on goods that are covered by the FTA are subject to negotiation, but the commission mandate envisages that 38 percent of South Africa's current agricultural exports would be excluded from the FTA. The exclusion of commodities from the FTAs is covered by rulings from the WTO. These issues are discussed in Annex I.

The FTA proposal raises four sets of issues: (i) the impact on South Africa's access to the EU market; (ii) tariff reductions on EU products imported by South Africa; (iii) the impact of the FTA arrangement on the South African economy; and (iv) South Africa's trade relations with its neighboring countries. These issues are discussed in the following four sections.

3. Access to the EU market

The FTA would raise the share of South Africa's duty-free exports from 80 percent to 90 percent or more, with the increases likely to be concentrated in manufactured exports and in some agricultural commodities. Under WTO rules, the negotiators may determine the exact product mix to be covered by the FTA, subject to the constraints that no principal sectors may be completely excluded, and that the overwhelming bulk of bilateral trade is covered.

^{1/} Under this convention, the EU grants a number of preferential benefits to 70 African, Caribbean, and Pacific developing countries, as follows: unrestricted, non-reciprocal, and duty-free access for industrial products--including coal, steel, textiles, and clothing; duty reductions; and quantitative access for agricultural products. Compared with other forms of EU trade concessions, the Lomé Convention gives greater preference to agricultural products than to industrial goods, because most industrial goods had already been granted zero most-favored-nation tariff rates.

The EU prefers offering duty-free rates to a broader range of industrial products and will likely seek to increase duty-free coverage for these goods to near complete coverage. In contrast, there is considerable resistance to extending duty-free status to South Africa's agricultural products, in part because of the precedent such an agreement with South Africa would set in other FTA negotiations already underway involving the EU and other countries.

Given these considerations, the benefits from increased preferential access to EU markets for South African exporters are broadly as follows:

- The share of South African manufacturing exports to the EU that would enter duty free would rise by some 20 percent. As the EU is targeting a reduction in its tariff for industrial products under the WTO framework--originating from anywhere in the world--to 4 percent, the FTA proposal would exempt a substantial portion of actual and potential South African exporters from this tariff. This benefit would not accrue to those South African products that already enter the EU market duty-free, notably traditional exports--such as precious stones, metals (e.g., gold and platinum), and minerals (e.g., copper and coal)--which account for one half of total South African exports to the EU. ^{1/}

- As concerns agricultural commodities, the EU foreign ministers agreed to increase the duty-free coverage of agricultural products from a current level of 27 percent to 62 percent. Despite this increase, it is unfortunately clear that the EU is seeking to minimize this access. The scope for doing so is considerable, within WTO rules, because these goods have not been exported to the EU in the past--due largely to the protective regime maintained by the EU. The WTO rules require that the FTAs cover substantially all "actual" trade as opposed to substantially all "potential" trade. This reduces the obligation on the EU to concede preferential access for agricultural goods that were traded in the past under its FTA proposal. For example, maize products, which account for about 45 percent of total field crop area cultivated and about 75 percent of total grain production, are not exported to the EU. In addition, the EU intends to exclude certain agricultural products that have been imported from South Africa. The precise exclusions will be determined in negotiations.

Thus, the FTA proposal as it currently stands will provide additional preferential access to EU markets for some South African exports, notably some manufactures and specified agricultural exports. This access may be enlarged through successful negotiations by the South African officials.

^{1/} At present, South African nonagricultural exports to the EU accounted for about 91 percent of total exports to that market.

4. Protection against imports from the EU

The FTA would also affect the current trade reform process that began in 1994. It would commit the authorities to further reductions in protection to 2006--if implemented in 1997--whereas the current trade reform set a pre-determined path of tariff reductions until 1999 for most industrial products, 2000 for agricultural products, and 2002 for products in "sensitive" industries.

The FTA is also likely to accelerate tariff reductions on industrial products--particularly manufactured products, as compared with the current trade reform. Under this reform, the import-weighted tariff rate, including zero-rated tariffs, would be reduced from 4 percent in 1995 to 2 percent by 1999 for mining products, and from 12 percent in 1995 to 8 percent in 2002 for manufactured products. These rates would fall under the FTA, particularly in the agricultural sector. Some of the authorities' targets in this area remain prohibitively high--e.g., 160 percent for bovine boneless meat--and these would fall substantially under the FTA arrangement.

The FTA may also impact arrangements for the "sensitive" industries under the current trade reform, though these could be minimized by scheduling tariff reductions for them toward the end of the 10-12 year phase-down period if they were brought into the FTA process. Imports of textiles and clothing accounted for about 2 percent of total imports from the EU in 1994 while those of motor vehicles and parts recorded about 11 percent of total imports from the EU. Since imports of these products from the EU exceed 10 percent of total imports from the EU, they cannot be entirely excluded from that process. And though they could be excluded in large part, a good case could be made to incorporate them into the agreement to accelerate the restructuring process for those industries.

In addition to setting more ambitious targets for trade reform, the FTA would substantially diminish the degree of discretion in the trade reform process by making a much higher portion of tariff lines subject to ceilings agreed in a formal agreement with an external bilateral partner. Finally, the FTA arrangement would eliminate the tariff escalation implicit in both the WTO and the authorities' own targets for tariffs.

5. Impact on the South African economy

The Free Trade Agreement (FTA) with the EU would have a number of effects on the South African economy. This section discusses these effects, notably on the budget, on trade diversion, and on economic growth and employment.

a. Loss of fiscal revenue

This agreement with the EU is likely to have a limited impact on South Africa's fiscal position. In 1995/96, taxes on international trade yielded some 1.2 percent of GDP, or some 5 percent of total revenue and grants. The

contribution of these taxes to total revenue will fall in future, irrespective of the FTA, as the current trade reform process unfolds. So the additional loss of fiscal revenue consequent upon the FTA agreement would not be substantial. Nevertheless, this revenue loss will need to be replaced.

b. Trade diversion

The prospect of trade diversion derived from the FTA is probably a more significant economic issue for South Africa than is the question of its fiscal impact. Given that the EU supplies around half of South Africa's imports, as trade barriers are reduced for EU exporters to South Africa relative to other suppliers, the trade-diverting effects would likely be substantial in South Africa. However, the trade-diverting effects would, of course, be negligible if South Africa phased down its tariffs on non-EU suppliers at the same pace as those facing EU suppliers in the context of the FTA.

c. Impact on economic growth and employment

The current program of trade reform reflects, in part, a consensus that the pre-existing trade regime was impeding growth and employment by protecting inefficient industries, encouraging inward-oriented investment, discouraging nontraditional exports, and by inflating skilled wage rates (see Chapter I). The reform program is deliberately phased so that firms have time to adjust, but seeks to address this fundamental constraint to growth.

The FTA agreement would contribute in two ways to strengthening the impact of the current trade reform on employment and growth. First, as discussed in Chapter III, the high degree of discretion inherent in the current program of trade reform may be increasing the employment and output losses occurring while the trade reform is being implemented. It does this by generating a "wait-and-see" attitude in the affected industries and among potential investors. By reducing this element of discretion, the FTA may reduce these transitional adjustment costs.

However, this reduced discretion still allows for an appropriate phasing of tariff reductions to permit weak industries time to adjust. The protection for those sectors that are ready to face EU competition could be eliminated early in the 10- to 12-year phase-in period, while protection for weaker industries could be eliminated later in that period. But because the phase-down timetable is agreed as part of a bilateral arrangement with an external party, the EU, those industries scheduled later in the process would be more certain that their protection was going to be removed. Hence, these industries would have incentives to commence the necessary adjustment process earlier. Under the current trade reform, such industries may instead have incentives to delay adjustment, and then to resist the scheduled fall in protection. In this way, the FTA would anchor the process of the current trade reform more firmly.

Second, the FTA embodies more ambitious targets for liberalization, albeit phased in over a longer period, than the authorities' own targets (see Chapter III). Since effective protection will remain considerable in many industries under the authorities' targets, it will continue to constrain growth and employment through the mechanisms described on page 51, namely, high remuneration of skilled workers, excessive capital intensity in production, and weak export competitiveness. Thus a more ambitious trade reform would raise growth to levels adequate to begin to reduce unemployment.

6. Regional trading arrangements

The implementation of an FTA with the EU would have to be reconciled with South Africa's various trading relationships with countries in the region, not least in regard to the trade diverting effects of the FTA noted above.

a. Southern African Customs Union (SACU)

South Africa forms SACU with four smaller countries (Botswana, Lesotho, Namibia, and Swaziland). SACU is a customs union established in 1910, which provides for the free movement of goods and the right of transit among member countries. Under SACU, South Africa administers duty collection and distributes shares of the common revenue pool to the four countries according to a revenue-sharing formula.

South Africa's FTA accord with the EU would impact these countries in a number of ways. It would have negative consequences for them in three respects. First, these countries would lose fiscal revenue--in addition to the losses already inherent in the current trade liberalization process (Table 11). Given these countries' heavy dependence on SACU customs revenue, the fall in the common revenue pool caused by the FTA would be substantial.

Second, these countries are members of the Lomé Convention. South Africa has not enjoyed the preferential access to EU markets accorded by the convention, and so the SACU countries enjoyed a comparative advantage over South Africa as an investment location on this basis. Once the FTA is in place for South African exporters, this source of comparative advantage for the SACU members would be largely eliminated. Finally, these economies would also be directly affected by the increased competitive pressures following the phase-down in import tariffs under the FTA.

At the same time, however, there are substantial benefits for these countries from South Africa's prospective FTA with the EU. To the extent that the FTA stimulates South African growth, they would benefit from the strength of their principal export market, and from its increased absorption

Table 11. SACU Receipts as a Share of Total Revenue and Grants,
and as a Share of Tax Revenue (shown in brackets)

Year	Botswana	Lesotho	Namibia	Swaziland
1990/91	13 (25)	43 (66)	23 (27)	45 (50)
1991/92	19 (37)	44 (62)	37 (43)	44 (49)
1992/93	21 (43)	47 (63)	26 (30)	39 (46)
1993/94	15 (33)	55 (68)	26 (28)	46 (50)
1994/95*	16 (31)	53 (67)	27 (30)	49 (52)
1995/96**	16 (34)	51 (65)	30 (34)	53 (56)

* Estimates or preliminary outcomes.

** Based on budget.

of their migrant labor. In addition, they would benefit from the reduced costs of imports as trade barriers are reduced, and would also become increasingly competitive under the influence of the competitive pressures the arrangement induces.

The FTA arrangement is likely to create significant net gains to these four countries in the long run, but will also entail short-run adjustment costs. Accordingly, in the context of the negotiations over the revenue-sharing formula, it would be useful to consider how such adjustment costs could be alleviated, including through adjusting the phase-down of tariffs under the FTA.

b. Southern African Development Community (SADC) 1/

SADC was originally established in 1980, with the goals of developing investment coordination in key productive and infrastructural sectors, and reducing economic dependence on South Africa. These goals were transformed in 1992 to a closer and wider economic integration in areas including monetary and fiscal policies, exchange rate and trade regimes, and mobility of capital and labor.

The impact on the (non SACU) SADC countries of the FTA with the EU is different from that on SACU in key respects. In particular, it would have no direct bearing on their own import liberalization programs, or fiscal positions. However, the impact on SADC countries is similar to that on SACU

1/ The members of the Southern African Development Community are: Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Tanzania, Swaziland, Zambia, Zimbabwe, and South Africa.

in two respects: namely, the loss of their comparative advantage as an investment location due to their status under the Lomé convention, and the gains to them if South Africa grows more rapidly.

The gains for SADC countries could be substantially enhanced if the FTA occurs in parallel with tariff reductions facing all exporters to South Africa, including those from SADC. The Trade Facilitation Protocol drafted in February 1996 envisages an FTA among SADC member countries with reciprocal tariff reductions, eventually leading to a customs union. Clearly, this process would be strengthened by a South African FTA with the EU, as South African growth rates are stimulated by its wider trade reform program under the auspices of the FTA with the EU.

6. Conclusion

The trade reform under the auspices of the Uruguay Round was substantially motivated by a consensus that protection was impairing South Africa's competitiveness, and impeding its access to international markets. However, as noted in Chapter III, the reform program leaves considerable room for concessions and discretion, reducing its credibility and effectiveness, and is irrevocably committed to relatively limited goals. Both of these factors may be slowing the adjustment process, and increasing its employment and output costs.

An FTA arrangement between South Africa and the EU, if implemented, could strengthen the current trade reform program. It would reduce the degree of discretion inherent in the reform while still accommodating the variety of needs of different sectors for protection in the phase-down period, and would target more ambitious goals. The former is likely to reduce the adjustment and unemployment costs inherent in the current trade reform program, while the latter will increase its benefits.

By strengthening the competitiveness of South African producers, it will contribute directly to enhancing their access to export markets worldwide. Though EU resistance to wider preferential access for South African agricultural exporters to its markets is highly regrettable, the larger benefit from the FTA is its potential role in increasing access for all South African exporters to worldwide markets by strengthening their competitiveness.

WTO Rules on Regional Trading Agreements

The Most Favored Nation (MFN) rule, depicted in Article 1 of the WTO rules issued in April 1995, obliges each signatory country to extend equally to all other signatory countries any advantage, favor, privilege, or immunity affecting customs duties, charges, rules, and procedures originating in or destined for any other signatory country. Equal treatment of imports regardless of country of origin helps ensure that a signatory country is able to purchase imported products from lowest-cost foreign suppliers, thereby reinforcing the country's comparative advantage in the world market and minimizing its cost of protection. Such a rule provides regularity, orderliness, and predictability by barring discrimination against imports from particular sources, thereby ultimately contributing to high trade and economic growth.

As the exception to the MFN principle, Article 24 of the GATT allows signatory countries to form customs unions and FTAs with the view that a removal of trade restrictions represents an important step toward free trade, similar to the process of integrating different provinces within a single country. The article provides two main conditions governing such arrangements: a "substantially-all-trade" requirement and a "not-on-the-whole-higher-or-more-restrictive" requirement. 1/

1. "Substantially-all-trade" requirement

The substantially-all-trade requirement aims at mitigating political resistance against tariff reductions and, at the same time, increasing the positive effect of trade creation. It requires participating countries in free trade accords to liberalize most of their mutual trade. 2/ Nevertheless, this requirement could be potentially ineffective provided a

1/ Other requirements include transparent rules of origin, liberal rules of access, and strengthened discipline on the use of anti-dumping action against third countries.

2/ Regional trading arrangements consist basically of four types of arrangement, with differences in the degree of cooperation (IMF 1994). An FTA entails the full elimination of tariff and nontariff trade barriers between participating countries, while each participating country's trade barriers with third countries are left, in principle, unchanged. A customs union is an FTA that adopts a common external tariff against third countries. A common market is a customs union with provisions to liberalize regional factor movements. Finally, an economic union is a common market with provisions for the harmonization of certain economic policies, particularly macroeconomic and regulatory policies.

signatory country is able to impose duties or other trade restrictions by exercising special provisions as exceptions to the requirement. ^{1/}

Significant differences of opinion exist among signatory countries with respect to the interpretation of the substantially-all-trade requirement. The main difference is whether the coverage of trade liberalization should be understood in qualitative or quantitative terms. Under the former, no major sectors may be excluded, whereas under the latter the percentage of a country's export value that is free of trade restrictions determines how much the requirement is met.

2. "Not-on-the-whole-higher-or-more-restrictive" requirement

The not-on-the-whole-higher-or-more-restrictive requirement aims at mitigating the effect of trade diversion with a practice of compensation negotiations. Suppose the requirement is not met by participating countries because the level of common external tariff applied to third countries is determined in such a way that each third country's bound tariff is raised; in this case, Article 28 requires participating countries of a customs union to negotiate with third countries, before a common external tariff is implemented, on a compensatory reduction in tariffs on other products.

However, the requirement does not necessarily achieve its goal of reducing trade diversion, since trade diversion may increase if tariffs on some products are raised in exchange for a reduction in tariffs on other products. If the requirement includes a reduction of external trade barriers, it could be said that the requirement is likely to reduce the scope for diverting efficient producers in third countries to inefficient producers in participating countries. Therefore a desirable requirement on customs unions and FTAs would be for customs unions to set the common external tariff to the lowest (or lower) tariff of any union participating country, and FTAs simultaneously to reduce external tariffs in line with internal trade barriers.

There are diverse views on the interpretation of the requirement. The common external tariff could be calculated by several different methods, such as simple averaging, trade-weighted averaging, or alignment at the lowest tariff. A related issue is whether it is necessary to examine the effect of increases in tariffs on a country-by-country and product-by-product basis, for the purpose of making a comparison between ex ante and ex post market access opportunities of third countries. For example, in the formation of the Treaty of Rome in 1957, third countries argued that participating countries in the EEC should not raise barriers to the trade of

^{1/} Special provisions include Article 11 (quantitative restrictions), Article 12 (restrictions applied for balance of payments purposes), Article 13 (nondiscriminatory administration of quantitative restrictions), Article 14 (exceptions to the rules of nondiscrimination), Article 15 (exchange arrangements), and Article 20 (general exceptions).

any individual third country. However, the EEC member countries used an arithmetic average by refusing to discuss the best method of calculation since they viewed that the requirement was satisfied. They interpreted the requirement as applying to third countries as a group rather than individually, and as enabling the EEC to raise trade barriers in one sector provided those barriers are reduced in other sectors.

The Southern Africa Customs Union

In 1969, SACU revised its original agreement of 1910, as Botswana, Lesotho, and Swaziland (hereafter called BLS) became independent. The objective was to increase their shares of regional imports. The agreement was renegotiated again in 1979, and further negotiations are underway. Namibia, which had been administered by South Africa as part of SACU, joined the union as an independent country in 1990. Member countries of SACU are characterized by the substantial differences in the stage of economic development between South Africa and the four other countries, hereafter called BLNS countries (Table 12).

Table 12. Economic Indicators of Member Countries of SACU

Year	Botswana	Lesotho	Namibia	Swaziland	South Africa
GNP per capita (1993)	\$2,790	\$650	\$1,820	\$1,190	\$2,980
Average annual growth rate of real GNP per capita (percent)					
1980-93	6.2	-0.5	0.7	2.3	-0.2
Average annual growth rate of real GDP (percent)					
1970-80	14.0	8.6	NA	5.0	3.2
1980-93	9.6	5.5	1.3	3.7	0.9
Population (millions, 1995)	1.6	2.0	1.6	1.0	42.5
Average annual population growth (1990-95)	3.3	2.7	3.0	3.5	2.3

Source: Industrial Development Corporation, 1995; and World Development Report, 1995.

The 1910 SACU agreement stipulated that manufactured goods were freely transferred between South African and BLS countries. BLS countries received a fixed share of SACU customs revenue on the basis of a three-year average of customs and excise revenue shares of the respective countries prior to the agreement.

In the early 1950s South Africa adopted a policy of import-substituting industrialization and introduced a number of trade restraints. Under the 1969 SACU agreement, South Africa agreed to compensate smaller member countries by increasing the share of SACU duty revenue allocated to them by 42 percent. Compensation was based on the grounds that South Africa's exclusive role in determining the common external tariff, through protecting South African industries, had polarized SACU member countries to the detriment of BLS countries. Compensation also took into account disadvantages of BLS countries, including price increases as a result of importing more expensive South African products, a loss of fiscal discretion because of South Africa's retention of tariff-sharing power for the region, and South Africa's use of nontariff barriers.

The revenue-sharing formula was modified in 1976 when a stabilization factor was introduced to counteract variations in payments, resulting from changes in South Africa petroleum tariff and excise policies. 1/ The stabilization factor was centered on a mean of 20 percent of imports, with a lower bound of 17 percent and an upper bound of 23 percent of the tax base, which was the sum of duty-inclusive imports (on a c.i.f. basis) and excise tax-inclusive value of goods produced in the union and consumed in a particular BLNS country.

Any member of SACU may leave the arrangement with 12 months' notice. The consequences of an abrupt termination of the SACU agreement would, however, be serious for all of the BLNS countries because of their heavy reliance on SACU receipts as the main source of fiscal revenue.

1/ Customs duties refer to levies on imports from outside the union, while excise duties are levies on products produced within the union. The formula used for allocation of SACU duty revenues to BLNS countries is expressed as follows:

$$(1) \quad r_1 = R / (M + P); \quad (2) \quad r_2 = r_1 * 1.42$$

$$(3) \quad r_3 = 0.2 \pm 0.5 (0.2 - r_2)$$

$$\text{where } 0.17 \leq r_3 \leq 0.23$$

$$(4) \quad A = (m + p) * r_3$$

$$(5) \quad S_t = A_{t-2} + (A_{t-2} - A_{t-4}) + (A^*_{t-3} - A_{t-3})$$

where R=customs and excise duties paid into the Consolidated Fund; M=duty-inclusive value of dutiable imports (c.i.f.) from outside the SACU; P=duty-inclusive value of dutiable domestic production consumed within the SACU; r_2 =compensated average rate of duty; r_3 =stabilized average rate of duty; A=accrued revenue share; m and p defined in the same way as M and P, although referring to a country concerned; S_t =actual revenue share in year t; A^*_{t-3} =actual share in t-3 using data available and A_{t-3} =the first estimate as calculated in t-1.

The Southern African Development Community

Member countries (Table 13) of the SADC are diverse and stand in different stages of economic development. Gross National Product (GNP) per capita ranged from US\$90 (Mozambique and Tanzania) to US\$3,030 (Mauritius). Mauritius and BLNS (listed in Appendix II) are relatively small in terms of population (1-2 million people), while their per capita incomes are higher than other member countries. South Africa is by far the dominant economy within SADC. South Africa accounts for 21.4 percent of total SADC area and 46.6 percent of total SADC population. Compared with other member countries in 1993, South Africa's GNP was 4 times higher and its GNP per capital was 7 times greater (Holden 1995). South Africa's relative prosperity as opposed to the dearth of development elsewhere has created large-scale migration flows to South Africa (approximately 350,000 permanent workers and another 1 million workers entering illegally or as temporary laborers in one year). 1/ South Africa's fear of further massive migration explains in part its efforts to participate in regional economic development projects.

Table 13. Basic Economic Indicators of Member Countries of the SADC
(excluding SACU member countries)

Country	<u>GNP per capita</u>		<u>GDP growth</u>		<u>Population</u>	
	<u>(US\$)</u>	<u>Growth(%)</u>			<u>(millions)</u>	<u>Growth (%)</u>
	(1993)	(1980-93)	(1970-80)	(1980-93)	(1995)	(1990-95)
Angola	520	NA	NA	NA	11.5	2.8
Mauritius	3,030	5.5	6.8	6.0	1.1	0.9
Malawi	200	-1.2	5.8	3.0	10.1	0.9
Mozambique	90	-1.5	NA	1.0	18.1	2.9
Tanzania	90	0.1	3.0	3.6	28.5	3.0
Zambia	380	-3.1	1.4	0.9	9.5	3.2
Zimbabwe	520	-0.3	1.6	2.7	11.2	2.7

Source: Industrial Development Corporation, 1995; and World Development Report, World Bank, 1995.

SADC is characterized by the fact that economic performance of SACU member countries has surpassed that of the rest of SADC, except Mauritius. The latter countries experienced prolonged economic recession with declining GDP per capita during 1980-93. Slow economic recovery of these countries suggests that the role of SADC in improving their economic performance has

1/ See African Development Bank (1993).

been limited because of their difficult problems, including macroeconomic fragility, large external debt, and balance of payments problems.

The Trade Protocol, which was drafted in February 1996, envisages a formation of an FTA. The Protocol aims at reciprocally reducing import duties and removing import controls. However, a number of articles allow member countries to suspend these obligations when a member country (a) wants to protect their infant industries (Article 16); (b) faces a sharp deterioration of balance of payments (Article 17), and (c) experiences a substantial increase in imports, causing serious injury to a domestic industry (Article 18). This draft Protocol was discussed by executive senior officials of SACU member countries in April 1996, and will be discussed by the SADC Council of Ministers at the end of June. The draft Protocol is planned to be finalized by the end of August 1996.

The FTA formation in the SADC is likely to accelerate trade expansion, which has become a prominent form of economic interaction within the community. While SACU member countries as a group have consistently been net exporters to the remainder of the SADC member countries, South Africa's recent political transformation has increased SACU's exports to the latter from R 1.8 billion in 1988 to R 7.2 billion in 1994. Consequently, SACU countries have become the most important source of imports for non-SACU, SADC member countries. In particular, Zimbabwe accounted for 34 percent of SACU's exports to the rest of the SADC member countries in 1994, and Mozambique's share was 24 percent after the end of its civil war. SACU's major exports to other SADC member countries included capital products (27 percent) and consumer products (34 percent).

Although SACU's imports from non-SACU, SADC member countries were less pronounced compared with export transactions, SACU member countries increased their imports from the latter from R 500 million in 1988 to R 1.5 billion in 1994. Zimbabwe has been the largest exporter to SACU, accounting for 77 percent of SACU's imports from the non-SACU, SADC member countries. Major products imported by SACU in 1994 included intermediate products (59 percent) and consumer products (34 percent). SACU imported mainly manufactured products (69 percent), mostly from Zimbabwe and Malawi. Agricultural imports accounted for 30 percent, mostly originating from Zimbabwe and, to a lesser extent, from Malawi and Mozambique.

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V. Accelerating Growth and Fiscal Policy

1. Introduction

A sustained increase in South Africa's growth to 6 percent a year, a level consistent with declining unemployment, will require an increase in the level of fixed investment from a projected 18 percent of GDP in 1996 to about 26 percent of GDP by the turn of the century. Funding this increase in investment raises four questions. First, how much of the increase in investment can be financed from abroad and, thus, how much will domestic saving need to rise? Second, to what extent might fiscal actions aimed at stimulating domestic saving be offset by declines in private sector saving? Third, given the Government's commitments to avoid increasing the tax burden (presently at around 26 percent of GDP) and to maintain capital expenditure at 2.7 percent of GDP, can the required public saving be generated without recourse to unrealistic cuts in noninterest current expenditure? If not, what is the role of fiscal policy in the efforts to promote the growth and employment objectives?

The chapter is organized along the lines of answering these questions. The second section discusses the issue of the level of foreign saving that can be expected to be available to the South African economy over the medium term. It is argued that while no specific level can be ascertained with certainty, there are reasons to assume that, under current economic conditions, foreign saving are unlikely to exceed 4 percent of GDP. Moreover, a pre-condition for any sustained inflow of foreign saving is that the authorities' fiscal stance is sustainable, in the sense that the debt-to-GDP ratio declines over time, i.e., there is no public-debt trap. Section 2 concludes with an analysis of this issue.

The third section analyzes the impact of efforts to raise public sector saving on private saving behavior. It is shown that in South Africa any effort to raise public sector saving leads to a decline in private saving. However, the offset may vary depending upon the policies employed to generate the increase in public saving, i.e., the offset is likely to be lower when expenditure cuts rather than tax hikes produce the increase in public saving.

Finally, the last section discusses elements of the role of fiscal policy, as part of a wider program of action aimed to raise growth and employment. It is suggested that public sector dissaving would need to be eliminated and indeed saving be generated and that a number of changes in the composition of public expenditure would be desirable.

2. Foreign saving constraint

The level of foreign saving that can be expected to finance increased investment in South Africa depends on domestic considerations and the external environment. With respect to the former, the fiscal stance assumed by the authorities will have a significant role, as it affects the country's

risk premium. While no particular level of deficit or surplus can guarantee unlimited access to foreign saving, an unsustainable fiscal position would raise the perceived risk and result in little, if any, access to foreign resources. In this regard, there is an ongoing debate in South Africa as to whether the country is in a public-debt trap (defined as an increasing ratio of government debt to GDP), and therefore whether the present stance of fiscal policy is sustainable. Critics of current policy claim that proof that South Africa is in a debt trap can be seen from the fact that the current yield-to-maturity on government debt exceeds the growth rate of nominal GDP.

Appendix 1 of this chapter shows that the relationship between the yield-to-maturity on public debt and nominal GDP growth is only one element of the sufficient condition for a rising debt-to-GDP ratio. Other key elements include the overall fiscal stance, particularly the primary balance. At current rates of growth of nominal GDP, a public-debt trap would be avoided if the surplus in the primary balance averages between 1.5 percent and 2 percent of GDP. The current medium-term fiscal framework would lead to a primary surplus exceeding 1.5 percent of GDP by 1997/98, and assuming that the overall deficit continues to be reduced by 0.5 percent of GDP a year thereafter, the primary balance would show surpluses on the order of 3 percent of GDP by the turn of the century (Table 14); this would be sufficient to avoid a public-debt trap.

In these circumstances, no absolute limit on the availability of foreign saving to South Africa can be determined precisely, but a reference level can be established (and will be used in section 3 for simulations regarding the extent to which fiscal policy can generate the necessary higher domestic saving).

In the last Selected Economic Issues paper (SM/95/21), it was pointed out that during the period 1960 to the mid-1980s investment in South Africa averaged 26 percent of GDP, and external saving played an important role in maintaining that investment level in the face of changes in the level of national saving. After the imposition of financial and economic sanctions and the re-establishment of the financial rand system, there was a steady outflow of capital that constrained investment to the level of national saving.

The end of apartheid and the recent abolition of the financial rand created the opportunity for external capital flows to return to the role they played for the quarter century before the mid-1980s, when foreign saving averaged more than 5.5 percent of GDP. However, there is still a significant risk premium that results from domestic political considerations, as well as from continued public sector dissaving through fiscal year 2000/01. Moreover, in the wake of the Mexican crisis of December 1994, financial markets have been quite cautious, and it is unlikely that South Africa could run external current account deficits in excess of 4 percent of GDP, even assuming that net foreign direct investment rise to about 2 percent of GDP a year. Furthermore, it is likely that this

Table 14. South Africa: Macroeconomic Framework-- Authorities' Fiscal Scenario

	1996/97	1997/98	1998/99	1999/2000	2000/01
	<u>(In percent)</u>				
Real GDP growth	4.0	3.0	3.0	3.0	3.0
GDP deflator growth	8.0	8.0	8.0	8.0	8.0
Real interest rate (new issues)	5.6	5.6	5.6	5.6	5.6
Central Government	<u>(In percent of GDP)</u>				
Revenue	25.8	26.0	26.0	26.0	26.0
Expenditure	31.0	30.5	30.0	29.5	29.0
Current primary	22.4	21.6	21.0	20.6	20.4
Interest	6.1	6.2	6.3	6.2	5.9
Capital expenditure	2.5	2.7	2.7	2.7	2.7
Balance	-5.2	-4.5	-4.0	-3.5	-3.0
Debt stock (face value)	55.5	54.4	52.9	51.0	48.9
<u>Memorandum items:</u>					
Primary balance	0.9	1.7	2.3	2.7	2.9
Government savings	-2.7	-1.8	-1.3	-0.8	-0.3

level of foreign saving will be available only over time, as international lending markets stabilize and political and economic uncertainties in South Africa are removed.

As shown in the scenario presented in Table 15, an investment target of 26 percent of GDP by the turn of the century along with foreign saving availability that rises over time to almost 4 percent of GDP implies that domestic saving must rise from 15.5 percent of GDP at present to 22.1 percent by FY 2000/01. ^{1/} Then, the key question is how much of the domestic saving increase should be generated by the public sector?

3. Public sector saving target over the medium term

An increase in public sector saving is offset fully when conditions for strict Ricardian equivalence prevail. However, when conditions for strict Ricardian equivalence do not prevail, it is possible that a rise in public saving is only partly offset by lower private saving. A situation of no offset is consistent with textbook Keynesian analysis.

There is evidence that the size of the offset in developing countries is not only affected by the degree to which the conditions for Ricardian equivalence apply. It is also affected by the composition of the fiscal measures with higher offsets when the fiscal balance is strengthened by tax increases than when it is strengthened by equivalent expenditure reductions. Empirical estimates of these offsets (see Appendix II) suggest that a 1 percentage point of GDP increase of government saving is offset by a decline in private saving of 0.16 percentage point of GDP, when the public sector saving increase is generated by expenditure reductions, and 0.7 percentage point of GDP, when the public sector saving increase is generated by raising taxes.

The results of the empirical work suggest that to reach an overall increase in domestic saving of 6.6 percentage points of GDP, and assuming no change in private sector saving behavior from other sources, public sector saving would need to rise to unrealistic levels. Even if the offset is as low as 0.16 percentage point of GDP per percentage increase in government saving, the necessary hike in government saving would be just under 8 percentage points of GDP, implying continuous cuts in real expenditure throughout the remainder of the decade (Table 15).

^{1/} The 4 percent constraint is illustrative, and the results could be adjusted for the use of higher (or lower) maximum external current account deficits.

Table 15. South Africa: Fiscal Policy-- Six Percent Real Growth by FY 2000/01

	1996/97	1997/98	1998/99	1999/2000	2000/01
	<u>(In percent)</u>				
Real GDP growth	4.0	4.0	4.5	5.5	6.0
GDP deflator growth	8.0	8.0	7.0	6.0	5.0
Real interest rate (new issues)	5.6	5.6	5.6	5.6	5.6
	<u>(In percent of GDP)</u>				
Fixed investment	18.0	20.0	22.0	24.0	26.0
Foreign savings	2.5	2.8	3.0	3.5	3.9
Domestic savings	15.5	17.2	19.0	20.5	22.1
Public savings	-2.7	-0.8	1.2	3.2	5.2
Private savings	18.2	18.0	17.8	17.3	16.9
Central government overall balance	-5.2	-3.5	-1.5	0.5	2.5
Primary balance	0.9	2.6	4.3	5.7	6.8
Current Revenue	25.8	26.0	26.0	26.0	26.0
Current expenditure	28.5	26.8	24.8	22.8	20.8
Wages	11.6	11.0	10.3	9.5	8.9
Goods and services	3.4	3.3	3.0	2.8	2.6
Business subsidies 1/	1.5	0.9	0.5	0.5	0.4
Household subsidies	3.2	3.1	2.9	2.6	2.5
Transfers	2.6	2.5	2.3	2.2	2.0
Interest	6.1	6.1	5.8	5.2	4.3
Capital expenditure	2.5	2.7	2.7	2.7	2.7
Debt stock (face value)	55.5	53.2	49.0	43.4	36.5
General government savings	-2.7	-0.8	1.2	3.2	5.2
<u>Memorandum items:</u>	<u>(Real growth rates)</u>				
Current revenue	5.4	5.0	4.5	5.5	6.0
Current expenditure	2.8	-2.2	-3.3	-3.1	-3.4
Wages	2.4	-0.9	-2.7	-2.5	-0.8
Interest	9.1	3.2	-0.2	-5.4	-12.1
Capital expenditure	4.8	14.3	4.5	6.8	6.5

1/ The reduction in 1997-99 would come from a 40 percent reduction in all subsidy programs.

An argument can be made, however, that increased investment and growth would "crowd in" private saving. But these increases are most unlikely to be sufficient to fund the required increase in fixed investment without a strengthening of the authorities' current fiscal program. The mid-panel of Table 16 shows that private saving would have to rise by 4 percentage points of GDP in order to fund the increase in investment under the current fiscal program.

4. Fiscal policy and structural reform

As just indicated a program of structural reforms aimed at increasing employment and growth would promote private saving and thus alleviate the burden on fiscal policy for several reasons. First, evidence from the fast growing economies in Southeast Asia suggests that faster growth leads to increased private saving. Second, accelerated efforts at reform of tax and pension systems (described in the background section of this report), as well as privatization, would also spur private saving. Third, structural reforms may "crowd in" private saving by imparting greater confidence in the economy's long-term prospects. Fourth, implementation of a structural reform program, *ceteris paribus*, would eventually raise the availability of foreign saving that could be channelled into the domestic economy beyond the 4 percentage points of GDP assumed above.

The lower panel of Table 16 outlines a fiscal policy stance over the medium-term consistent with our previous analysis and the implementation of a structural reform program. While it is rather difficult to quantify the stimulus to private saving of the structural reform package, the level of public sector saving that would need to be generated would be of a far lesser scale than implied in the previous analysis and as called for today in some South African circles.

In light of the discussion in section 3, public sector saving would need to rise through a reduction in expenditure to minimize the offset. Recent work by the Fund's Fiscal Affairs Department on fiscal policy and its impact on growth concludes that a growth promoting public sector should complement private sector activity in order to foster a more intensive utilization of existing capacity and/or reallocation of existing resources and should promote increases in the stocks of physical and human capital and technological development. ^{1/}

In South Africa, aggregate education spending is arguably already sufficient; however, the composition of that spending is inefficient: spending at the tertiary level could be reduced with a concurrent increase in the allocation to primary and secondary education, and moreover, nearly 85 percent of current education-related expenditure is in wages; this could be scaled back through improved targeting of wages and teacher expertise

^{1/} EBS/95/166 and the companion paper SM/95/275 address the issues of the composition of fiscal adjustment and growth.

Table 16. South Africa: High Growth Framework -- Public and Private Savings

	1996/97	1997/98	1998/99	1999/2000	2000/01
	<u>(in percent)</u>				
Real GDP growth	4.0	4.0	4.5	5.5	6.0
GDP deflator growth	8.0	8.0	7.0	6.0	5.0
	<u>(In percent of GDP)</u>				
Fixed investment	18.0	20.0	22.0	24.0	26.0
Foreign savings	2.5	2.8	3.0	3.5	3.9
Domestic savings	15.5	17.2	19.0	20.5	22.1
I. <u>Private savings balances required under the authorities current fiscal program</u>					
Public savings	-2.7	-1.8	-1.3	-0.8	-0.3
Private savings	18.2	19.0	20.3	21.3	22.4
Central Government					
Revenue	25.8	26.0	26.0	26.0	26.0
Expenditure	31.0	30.5	30.0	29.5	29.0
Current primary	22.4	21.6	21.2	20.9	20.9
Interest outlays	6.1	6.2	6.1	5.9	5.4
Capital	2.5	2.7	2.7	2.7	2.7
Balance	-5.2	-4.5	-4.0	-3.5	-3.0
Debt stock (face value)	55.4	53.8	52.1	50.1	48.0
Real interest rate (in percent)	5.6	5.6	5.6	5.6	5.6
II. <u>Public and private savings balances under a structural program</u>					
Public savings	-2.7	-0.8	0.2	1.2	1.2
Private savings	18.2	18.0	18.8	19.3	20.9
Central Government					
Revenue	25.8	26.0	26.0	26.0	26.0
Expenditure	31.0	29.5	28.5	27.5	27.5
Current primary	22.4	20.7	20.0	19.5	20.1
Interest outlays	6.1	6.1	5.8	5.3	4.7
Capital	2.5	2.7	2.7	2.7	2.7
Balance	-5.2	-3.5	-2.5	-1.5	-1.5
Debt stock (face value)	55.4	52.8	49.8	46.0	42.8
Real interest rate (in percent)	5.6	5.6	5.0	4.5	4.0

with the savings shifted to infrastructure improvements. In the area of healthcare, there may be a need for more resources, and this is being addressed, in part, through the RDP. There may also be further scope to shift resources away from military expenditure and toward police and judicial services.

One area of expenditure that stands out as a drain on budgetary resources and that distorts private sector decision-making is subsidies. Also, certain nonessential economic services could be reduced or eliminated. While certain consumer subsidies may be justified on social welfare grounds, business subsidies are generally unwarranted. Appendix III of this chapter contains a list of subsidies to private sector firms that could be cut or eliminated in amounts consistent with the fiscal strategy set out in the lower panel of Table 16.

In summary, the current fiscal strategy of the authorities is sufficient to avoid a public-debt trap, but insufficient to generate sufficient domestic saving to fund a rise in investment of 8 percentage points of GDP by the turn of the century. Fiscal adjustment will thus form a central element of the structural reform effort to stimulate private saving, growth, and employment.

Primary Balance and a Declining Debt-to-GDP Ratio

The relationship between the overall fiscal position and changes in the stock of debt can be stated as follows:

$$D_t = G_t + D_{t-1}, \quad (1)$$

where:

D_t = the face value of the stock of debt at the end of period t , and
 G_t = the government deficit in period t .

More substantively, eq. 1 can be rewritten as:

$$D_t = -PS_t + i * ((D_t + D_{t-1}) / 2) + D_{t-1}, \quad (2)$$

where:

PS_t = the primary surplus in period t ,
 i = the nominal interest rate, and the second term is the interest bill in period t .

Generating the sufficient condition for a decline in the stock of debt as a percentage of GDP is most easily discerned by first finding the condition under which the debt-to-GDP ratio remains constant. By definition, a constant ratio of debt-to-GDP implies that:

$$D_t = (1+g) * D_{t-1} \quad (3)$$

where:

g = the growth of nominal GDP.

Substituting eq. 3 into eq. 2 and collecting terms yields:

$$PS_t = D_t * ((i-g)/(1+g) + (i*g)/(1+g)). \quad (4)$$

Rewriting eq. 4 in terms of proportions of GDP yields:

$$ps_t = d_t [-] 1 * ((i-g)/(1+g) + (i*g)/(1+g)) \quad (5)$$

where: $ps_t = PS_t / GDP_t$, and
 $d_{t-1} = (D_{t-1}) / (GDP_{t-1})$.

The first factor on the right-hand side of eq. 5, $(i-g)/(1+g)$, is the real interest rate in terms of nominal GDP. Thus, to maintain a constant debt-to-GDP ratio, the primary balance as a percentage of GDP must cover the real interest bill. The second term is the standard differential growth term that in many analyses is assumed to be second-order small and, therefore, ignored. However, in the case of South Africa, this interest growth term is almost equal to the real interest factor and, thus, cannot be assumed away. Eq. 5 implies that the debt-to-GDP ratio falls (rises) when the primary surplus is larger (smaller) than the real interest bill plus the growth factor in the interest bill.

Under present circumstances and forecasts for beyond 1996/97, $d_{t-1} = 0.56$, $g = 0.1124$ over the medium term, and i can range from 0.128-0.14. Substituting these parameters into eq. 5 yields a range for ps_t of between 0.015-0.20. Therefore, a sustainable fiscal position requires a primary balance of 1.5-2 percentage points of GDP. Under the authorities' stated objectives, the primary balance will reach 1.7 percent of GDP in 1997/98 and over 3 percent of GDP by the turn of the century.

The Behavior of Public and Private Saving in South Africa

The analysis of the relationship between private and public saving in South Africa follows a study done by Corbo and Schmidt-Hebbel. 1/ In this research, the authors sampled 13 developing countries over the period 1968-1988 to analyze the impact of public saving on private saving. 2/ The authors first sought evidence for the existence of conditions for strict Ricardian equivalence. They reported that while there was evidence that some private agents do not face liquidity constraints, fiscal policy has a role in raising overall domestic saving as certain agents are not able to smooth out their consumption paths in a perfect manner. 3/ The second stage of their analysis was to see the effect of public saving on private saving. The model they employed of the determinants of private saving is:

$$P_t = b_0 + b_1 P_{t-1} + b_2 PDY_t + b_3 PS_t + b_4 RI_t + b_5 CPI_t + b_6 W_t + b_7 FS_t + e_t \quad (1)$$

where:

- P_t - private saving as a percent of disposable income at time t; 4/
- PDY_t - permanent disposable income (measured as the trend disposable income) as a percent of current disposable income at time t;
- PS_t - public saving at time t (measured in one regression as current public saving in line with a Keynesian analysis and in a second as a three-year forward-looking average as a proxy for permanent public saving) as a percent of disposable income;
- FS_t - foreign saving as a percent of disposable income at time t;
- RI_t - real interest rate at time t;
- W_t - private wealth as measured by a broad monetary aggregate as a percent of disposable income at time t; and
- CPI_t - domestic inflation at time t.

The authors found that raising public sector saving raises overall domestic saving ($b_3 > -1$), while the impact of interest rates and inflation on saving rates is minimal. The stock of wealth does appear significant but

1/ Corbo, V. and Schmidt-Hebbel, K., "Public Policies and Saving in Developing Countries", Journal of Development Economics, Vol. 36, 1991, pp.89-115.

2/ The authors carried out both individual country least squares estimations and a panel estimate.

3/ This is consistent with other studies that reject the notion of the Ricardian equivalence in developing countries. See Montiel, P. and Haque, N.U. Ricardian Equivalence, Liquidity Constraints, and the Yari-Blanchard Effect; Tests for Developing Countries, IMF Working Paper, 1987.

4/ Data is scaled to income to mitigate the problem of nonstationarity of the time series.

with the opposite sign as expected. Foreign saving, however, do substitute strongly for domestic saving.

Finally, the authors tested the sensitivity of private saving to improvements in public saving generated by tax increases and expenditure reductions. They found that if public saving is increased 1 percentage point of GDP through a reduction in public expenditure, private saving will be reduced by 0.16 or 0.50 percentage point of GDP depending upon the model specification of the expected permanence of the increase in government saving. If public saving is increased 1 percentage point of GDP through a hike in taxes, private saving will be reduced by 0.48 or 0.65 percentage point of GDP depending upon the model specification of the expected permanence of the increase in government saving.

These results are basically at the lower end of the spectrum regarding the offset factor for developing countries. Masson, Bayoumi, and Samiei (1995) found in a sample of 40 developing countries that a one percentage point of GDP rise in public saving is offset by a 0.66 percentage point of GDP decrease in private saving and an even higher offset of 0.94 percentage point of GDP for a subset of high-income developing countries. 1/ Savastano found in a sample of developing countries with Fund-supported programs that a one percentage point of GDP rise in public saving is offset by a 0.70 percentage point of GDP decrease in private saving. 2/

The model of saving being used builds on the work of Corbo and Schmidt-Hebbel and is as follows:

$$P_t = C + b_1 G_t + b_2 FS_t + b_3 RPG_t + b_4 TOT_t + b_5 ACT_t + b_6 RI_t + b_7 W_t + b_8 DISC_t + b_9 APART + e_t \quad (2)$$

where:

- P_t - private saving as percent of GDP;
- G_t - public saving as a percent of GDP;
- FS_t - foreign saving as a percent of GDP;
- TOT_t - nongold terms of trade;
- ACT_t - an index of real activity in South Africa's main trading partners;
- W_t - proxy for the stock of wealth (Johannesburg stock market index);
- RI_t - real interest rate;
- $DISC_t$ - financial rand discount;

1/ Masson, P., Bayoumi, T., and Samiei, H., "International Evidence on the Determinants of Private Saving", IMF WP/95/51, May 1995.

2/ Savastano, M., "Private Saving in Fund Arrangements", Schadler, et. al., IMF Conditionality Review, OP 129, September 1995.

$APART_t$ = dummy variable with value 1 when international sanctions were operative;

RPG_t = the real price of gold; and

C = constant.

$DISC_t$ and $APART_t$ included to measure the impact of risk on saving behavior: country risk in South Africa should be captured through the financial rand discount and the imposition of official sanctions. The real price of gold is included as an explanatory variable because of the potential impact on corporate saving in the mining sector. Saving rates are scaled in terms of GDP (not disposable income) since the analysis is in terms of total private saving, including corporate saving. Wealth is measured by the Johannesburg stock market index rather than a broad monetary aggregate, and the nongold terms of trade is included as an explanatory variable (again in reflection of the inclusion of corporate saving).

Preliminary work found several of the explanatory variables not significant and these were dropped from the final regressions. The results reported below are for the following restricted model:

$$P_t = C + b_1 G_t + b_2 FS_t + b_3 RPG_t + e_t$$

The time series for these variables cover the period 1961-1994 and were tested for stationarity and cointegration. The data were tested for stationarity using Augmented Dickey-Fuller (ADF) tests. Stationarity was accepted at the 5 percent significance level only in the case of real interest rates. 1/ However, bivariate tests for cointegration revealed that all the explanatory variables cointegrated with private saving. 2/ In this circumstance two sets of OLS regressions were run. First, given that the series cointegrated, the long-term relationship between private and public saving described in equation 3 was analyzed using a simple OLS regression model (with data corrected for first-order autocorrelation using a Cochrane-Orcutt transformation). 3/ The results are presented in Table 17.

1/ Tests at the 1 percent level would reject stationarity

2/ Tests on foreign savings were inconclusive at the 1 and 5 percent significance levels.

3/ For a full treatment of the issues of stationarity and cointegration see, C.W.J. Granger, "Some Properties of Time Series Data and Their use in Econometric Model Specification," Journal of Econometrics, Vol. 16, No. 1, 1981, pp. 121-130, and R.F. Engle and C.W.J. Granger, "Cointegration and Error Correction: Representation, Estimation and Testing," Econometrica, Vol. 55, No. 2, 1987, pp. 251-276.

Table 17. South Africa: OLS Regression Results for Saving Model

(Data corrected for first-order autocorrelation)

	Coefficient	T-stat
<u>Restricted model</u>		
G	-0.6043	3.15
FS	-0.1549	2.24
RPG	0.0039	4.87
CONSTANT	0.2673	8.35
R Bar Squared:	0.4422	
DW (1):	1.8475	
Sum of Squares:	0.0086	

The offset in private saving from a one percentage point of GDP increase in public saving in this case is 0.60 percentage point of GDP in private saving, and public saving was statistically significant. 1/

In the second regression, as the data was nonstationary, it was first differenced to remove trends that allowed for testing of the shorter-term dynamics between public and private saving. 2/ In this case a one percentage point of GDP rise in public saving was offset by a decline in private saving by 0.69 percentage point of GDP, and public saving was again significant (Table 18). 3/ The larger short-term offset factor may be

1/ In previous work done by FAD staff in this area, it was found that most of the offset was generated in corporate saving, while household saving behavior was generally unresponsive to changes in public savings. Moreover, corporate savings were strongly correlated (negative) with real wages. the latter was not included in the model as the series does not begin until 1970.

2/ the first-differenced data were stationary under ADF tests.

3/ Vector autoregressions (VARs) were run on the restricted model (first-differenced data) with public savings, foreign savings, the real price of gold, and private savings treated as endogenous variables; however, the VARs did not improve upon the explanatory power of the simpler OLS regressions. Also, regressions were run with proxies for distinguishing between permanent and transitory income and policy shocks in line with the work of Corbo and Schmidt-Hebbel (1991) and other literature in this area; however, the results were not robust.

reflecting that liquidity constraints are stronger in the short run than in the long run.

Table 18. South Africa: OLS Regression Results for Saving Model
(First-differenced data)

	Coefficient	T-stat
<u>Restricted model</u>		
G	-0.6859	2.71
FS	-0.1851	2.77
RPG	0.0035	4.20
CONSTANT	0.0001	0.04
R Bar Squared:	0.4260	
DW (1):	2.1980	
Sum of Squares:	0.0107	

Possible Subsidy Reduction Program

Projected Cost in 1995/96 (Percent of GDP)

Subsidies to be eliminated by 1997/98:	0.99
Trade and Industry	0.79
Export promotion	0.47
Regional industrial development programs	0.32
Agriculture and Water Supply	0.08
Agricultural Corp. interest subsidy	0.04
Fodder subsidy	0.01
Land Bank subsidies	0.01
Other	0.02
Other programs	0.12
ARMSCOR	0.09
Film industry & Restaurants	0.01
Consumer affairs	0.02
Subsidies to be eliminated in 1998/99:	0.25
Nuclear energy	0.24
Water works	0.01
Subsidies to remain:	0.31
Manpower (mainly disability programs)	0.006
Housing	0.06
Nuclear safety	0.002
Transportation (rail and bus)	0.24

VI. Narrow Monetary Aggregates

For some years, the South African Reserve Bank has announced guidelines for broad money, M3, ^{1/} as part of its apparatus for executing monetary policy. These guidelines were supplemented in 1995 by bank-by-bank guidelines on the growth of credit to the private sector.

The M3 guidelines were substantially overshot in 1994, and both guidelines were overshot in 1995. But even as the official guidelines were being substantially breached, underlying inflation has remained under control and indeed has fallen in the latter part of 1995. This experience is compounded by inflation expectations--implicit in long bond yield differentials--through 1995 which indicated that inflation was anticipated to remain subdued, and even fall. To this extent, market participants implicitly rejected the view that the high growth rates of broad money and credit to the private sector, that have been sustained for a considerable period of time, presaged renewed inflation (see Chapter I). The implication is that market participants doubt the usefulness of these aggregates as indicators of inflationary pressures.

This chapter focusses on one set of issues arising from this, namely the possible role of narrow monetary aggregates in the monetary policy framework. This focus is motivated both by the absence of published academic research in this area on South African data and by the prominent role of similar aggregates in the monetary arrangements of a number of other countries. This chapter does not attempt a formal study of the nominal anchor issue. Such a study is simply not possible given the limited formal research on both narrow and broader aggregates and on the behavior of inflation in South Africa. Instead, this discussion highlights a number of issues concerning the narrow aggregates that may be more fully pursued in further research.

Accordingly, the approach is exploratory rather than definitive. The findings suggest that there may be grounds for a greater use of narrow money aggregates in the monetary policy framework than at present because narrow aggregates appear to meet the twin requirements of a nominal anchor: the demand for narrow money has identifiable components, and there is initial evidence that this aggregate is a leading indicator of inflation. However, this does not imply that narrow money can or should be used for operational purposes in the design of monetary policy in its current form now. As currently measured, it exhibits a high degree of volatility which greatly diminishes its information content. But in view of its inflation predicting properties, consideration might be given to addressing this measurement issue directly.

^{1/} This comprises notes and coin in circulation outside the banks, cheque and transmission deposits, short-, medium-, and long-term deposits with the banks.

1. Selection criteria for a nominal anchor

In the context of a floating exchange rate regime, such as applies in South Africa, there are two basic requirements that a nominal anchor should meet: its behavior should be explained by a relatively limited number of factors and should be stable over time with respect to these factors; and it should have demonstrated leading indicator properties of the nominal variable--in particular, inflation--that is the ultimate goal of monetary policy.

If either test is failed, the candidate should be rejected. This dual criteria is intuitive. If the anchor lacks a stable relationship with a few variables (such as interest rates), its behavior cannot be explained, so policymakers cannot know what actions to take to ensure that the anchor remains within a desired target range. But even if its behavior is stable with regard to a few key variables, it would still fail as an anchor if it was not a leading indicator of inflation.

The specific choice of target variable is also critical. While public discourse generally focusses on the headline consumer prices index (CPI), there may be good reasons for monetary policy to focus on a different measure of inflation. The CPI can be affected by changes to indirect taxes, temporary shocks to some of its major components such as food prices, or the way in which housing mortgage costs are reflected in it. The SARB calculates--but does not publish--a measure of "underlying" inflation which corrects for these factors. Other possibilities might be the GDP deflator (though that is only published quarterly and with a longer lag than the CPI), the Producer Price Index, or the domestic demand deflator.

Alternatively, it might be argued that some combination of growth and inflation should form the ultimate target of monetary policy. The implications of this are not pursued here, in part because there is no strong evidence in South Africa of a long-run tradeoff between inflation and output variables. ^{1/}

It is conceivable that no single aggregate or combination of aggregates meets both criteria for selection. In such extreme cases, there would be no guide as to how to hit the inflation target, because there would be no leading indicators of inflationary pressures. This might form a basis for targeting inflation directly, without specifying intermediate targets for other variables. But even those countries that target inflation generally supplement their inflation targets with specific intermediate targets, e.g., M0 and M4 in the UK.

Research into aggregates that might be used for intermediate targets in South Africa is limited. It is certainly insufficient to form the basis of

^{1/} See Pretorius and Smal.

a case for an explicit inflation target rooted in the lack of an intermediate target that pass both the selection criteria noted here.

2. Reserve money

One of the potential nominal anchors that has received little attention in South Africa currently is reserve money, despite the focus on this aggregate internationally. This section discusses preliminary econometric analysis of the demand for, and inflation predicting qualities of, reserve money in South Africa.

a. Which parts of reserve money?

Chart 14 breaks down reserve money into its various components--cash outside banks, required reserves with the SARB, excess reserves with the SARB, and cash in till--all reported in constant prices. This exercise is intended to highlight which parts of reserve money are responsible for the principal movements in the aggregate as a whole. ^{1/} The chart shows that required reserves have changed markedly, notably between 1979 and 1982 when they were raised as part of the attempt to sterilize the inflows emanating from the gold price boom of those years. These changes clearly do not reflect market-based demand for reserve money, but rather the policy decisions of the authorities, and so they should be excluded from consideration of the potential role of reserve money as a nominal anchor.

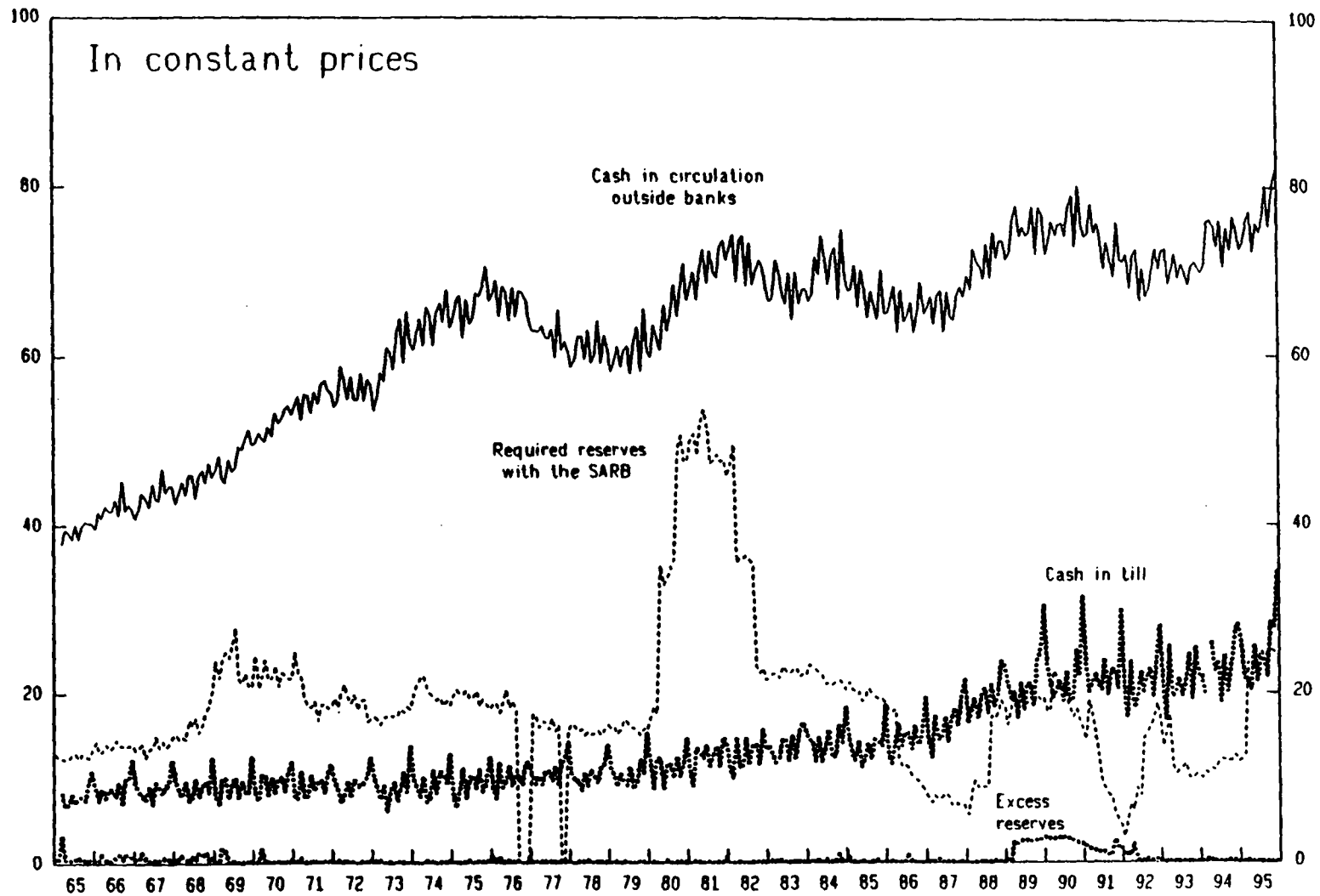
It is debateable whether or not cash in till should also be excluded. The evidence from the chart might suggest that in South Africa's case, it might be excluded because its trend is so stable. But in addition, changes in that trend would be expected to reflect, at least in part, shifts in banking technology, such as changes in the average distance between bank branches and the nearest SARB cash-distributing branch--i.e., factors that will in general have little to do with inflation.

Excess reserves have commonly been a small portion of reserve money, except from 1989 to 1992, when they were temporarily boosted through a forex scheme in which banks were required to maintain balances with the SARB in order to participate in the scheme. Thus, such excess balances might be excluded from study also.

On these grounds, the component of reserve money on which this chapter focuses is cash in circulation outside the banking system. However, this selection is one of the areas where further study would be warranted to

^{1/} The definition of reserve money may also be extended to include liabilities of the Corporation for Public Deposits, as is the case for data reported in IFS. This extension is not considered here, but could be added in future research.

CHART 14
SOUTH AFRICA
COMPOSITION OF RESERVE MONEY, 1965-95



Source: South African Reserve Bank.

identify whether the results of the tests noted in this chapter would be substantially altered by the addition to cash outside banks of one or all of the parts of reserve money excluded here.

An immediate concern with this aggregate is that its demand may be unstable because it is such a close substitute to noninterest bearing deposit accounts held with banks. Chart 15 shows that while the share of notes and coin outside banks in M1 changes over time, its volatility is perhaps surprisingly low. Thus, it is not immediately obvious that the attempt to estimate the demand for cash outside banks formally is ill-fated.

b. Identifying the scale variable

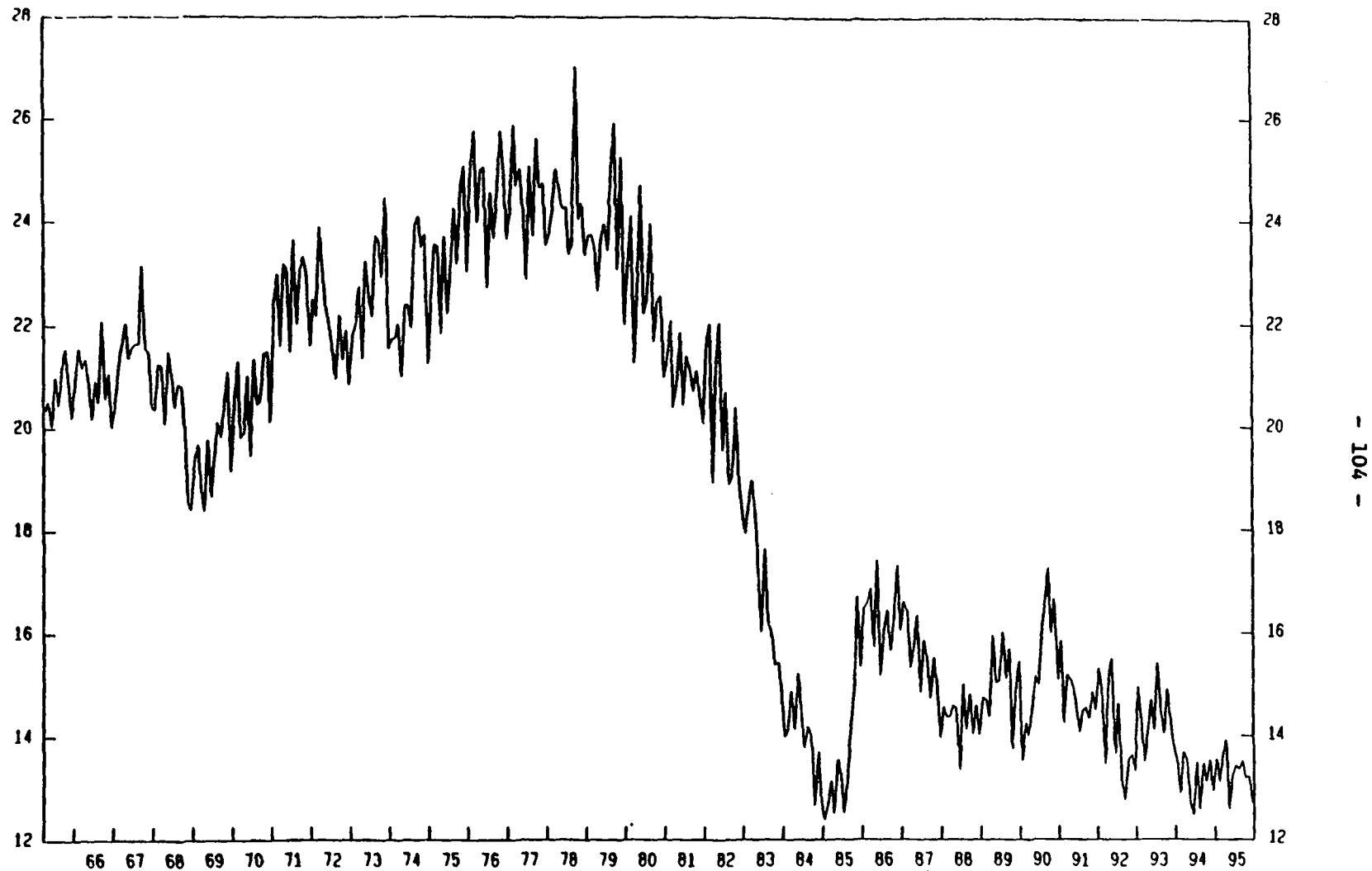
The first task was to identify the correct scale variable, i.e., the variable which fundamentally determines the demand for cash in South Africa, as opposed to a variable--such as GDP--that is used to define its velocity. One approach to this task would be to complete a direct survey of households to identify the sources of cash they hold--pay packets, ATMs, etc--and the uses to which that cash is put, such as for retail purchases, spontaneous retail purchases, debt service, purchases by companies, etc. However, such survey data is not available in South Africa.

Accordingly, econometric techniques form the only means of identifying the scale variable. The standard approach to this is to identify a long-run cointegrating vector, using the Johansen technique (See Johansen). The approach employed embodies two simple tests: first, it identifies if there is some linear combination of the series--for cash in circulation, the scale variable being tested, and other series used in the test which might account for changes in cash holdings relative to the scale variable--which yields an error series that is stationary; and second, it checks whether or not the estimated parameters that yield the stationary error series are "sensible". Unless both tests are passed, the variable being studied is unlikely to be the correct scale variable.

Four potential candidates for the scale variable for notes and coin in circulation outside banks were considered: retail sales, GDP, private consumption, and private nondurable consumption. Chart 16 shows the behavior of notes and coin in circulation outside banks relative to these aggregates. In all cases bar retail sales, these series compare the quarter average for cash outside banks to the scale variable.

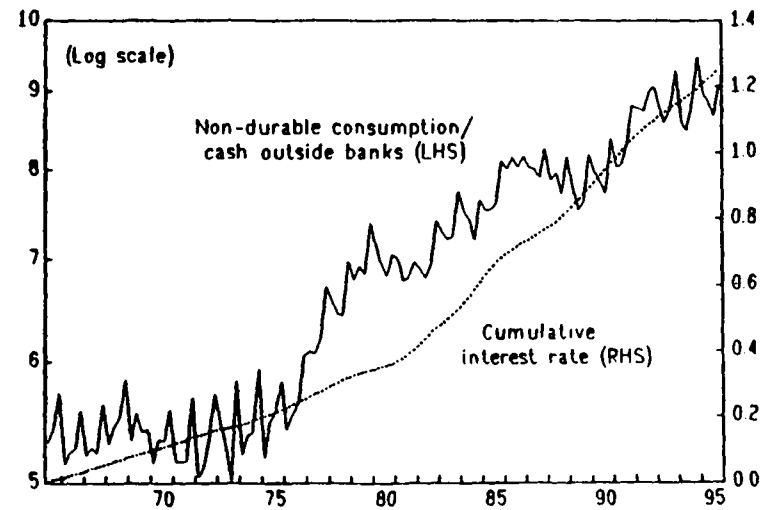
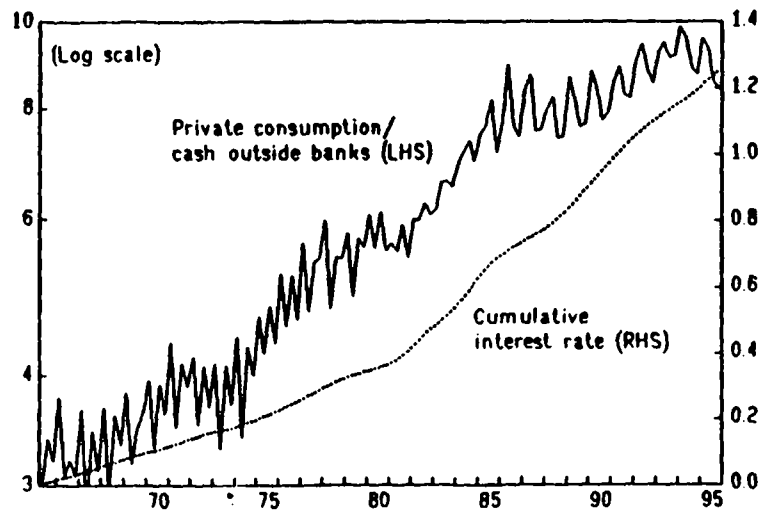
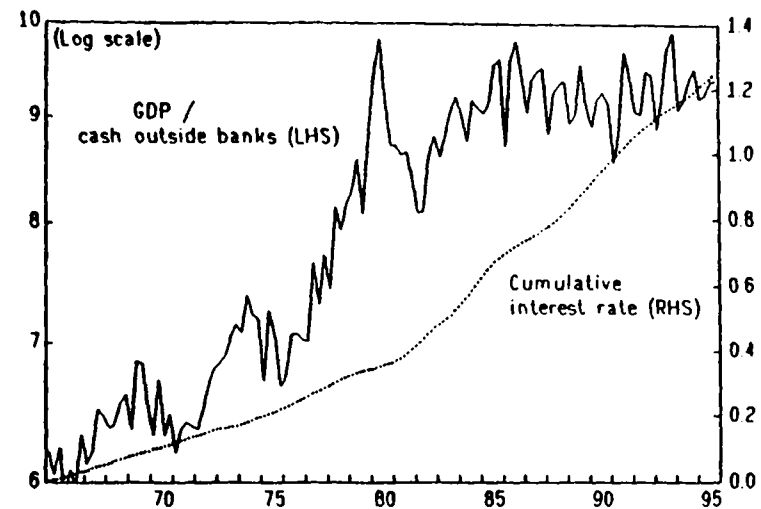
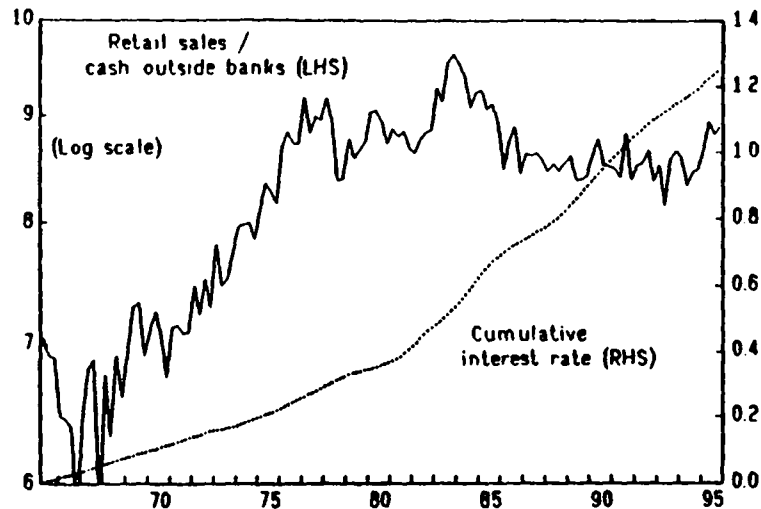
The chart shows that these series behave very differently: there is a steep jump in the ratios of nondurable consumption and GDP to cash outside banks from the mid-1970s, with no change in trend in this period in the ratio for retail sales and a slight change for private consumption. The ratios for private consumption and nondurable consumption continue to rise in the 1980s, while those for retail sales and GDP flatten, and even fall somewhat in the case of retail sales.

CHART 15
SOUTH AFRICA
SHARE OF NOTES AND COIN OUTSIDE BANKS IN M1, 1965-95



Source: South African Reserve Bank.

CHART 16
SOUTH AFRICA
VELOCITY OF NOTES AND COIN OUTSIDE BANKS, 1965-95



Source: South African Reserve Bank.

These differences may be critical to the assessment of the econometric results, and the subsequent discussion of those results refers back to them.

(1) Structural breaks in notes and coin

However, these ratios may be distorted by shifts in the demand for rand cash outside South Africa as the Common Monetary Area countries began to issue their own currencies to circulate alongside the rand, and thus replace it to some extent. These developments represent structural breaks in the series for cash in circulation outside South African banks.

An attempt was made to correct for these breaks. The stock of nonrand cash in circulation in the CMA was taken from IFS. This showed that by the late 1980s, it was equivalent to a little under 3 percent of rand in circulation outside the South African banks. The first point to note is that this ratio is low, and so the structural breaks implied by the introduction of these currencies are not substantial. Nevertheless, the formal cointegration tests were conducted on a break-adjusted series, which corrected for these breaks.

It was not possible, however, to correct for all the breaks in this series, since there may also have been shifts in the demand for rand cash held outside the CMA. It is not clear, however, when shifts in this source of demand for rand were most likely to have taken place, or how large such holdings were (or are) relative to the total rand outside South African banks. Rand currency is used in the region as a means of settlement, even though this breaches CMA foreign exchange regulations, but precisely because of their legal status, information about this stock is anecdotal only. Accordingly, no attempt was made to adjust for these breaks in the series.

(2) Cointegration tests

The cointegration tests were carried out as follows. The break adjusted quarter average series for cash outside banks was seasonally adjusted, and deflated by the deflator for the scale variable being tested--the GDP deflator for GDP, the nondurables deflator for nondurable consumption, etc. The constant price seasonally adjusted scale variable constituted the second series. The data period is from 65:q2 to 95:q4. A VAR lag length of 4 periods was used throughout.

The tests for retail sales were complicated by the lack of the retail sales deflator. The consumer prices index was used as a proxy for this.

A further series was used in each test, a cumulative interest rate term. The motivation for including this series is that it may constitute a useful indicator of shifts in the demand for cash relative to its scale variable. The argument is that the demand for cash not only reflects the opportunity cost--the interest forgone--but also reflects fixed "entry" costs into the banking system. Potential depositors, who may be unfamiliar with banks, may not open bank accounts while nominal interest rates are low

because the entry costs of acquiring that familiarity and committing the minimum balance to open a bank account are prohibitive relative to the benefits. But once nominal interest rates rise sufficiently, and are expected to stay at those levels for a sufficient time, it becomes worthwhile for potential depositors to incur those entry costs. This implies that if nominal interest rates rise to historically exceptionally high levels, and then fall back to their historical norms, that the demand for cash will be lower afterwards for given nominal interest rates. The cumulative t-bill rate was used as proxy for this "ratchet" feature of behavior, a proxy that has been used with considerable success in models of long-run demand for M0 in the UK. ^{1/} The results of the tests are shown below:

Table 19. Quarterly Model of Notes and Coin: Long-run Relationships

Scale Variable	No. of co-integrating vectors	Parameter on the scale variable	Parameter on Cumulative T bill	Chi-sq test on scale ^{2/} variable
Personal consumption	1	0.869	-0.61	1.29
Nondurable consumption	1*	1.279	-0.429	0.40
GDP	1	0.284	0.479	8.49
Retail sales	2	0.539 1.421	0.007 0.441	16.26

* The co-integration results were weak, just below the 90 percent confidence interval.

The tests show that only private consumption cointegrates with "sensible" parameters, i.e., parameters on the scale variable that can be constrained to 1, with the parameters on the cumulative interest term also correctly signed. This suggests that it is the relevant scale variable.

However, this result should be interpreted with caution. Referring back to Chart 16 above, private consumption may be being identified by this test as the scale variable because the change in the ratio of cash outside

^{1/} Hall et al. (1989), and Brendon and Fisher (1992).

^{2/} The Chi-squared test assesses if the parameter equals 1.

banks to it changes less in the late 1970s than it does for either nondurable consumption or GDP.

But these developments may be reflecting the relaxation of the regime of direct controls on the banking system--though many controls were not actually withdrawn totally until the early 1980s--and no account is taken of these developments in the testing procedure described.

This regime shift may have reduced the demand for cash relative to its (true) scale variable. Possible reasons for this include increased returns on bank deposits relative to cash holdings due to falling banking spreads, and decreased credit rationing, raising the benefit to prospective borrowers of relationships with banks as depositors to strengthen their credit standing with those banks. However, the effect on demand for cash of the change in the control regime could equally go the other way, if the termination of credit rationing diminishes the need for a relationship with a bank as a depositor prior to borrowing from it.

The issue here is whether or not a regime of direct controls substantively affects the demand for this particular monetary aggregate, whatever its effects may have been on the demand for other aggregates. This is fundamentally an empirical issue. However, identifying such effects is problematic because there is no readily available proxy for the degree to which the control regime was binding at different times. In this light, studies of the demand for cash in circulation could take one of two approaches to these difficulties: either they could discard all control-era data on the grounds that these may be distorted by unmeasurable effects of the control regime, or they could assert that since a cointegrating relationship has been found for a scale variable that encompasses both the direct control and indirect control eras, that this relationship should be the preferred one.

The difficulties with the first option are that the remaining 15 years of data--from 1980 to 1995--provide insufficient degrees of freedom to distinguish between the various options for the scale variable, and that there are well-known econometric reasons for attempting to model structural breaks where they occur, rather than simply discarding data around them. The difficulty with the second option is that the presumption cannot be independently tested that the control regime had at most a minor effect on the demand for cash, whatever its effects on the demand for other banking aggregates may have been, due to the absence of a good measure of the impact of the controls on the demand for cash. This study will take the second option, on the basis that other studies of demand for cash in economies which shifted from controlled to liberalized regimes have done so without having to model the impact of the control regimes on the demand for cash, carrying the implication that the impact of such regimes on demand for this particular monetary aggregate is limited in practice.

To summarize, there is some evidence that the demand for notes and coin in circulation--break adjusted--can be successfully estimated, with sensible

parameter estimates, though as noted, there are a number of avenues that future research could develop to enrich and verify this finding.

Further development of this work would include the estimation of a short-run model of the demand for cash. This is not reported here. The principal reason is that, as discussed below, the way notes and coin in circulation outside the banking system is measured imparts a high degree of volatility to the monthly (and even quarter average) data. This makes an attempt to estimate a short run model somewhat redundant.

c. Inflation predicting properties

The second criterion for identifying a nominal anchor concerns its leading indicator properties. This section reports the results of initial tests of this for break-adjusted cash in circulation outside banks.

The test is conducted in the form of a simple VAR. The dependent variable was the 1-quarter change in the 4-quarter growth rate of the unadjusted CPI. The explanatory variables tested were 4 lags of this same variable, and 4 lags of the 1-quarter change in the 4-quarter growth rate of cash in circulation outside banks. This test simply identifies whether rising annual rates of growth of cash in circulation are followed by rising annual rates of inflation.

This VAR was then tested down, eliminating the insignificant lags of both explanatory variables, using an F-test to establish whether or not the variable deletions were accepted. Deletion of all the lags on cash in circulation lags were accepted by the F-test except that for the first- and fourth-quarter lag. These deletions were rejected at the 1 percent confidence level. This implies that if the four-quarter growth rate of cash in circulation is rising, then inflation will tend to rise in the following quarter, and four quarters later. This constitutes preliminary evidence that this aggregate is a leading indicator of inflation.

However, there are several issues that ought to be addressed in future research into the leading indicator properties of cash in circulation outside banks. One would be to examine the inflation predicting properties of cash in circulation against the SARB's measure of underlying inflation. A further development would be to test the stability of this finding across a greater number of sub-periods--the structural break test used in this study simply breaks the data set into two, and checks that the parameters are stable across the two sub-sets, but this sub-division could (and should) be considerably extended. It might be interesting to check if the relaxation of monetary controls in the early 1980s affects these leading indicator properties. Third, the test could be carried out testing down from a larger VAR, in which cash in circulation was one of several alternative indicators whose inflation predicting features was being considered. This test would help to identify whether cash in circulation was a better predictor than other indicators, or whether some combination of

cash in circulation and other indicators yielded a superior inflation predictor.

The findings reported here suggest that there are grounds for a closer study of cash in circulation from the perspective of its use in a nominal anchor framework: the results are certainly not sufficient to establish the case for it as a principal element of the monetary regime now.

3. Measuring cash in circulation outside banks

One issue that would have to be considered further is the fact that the aggregate currently has a high monthly volatility. This high noise-to-signal ratio in the aggregate is clearly problematic, not least for the tests reported above.

However, this problem appears to derive from the way it is measured. Currently, it is measured at the last working day of each month. But since the daily fluctuations in this aggregate are large, this measurement practice obscures its signal content. The results reported here attempted to tackle the problem by using quarter average data--that is the average on the last working day of each month in a quarter--but this is only partially successful in enhancing the information content of the variable.

A better means of increasing the information content may be to measure it as a within-month period average--say an average of the Fridays of each month, or an average of all days in the month. This approach is taken to the measurement of notes in circulation outside the SARB, ^{1/} and in this case, it is clear that virtually all of the monthly volatility is eliminated from that series. If further study of the characteristics and behavior of notes and coin in circulation outside the banking system, as suggested above, supports the initial findings reported here, then there might be a case for remeasuring this on a within-month period average basis, and repeating the tests on that data to check once again that the findings are robust to this change in measurement technique. If so, then a strong case might be made for the aggregate to be given greater prominence in the monetary policy structures for South Africa.

4. Conclusion

The results reported here provide preliminary evidence that notes and coin in circulation meet the two key criteria for a nominal anchor: demand for cash appears to be determined principally by private consumption, and movements in cash appear to have leading indicator properties of inflation.

However, further research is necessary to develop and verify these findings, to confirm their robustness, and to measure the performance of other aggregates, including those used more prominently currently such as

^{1/} Series 1392m on p S-25 in the March 1996 SARB bulletin.

broad money and credit to the private sector, in a similar manner so that an informative comparison may be made. But these results suggest that narrow aggregates may be worthy of further consideration, and that they may ultimately warrant a more prominent role in the monetary arrangements in South Africa than at present.

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VII. Mining Taxation

1. Introduction and background

The taxation of the mining industry has been the subject of several reviews over the last decade, notably a comprehensive review by the 1987 Commission of Inquiry into the Tax Structure (the Margo report) and the subsequent report by the Technical Committee on Mining Taxation (the Marais Committee) in 1988. The Minerals Act of 1991 introduced a number of important changes to the structure of the mining industry, particularly with regard to the treatment of mineral rights. A major government review of minerals and mining policy is now refocussing attention on the system of mineral rights and mining taxation, with the aim of establishing a new policy framework for the mining industry.

This review occurs in a context of decline in the gold industry: annual gold production has dropped from around 670-680 tons in the mid-1980s to a current level of just more than 520 tons and employment has fallen by 25-30 percent from a peak of more than 560,000 in 1987 to a current level of around 400,000. A significant part of gold production is marginally viable at current gold prices, investment has declined sharply, and the conditions necessary for investment in an expansion of productive capacity--reportedly a gold price of US\$600 per fine ounce--are unlikely to be realized in the near future. In sum, the gold mining industry is considered to have moved into a "mature" phase during the last decade, and despite substantial underground reserves, is facing the prospect of entering into a "declining" phase in the next. Other sectors of the mining industry--notably coal and platinum production--have flourished. However, it is the drop in gold production, which has set the tone for debates concerning mining policy.

This chapter outlines the key features of the mining taxation system, including some of the major changes in recent years, and assesses the main arguments in the ongoing debate over mineral tax policy. In particular it seeks to address two issues: (i) was the decision taken in 1991 to forfeit a charge on the right to mine minerals consistent with the new Government's strategy of promoting a more outward-oriented economy; and (ii) are there structural features peculiar to mining which justify a separate structure of income taxation. The Chapter argues that there is a strong case for reforming the taxation of the mining sector, to reduce the distortions in the allocation of resources and facilitate the structural change toward nonmineral export production. It leaves open the question of whether the reform of mining taxation should be revenue neutral or result in higher revenue for the Government, but there would generally be a preference for the former given the Government's commitment to avoid any higher increase in the tax burden.

2. Mineral rights

There are four basic categories of mineral rights: (i) mineral rights with respect to tribal land (owned by the state or the relevant tribes);

(ii) mineral rights owned by the state; (iii) mineral rights owned by the mining companies; and (iv) mineral rights owned by the surface owners, in those instances where mineral rights have not been severed from the ownership of the land. 1/ The Department of Energy and Mineral Affairs estimates that approximately two thirds of the prospecting licenses (by surface area) are for mineral rights held by the private sector.

However, prior to passage of the 1991 Minerals Act, ownership of mineral rights did not confer the right to mine precious stones, precious metals, or oil: those rights were vested in the state. 2/ To mine such minerals a mining company had, in addition to securing the mineral right, to obtain a government lease. The lease in turn specified a profit sharing arrangement which was calculated according to a formula, very similar to that of the current gold tax formula.

In early 1988, the Marais Committee 3/ recommended that future mining projects should not be subject to mine leases and that the existing leases should be phased out. It acknowledged that minerals constituted part of the national patrimony--and that therefore there were grounds for compensation to be paid to the state for extraction--but believed that the "objectives of ensuring continued investment in mining and maintaining the industry's international competitiveness should enjoy priority over the patrimony argument." 4/ More specifically, the committee argued that as "the mineral resource base...must be actively maintained through exploration and investment...it is unwise to discourage this process by imposing additional taxes [over-and-above income tax]." 5/

The initial response of the Government of the day to this recommendation was not favorable. The 1989/90 Budget Review makes clear that the Government was "very conscious of the fact that the mines were reducing the country's mineral wealth" 6/ and should therefore bear an additional taxation burden. The Government was also concerned that the revenue loss

1/ Mineral rights can be separated from the ownership of the land and be registered separately.

2/ The right to mine other minerals was vested in the owner of the mineral right.

3/ The committee had been established to investigate a number of the proposals emerging from the Margo Commission report. Part of the terms of reference of the committee was an investigation into the system of compensation for mine leases.

4/ Report of the Technical Committee on Mining Taxation, paragraph 1.13. (December 1988).

5/ Ibid. paragraph 10.8. The representatives of the Inland Revenue on the committee expressed a dissenting opinion, arguing in favor of a royalty payment in the form of a relatively small fixed percentage of gross revenue for all minerals over and above the normal tax.

6/ Paragraph 4.7.3.3.

resulting would be unacceptably high, 1/ and opposed any proposal whereby this "forfeiture of revenue would be recovered from other sectors." 2/ The Review did recognize, however, that if the Minerals Bill was enacted unchanged, the state would no longer be entitled to mining leases in those cases where it did not hold the mining rights. Under such circumstances, the Review indicated that it would be necessary to investigate alternative taxes or levies on the mining sector to replace the lease payments and to consider the possibility of extending those levies to include all metals and minerals and not just the precious metals (and stones) covered by the existing lease payment system.

The 1991 Minerals Act did not incorporate the relevant clauses of previous Acts, 3/ which had vested in the state the right to mine precious stones, precious metals and oil, and consequently the legal basis for the lease consideration system was removed. However, in light of concerns about the weakened financial position of the gold mining industry and the need to encourage development of new mines, the Government decided not to introduce a new levy or tax to replace the lease consideration, and the Budgets subsequent to the Marais Committee report sought to alleviate the burden of taxation on the mining sector further along the lines recommended in that report.

The statements of the African National Congress (ANC) on mining policy during the transition period to a Government of National Unity created much controversy. One of the central tenets of the ANC's mineral policy was that "the mineral wealth beneath the soil is the national heritage of all South Africans, including future generations," and consequently "users must pay rent to the 'people' or state to deplete [them]". 4/ To this extent, therefore, its position was virtually indistinguishable from that set out in the 1989/90 Budget Review. Where the ANC policy differed markedly from that of the previous Government was on the proposed mechanism for achieving this goal. Rather than seek to reinstate government control over the right to mine, the ANC proposed the "return of mineral rights to the democratic Government." 5/ In part, this policy reflected a concern that private ownership of mineral rights was causing suboptimal exploration and development of the country's mineral reserves. The ANC position suggested that the existing system of privately owned mineral rights provided no incentive to mining companies to develop their stock of mineral rights,

1/ Lease payments in 1989/90 amounted to R 540 million, approximately 0.2 percent of GDP and 0.8 percent of government revenue.

2/ 1989/90 Budget Review, paragraph 4.7.3.3.

3/ The 1964 Precious Stones Act and the 1967 Mining Rights Act.

4/ The policy statements arising from the Ready to Govern Conference (1992) and Reconstruction and Development Programme Conference (February 1994) were refined and developed more fully in the Minerals and Energy Policy Discussion Document published by the ANC in November 1994.

5/ Reconstruction and Development Programme conference (February 1994).

while denying other interested parties, in particular foreign investors, access to those rights--the so-called "freezing" of mineral rights. 1/

Despite the assurances by the ANC that security and continuity of tenure for mineral exploration and mining would be guaranteed under a system of public ownership of mineral rights, much of the criticism of the ANC proposal has focused on its impact on investor confidence. The Chamber of Mines argued that private ownership of mineral rights provides the necessary security of tenure to encourage investors to commit the substantial resources required to explore and develop mineral bodies, and that government assurances of security of tenure would be inadequate for this purpose.

In the absence of convincing evidence that private ownership of mineral rights results in a socially suboptimal exploration and development of the country's mineral reserves, the case for private ownership on the grounds of security of tenure seems sound. The central issue of mineral rights, therefore, revolves around the case for imposing a charge on mining companies for the extraction of a nonrenewable resource.

3. Gold and the economy

Removing the charge on mining companies for extracting a nonrenewable resource is equivalent to subsidizing the mining industry, because it represents a transfer to the mining companies, free of charge, of a rent on part of the country's patrimony, namely its mineral wealth. The majority opinion in the Marais Committee believed that the strategic status of the mining sector, gold mining in particular, justified this subsidy, notwithstanding the consequent switch in the relative tax burden from the mining sector to the nonmining sector and the replacement of a relatively efficient tax instrument 2/--a tax on rent--with less efficient tax instruments. It is clear from the 1989/90 Budget Review that the Government of the day was very concerned about these tax policy implications.

1/ It is not clear, however, what evidence was used to support the contention of suboptimal development of mineral rights, apart from the fact that the mining companies own mineral rights to reserves that are substantially in excess of their current exploration programs. That fact does not, in itself, indicate a suboptimal depletion of the existing mineral reserves; it may merely reflect the judgment of the mining company that the shadow price of extraction will appreciate faster than the company's discount rate. As long as there is not a substantial difference between the private and social discount rates, it is not clear why the rate of extraction on privately owned mineral rights would be socially suboptimal either.

2/ In terms of the distortions arising from the tax.

The view that the mining sector holds a special status in the economy was not new and remains influential. 1/ The introduction to the recent discussion document on mining policy states: "the centrality of the mining industry to South Africa's economy is a common point of departure for all parties...it is widely recognized that, because the industry is a cornerstone of the South African economy...any changes that may take place will have far reaching ramifications." 2/ The ANC Minerals and Energy Policy Discussion Document reflects a similar perspective. This mode of thought immediately establishes a prima facie case for providing special assistance to the mining sector, especially in the context of a gold mining industry under pressure.

But it is not clear that this implication is well founded. In the past, the mining sector, gold mining in particular, was an engine of growth of the economy. For much of the period since the 1960s, the Government pursued an inward-looking growth strategy. Once the early opportunities for growth from import substitution had been exhausted, the economy, hampered by the weak competitiveness of the nonmining export sector, relied increasingly on the mining sector to maintain the momentum of economic growth, by relieving the balance of payments constraint, and by providing a source of employment.

The mining industry remains an important sector in the economy. Although mining production now accounts for only 9-10 percent of GDP, and makes a negligible contribution to government revenue--less than 2 percent of total revenue--mining exports are still approximately 40-50 percent of total exports. 3/ However, since the early 1980s it has become increasingly clear that the mining sector is unable to maintain the role of the engine of growth, nor can it support the employment generation required to address the unemployment problems of the economy. 4/ The prospects for the future are no more promising: gold mining is confronted with a trend deterioration in production levels and a weak gold price; the prospects for

1/ It was perhaps most clearly, if somewhat extremely, argued in the 1946 report of the Holloway [Tax] Committee: "working of ore of so low a grade that it contributes nothing to profits or taxes, is of great value to the country; the gold produced pays the wages of a large number of workmen and the costs of stores from which workmen in industry and agriculture draw their living."

2/ Discussion Document on a Minerals and Mining Policy for South Africa. Department of Minerals and Energy Affairs (November 1995).

3/ Gold mining accounts for 4-5 percent of GDP and contributes approximately 0.8 percent of total revenue. Gold's share of total exports was just under 20 percent in 1995.

4/ Since 1985, value added in constant prices has declined by 13 percent in the mining sector, and by 23 percent in gold mining. The decline in mining employment has outstripped that of value added: employment in the mining sector has declined by around 17 percent over the same period, with employment in gold mining sector falling by 23 percent.

the nongold mining sector are brighter, but the contribution to employment from that sector is expected to be modest as production has become increasingly capital-intensive. Partly in recognition of the waning ability of the mining sector to maintain the momentum of economic growth and employment generation, the Government has begun the process of shifting toward a more outward-oriented economic strategy since the late 1980s.

This change in growth strategy, however, has an important bearing on the policy to forfeit a charge on the extraction of nonrenewable resources. The paramount importance of ensuring "continued investment in mining and maintaining the industry's international competitiveness" is not synonymous with the development of a dynamic outward-oriented economy, and may even be detrimental to it, particularly if pursued through the tax system. Artificial support of the mining sector delays a shift in the structure of relative prices in favor of the production of nonmining exportables, impedes efforts to reduce the tax burden on other sectors of the economy, and embodies the use of less efficient tax instruments.

In summary, the switch in growth strategy essentially removes the basis for providing a subsidy to the mining sector. Consequently, the rationale for terminating the lease payment system--at least the failure to impose a replacement levy--is considerably diminished and so there may be a strong case for reconsidering the orderly introduction of some form of levy on the right to mine, as proposed by the Government of the day in 1989 and, more recently, by the ANC.

There are a number of issues related to the appropriate form of such a levy and these are discussed in greater detail in Appendix I. However, there are some basic principles that should be taken into account. First, the levy on the right to mine should be considered as a factor payment for the use of a nonrenewable resource. The state must take into consideration the opportunity cost of extracting the mineral resource when setting the levy on the right to mine. Second, the state must ensure that the structure of the levy does not leave it bearing an inappropriate share of the risk in the mining venture and to the extent that the Government wishes introduce a risk-sharing arrangement into the levy structure, it should ensure that an appropriate price is charged for bearing a portion of the risk. Third, the levy structure should aim to minimize sovereign risk borne by the private mine proprietors, that is, the risk that the state will alter the fiscal arrangements after commitments have been made to mineral exploration and development.

For these reasons, it is argued that a severance tax should play an important role in the levy on the right to mine. The severance tax may be supplemented by profit based charges but the latter should not be relied upon as a major part of the levy on the right to mine.

4. Mining taxation

We now consider the merit of arguments suggesting that characteristics inherent in the mining process--notably risk--form a basis for a separate structure of taxation distinct from that for nonmining activities. The arguments presented in favor of a separate tax structure are not based on claims for subsidies, but suggest that were mining activities taxed on the same basis as nonmining activities--through the standard corporate tax structure--they would be disadvantaged because they are subject to substantially greater risk than nonmining activities.

This issue arises because the mining sector is eligible for a system of accelerated depreciation allowances--the redemption allowance, the capital allowance, and the ring system--which is markedly different from that available to nonmining companies. Furthermore, gold mines are subject to a formula tax, rather than the standard rate of corporate tax. These two features of the mining tax system have generated much debate.

a. Accelerated depreciation allowances

The tax system provides for an extreme form of accelerated depreciation allowance in the mining industry: the redemption allowance allows eligible 1/ capital expenditure to be deducted in full against income in the year of assessment in which such expenditure occurs. The deduction is, however, subject to Sections 36(7E) and 36(7F) of the Income Tax Act--the "ring fencing" provisions. 2/ Section 36 (7E) restricts the deduction of the redemption allowance to taxable income from mining operations, with the balance carried forward to subsequent years. For all new mines developed after 1984, Section 36(7F) further restricts the deduction of capital expenditure on a mine to the taxable income of that mine. In 1990, the Government introduced a partial relaxation of the ring fencing system. Section 36(7G) allows 25 percent of an existing mine's taxable income to be available for write-off against the development of a new mine.

In addition to the redemption allowance, some mines are eligible for a capital allowance. The capital allowance provides for the redemption allowance to be carried forward with interest. There are three basic categories of mines eligible for capital allowances: (i) post-1973 mines are eligible for a capital allowance of 10 percent; (ii) "other deep level"

1/ Most capital expenditure is eligible for the redemption allowance, with the following major exceptions: (i) expenditure on mineral or surface rights; (ii) expenditure on the acquisition of land titles; (iii) mine housing and residential infrastructure (written off over 10 years); and (iv) expenditure on transport infrastructure such as railway lines or pipelines (written off over 10 years).

2/ Sections 36(7E) and 36(7F) were introduced in 1984. Prior to 1984, the unredeemed balance of capital expenditure qualified as a deduction against income from any source.

mines are eligible for a capital allowance of 10 percent; and (iii) post-1990 mines, eligible for a capital allowance of 12 percent.

The mining industry has vigorously defended the redemption allowance. First, it has argued that a system of accelerated depreciation allowances is essential for the mining industry to compensate the mining industry for the high risks associated with its mining activities. These risks come in a number of forms: (i) the geology of South Africa's mineral reserves, particularly its gold reserves: the reserves are at great depth, which not only greatly enhances the costs associated with mine development but also increases the risk of mine failure post exploration; (ii) the long lead times until a project comes on stream; and (iii) the risks associated with operating in volatile commodity markets. Second, it has been argued that although the immediate redemption of capital expenditure is an extreme form of accelerated depreciation, it has the advantage of simplicity. In particular, it avoids the difficulty of having to distinguish between capital expenditure and current expenditure in a mining operation. 1/

The case against the system of redemption and capital allowances was argued eloquently in a dissenting opinion in the Marais Committee report. 2/ The opinion argued that the retention of a system of accelerated depreciation allowances ran contrary to the trend in international tax reform to move away from such incentives. The move away from accelerated depreciation allowances, the opinion argued, was driven by evidence that tax incentives for capital expenditure tended to promote "the quantity of investment at the expense of its quality" and "biased economic activity toward capital intensity." The overall impact was not to enhance economic performance but merely to depress effective rates of corporate tax far below the statutory rate.

The Margo Commission focused more closely on the distortions arising from the ring fencing system, and the consequent damage done to the

1/ The industry has argued that a significant proportion of capital expenditure in a mining operation is a continuous process of providing new shafts and development expenditure required to access new mining areas. It argues that such expenditures should be treated as the ongoing cost of production, similar to current expenditure. The industry has also argued that underground capital items such as shaft systems and haulage ways have no value once an area is mined out. These arguments appear to reflect a misunderstanding of the distinction between expenditure on a capital asset and recurrent expenditure. The definitions are used to distinguish assets that have a useful life of more than one year from those that do not. The fact that capital expenditure is used to develop an existing asset rather than create a new one, is clearly irrelevant, as is the fact the assets do not have a terminal value. There may, however, still be difficult issues relating to the economic life of various mining assets, but these are unlikely to be insoluble.

2/ Dr. D. G. Franzsen, University of Stellenbosch.

efficient allocation of resources. Nevertheless, despite the costs associated with the ring-fencing system, it was clear to the Commission that it was a necessary evil as long as the system of accelerated depreciation remained in place. The Commission argued that the most effective way of addressing the distortions created by the accelerated depreciation allowance and ring fencing systems was to abolish the redemption allowance and replace it with ordinary depreciation allowances granted to other branches of the economy. Once the redemption allowance was abolished, the ring fencing system could safely be abolished as well. 1/

Clearly, as recognized by the Marais Committee, the issue of accelerated depreciation allowances turns on whether the mines are subject to special risks and, more importantly, the appropriate policy response to such risks. This issue will be addressed following a discussion of the special tax treatment of the gold sector.

b. The gold tax formula

The tax rate payable by a gold mine on its taxable income--profits--is determined by the following formula:

$$y = a(1-b/x),$$

where a and b are fixed parameters and x is the ratio of taxable income to revenue. The parameter b, currently set at 5 percent, defines the tax threshold, below which profits are not taxed (the "tax tunnel"). Parameter a is linked to the standard rate of corporate tax. 2/ As is clear from the above, the gold tax formula is progressive and provides a tax incentive to mine marginal ore bodies (see chart 17). 3/

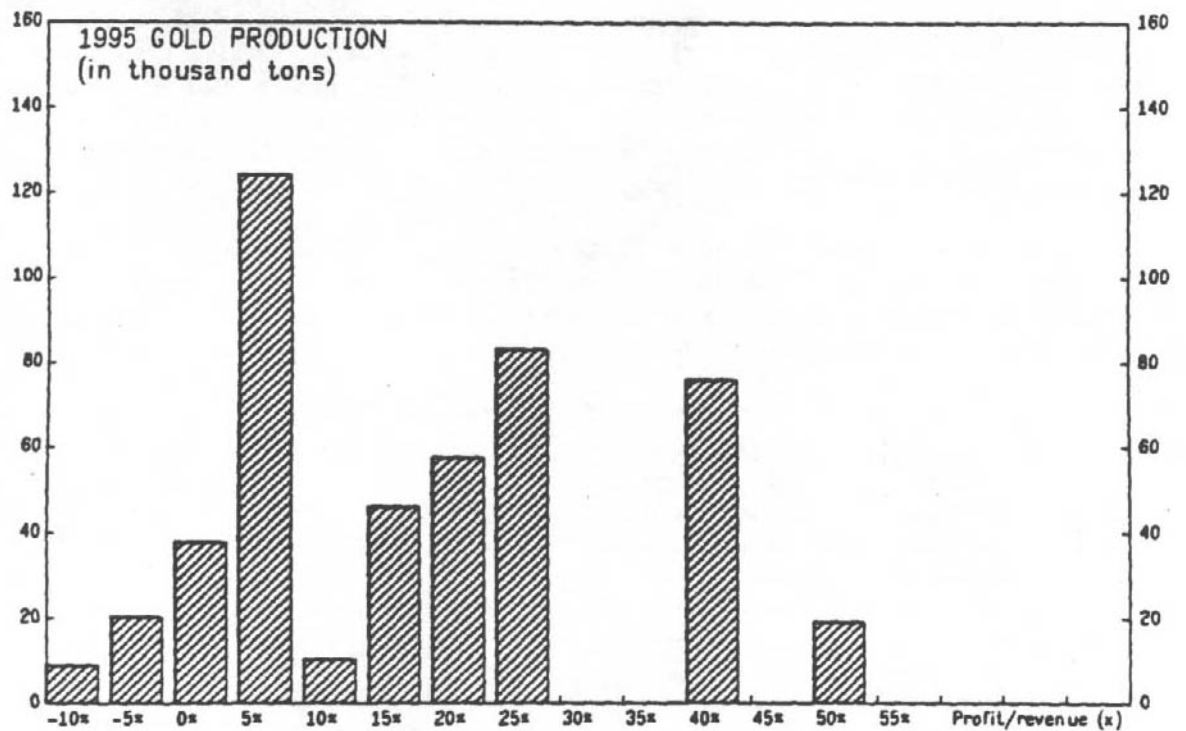
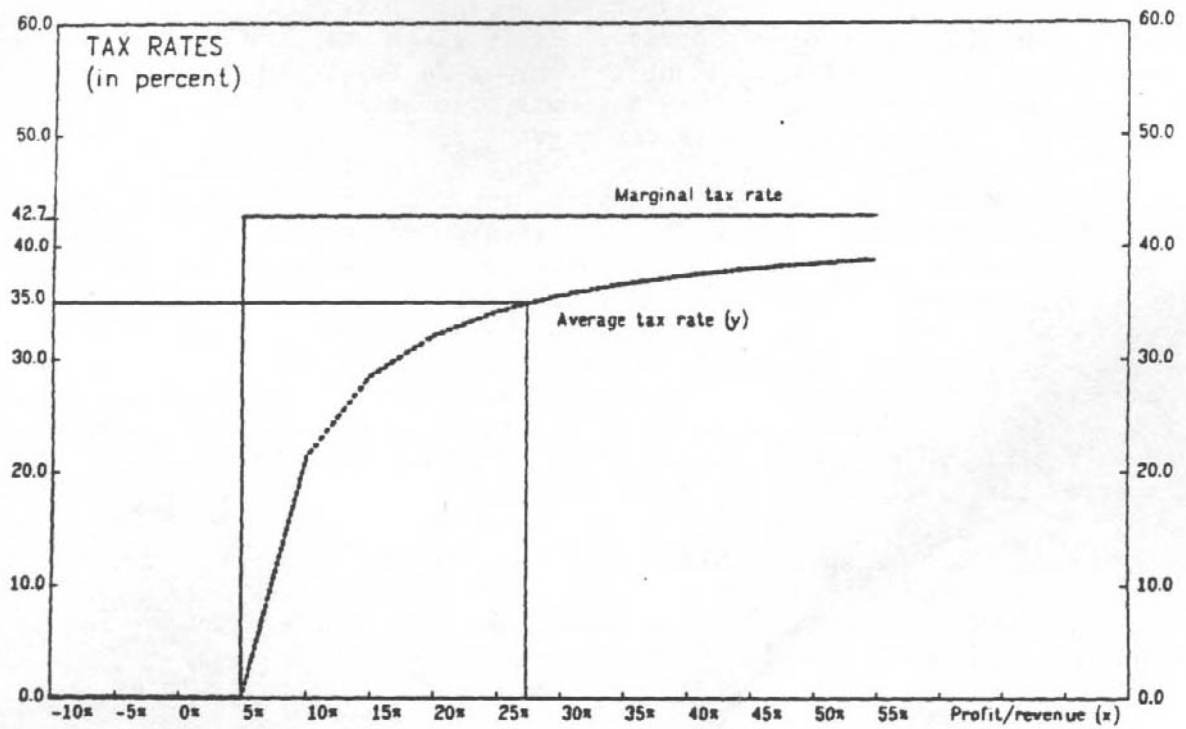
Advocates of a switch to a flat rate tax, the Margo Commission included, have argued that the gold tax formula is flawed because it breaches the principle of tax neutrality and introduces an undesirable incentive to mine marginal ores.

1/ The mining industry, however, while opposed to the abolition of the redemption allowance, fully support the Commission's concern about the ring fencing system. In a recent submission (February 1996) in response to the discussion document on minerals and mining policy the Chamber of Mines have argued strenuously for the abolition of section 36(7F) of the Income Tax Act. The ANC Minerals and Energy Discussion Document also proposes an reassessment of the ring fencing system to encourage development of otherwise uneconomic mineral deposits.

2/ $a = 1.22 \times$ corporate tax rate.

3/ Specifically, the ore pay limit is lowered by a factor equal to $ab/(1-a)$, with the ore pay limit being the minimum grade consistent with making a working profit (post-tax). At the margin, under the current tax formula, an ore body could have a unit cost 4 percent above unit revenue and still break even, as long as the mine as a whole was paying tax.

SOUTH AFRICA GOLD TAX FORMULA



The Marais Committee, however, rejected recommendations to replace the formula tax with a flat rate tax, arguing as follows:

(i) the inducement to mine marginal ores, far from being undesirable, is an essential feature of the gold tax formula. It argued that the inducement was in the best interest of the country because it increases mine output in the long run and extends the lives of the country's mines.

(ii) The formula has the benefit of providing a degree of burden sharing, both between mines, with richer mines paying a higher rate of tax, and between the industry and the Government, with the Government receiving a share of the windfall profits during a commodity boom and providing tax relief to the industry when commodity prices weaken. The latter breach of the principle of tax neutrality was considered necessary because of the high risks associated with gold mining.

To the extent that the first argument pertains to the need to subsidize the development of sub-economic projects in the gold mining industry, the argument has been addressed--and rejected--above. And was recognized by the Margo Commission, subsidies to mine marginal ores introduce an undesirable distortion into the extraction profile of a mineral reserve, inhibiting flexibility of mine production. 1/

The case for providing a degree of burden-sharing requires more careful consideration, as some recognition by the tax system that the geology of some mines makes them substantially more profitable than others has some superficial attraction. However, the superior "profitability" of favorably located mines reflects the fact that these mines have access to "high-rent" minerals. The corporate tax is not the appropriate fiscal instrument for addressing the issue of differential mineral rents. Other instruments need to be developed, primarily in the context of the contract negotiated between the state and the mining companies regarding the right to mine.

The prominence of the "ability-to-pay" arguments in the Marais Committee report clearly also reflected pressing concerns that the shift to a flat

1/ The decision to mine low grade (high cost) ores before/after high grade (low cost) ores depends essentially on the expected future path of the costs of extraction. If unit costs of extraction are expected to decline relative to unit prices then there will be an incentive to bring low cost mineral deposits into production earlier than high cost deposits and vice versa. In the extreme case where an entity has insider information about a substantial rise in the mineral prices, for example as a result of the collapse of the Bretton Woods arrangement in the late 1960s, then there would be a clear incentive to mark time by "mining dirt", in the words of the Margo Commission. However, the fact that under some circumstances it might be preferable to mine high cost ores before low cost ores does not constitute the basis for introducing a permanent incentive into the tax system to do so.

rate tax would have substantial negative financial effects on low grade, low margin mines. These concerns will, if anything, have intensified in the intervening period. However, the appropriate response to these concerns is not provide support through tax expenditure. Rather, if support is deemed to be warranted it should, as proposed by the Margo Commission, be provided through a system of grants which would enable the Government to target aid to the gold-mining sector accurately and effectively.

There remains the case for providing some degree of burden sharing between the Government and the mining industry, particularly with respect to the risk that some deposits might not live up to expectations. Clearly, the fact that the gold tax formula is restricted to gold mining ^{1/} carries the implication that gold mining is subject to special risks that do not apply to nongold mining. ^{2/} However, the fundamental argument is the same as that for the accelerated depreciation allowances: the mining industry is subject to special risks, which should be shared with the Government. It is this case that is considered next.

5. Risk insurance

The risk argument of the mining industry merits closer attention, because it has played a key role in the mining taxation debate. Two sets of risks need to be distinguished. Firstly, the risks pertaining to investment in individual mines. As noted above these are fundamentally risks related to the geology of the mineral reserves. Secondly, there are the risks confronting the industry as a whole. These include not only the risks associated with operating in a volatile commodity market, but also risks related to security of tenure and the stability of the fiscal regime. For both the enterprise and the industry risks, three principal issues need to be considered: (i) what is the appropriate policy response to the risks, and should government bear a portion of the risk, as it does implicitly through the current tax regime? (ii) if so, what price should the government charge investors in the mining industry for providing insurance cover? and (iii) is the corporate tax system--in particular its system of accelerated depreciation allowances--the appropriate instrument for providing such insurance?

With respect to the industry risk, the case is relatively straightforward. There would appear to be fairly general agreement that the problem of volatile commodity markets is not unique to the mining industry and that

^{1/} Although the ANC has proposed that the gold tax formula be extended to other minerals.

^{2/} In some instances it has been argued that the gold tax formula partially addresses the patrimony argument, though it is not clear why the patrimony argument should then only apply to gold. More fundamentally, if the argument about the validity of a charge on the right to mine is accepted then appropriate fiscal instruments to levy this charge should be developed. The corporate tax is not such an instrument.

risks arising from this source do not therefore constitute a strong case for a special mining tax regime to absorb some of the risk. Indeed, there is evidence that the private sector is generally better able to manage this risk than the public sector (See Collier and Gunning, 1996).

The risks associated with security of tenure and the stability of the mining fiscal regime, clearly lie within the domain of government policy, but the appropriate response is not to compensate the mining industry for such risks but rather to seek to minimize them. In this light, there would appear to be a strong case for retaining the current system of mineral rights combined with a mechanism to ensure an adequate return to both the state and the mining company for the depletion of the country's mineral resource. Historically, the fiscal regime has not performed this function well; it has undergone a number of sizable changes in the past--e.g., the use of mining surcharges and the introduction of the ring fencing system in the early 1980s--as governments attempted ex-post to capture an adequate share of the mineral rents generated by mining activities. Such ex-post adjustments to the fiscal regime are clearly undesirable as they raise the risks associated with investment in the mining industry. To minimize the risk of such upheavals, the fiscal regime should ensure that it provides for adequate compensation across a wide range of contingent states at the outset.

The issues with respect to the appropriate response to mine-specific risk are more difficult, but again it is not clear that it is in the best interest of the economy for the Government to bear a portion of this risk of a mining venture. A number of factors need to be taken into consideration:

- The risks associated with a mining venture can be diversified by the private sector. While the risks of an individual mining venture may be high, the risks associated with a portfolio of mining investments are likely to be substantially lower, and the risks associated with a portfolio of investments of which mining is but a component will be lower still. Thus, the risk that should be of concern to policy is not the risk at the level of an individual mine, but the residual risk that remains after such mine-specific risks have been as fully diversified as possible (through the financing structures of such mines). Government's attempts to transfer some of the nonresidual mine-specific risk to itself, may not therefore be an appropriate policy response to such risks. Firstly, the Government may be less well positioned to diversify or adapt flexibly to the risks that it is taking on than the private investors to which it is providing insurance. Secondly, the provision of insurance may induce the private sector to adopt investments that are less well adapted to the conditions confronting the economy. There should therefore generally be a prima facie case against the state providing risk insurance to private investors, particularly if potential investors--both domestic and foreign--in mines have access to a full range of financial instruments through which they can diversify such mine-specific risks.

• If the Government is persuaded that there is a case for intervening to address the residual--i.e., nondiversifiable--risks associated with investment in a particular sector of the economy, it will need to consider carefully the price that it will charge for providing that insurance. It's own ability to diversify the risks that it is taking on will be important factors in determining the appropriate price. Given the relative characteristics of the Government and the type of investor attracted to large scale mining ventures, it is highly likely that the price that the Government would have to charge investors in the mining sector to adequately compensate it for providing insurance for mining activities would render that insurance unattractive.

• As with all policy interventions, the possibility of unintended effects of publicly provided insurance for mining activities must also be considered. For example, even if one could argue that the gold tax formula addressed residual risks in gold mining, this formula clearly has effects additional to this, namely, it subsidizes the exploitation of marginal ores, an effect that, as argued above, is undesirable from an efficiency standpoint. And given that South Africa is still a large producer relative to world markets in a number of mineral markets, one of the unintended effects to which careful consideration should be given is its impact on the world prices of the commodities concerned. 1/

Finally, as noted above, the corporate tax system is not an appropriate instrument for addressing such residual risks. The function of the corporate tax system is to levy a tax on corporate income in the economy in a manner that minimizes, to the extent possible, distortions in the intersectoral allocation of resources. One of the great weaknesses of many systems of mineral taxation--including that in South Africa--is that a multiplicity of objectives have been loaded onto a single instrument, the corporate tax. 2/ As a result, it is difficult to identify the effective tax rate on corporate income in the mining sector, especially the gold mining sector, because the rate of corporate tax includes: (i) the implicit charge that the Government is levying on the mining sector for the extraction of a nonrenewable resource; (ii) the adjustment to that levy for the implicit price the government is charging for providing risk insurance; and (iii) a tax on corporate income which should adhere to the principle of tax neutrality. In general, the corporate tax should be relieved of the burden of providing a levy on the extraction of a nonrenewable resource and the associated risk insurance (if any), and that other fiscal instruments should be developed to address these issues.

1/ It should be noted that the impact of a strategy to raise gold production will tend to depress gold prices, even if the immediate impact is a reduced flow of gold into the spot market. (The mining industry had argued in the Marais Committee that as the formula tax only leads to increased production in the long term--itself a doubtful contention--this would not depress the gold price.)

2/ See Conrad et al. World Bank (1990).

6. Summary and conclusion

The evolution of the debate on the system of mining taxation can be summarized as follows:

a. The state's claim on the right to mine was forfeited in the early 1990s, despite a general agreement that the mineral resources formed part of the patrimony of the country. It was forfeited because it was believed that this claim should be subordinated to the need to encourage the development of the gold mining industry. These arguments were given an added urgency by the difficulties that the gold mining industry had confronted since the mid-1980s.

But the arguments in favor of forfeiting the patrimony over mineral resources are rooted in a view of the economy that is now out of date and inconsistent with the government's strategy to develop an outward-oriented economy. The Government should reconsider the orderly introduction of some form of levy on the right to mine. Issues that the Government will have to consider with respect to the appropriate form of such a levy are discussed in Annex I.

b. The retention of the gold formula tax rested on two arguments: (i) that it was appropriate to provide an inducement to mine marginal ores; and (ii) that the formula allowed the Government to both take into account the ability to pay of different mines and share some of the risks of gold mining more generally. Underlying the decision to retain the formula tax was a concern about the impact of a move to a flat rate tax on the financial position of existing marginal mines.

Neither of the two arguments is particularly convincing and if support to marginal mines is merited, it should not be provided through the tax system, but rather through a system of grants, which would enable the Government to target the aid accurately and transparently. The Government should consider abolishing the current gold formula tax and applies the standard rate of corporate tax to the gold-mining sector.

c. The arguments for retaining the system of accelerated depreciation allowances--the redemption allowance, capital allowance, and the ring fencing system--rested on the belief that the Government should bear some of the special risks associated with mining activities.

This chapter has argued that it is not necessarily appropriate for the Government to attempt to modify the risk characteristics of activities in an economy even in the case of nondiversifiable, or residual risks. However, if the Government believes that there is a case for providing some form of insurance to investors in the mining industry to cover this sort of risk, then it should ensure that the insurance it is providing is priced appropriately. Finally, the paper has pointed out that, whatever the case for providing insurance to investors in the mining industry, the corporate tax system is not the appropriate vehicle for doing so. Rather, the appropriate instruments should be developed in the context of the contract

between the Government and mining companies governing the right to mine. Therefore, the Government should consider abolishing the system of accelerated depreciation allowances--the redemption allowance, capital allowance, and the ring fencing system--for the mining sector, and replacing them with a system of depreciation allowances, which would ensure intersectoral neutrality.

Given the prominent role that the mining industry has played in the South African economy, the decision to embark on an economic strategy which does not have the mining sector as its focal point clearly represents a significant break with the past. There is clearly the temptation to keep a "foot in both camps." Such a stance will be unsustainable if it results in continued distortions in the tax system to support and prolong mining activity artificially. Nevertheless, it is also clear that concerns about the transition away from a mining-based economy will be difficult to assuage while the nonmining sector has difficulties competing internationally, hence has a limited capacity to address the unemployment problem. A strategy to promote growth and employment in the nonmining economy would both greatly facilitate, and be reinforced by, the reform of the mining taxation system.

Implementation of a Levy on the Right to Mine

One of the weaknesses of the fiscal regime for the mining sector has been that the distinction between mineral taxation and mineral pricing policies has not been adequately delineated. Mineral tax policy should be separated conceptually from the state's role as a guardian of a national resource, with decisions about natural resource pricing policy and associated risk sharing arrangements that arise when Government negotiates with a mining company over the right to mine a nonrenewable resource handled through a separate set of fiscal instruments.

The institutional framework for the separation of tax policy and mineral policy was in place with the lease payment system prior to the 1991 Minerals Act and remains substantially intact, because the Government continues to negotiate with mining companies over the right to extract minerals on government-owned mineral rights.

This section reviews briefly some of the basic principles that the Government should take into account when considering appropriate instruments to capture the levy on the right to mine, and reviews some of the pros and cons of profit-based instruments versus production-based severance taxes. The review suggests that the old lease payment formula, which was based on a profit sharing arrangement, may not have been optimal. ^{1/}

The levy on the right to mine must fulfill a number of functions: (i) it must ensure that an appropriate price is paid for the mineral resource; (ii) it must reflect a decision on an appropriate risk-sharing arrangement (if any) that it will enter into with a mining company, and the price that it will charge for bearing a portion of the risk; and (iii) the levy structure should attempt to reduce sovereign risk, i.e., the risk that the Government will alter the fiscal arrangements after the investor has made a commitment to invest in mineral exploration or development. Clearly, sovereign risk is a much broader issue than the structure of the levy on the right to mine. However, an appropriately designed levy, which provides a

^{1/} The lease payment system in place prior to the 1991 Minerals Act was based on a formula, very similar to that of the current gold tax formula:

$$y = a - ab/x,$$

where y was the percent of eligible income paid to the government, x was a ratio of eligible income to revenue, and a and b were constants. The value of a tended to be in the range of 10-30 percent and 6 and 8 percent were common values for b. The term "6 percent" and "8 percent" leases, referred to the threshold profit before a lease payment was made to Government. As with the gold tax formula both the redemption allowance and the capital allowance were deductible from income. In the case of the lease formula all mines were eligible for a capital allowance at a compound interest rate of 6 percent.

reasonable prospect of a stable contract between the state and resource owners with respect to the extraction of mineral resources, will make an important contribution to reducing sovereign risk.

Analysis of the opportunity cost of the extraction of a mineral ore body is important to establish the reservation price that the Government would want to place on the mineral resource. 1/ The structure of the levy should also ensure that the government is not left bearing an inappropriate share of the risk involved in mining ventures. This latter point is important, because pure profit-sharing arrangements, such as the lease payment system, run the risk that the natural resource endowment will be extracted without significant positive payments being made to the state for the extraction of a nonrenewable resource.

In practice, it is unlikely that a single fiscal instrument will efficiently capture both the appropriate price for the resource and the risk sharing element. In general multiple fiscal instruments will be needed. Two such instrument warrant attention here:

1. The resource rent tax

The lease payment system--and to a lesser extent the gold formula tax--approximate closely to a resource rent tax (RRT). 2/ Recent literature on mining taxation has identified a number of problems with a RRT: (i) it is a high risk instrument, because it only provides a return to the state if a project yields above normal rates of return; international experience with RRTs suggests that they have not been successful in generating revenue 3/ --the experience of the lease payment system would tend to support that contention; (ii) the revenue stream, if any, is back-ended; and (iii) an RRT, used by itself, does not provide a framework for assessing the opportunity cost of proceeding with a project. For these reasons, it is argued that profit-based taxes such as the resource rent tax should not be

1/ The general equilibrium opportunity cost of extraction should also be taken into consideration. As noted above, the pace of development of a mineral resource will have an impact on the internal terms of trade, with a faster pace of development shifting the terms of trade against the production of tradables and vice versa.

2/ The RRT itself is an amended version of a cashflow tax ("Brown tax"). Under a cashflow tax, a constant proportional tax rate is levied on the difference between cash receipts and allowable expenses within a period. All exploration, development, and operating costs are fully recoverable; consequently there is a zero marginal effective tax rate on the returns on investment. The RRT is similar to the cashflow tax, but the tax is imposed only if the accumulated cashflow is positive. Net negative cashflows are accumulated at an interest rate that, in theory, equals the company's cost of capital or discount rate.

3/ See Nellor and Sunley (1994).

relied upon as a major part of the levy on the right to mine, although it could be retained as an element of the levy if the Government believes it necessary to provide some form of risk sharing.

2. Royalty payments ("severance taxes")

A royalty or severance tax is a specific or ad valorem duty levied on the volume or value of resources extracted. Severance taxes have been severely criticized by the mining industry on the grounds that they raise the marginal cost of extraction and may therefore discourage development of marginal projects, by making them submarginal.

Royalty payments have a number of attractive features, in addition to being easy to administer. Firstly, it is important to bear in mind that the levy on the right to mine is a factor payment charged by the Government for the extraction of a nonrenewable resource. As such the levy should serve an important role in determining whether an investment should proceed or not-- that is a resource should be left in the ground if mining companies are not prepared to pay the price reflecting the state's opportunity cost of extraction; there is no rationale for providing the resource for free. A royalty payment performs these functions well. Secondly, the royalty payment ensures that the state receives a minimum payment for the extraction of a mineral resource, and that it receives it relatively early in the development of a mining project (as soon as production commences). Thirdly, a regular stream of payments to the state is likely to enhance the stability of the fiscal regime governing the mining sector, and may therefore be in the interests of the mining companies, who have expressed serious concern about the adverse impact of an unstable fiscal regime. Lastly, as long as the royalty payment is not unduly high, the present value of the efficiency costs associated with severance taxes is likely to be small.

For the above reasons, it is argued that a severance tax should play an important role in the levy on the right to mine. The rates of royalties cannot be prescribed as a general rule, as they will depend, inter alia, on the perceptions of profitability and other fiscal aspects of the levy. However, international experience with royalty rates for gold, as well as the existing practice on leases for state-owned mineral rights, would suggest royalty rates ranging in the region of 3-6 percent of gross revenue. The rates of royalty may vary across leases and could have stepped rates triggered by higher commodity prices. Finally, the price mechanism used to determine the liability under the royalty should be transparent.

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South Africa: Tax Summary as of April 1, 1996

(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates		
1. Taxes on income, profits, and capital gains					
1.1. <u>Individual income tax</u>	Central government tax charged on taxable income received by or accrued to a person from any source within or deemed to be within South Africa. Taxable income is assessed as gross income less exemptions and deductions.	<u>Exemptions</u> include (i) the first R 2,000 of any taxable interest; (ii) dividends excluding dividends paid by building societies, fixed property companies, or unit portfolios; (iii) benefits payable under the Unemployment Act, and (iv) leave gratuities on retirement/retranchment up to R 30,000.	A single scale of rates applies to all individuals. Tax is reduced by <u>tax rebates</u> , which depend on taxpayer age. The tax rebate of a person under the age of 65 is R 2,660. There is an additional rebate for those 65 years of age and older of R2,500. Taking into account tax rebates, the following average income tax rates apply to a person under 65 years of age:		
Income Tax Act No. 58 of 1962 as amended.	Receipts or accruals of a capital nature are generally excluded from gross income. Capital gains derived from asset transactions deemed to be made with the purpose of making a profit are included in gross income.	<u>Deductions</u> are allowed for (i) annual contributions to pension and retirement funds (the greater of R 1,750 or 7 1/2 % of pensionable income); (ii) retirement annuity fund contributions (the greater of R 1,750 or R 3,300 less allowable pension contributions or 15 % of non-pensionable income), (iii) medical expenses (with deduction ceilings depending on age); and (iv) donations to certain educational institutions.	Taxable annual income (In rand)	Marginal tax rates (In percent)	Average tax rates (In percent)
	Wage and salary earners are subject to withholding tax at source (PAYE) may have to submit income tax returns at the end of the tax year. Persons whose income consists almost entirely of remuneration and of which the amount, after some deductions, does not exceed R 50,000 are subject to Standard Income Tax on Employees (SITE) under the PAYE system; SITE payers are not required to submit income tax returns. In the case of other individuals, tax levied on their taxable income in the tax year; provisional payments are effected in two half yearly installments. However, certain provisional taxpayers may make a third "topping up" payment six months after the end of their tax year.		0 - 15,000	17	0
	The tax year runs from the first day of March to the last day of February.		15,001 - 20,000	19	0.0-4.2
			20,001 - 30,000	21	4.2-9.8
			30,001 - 40,000	30	9.8-14.8
			40,001 - 60,000	41	14.8-23.6
			60,001 - 80,000	43	23.6-28.5
			80,001 - 100,000	44	28.5-31.6
			100,001 and above	45	31.6-...
			In FY 1996/97, <u>transition levies</u> were abolished.		
			In respect of others than individuals and companies, there is a similar scale of marginal rates, but no rebates are granted.		

South Africa: Tax Summary as of April 1, 1996

(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates
1.2. <u>Corporate taxes</u> Income tax act No. 58 of 1962 as amended.	Corporate income tax is a central government tax levied on the taxable income of any company registered in South Africa and on the taxable income of foreign companies generated in South Africa. Taxable income is defined as gross income, other than capital receipts and exempt income, less allowable deductions and loss effects. The year of assessment is the accounting year. Companies (other than gold mining companies) are required to make three provisional tax payments in respect of each year of assessment, viz., the first within six months after the commencement of the year of assessment, the second at the end of such year, and the third within a period of six months from the close of such year. Comprehensive agreements for the avoidance of double taxation on the same income are in force with 29 countries. Limited agreements for the avoidance of double taxation on profits derived from sea or air transport are also in force with 10 countries. Gold mining companies are subject to special tax provisions.	<u>Deductions</u> include normal operating costs, interest, and depreciation allowances but exclude dividends and capital expenditures. Depreciation allowances of non-mining companies vary according to type of asset, life expectancy, and intensity of use of assets. Generally, the straight-line method is used. Special depreciation allowances include initial allowances ranging from 10 % (certain housing projects) to 40 % (aircraft). Farming machinery may be written off at 30, 30, and 20 % over three years. Exporters are allowed to deduct a percentage of the marketing expenditure incurred by the taxpayer during a year. An <u>assessed loss</u> can be carried forward indefinitely but can not be carried backward. Capital expenditures by all types of mines are allowable as a deduction from income in the year of assessment in which they are incurred, limited, however to the annual mining working profit. Unredeemed balance ranks for redemption against future mining working profit. Cost of land, mineral rights, mining rights, servitude, etc., are not deductible.	a. <u>Non-gold mining companies</u> : 35 % of taxable income derived within South Africa. b. <u>Gold mining companies</u> : Formula-based tax rate according to: (a) Where the company is not exempt from the secondary tax on companies (STC): $y = \frac{n}{n+1} \frac{255}{x}$, or (b) where the company is exempt from the STC: $y = 50 - \frac{290}{x}$, where y is the tax rate and x is the profit-to-revenue ratio; e.g., a gold mine with a profit-to-tax revenue ratio of 10 % faces a corporate tax rate of 25.5 %. Gold mines were given the option to switch to the non-gold mining company tax system by August 31, 1993, but none did. Nonmining income is taxed at 42 %. c. <u>Oil extraction companies</u> : 61 %. d. <u>Long-term insurance companies</u> : If taxable income is determined under section 28, 45 %. If taxable income is determined under section 29, 35 % in respect to income derived from company policies and 30 % in respect of income derived from policies held by individuals. In FY 1994/95, taxable company incomes exceeding R 50,000 before the off-setting of any assessed loss brought forward are subject to a levy of 5 %. e. <u>Retirement fund industry</u> : a temporary (for fiscal year 1996/97) tax of 17 % was imposed with effect from March 1, 1996 on the gross interest and net rental income of retirement funds.

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(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates
1.3. <u>Secondary tax on companies (STC)</u> Income Tax Act No. 58 of 1962 as amended.	A central government tax payable on the net amount of dividends, i.e. the excess of dividends declared by the company over dividends accrued to the company.	<u>Exemptions</u> include dividend payments of fixed property companies as defined in section 1 of the Unit Trust Control Act. These dividends are taxed in the hands of the recipient. Dividends in specie deriving from <u>unbundling operations</u> are also exempt from STC. Dividends paid out of profits earned in South Africa by foreign companies are exempt (see section 1.3).	Rate was lowered with effect from March 13, 1996 from 25 to 12.5 %.
1.4. <u>Non-resident shareholders' tax (NRST)</u> Income Tax Act No. 58 of 1962 as amended.	Abolished with effect from October 1, 1995.		
1.5 <u>Tax on foreign branches</u>	A central government tax on income derived from South African sources on companies that are effectively managed from outside South Africa.	Interest income earned by foreign companies is exempt if the company does not operate in South Africa.	40 %.
2. Social security contributions			
2.1. <u>Unemployment insurance contributions</u>	A contribution collected by unemployment insurance funds.	Not payable for employees earning more than R 63,648 per year. Also excluded from unemployment insurance are domestic servants, homeworkers, and temporary workers who are employed for less than 8 hours or less than one full working day in any calendar year.	Employee and employer contributions of 1.0 % of insured's earnings.
2.2. <u>Work injury insurance contributions</u>	A compulsory insurance scheme.	Not payable by employees earning more than R 55,068 per year. Also excluded are domestic servants and casual workers.	Insurance premia vary with risk.

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(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates
3. Taxes on payroll and workforce			
3.1. Payroll tax Regional Service Councils Act.	A tax levied by Regional Service Councils.	A tax levied by Regional Service Councils on remuneration paid by employer or employee. Some Regional Service Councils grant discounts of 15, 20, or 25 % to farming enterprises.	Ranges from 0.25 to 0.38 % depending on Regional Service Council.
4. Taxes on property			
4.1. Property tax	A local tax payable on the capital value of land and improvements.	Method of valuation and rates differ across local governments. Rebates of up to 40 % are provided for different classes of property.	Rates differ across local governments and depend on valuation methods.
4.2. Estate duty Estate Duty Act No. 45 of 1955.	A central government tax payable on the estate of an individual. Property includes life insurance proceeds, pension or provident fund benefits, and donations made in contemplation of death.	Deductions include funeral and estate administration expenses, as well as outstanding debts of deceased. A single deduction of R 1,000,000 is applicable.	Raised with effect from March 14, 1996 from 15 to 25 %.
4.3. Donations tax Income Tax Act (No. 58 of 1962)	A central government tax payable by the donor on the cumulative value of property donated by residents.	Donations by public companies and donations to charitable, educational or ecclesiastical institutions are exempted (with effect from October 1, 1996 donations to the Bible Society will no longer qualify as a donation). Also, annual exemption limits of R 5,000 and R 25,000 (with effect from 1997 year of assessment) apply for legal and natural persons, respectively.	Raised with effect from March 14, 1996 from 15 to 25 %.

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(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates
4.4. <u>Transfer duty</u> (Transfer Duty Act No. 40 of 1949)	A tax payable on the purchase consideration of fair value (whichever is the greater) of transfers of immovable property.	Exemption limits of R 24,000 for unimproved property and R 60,000 for property with dwelling.	For natural persons, 1 % on the first R 60,000 plus 5 % on the value in excess of R 60,000 but under R 250,000 plus 8 % on amount in excess of R 250,000. For other persons or trusts, 10 % of total value of property.
4.5. <u>Marketable securities tax</u>	A tax payable on the purchase of marketable securities by a stockbroker on behalf of any person.		Lowered with effect from April 1, 1996 from 1 % to 0.5 %.
5. Domestic taxes on goods and services			
5.1. <u>Value-added tax (VAT)</u> Value Added Tax Act, No. 89 of 1991.	A central government tax levied on the sale of goods and services. VAT is collected at <u>single rate</u> , is <u>consumption-type</u> (allows full and immediate tax credit on capital goods), is based on <u>destination principle</u> (exports are zero-rated and imports are taxed), and uses <u>invoice-based credit method</u> (VAT is calculated on sales and purchases separately, and tax is paid on difference between VAT on sales and VAT on purchases adequately supported by invoices).	Main <u>zero-ratings</u> include (i) exports; (ii) several unprocessed food items including brown bread, maize meal, milk, eggs, fruit, and vegetables; (iii) petrol and diesel; (iv) several agricultural inputs including seeds, feed, and fertilizers; and (v) international transport services. Main <u>exemptions</u> include: (i) residential rents; (ii) passenger transport; and (iii) educational services. All fee-based financial services, except certain premiums on life policies, contributions to retirement funds, and unit trust charges are subject to VAT with effect from October 1, 1996.	14 %.
5.2. <u>Turnover tax</u> Regional Service Councils Act.	A tax on turnover levied by Regional Service Councils.	Exemptions: (i) religious, charitable and educational institutions; (ii) non-profit organizations engaged in nature conservation or animal protection; (iii) amateur sport clubs; and (iv) letting of accommodation to employees.	Ranges from 0.1 to 0.2 %.

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(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates
5.3. <u>Excise duties</u> Customs and Excise Act No. 91 of 1964 as amended.	Central government taxes payable by the manufacturer or importer of certain commodities. Most are specific, though some ad valorem rates exist.	A rebate is granted on dutiable goods that are used by government, provincial administrations, diplomatic representatives, etc., and on taxable goods used by producers in the manufacture of taxable goods for industrial or commercial purposes.	Beer (excluding sorghum beer): 88 cents per liter. Sorghum beer: 5.5 cents per liter. Sorghum powder: 25 cents per kilogram. Unfortified wine: 42.5 cents per liter. Fortified wine: 92 cents per liter. Sparkling wine: 118 cents per liter. Spirits: 2,260 cents per liter absolute alcohol. Other fermented drinks: 81 cents per liter. Cold drinks and mineral water: 14 cents per liter. Cigarettes: 52 cents per 10 grams. Cigarette tobacco: 65 cents per 50 grams. Pipe tobacco and cigars: 460 cents per kilogram.
5.4. <u>Fuel levy</u> Customs and Excise Act No. 91 of 1964 as amended.	A central government levy on the sale of petrol and diesel.		Petrol: 66 cents per liter. Diesel: 58 cents per liter. Present rate is 0.75 %. Tax to be abolished with effect from October 1, 1996 (see VAT above).
5.5. <u>Levy on financial services</u> Income tax act No. 58 of 1962 as amended.	A central government tax levied on certain transactions or 50 % of the minimum share capital and unimpaired reserve funds of financial institutions.	Exemptions: (i) government pension funds; (ii) private pension funds where interest per quarter does not exceed R 125,000; (iii) stabilization account of SADF group life assurance scheme; (iv) interest received by pension fund from other pension fund, insurer or unit trust.	
5.6. <u>Motor vehicle taxes</u>	A tax levied on all private motor cars, station wagons, and similar dual purpose motor vehicles. Motorcycles are not subject to the duty.	Rate no longer depends on local content, nor on type and size of motor vehicle.	3.5 % of the wholesale price of the motor vehicle. All specific excise duties were abolished on September 1, 1995.

South Africa: Tax Summary as of April 1, 1996

(All amounts in South African rand)

Tax	Nature of Tax	Exemptions and Deductions	Rates
6. Taxes on international trade transactions			
6.1. Customs duties			
Customs and Excise Act No. 91 of 1964 as amended.	A three-column tariff schedule based on the Brussels nomenclature with general, most favored nation, and preferential rates of duty. Preferential treatment is given to goods from the United Kingdom and in some cases, goods from Canada and Ireland. There is a Customs Union with Botswana, Lesotho, and Swaziland. Most duties are assessed ad valorem at c.i.f. value but there are a number of specific duties.	Rebates are allowed for certain goods used in manufacture by approved industries or by particular institutions and bodies.	There are 35 ad valorem rates, and 2,865 tariff lines with either formula, specific, or other types of duties. Import duties vary widely.
6.2. Import surcharges	Abolished with effect from October 1, 1995.		
7. Other taxes			
7.1. Stamp duties			
Stamp Duties Act.	Ad valorem or specific taxes payable on a wide range of legal documents such as agreements, bills of exchange, bonds, fixed deposit receipts, leases, marketable securities, transfer deeds, etc.	Most securities issued by certain public corporations and public authorities are exempt from stamp duty on issue and transfers. Where marketable securities tax is chargeable, brokers' notes do not attract stamp duty.	Rates of stamp duty vary for different instruments and also for a particular instrument. Examples are: R 2 for agreements; 5 cents per R 100 for bills of exchange; 10 cents per R 200 per annum on fixed deposit receipts; and 0.5 cents per R 100 on registration of share certificates. With effect from June 1, 1996, rate on debit entries posted to banks, credit cards, and other special accounts to be raised from 15 cents to 20 cents, and maximum rate on installment agreements be set at R 100 for values over R 200,000.

South Africa - Exchange Arrangements

A full description of South Africa's exchange arrangements as of March 31, 1995 is given in Exchange Arrangements and Exchange Restrictions, Annual Report, 1995. With the abolishment of the financial rand system on March 13, 1995, South Africa eliminated its last restriction subject to approval under Article VIII of the Fund's Articles of Agreement.

Other changes in the exchange system in 1995 and early 1996 include:

Payments for Invisibles:

August 23, 1995: Indicative annual limits on allowances for travelers to other than neighboring countries were raised as follows: (i) for tourism, from R 23,00 to R 25,00 for adults and R 11,500 to R 12,500 for children; and (ii) for business travel, from R 34,000 to R 38,000.

December 7, 1995: Limits on other service payments were raised, including on subscriptions to societies, club memberships, and director fees.

A administrative changes affecting purchases of travel allowances and export declaration forms were completed in June 1995 and March 1996.

Nonresident Accounts:

The abolishment of the financial rand system led to the elimination of restrictions on nonresident accounts and on emigrant blocked accounts.

Capital Restrictions on Residents:

On July 13, the Government announced that insurance companies, pension funds, and unit trusts would be permitted to invest abroad by way of swap arrangements providing foreign investors part of their existing asset portfolios in exchange for foreign assets.

On January 23, 1996, the Government announced an extension of the asset swap dispensation, permitting the above-mentioned institutions to acquire up to 10 per cent of the Government's £100 million Euro-sterling issue launched on the same day.

The South Africa Reserve Bank (SARB) Role in the Forward Market:

On July 13, 1995, the Reserve Bank announced its intention to withdraw from short-term transactions in the forward market for other than financial transactions. It will continue to participate in regular export/import transactions from time to time on its own initiative. The requirement for exporters to obtain forward cover was also abolished.

Table 1. South Africa: Expenditure on GDP, 1992-95

	1995		1992	1993	1994	1995	1994		1995					
	Billions of rand	Percent of GDP					III	IV	I	II	III	IV		
	(At current prices)		(Annual percentage change; at 1990 prices)				(Seasonally adjusted at annual rates)							
Private consumption	294.9	60.9	-1.4	0.3	3.1	4.9	3.9	5.4	4.1	5.7	6.4	5.0		
Public consumption	99.3	20.5	1.5	2.9	4.2	0.3	1.3	0.6	-2.1	0.4	2.1	2.2		
Gross fixed investment	81.8	16.9	-5.3	-2.8	8.7	10.4	13.6	18.3	8.2	7.8	7.6	4.0		
Final demand	476.0	98.2	-1.6	0.3	4.3	4.9	5.1	6.7	3.5	5.0	5.7	4.2		
Inventory demand 1/	11.9	2.5	0.5	0.9	1.6	1.1	4.6	2.7	1.0	2.3	-3.8	-0.8		
Statistical discrepancy 1/	-1.4	-0.3	-0.4	0.0	0.6	-0.4	0.4	0.2	-1.9	-0.0	-0.5	1.2		
Domestic demand	486.4	100.4	-1.5	1.3	6.7	5.6	10.3	9.6	2.5	7.2	1.2	4.6		
Exports of goods and nonfactor services	117.9	24.3	1.1	6.0	0.3	8.1	20.8	6.6	25.5	-15.3	23.1	-12.2		
Imports of goods and nonfactor services	119.7	24.7	5.3	7.0	16.1	17.1	51.2	18.6	28.9	0.3	15.2	-6.2		
Foreign balance 1/	-1.8	-0.4	-0.8	0.1	-3.6	-2.2	-5.4	-2.9	-0.7	-4.7	1.8	-1.8		
GDP at market prices	484.6	100.0	-2.2	1.3	2.7	3.3	4.2	6.5	1.7	2.2	3.0	2.7		

Source: South African Reserve Bank, Quarterly Bulletin.

1/ Contribution to GDP growth.

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Table 2. South Africa: Gross Fixed Investment and Capital Stock, 1992-95

	1995 Share of total	1992	1993	1994	1995	1994		1995			
						III	IV	I	II	III	IV
		(Annual percentage change, at 1990 prices)					(Seasonally adjusted at annual rates)				
Total gross investment	100.0	-5.3	-2.8	8.7	10.4	13.6	18.3	8.2	7.8	7.6	4.0
By type of organization											
Private enterprises 1/	74.6	-2.4	-1.6	13.3	13.3	29.1	26.8	5.2	8.4	8.7	3.8
Public corporations	13.2	-6.4	-13.4	-2.1	15.2	5.5	7.5	44.0	10.1	8.0	6.2
Public authorities	12.1	-15.4	2.6	-1.8	-8.3	-35.3	-12.7	-3.7	1.7	0.4	2.3
By sector											
Mining	9.3	-18.7	-27.4	19.8	8.6	29.5	27.6	-18.2	17.5	12.2	-17.8
Manufacturing	28.2	-6.0	5.1	9.9	21.3	43.3	42.4	20.2	5.6	10.8	8.7
Financial services 1/ 2/	23.3	-2.8	-0.1	10.7	8.3	18.2	12.3	5.5	5.9	4.2	4.1
Community, social, and personal services	11.1	6.2	1.8	-0.7	-7.8	-20.7	-19.3	-10.3	7.5	2.3	5.0
Other sectors	28.2	-5.3	-3.8	7.5	11.3	1.1	19.2	18.5	8.6	7.9	6.8
By type of assets											
Residential building	10.2	4.9	-2.3	2.0	0.1	-3.2	1.2	1.8	-1.9	3.1	-2.3
Nonresidential building	9.8	-17.7	-6.7	-1.1	-4.0	-12.5	-8.3	-6.0	2.6	8.5	9.9
Construction works	13.6	-21.0	-10.6	-3.0	-0.2	-20.6	-8.8	11.2	5.5	9.1	-7.8
Transport equipment	13.7	-8.4	-7.0	6.1	13.7	21.8	16.7	13.0	11.8	7.0	10.8
Machinery and other equipment	49.3	7.7	3.2	18.4	19.9	38.3	40.9	12.9	10.6	11.6	5.1
Transfer costs	3.5	0.7	1.3	15.9	-1.0	24.7	15.3	-15.3	7.4	-31.4	13.1
Real fixed capital stock 3/	100.0	0.6	0.5	0.9	1.3						
By type of organization											
Private enterprises 1/	48.9	1.2	1.0	1.8	2.6						
Public corporations	20.6	7.8	-2.3	-2.3	-1.7						
Public authorities 4/	30.5	-5.0	1.7	1.6	1.4						
By sector											
Mining	8.1	0.1	-2.0	-1.0	-0.5						
Manufacturing	13.4	2.5	2.8	3.2	4.6						
Financial services 1/ 2/	20.4	0.8	0.7	1.3	1.7						
Community, social, and personal services	27.5	2.1	2.0	1.9	1.7						
Other sectors	30.7	-1.2	-1.2	-0.8	-0.2						
Memorandum item:											
Net domestic fixed investment (in percent of GDP)		1.9	1.4	2.6	3.8						

Source: South African Reserve Bank, *Quarterly Bulletin*.

1/ Including transfer costs.

2/ Finance, insurance, real estate, and business services.

3/ End of period.

4/ General Government plus four departmental enterprises (Community Development Fund, Government Motor Transport Trading, Government Printing Works, National Housing Fund).

Table 3. South Africa: Financing of Domestic Investment, 1990–95
(In percent of GDP at market price)

	1990	1991	1992	1993	1994	1995
Total investment	17.6	16.9	15.9	15.7	17.7	19.3
Fixed investment	19.6	17.8	16.6	15.5	16.0	16.9
Private enterprises	12.9	11.9	11.4	10.8	11.7	12.6
Public corporations	3.2	2.8	2.6	2.1	2.0	2.1
Public authorities	3.5	3.1	2.6	2.5	2.4	2.1
Change in inventories	-2.0	-0.9	-0.8	0.2	1.7	2.5
Domestic saving	19.5	18.9	17.0	17.2	17.2	16.7
General government saving	1.2	0.3	-4.0	-4.9	-4.0	-3.0
Private saving	18.4	18.6	21.0	22.0	21.2	19.7
Personal saving	4.0	4.5	5.9	6.5	6.0	4.8
Corporate saving	14.4	14.2	15.0	15.5	15.2	15.0
Foreign saving	-1.9	-2.0	-1.2	-1.5	0.5	2.6
Memorandum item:						
Provision for depreciation	15.6	15.1	14.7	14.1	13.7	13.6

Source: South African Reserve Bank

Table 4. South Africa: Personal Income and Expenditure, 1992-95

	1995 Billions of rand	1992	1993	1994	1995	1994		1995			
						III	IV	I	II	III	IV
		(Annual percentage change: at market prices)				(Seasonally adjusted at annual rates)					
Personal disposable income 1/	302068	16.6	12.0	11.2	10.9	14.2	14.1	11.3	10.3	4.6	6.4
Remuneration of employees 2/	256256	13.1	11.0	10.2	11.7	9.0	8.0	15.5	15.0	8.2	6.3
Other 3/	45812	43.5	18.0	16.7	6.9	47.6	51.1	-7.3	-12.0	-13.9	7.1
Private consumption	294895	14.1	10.7	12.1	13.5	15.5	16.9	13.5	14.7	7.7	8.7
Durables	28001	5.4	10.6	9.6	19.4	4.7	7.7	35.1	31.8	17.6	6.5
Semi-durables	46301	10.1	12.8	10.9	12.3	10.8	13.0	17.7	8.2	12.9	7.2
Nondurables	140312	16.1	10.0	14.3	12.5	24.9	21.5	3.9	14.2	1.6	13.1
Services	80281	16.1	10.6	9.9	14.1	6.5	14.1	22.8	14.1	12.5	2.9
Transfer to General government and abroad	1142	-9.9	12.5	46.7	69.2	-66.2	596.3	53.9	62.0	7.6	179.6
		(As a percent of personal disposable income)									
Personal saving	6031	4.1	5.2	4.4	2.0	4.4	3.7	3.3	2.3	1.6	0.9
Memorandum items		(Annual percentage change: at market prices)				(Seasonally adjusted at annual rates)					
Private consumption (1990 prices)	169719	-1.4	0.3	3.1	4.9	3.9	5.4	4.1	5.7	6.4	5.0
Durables	16704	-4.7	-1.3	2.1	9.0	2.6	6.8	11.0	16.6	6.6	11.5
Semi-durables	30261	0.4	2.9	5.4	6.1	7.3	8.0	6.0	5.4	5.0	2.1
Nondurables	74845	-3.4	-0.1	3.4	4.3	3.8	5.3	1.1	5.2	8.1	5.8
Services	47909	1.9	-0.0	1.5	3.8	2.4	3.5	5.5	3.1	4.4	3.5

Source: South African Reserve Bank, Quarterly Bulletin.

1/ After provision for depreciation and inventory adjustment.

2/ After adjustment for net remuneration paid to non-residents.

3/ Income from property, current transfers (gross), less direct taxes.

Table 5. South Africa: Real Gross Domestic Product at Factor Cost, 1992-95

	1995		1992	1993	1994	1995	1994		1995			
	Billions of rand	Percent of total					III	IV	I	II	III	IV
	(At current prices)		(Annual percentage change; at 1990 prices)				(Seasonally adjusted at annual rates)					
Primary sector	<u>52.1</u>	<u>12.1</u>	<u>-8.9</u>	<u>8.7</u>	<u>2.3</u>	<u>-7.8</u>	<u>4.4</u>	<u>9.9</u>	<u>-12.4</u>	<u>-22.1</u>	<u>-17.1</u>	<u>1.0</u>
Agriculture, forestry, and fishing	18.8	4.4	-27.3	24.0	12.0	-14.9	11.4	27.8	-15.6	-42.2	-49.8	-2.4
Mining and quarrying	33.3	7.7	1.7	2.3	-2.5	-3.6	0.6	0.4	-10.4	-7.5	6.2	2.5
Industry sector	<u>135.9</u>	<u>31.6</u>	<u>-3.1</u>	<u>0.0</u>	<u>2.6</u>	<u>6.4</u>	<u>6.0</u>	<u>8.6</u>	<u>6.3</u>	<u>8.4</u>	<u>7.2</u>	<u>-1.5</u>
Manufacturing	104.5	24.3	-3.3	0.2	2.5	7.6	7.5	11.0	7.0	10.0	8.6	-2.8
Construction	13.6	3.2	-6.2	-6.8	1.2	1.8	1.1	1.2	2.3	1.8	2.0	1.7
Electricity, gas, and water	17.8	4.1	0.5	4.0	3.7	3.3	2.0	1.7	5.0	4.0	3.0	3.4
Service sector	<u>242.5</u>	<u>56.3</u>	<u>-0.1</u>	<u>0.6</u>	<u>2.5</u>	<u>3.6</u>	<u>2.7</u>	<u>3.6</u>	<u>2.7</u>	<u>4.8</u>	<u>4.4</u>	<u>4.0</u>
Wholesale and retail trade, and catering	70.1	16.3	-2.3	0.5	3.9	6.1	3.8	6.3	2.7	9.0	8.4	9.2
Transport, storage, and communications	32.7	7.6	1.9	2.4	3.7	4.7	1.8	2.0	6.4	7.3	6.1	3.7
Finance, insurance, real estate, and business services	56.9	13.2	-0.2	0.1	2.6	3.9	3.9	4.6	3.4	4.2	4.0	2.5
General government and other services	101.9	23.7	1.1	0.4	0.9	1.0	1.3	1.6	0.7	0.7	0.7	0.7
GDP at factor cost	<u>430.4</u>	<u>100.0</u>	<u>-2.4</u>	<u>1.6</u>	<u>2.5</u>	<u>2.8</u>	<u>4.0</u>	<u>6.1</u>	<u>1.4</u>	<u>1.6</u>	<u>2.1</u>	<u>1.7</u>
Memorandum item												
GDP excluding primary sectors	378.3	87.9	-1.2	0.4	2.5	4.7	3.9	5.5	4.0	6.1	5.5	1.8

Source: South African Reserve Bank, Quarterly Bulletin.

Table 6. South Africa: Indicators of Mining and Quarrying Activity, 1988-95

	Weights ^{1/}	1988	1989	1990	1991	1992	1993	1994	1995
(Annual percentage change)									
Production volume	100.0	2.9	-2.4	-1.9	-0.9	0.4	3.0	-1.5	-1.7
Gold	45.8	2.5	-2.4	-1.2	-0.7	2.0	1.0	-6.5	-9.2
Nongold	54.2	3.3	-2.2	-2.7	-1.1	-0.9	4.7	2.6	5.0
Of which:									
Coal	19.7	3.0	-2.4	-2.4	1.3	-1.8	4.3	6.6	3.6
Platinum	12.4	2.9	1.5	6.1	-0.1	7.8	15.2	-6.5	11.9
Diamonds	4.2	-5.6	6.2	-2.7	-0.6	14.6	-8.5	6.2	-18.1
Copper	2.7	-8.3	7.8	-3.0	5.1	-8.7	-0.4	1.8	-1.8
Iron ore	2.6	15.7	18.3	4.8	-5.2	-0.5	5.6	13.6	3.1
Manganese	2.0	22.7	27.0	-6.6	-28.9	-21.6	1.1	13.8	11.2
Chrome	1.2	9.9	16.6	-6.7	3.8	-29.8	-15.6	26.8	42.5
Gross fixed investment at 1990 prices		9.3	3.2	-6.2	-6.8	-18.7	-27.4	19.8	8.6
Fixed capital stock at 1990 prices		5.3	4.3	3.1	2.1	0.1	-2.0	-1.0	-0.5
Employment	100.0	-4.0	-3.5	-2.0	-5.7	-6.9	-7.6	9.3	...
Gold	69.8	-5.0	-2.6	-7.4	11.9	-23.5	-5.6	1.7	...
Nongold	30.2	-1.4	-5.9	13.3	-46.5	73.2	-12.0	26.5	...
Wage bill	100.0	14.6	13.1	14.5	8.4	4.9	-0.2	16.2	...
Gold	64.2	14.0	10.1	9.4	4.1	0.9	4.0	5.5	...
Nongold	35.8	16.1	20.0	25.1	16.0	11.3	-6.2	33.5	...
(In percent)									
Memorandum items:									
Share in total capital stock at 1990 prices		8.1	8.4	8.5	8.6	8.6	8.4	8.2	8.1
Share in total nonagri- cultural employment		14.6	14.3	14.0	13.2	12.4	11.8	11.7	...
Share in real GDP at factor cost		10.1	9.7	9.7	9.6	10.0	10.1	9.6	9.0

Sources: South African Reserve Bank, Quarterly Bulletin; Central Statistical Service, Bulletin of Statistics.

^{1/} In 1990.

Table 7. South Africa: Indicators of Manufacturing Activity, 1990-95

	1990	1991	1992	1993	1994	1995	1994		1995			
							III	IV	I	II	III	IV
	<u>(Annual percentage change)</u>						<u>(Seasonally adjusted at annual rates; period average)</u>					
Production volume	-0.4	-3.6	-3.0	-0.2	2.7	7.4	17.5	10.4	8.3	13.8	-6.3	-4.8
Durable goods	-3.2	-5.1	-6.2	-1.7	3.5	10.2	16.5	25.2	7.8	20.3	-12.2	-2.3
Nondurable goods	1.8	-2.5	-0.8	0.9	2.2	5.5	18.1	1.6	8.3	9.3	-1.7	-6.5
Sales (at 1990 prices)	-0.5	-3.5	-4.0	-0.8	2.3	7.1	12.3	14.5	5.0	8.6	-3.0	4.6
New orders (at 1990 prices)	-5.2	-5.4	-4.2	-0.6	7.3	7.2	30.2	30.7	-22.6	22.3	-3.9	4.0
Unfilled orders (at 1990 prices)	-7.1	-16.7	1.2	-0.9	12.6	2.6	41.1	36.6	-14.1	-5.2	-19.6	-7.6
Gross fixed investment (at 1990 prices)	13.8	-11.7	-6.0	5.1	9.9	21.3	43.3	42.4	20.2	5.6	10.8	8.7
Net fixed investment (at 1990 prices)	85.5	-27.8	-15.5	17.8	17.1	47.8	...	...	...	...	...	...
Unit labor costs	15.7	14.8	15.9	9.0	7.9	...	-2.0	3.4	-4.5	18.9	...	...
Production prices	-7.1	-16.7	1.2	-0.9	12.6	2.6	12.3	7.9	13.1	10.1	5.8	9.2
Labor productivity	--	-1.0	0.1	2.1	2.7	...	12.7	7.4	10.5	11.8	...	...
	<u>(In percent)</u>											
Capacity utilization	81.9	81.0	78.5	77.9	80.0	...	80.0	81.8	83.3	83.7	83.4	...
Durable goods	81.5	78.2	75.1	74.8	78.5	...	77.8	81.4	83.1	84.0	83.4	...
Nondurable goods	81.8	83.0	81.0	80.3	81.5	...	82.1	83.0	83.5	83.5	83.6	...

Source: South African Reserve Bank, Quarterly Bulletin.

Table 8. South Africa: Nonagricultural Employment, 1988-95
(1990 = 100)

	Public Authorities 1/			Private sector			Grand total
	General govt.	Business enterprises 2/	Total	Mining	Manufacturing	Total 3/	
1988	95.9	105.7	97.2	103.7	100.4	100.6	99.5
1989	98.6	102.2	99.0	102.4	100.4	100.9	100.3
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	103.2	98.5	102.4	92.7	97.4	96.3	98.2
1992	105.3	94.5	103.6	85.3	94.3	92.8	96.1
1993	106.1	82.4	102.3	79.6	92.3	90.3	94.0
1994	107.6	76.8	102.8	78.0	92.2	89.1	93.3
(End of quarter: seasonally adjusted)							
1990							
I	99.2	101.4	99.6	101.8	100.6	101.2	100.7
II	100.0	99.7	100.0	101.4	100.1	100.5	100.3
III	100.1	99.7	100.0	98.6	99.6	99.8	99.8
IV	100.7	99.3	100.4	96.2	98.9	98.6	99.1
1991							
I	102.6	99.2	102.0	93.9	98.0	97.3	98.8
II	102.7	98.5	102.0	92.5	97.5	96.4	98.1
III	103.0	98.8	102.3	92.2	97.0	96.0	97.9
IV	104.4	97.6	103.3	91.0	96.3	95.5	97.9
1992							
I	104.3	96.7	103.1	87.8	95.3	94.1	96.9
II	104.1	95.5	102.8	85.2	94.5	93.3	96.3
III	105.5	94.0	103.7	83.7	93.5	92.1	95.7
IV	107.3	91.7	104.8	82.5	93.7	91.6	95.7
1993							
I	106.9	86.7	103.7	80.8	93.1	91.3	95.1
II	104.4	83.9	101.2	78.7	92.3	90.6	93.9
III	105.4	80.3	101.4	78.7	91.8	90.1	93.6
IV	107.6	78.9	103.0	78.1	90.2	89.3	93.5
1994							
I	107.6	77.6	102.9	78.3	91.6	88.9	93.2
II	105.7	76.6	101.2	78.4	92.0	88.9	92.7
III	107.2	75.8	102.3	77.3	92.8	89.1	93.2
IV	110.0	77.0	104.9	77.9	92.6	89.5	94.2
1995							
I	108.7	77.1	103.8	77.2	92.5	89.7	94.0
II	106.2	77.3	102.0	76.5	93.2	89.9	93.7

Source: South African Reserve Bank, Quarterly Bulletin.

1/ Central Government, local authorities, provincial administrations, statutory bodies, and national and independent states (TVBC).

2/ Transnet and the Department of Posts and Telecommunications.

3/ Includes Electricity Supply Commission, Boards of Control, and universities.

Table 9. South Africa: Remuneration, Labor Productivity, and Unit Labor Costs in the Nonagricultural Sector, 1991-95

	1991	1992	1993	1994	1994 1/				1995 1/	
					I	II	III	IV	I	II
<u>(Annual percentage change)</u>										
Remuneration per worker										
At current prices										
Public authorities	16.7	14.8	9.2	15.3	9.1	21.6	14.8	15.9	11.7	-1.2
Private sector	15.4	15.2	11.2	10.2	9.6	10.4	11.4	9.4	10.4	12.9
Total	16.1	15.2	10.5	12.2	9.5	14.7	12.7	11.8	10.9	7.4
At constant 1990 prices 2/										
Public authorities	2.1	1.4	-1.5	6.0	0.3	11.6	6.0	7.7	3.0	-0.8
Private sector	0.9	1.7	0.4	1.6	0.9	1.3	2.7	1.8	1.7	4.3
Total	1.5	1.6	-0.3	3.3	0.7	5.1	4.0	4.0	2.2	-0.8
Labor productivity	0.4	1.2	2.9	2.8	3.4	3.1	2.5	2.0	2.4	2.9
Unit labor costs										
Nominal	15.7	13.8	7.4	9.0	5.9	11.2	10.0	9.6	8.3	4.4
Real 2/	1.2	0.5	-3.0	0.6	-2.7	2.0	1.5	1.9	-0.2	-3.6

Source: South African Reserve Bank, Quarterly Bulletin.

1/ Seasonally adjusted.

2/ At 1990 prices; deflated by nonagricultural deflator.

Table 10. South Africa: Price Developments, 1991-95

(Percentage change over the previous period; period average)

	Weight 1/	1991	1992	1993	1994	1995	1994				1995			
							I	II	III	IV	I	II	III	IV
(Seasonally adjusted at annual rate)														
Consumer prices	100.0	15.3	13.9	9.7	9.0	8.6	9.0	7.9	14.3	8.5	8.9	10.9	1.7	4.8
Goods	57.9	17.0	16.3	10.4	9.4	7.4	8.4	8.9	18.1	6.7	7.1	9.9	-2.7	4.0
Of which:														
Food	19.3	(19.6)	(24.8)	(7.2)	(13.6)	(8.6)	(13.9)	(18.1)	(39.3)	(8.0)	(5.5)	(11.2)	(-12.6)	(1.4)
Services	42.1	12.6	11.2	8.6	8.9	10.7	7.9	8.0	14.7	9.6	9.2	13.5	12.5	3.4
Of which:														
Housing	21.4	(5.6)	(2.0)	(0.1)	(5.0)	(13.6)	(0.1)	(7.3)	(6.7)	(12.9)	(14.8)	(20.3)	(15.2)	(7.6)
Producer prices	100.0	11.3	8.2	6.7	8.2	9.6	10.0	10.3	13.9	5.6	14.3	10.1	2.8	7.9
Goods produced in														
South Africa	80.5	12.2	9.1	6.9	8.9	9.9	10.9	9.8	13.6	7.4	13.5	10.0	3.7	9.8
Imported goods	19.5	8.4	4.1	4.9	5.5	7.6	5.3	14.1	13.8	-2.1	15.5	10.5	-0.5	2.8
GDP deflator at market prices		13.5	12.4	11.1	9.5	8.7	7.6	16.6	8.1	3.8	12.1	9.4	7.8	4.2
Memorandum items:														
Twelve-month rate to end of period														
Consumer prices		16.0	9.5	9.7	10.0	7.0	9.1	7.6	9.9	10.0	10.0	10.1	6.3	7.0
Producer prices		8.3	6.9	6.3	10.3	8.8	6.3	7.9	9.8	10.3	11.1	10.4	7.8	8.8

Source: South African Reserve Bank, Quarterly Bulletin.

1/ The consumer price series uses 1990 weights; the producer price series uses 1985 weights.

Table 11. South Africa: Government Finances, 1991/92-1996/97 1/

	1991/92	1992/93	1993/94	1994/95	1995/96 Budget	1995/96 Prel.	1996/97 Budget
(In millions of rand)							
Revenue	78,700	83,864	98,145	112,188	124,063	128,285	144,688
Inland Revenue	64,581	66,253	77,884	92,368	103,330	106,438	120,031
Income tax	44,032	46,956	50,172	59,868	67,123	68,328	80,304
Sales tax/VAT	18,792	17,506	25,449	29,288	32,750	32,600	36,930
Other	1,757	1,791	2,262	3,212	3,457	5,510	2,797
Customs and Excise	11,622	14,308	16,241	17,892	17,989	17,867	20,824
Import duty and surcharge	4,192	4,482	5,170	5,418	5,345	5,856	6,230
Excise duty	3,825	4,436	4,967	5,804	6,111	6,574	6,918
Fuel levy and other	6,365	8,374	9,194	9,919	10,423	9,327	12,039
SACU payments	-2,760	-2,984	-3,089	-3,249	-3,890	-3,890	-4,363
Extraordinary Revenue	834	1,105	1,435	16	1,215	1,247	1,896
Montax Revenue	1,662	2,198	2,585	1,913	1,529	2,733	1,936
Expenditure	91,725	111,501	121,940	137,617	153,248	155,765	173,490
Primary recurrent expenditure	72,498	88,093	93,535	105,036	110,104	113,671	125,278
Capital expenditure	5,341	5,879	7,577	8,348	13,651	12,882	13,768
Interest payments	13,886	17,530	20,828	24,233	29,493	29,213	34,445
Balance before borrowing	-13,025	-27,637	-23,795	-25,429	-29,186	-27,480	-28,802
(In percent of GDP)							
Revenue	24.6	24.1	24.9	25.2	24.8	25.7	25.8
Inland Revenue	20.2	19.0	19.7	20.7	20.7	21.3	21.4
Income tax	13.8	13.5	12.7	13.4	13.4	13.7	14.3
Sales tax/VAT	5.9	5.0	6.5	6.6	6.6	6.5	6.6
Other	0.5	0.5	0.6	0.7	0.7	1.1	0.5
Customs and Excise	3.6	4.1	4.1	4.0	3.6	3.6	3.7
Import duty and surcharge	1.3	1.3	1.3	1.2	1.1	1.2	1.1
Excise duty	1.2	1.3	1.3	1.3	1.2	1.3	1.2
Fuel levy and other	2.0	2.4	2.3	2.2	2.1	1.9	2.1
SACU payments	-0.9	-0.9	-0.8	-0.7	-0.8	-0.8	-0.8
Extraordinary Revenue	0.3	0.3	0.4	--	0.2	0.2	0.3
Montax Revenue	0.5	0.6	0.7	0.4	0.3	0.5	0.3
Expenditure	28.6	32.1	30.9	30.9	30.6	31.2	30.9
Primary recurrent expenditure	22.6	25.3	23.7	23.6	22.0	22.7	22.3
Capital expenditure	1.7	1.7	1.9	1.9	2.7	2.6	2.5
Interest payments	4.3	5.0	5.3	5.4	5.9	5.8	6.1
Overall balance	-4.1	-7.9	-6.0	-5.7	-5.8	-5.5	-5.1
Memorandum items:							
Overall balance, excluding extraordinary revenue	-4.3	-8.3	-6.4	-5.7	-6.1	-5.7	-5.3
Primary balance before borrowing	0.3	-2.9	-0.8	-0.3	0.1	-0.3	1.0
Golden rule gap 2/	-2.4	-6.3	-4.1	-3.8	-3.1	-2.9	-2.7
Government debt 3/	39.5	44.5	48.7	54.9	54.7	55.3	54.9
Nominal GDP (in millions of rand)	320,226	347,785	394,434	445,600	500,000	500,000	561,000

Sources: Department of Finance; and Fund staff estimates.

1/ National budget; fiscal year begins April 1.

2/ Balance before borrowing plus capital expenditure.

3/ At end of fiscal year.

Table 12. South Africa: Central Government Revenue, 1991/92-1996/97 ^{1/}

(In millions of rand)

	1991/92	1992/93	1993/94	1994/95	1995/96 Budget	1995/96 Prel.	1996/97 Budget
Revenue	78,700	83,864	98,145	112,188	124,063	128,285	144,688
Revenue, excluding extraordinary revenue	77,866	82,759	96,710	112,173	122,848	127,038	142,792
Inland Revenue	64,581	66,253	77,884	92,368	103,330	106,438	120,031
Income tax	44,032	46,956	50,172	59,868	67,123	68,328	80,304
Gold mines	524	422	622	1,173	1,485	950	865
Other mines	1,049	576	509	457	813	898	1,354
Nonmining companies	12,491	12,126	11,236	13,265	15,070	15,260	20,110
Individuals	29,969	33,833	37,805	44,973	49,755	51,220	57,975
Sales tax/VAT	18,792	17,506	25,449	29,288	32,750	32,600	36,930
Other	1,757	1,791	2,262	3,212	3,457	5,510	2,797
Customs and Excise	11,622	14,308	16,241	17,892	17,989	17,867	20,824
Customs duty	2,736	2,961	3,413	4,247	4,700	5,400	6,230
Surcharge	1,456	1,321	1,756	1,171	645	456	--
Excise duty	3,825	4,436	4,967	5,804	6,111	6,574	6,918
Fuel levy	5,421	7,083	7,860	8,352	8,855	8,900	10,360
Other	944	1,291	1,334	1,567	1,568	427	1,679
SACU payments	-2,760	-2,984	-3,089	-3,249	-3,890	-3,890	-4,363
Extraordinary Revenue	834	1,105	1,435	16	1,215	1,247	1,896
Nontax Revenue	1,662	2,198	2,585	1,913	1,529	2,733	1,936
Memorandum items:							
Direct taxes	44,662	47,359	50,934	61,005	68,230	69,123	81,054
Indirect taxes	31,542	33,002	43,191	49,255	53,089	53,859	59,801

Sources: Department of Finance; GFS definition.

^{1/} Fiscal year begins April 1.

Table 13. South Africa: Central Government Revenue, 1991/92-1996/97 ^{1/}

(In percent of GDP)

	1991/92	1992/93	1993/94	1994/95	1995/96 Budget	1995/96 Prel.	1996/97 Budget
Revenue	24.6	24.1	24.9	25.2	24.8	25.7	25.8
Revenue, excluding extraordinary revenue	24.3	23.8	24.5	25.2	24.6	25.4	25.5
Inland Revenue	20.2	19.0	19.7	20.7	20.7	21.3	21.4
Income tax	13.8	13.5	12.7	13.4	13.4	13.7	14.3
Gold mines	0.2	0.1	0.2	0.3	0.3	0.2	0.2
Other mines	0.3	0.2	0.1	0.1	0.2	0.2	0.2
Nonmining companies	3.9	3.5	2.8	3.0	3.0	3.1	3.6
Individuals	9.4	9.7	9.6	10.1	10.0	10.2	10.3
Sales tax/VAT	5.9	5.0	6.5	6.6	6.6	6.5	6.6
Other	0.5	0.5	0.6	0.7	0.7	1.1	0.5
Customs and Excise	3.6	4.1	4.1	4.0	3.6	3.6	3.7
Customs duty	0.9	0.9	0.9	1.0	0.9	1.1	1.1
Surcharge	0.5	0.4	0.4	0.3	0.1	0.1	--
Excise duty	1.2	1.3	1.3	1.3	1.2	1.3	1.2
Fuel levy	1.7	2.0	2.0	1.9	1.8	1.8	1.8
Other	0.3	0.4	0.3	0.4	0.3	0.1	0.3
SACU payments	-0.9	-0.9	-0.8	-0.7	-0.8	-0.8	-0.8
Extraordinary Revenue	0.3	0.3	0.4	--	0.2	0.2	0.3
Montax Revenue	0.5	0.6	0.7	0.4	0.3	0.5	0.3
<u>Memorandum items:</u>							
Direct taxes	13.9	13.7	12.9	13.7	13.6	13.8	14.4
Indirect taxes	9.8	9.5	11.0	11.1	10.6	10.8	10.7

Sources: Department of Finance; GFS definition.

^{1/} Fiscal year begins April 1.

Table 14. South Africa: Economic Classification of General Government Expenditure, 1992/93-1996/97 1/

	1992/93	1993/94	1994/95	1995/96 Budget	1995/96 Prel.	1996/97 Budget
(In millions of rand)						
Goods and services	60,090	67,485	77,203	77,309	...	...
Remuneration of employees	42,417	47,733	56,461	56,741	...	...
Other	17,673	19,752	20,742	20,568	...	...
Interest	17,530	22,150	24,863	29,493	29,213	34,445
Current transfers	32,707	31,625	34,818	37,331	...	...
Businesses	10,829	8,620	7,961	7,917	...	...
Households	10,677	11,360	14,904	15,727	...	...
Foreign	187	338	231	248	...	...
Other general government institutions and funds	11,014	11,307	11,723	13,439	...	...
Capital expenditure	7,771	10,150	11,347	13,936	13,066	13,500
Investment	5,155	6,843	7,935	8,817	...	...
Capital transfers	2,282	2,974	2,987	4,124	...	...
Businesses, households and foreign	353	840	508	617	...	...
Other general government institutions	1,929	2,135	2,479	3,507	...	...
Purchases of shares and loans	334	333	425	125	...	...
Unallocated	...	...	...	870	...	...
Total general government expenditure	118,097	131,410	148,231	158,068	157,360	173,659
(In percent of GDP)						
Goods and services	17.3	17.1	17.3	15.5	...	...
Remuneration of employees	12.2	12.1	12.7	11.3	...	...
Other	5.1	5.0	4.7	4.1	...	...
Interest	5.0	5.6	5.6	5.9	5.8	6.1
Current transfers	9.4	8.0	7.8	7.5	...	...
Businesses	3.1	2.2	1.8	1.6	...	...
Households	3.1	2.9	3.3	3.1	...	...
Foreign	0.1	0.1	0.1	--	...	...
Other general government institutions and funds	3.2	2.9	2.6	2.7	...	...
Capital expenditure	2.2	2.6	2.5	2.8	2.6	2.4
Investment	1.5	1.7	1.8	1.8	...	...
Capital transfers	0.7	0.8	0.7	0.8	...	...
Businesses, households and foreign	0.1	0.2	0.1	0.1	...	...
Other general government institutions	0.6	0.5	0.6	0.7	...	...
Purchases of shares and loans	0.1	0.1	0.1	--	...	...
Unallocated	--	--	--	0.2	...	...
Total general government expenditure	33.9	33.2	33.3	31.6	31.5	31.0

Sources: Department of Finance; and Fund staff estimates.

1/ Fiscal year begins April 1; general government comprises central and provincial governments, but excludes local governments, extrabudgetary funds, and social security funds.

Table 15. South Africa: Functional Classification of
General Government Expenditure, 1991/92-1995/96 ^{1/}

(In millions of rand)

	1991/92	1992/93	1993/94	1994/95 Budget	1994/95	1995/96 Budget
Protection services	19,229	21,166	23,076	25,385	27,065	26,459
Defence	10,488	10,803	10,683	12,124	12,908	11,927
Other ^{2/}	8,741	10,363	12,393	13,261	14,157	14,532
Social services	41,841	51,758	57,984	63,094	65,371	72,368
Education	19,929	24,393	27,761	30,850	31,625	33,443
Nontertiary	17,093	21,018	23,794	26,520	27,064	27,860
Tertiary	2,836	3,375	3,967	4,330	4,561	5,583
Health	10,630	12,709	13,969	14,299	15,565	15,688
Social security and welfare	7,431	10,031	10,794	13,015	13,672	15,209
Housing and related services	1,555	1,256	1,571	1,797	1,648	2,953
Other ^{3/}	2,296	3,369	3,889	3,133	2,861	5,075
Economic services	12,530	18,418	18,259	16,367	17,777	17,945
Agriculture, forestry and fishing	2,392	6,059	3,719	3,322	3,645	3,893
Transport and communication	4,402	5,628	6,601	6,526	6,701	7,243
Other economic services ^{4/}	5,736	6,731	7,939	6,519	7,431	6,810
Of which: export trade promotion	-1,623	-2,684	-2,528	-2,179	-2,248	-2,218
Other noninterest ^{5/}	8,743	9,224	9,943	13,762	13,156	11,804
Interest payments	14,460	17,530	22,150	24,573	24,863	29,493
Total general government expenditure	96,803	118,096	131,410	143,181	148,231	158,068

Sources: Department of Finance; and Fund staff estimates.

^{1/} Fiscal year begins April 1; general government comprises central and provincial governments, but excludes local governments, extrabudgetary funds, and social security funds.

^{2/} Police, prisons and law courts.

^{3/} Recreation and culture, community development, other community services and sewerage and sanitation.

^{4/} Including water, fuel and energy, mining, manufacturing and regional development.

^{5/} Including foreign affairs, general research, general administration, cost of raising loans, unallocable expenditure, and certain transfers to government enterprises.

Table 16. South Africa: Functional Classification of
General Government Expenditure, 1991/92-1995/96 1/

(In percent of GDP)

	1991/92	1992/93	1993/94	1994/95 Budget	1994/95	1995/96 Budget
Protection services	6.0	6.1	5.8	5.7	6.1	5.3
Defence	3.3	3.1	2.7	2.7	2.9	2.4
Other 2/	2.7	3.0	3.1	3.0	3.2	2.9
Social services	13.1	14.9	14.7	14.3	14.7	14.5
Education	6.2	7.0	7.0	7.0	7.1	6.7
Nontertiary	5.3	6.0	6.0	6.0	6.1	5.6
Tertiary	0.9	1.0	1.0	1.0	1.0	1.1
Health	3.3	3.7	3.5	3.2	3.5	3.1
Social security and welfare	2.3	2.9	2.7	2.9	3.1	3.0
Housing and related services	0.5	0.4	0.4	0.4	0.4	0.6
Other 3/	0.7	1.0	1.0	0.7	0.6	1.0
Economic services	3.9	5.3	4.6	3.7	4.0	3.6
Agriculture, forestry and fishing	0.7	1.7	0.9	0.8	0.8	0.8
Transport and communication	1.4	1.6	1.7	1.5	1.5	1.4
Other economic services 4/	1.8	1.9	2.0	1.5	1.7	1.4
Of which: export trade promotion	-0.5	-0.8	-0.6	-0.5	-0.5	-0.4
Other noninterest 5/	2.7	2.7	2.5	3.1	3.0	2.4
Interest payments	4.5	5.0	5.6	5.6	5.6	5.9
Total general government expenditure	30.2	33.9	33.2	32.4	33.3	31.6

Sources: Department of Finance; and Fund staff estimates.

1/ Fiscal year begins April 1.

2/ Police, prisons, and law courts.

3/ Recreation and culture, community development, other community services and sewerage, and sanitation.

4/ Including water, fuel and energy, mining, manufacturing and regional development.

5/ Including foreign affairs, general research, general administration, cost of raising loans, unallocable expenditure, and certain transfers to government enterprises.

6/ These funds have been committed to expenditure but have not yet been spent. They are rolled over into the next fiscal year.

Table 17. South Africa: Financing of the Central Government Budget, 1991/92-1996/97 1/

(In millions of rand)

	1991/92	1992/93	1993/94	1994/95	1995/96 Budget	1995/96 Prel.	1996/97 Budget
Fiscal balance before borrowing 2/	-14,265	-29,446	-26,819	-25,522	-30,257	-28,727	-30,699
Government stock	13,479	28,180	38,755	24,990	27,666	27,804	27,856
Government stock issued	17,628	32,218	41,386	33,012	28,095	30,219	30,684
Discount on government stock	-4,149	-4,038	-2,631	-8,022	-429	-2,415	-2,828
Loan levy	2	1	--	-710	--	--	--
Foreign loans	551	537	-140	2,604	1,391	1,745	947
Use of cash balances	1,194	5,286	1,537	-1,374	--	-1,410	--
Unusual receipts	839	1,222	1,506	31	1,200	1,247	1,896
Privatisation	--	108	--	--	--	--	--
Other 3/	839	1,114	1,506	31	1,200	1,247	1,896
Unusual transfers	-1,800	-5,777	-14,840	--	--	-3,073	--
Gold and Foreign Exchange							
Contingency	--	-3,777	-7,500	--	--	-3,073	--
Government Pension Funds	-1,000	-2,000	-7,340	--	--	--	--
Other	-800	--	--	--	--	--	--
Total financing:	14,265	29,449	26,818	25,541	30,257	28,727	30,699

Sources: South African Reserve Bank, Quarterly Bulletin; and Fund staff estimates.

1/ Fiscal year begins April 1.

2/ Reserve Bank data for the central government deficit differ from Department of Finance data owing to differences of definition and timing.

3/ Includes National Supplies Procurement and Central Energy Funds.

Table 18. South Africa: Central Government Debt, 1991-95

	1991	1992	1993	1994	1995
<u>(In millions of rand: end of period)</u>					
External debt	2,099	2,367	4,996	8,058	9,610
Domestic debt	112,470	136,229	171,608	215,373	249,284
Marketable	103,403	130,816	168,005	212,974	248,212
Bonds	100,114	122,035	159,731	205,484	240,414
Bills	2,580	8,072	7,564	7,489	7,798
Loan levies	709	710	710	--	--
Nonmarketable	9,066	5,413	3,603	2,399	1,072
Bonds	1,124	1,128	959	687	508
Bills	7,940	4,281	2,641	1,709	562
Loan levies 1/	3	3	3	3	3
Gold and foreign exchange contingency reserve account 2/	10,351	8,731	8,934	2,190	4,147
Debt of former homelands	...	...	...	...	15,354
Total government debt	124,920	147,327	185,537	239,715	276,232
(In percent of GDP)	40.3	43.2	48.4	55.5	57.0
<u>(In percent of total debt)</u>					
External government debt 3/	1.7	1.6	2.7	3.4	3.5
Domestic government debt	90.0	92.5	92.5	89.8	90.2
Marketable	82.8	88.8	90.6	88.8	89.9
Nonmarketable	7.3	3.7	1.9	1.0	0.4

Source: South African Reserve Bank, Quarterly Bulletin.

1/ Including tax exemption certificates and personal saving.

2/ Includes losses on forward exchange cover provided by the Reserve Bank.

3/ Adjusted for exchange rate changes.

Table 19. South Africa: Growth Rates of Monetary Aggregates, 1983-95 1/

(In percent)

	M1A	M1	M2	M3
Changes in the year to the end of:				
1983	24.7	37.7	22.7	16.4
1984	14.0	33.6	24.3	18.0
1985	19.8	-7.3	14.1	12.3
1986	20.5	12.8	4.3	9.3
1987	24.8	36.0	22.0	17.6
1988	25.0	23.1	35.2	27.3
1989	10.4	9.6	26.7	22.3
1990 March	6.9	18.1	23.1	20.2
June	10.7	14.7	20.0	16.5
September	9.8	5.8	13.0	12.6
December	14.3	15.1	12.8	12.0
1991 March	13.6	8.4	16.3	14.1
June	17.0	15.4	20.2	15.7
September	26.2	23.5	22.6	15.3
December	17.7	14.0	15.7	12.3
1992 March	25.2	13.5	11.5	9.0
June	18.6	10.5	11.5	7.2
September	23.6	23.2	12.8	8.7
December	16.2	17.5	10.8	8.0
1993 March	19.4	10.4	5.1	5.7
June	18.1	11.0	1.8	3.3
September	6.9	-0.0	1.3	4.3
December	16.6	6.7	3.9	7.0
1994 March	25.7	19.4	13.6	12.3
June	25.1	28.2	17.4	15.0
September	28.8	26.1	18.5	14.3
December	24.8	23.7	20.6	15.7
1995 March	6.6	10.4	12.6	12.2
June	17.0	7.8	15.6	16.8
September	12.9	12.7	11.5	16.1
December	16.8	19.3	13.8	15.1

Source: South African Reserve Bank, Quarterly Bulletin.

1/ M1A includes coins and bank notes in circulation and check and transmission deposits with banking institutions, building societies, and the Post Office Savings Bank. M1 is defined as M1A plus other demand deposits with banking institutions. M2 is defined as M1 plus other short-term deposits and medium-term deposits with banking institutions and building societies (including, for the latter, savings deposits and certain "share" investments), plus savings deposits with, and savings bank certificates of, the Post Office Savings Bank. M3 is defined as M2 plus all long-term deposits with banking institutions and building societies (including, for the latter, other "share" investments), plus investments in national savings certificates issued by the Post Office Savings Bank.

Table 20. South Africa: Monetary Survey, 1991-95

	1991	1992	1993	1994	1995
	December				
	(In billions of rand)				
Broad money (M3)	182.6	197.2	211.0	244.1	281.1
Coin and notes	8.8	9.5	10.5	12.2	14.3
Private deposits	173.8	187.6	200.5	231.9	266.8
Counterparts to broad money					
Net foreign assets	1.1	-1.8	-6.5	-7.4	-7.5
Short-term	0.2	-3.5	-8.2	-9.0	-9.2
Gross reserves	9.8	11.2	11.0	14.1	18.2
Reserve Bank	8.2	9.1	9.1	11.1	15.7
Commercial banks	1.7	2.1	2.0	3.0	2.5
Liabilities	-9.7	-14.7	-19.3	-23.1	-27.4
Reserve Bank	-0.1	-0.9	-5.6	-5.2	-0.0
Commercial banks	-9.5	-13.7	-13.7	-18.0	-27.3
Long-term	0.9	1.7	1.7	1.7	1.7
Net domestic assets	181.6	198.9	217.5	251.5	288.6
Government	3.6	7.2	7.5	15.5	5.8
Claims on Government	20.5	20.7	26.8	31.9	31.8
Government deposits	-16.9	-13.5	-19.3	-16.4	-25.9
Claims on private sector	192.7	209.5	229.8	268.9	316.1
Other items, net	-14.7	-17.8	-19.8	-32.9	-33.3
Other assets	49.4	49.0	47.9	46.6	56.5
Capital and reserves	-12.2	-16.1	-20.2	-24.0	-29.4
Other liabilities	-52.0	-50.7	-47.5	-55.5	-60.4
Contributions to growth of M3					
	(In percent)				
Net foreign assets	0.3	-1.6	-2.4	-0.4	-0.0
Short-term	0.6	-2.0	-2.4	-0.4	-0.1
Long-term	-0.1	0.4	0.0	-0.0	0.0
Net domestic assets	11.8	9.5	9.4	16.1	15.2
Government	-1.7	2.0	0.1	3.8	-4.0
Claims on Government	1.0	0.1	3.1	2.4	-0.0
Government deposits	-2.7	1.9	-3.0	1.4	-3.9
Claims on private sector	15.0	9.2	10.3	18.5	19.3
Other items, net	-1.5	-1.7	-1.0	-6.2	-0.2
Growth of broad money	12.3	8.0	7.0	15.7	15.1
Memorandum items:					
Income velocity of M3	1.80	1.80	1.88	1.90	1.85
Bills discounted by Reserve Bank					
(in billions of rand) 1/	2.8	3.7	5.8	5.1	5.2
Deposits at Reserve Bank					
(in billions of rand)	13.1	8.6	9.3	9.3	9.9

Source: South African Reserve Bank, Quarterly Bulletin.

1/ Includes overnight loans accommodation system introduced by the Reserve Bank in May 1993.

Table 21. South Africa: Interest Rate Developments, 1991-95

(In percent per annum)

	Short-term rates					Long-term rates	
	Bank rate 1/	Clearing bank prime overdraft rate 2/	Rate on three-month deposits with commercial banks 3/	Rate on interbank deposits at call 3/	Treasury bill rate 4/	Government bond yield 5/	Predominant rate on new mortgages: participation bonds 2/
1991 March	17.0	21.0	17.4	17.8	16.9	15.6	20.5
June	17.0	20.0	17.2	16.8	16.7	16.3	19.5
September	17.0	20.0	17.2	16.5	16.6	16.8	19.5
December	17.0	20.2	17.0	16.0	16.1	16.7	18.9
1992 March	16.0	20.2	15.5	15.5	15.5	16.4	18.9
June	15.0	19.2	13.5	13.8	14.0	16.0	18.9
September	15.0	18.2	12.2	13.0	12.1	14.2	18.4
December	14.0	17.2	12.1	12.0	12.0	14.9	15.9
1993 March	13.0	16.2	11.9	10.9	11.3	14.6	15.9
June	13.0	16.2	12.0	10.8	11.9	14.8	15.1
September	13.0	16.2	11.6	11.2	11.6	13.6	15.1
December	12.0	15.2	10.3	9.6	10.2	12.3	15.1
1994 January	12.0	15.2	10.3	9.8	10.1	12.2	14.0
February	12.0	15.2	10.3	9.5	10.2	12.8	14.0
March	12.0	15.2	10.3	9.6	10.1	13.0	14.0
April	12.0	15.2	10.3	10.1	10.3	13.2	14.0
May	12.0	15.2	11.0	10.8	10.8	13.8	14.0
June	12.0	15.2	10.5	10.4	10.8	14.5	14.0
July	12.0	15.2	10.9	10.0	10.8	15.1	14.0
August	12.0	15.2	10.9	9.6	10.8	15.9	14.0
September	13.0	16.2	11.5	9.8	10.8	16.9	14.0
October	13.0	16.2	12.2	11.0	11.8	16.9	14.0
November	13.0	16.2	12.5	10.8	12.2	16.9	14.0
December	13.0	16.2	12.6	11.6	12.5	16.8	15.1
1995 January	13.0	16.2	11.5	11.6	12.7	17.0	15.1
February	14.0	17.5	13.5	11.7	12.9	16.8	15.1
March	14.0	17.5	13.5	11.8	13.0	16.7	15.1
April	14.0	17.5	13.5	12.5	13.0	16.8	16.7
May	14.0	17.5	14.2	13.1	13.7	16.9	16.7
June	15.0	17.5	14.2	12.9	13.8	16.8	16.7
July	15.0	18.5	13.8	13.4	14.0	16.6	16.7
August	15.0	18.5	13.8	13.5	13.9	16.0	16.7
September	15.0	18.5	13.8	13.6	14.0	15.5	17.5
October	15.0	18.5	13.8	13.9	13.8	15.1	17.5
November	15.0	18.5	13.5	14.1	13.6	14.4	17.5
December	15.0	18.5	13.5	14.8	13.9	14.6	17.5

Sources: International Monetary Fund, International Financial Statistics; and South African Reserve Bank, Quarterly Bulletin.

1/ Until April 1993, Reserve Bank's discount rate for treasury bills. Thereafter, accommodation rate for overnight loans using government paper as collateral.

2/ End of period.

3/ Period average.

4/ Averages for each Friday of the month.

5/ Average yield on government bonds with a maturity of more than ten years.

Table 22. South Africa: Changes in Bank Credit, 1991-95 1/

	Credit to the private sector						Credit to Government, net	Total bank credit	Credit to the private sector	Total bank credit
	Bills discounted, deposits, and investments	Hire purchase credit	Leasing finance 2/	Mortgage advances	Other loans and advances	Total				
	(Change from previous period: in millions of rand)								(Percentage change from year ago)	
1991	1,995	1,205	2,258	10,729	8,145	24,331	-2,762	21,569	14.5	12.3
1992	2,463	293	1,266	12,160	632	16,815	3,606	20,421	8.7	10.4
1993	-4,976	3,510	993	14,619	6,173	20,317	245	20,563	9.7	9.5
1990 March	45	255	419	1,587	1,177	3,483	-535	2,949	17.5	14.6
June	1,371	746	303	1,838	2,072	6,330	1,452	7,782	18.4	16.3
September	22	735	571	2,160	-287	3,201	-1,342	1,859	15.3	13.8
December	2,134	718	554	2,027	4,377	9,811	6,008	15,819	15.7	19.4
1991 March	1,600	-84	169	2,487	4,630	8,801	-3,818	4,983	18.9	20.4
June	-1,924	334	381	2,736	2,526	4,054	935	4,990	16.7	17.6
September	1,660	284	846	2,837	964	6,591	-1,012	5,578	18.5	19.7
December	659	671	862	2,669	25	4,885	1,133	6,018	14.5	12.3
1992 March	-1,818	-894	630	2,819	1,352	2,090	-992	1,097	9.9	9.8
June	1,778	168	347	2,833	-1,260	3,866	-1,123	2,744	9.6	8.4
September	2,343	492	70	3,064	-645	5,322	1,049	6,372	8.6	8.3
December	160	527	219	3,444	1,185	5,537	4,672	10,208	8.7	10.4
1993 March	-1,505	-33	167	3,585	151	2,363	-1,327	1,036	8.8	10.3
June	-2,311	1,135	-141	3,217	-1,188	713	-3,962	-3,249	7.0	7.2
September	-742	1,087	608	4,154	3,790	8,893	2,898	11,793	8.6	9.6
December	-418	1,321	359	3,663	3,420	8,346	2,636	10,983	9.7	9.5
1994 March	-1,208	1,125	302	3,270	3,644	7,134	14,133	21,266	11.8	18.7
June	552	1,325	-43	3,909	-1,926	3,815	936	4,751	13.3	22.7
September	3,648	1,603	275	4,679	4,334	14,541	-1,401	13,140	15.3	22.2
December	1,892	2,308	586	5,476	4,174	13,636	-5,636	8,000	17.0	19.9
1995 March	-802	918	432	5,544	3,569	9,661	-2,046	7,615	17.6	13.0
June	-183	2,260	884	4,636	1,491	9,087	2,417	11,504	19.5	15.3
September	613	2,133	958	4,895	5,026	13,626	-6,743	6,883	18.0	12.3
December	2,447	2,706	488	5,150	3,978	14,769	-3,280	11,489	17.5	13.2

Sources: South African Reserve Bank, *Quarterly Bulletin*.

1/ Credit extended by the banking sector, which comprises the Reserve Bank, the former National Finance Corporation, the Corporation for Public Deposits and the "pooled" funds of the former Public Debt Commissioners, the discount houses, the short term business of the Land Bank, the commercial and merchant banks, and other general banking institutions.

2/ Excluding unearned, finance, charges.

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Table 23. South Africa: Balance of Payments, 1991-95

(In millions of U.S. dollars)

	1991	1992	1993	1994	1995
Current account balance	<u>2,241</u>	<u>1,382</u>	<u>1,784</u>	<u>-629</u>	<u>-3,489</u>
Trade balance	6,125	5,430	5,777	3,197	745
Exports	23,288	23,624	24,104	24,678	27,886
Net nongold, f.o.b.	16,194	17,187	17,299	18,298	22,330
Gold ^{1/}	7,094	6,437	6,805	6,380	5,556
Imports, f.o.b.	-17,163	-18,194	-18,327	-21,481	-27,142
Nonfactor services	-513	-946	-1,229	-1,282	-1,246
Credits	3,594	3,754	3,757	4,078	4,611
Debits	-4,108	-4,700	-4,985	-5,359	-5,857
Factor services	-3,444	-3,207	-2,895	-2,589	-3,025
Credits	892	914	690	985	982
Debits	-4,336	-4,121	3,585	-3,574	-4,007
Interest	-3,133	-2,875	-2,659	-2,626	...
Dividends and profits	-1,084	-1,148	-825	-827	...
Taxes	-120	-98	-101	-120	...
Transfers	73	105	131	45	...
Private	-27	32	68	-29	...
Official	100	73	64	74	...
Capital account balance	<u>-780</u>	<u>-1,288</u>	<u>-4,598</u>	<u>1,508</u>	<u>5,992</u>
Long-term capital, net	-627	-530	-83	987	3,451
Private	-1,007	-1,632	800	-169	2,338
Public	381	1,102	-883	1,156	1,113
Short-term capital, net	664	878	-1,555	1,392	1,808
Private	815	892	-1,725	860	2,237
Public	-151	-14	169	533	-429
Errors and omissions	-818	-1,636	-2,960	-871	734
Change in net reserves (on a transactions basis) ^{2/}	<u>1,461</u>	<u>94</u>	<u>-2,814</u>	<u>879</u>	<u>2,503</u>
Change in liabilities relating to reserves ^{3/}	-371	283	2,274	-0	-1,376
SDR allocations and valuation adjustments	-170	114	493	-19	0
Change in gross reserves	920	491	-47	860	1,127
Memorandum item:					
Current account/GDP (in percent)	2.0	1.2	1.5	-0.5	-2.6

Source: South African Reserve Bank, Quarterly Bulletin; and staff calculations.

^{1/} Net foreign sales of gold plus changes in the gold holdings of the Reserve Bank and other banking institutions.

^{2/} Gold and foreign exchange reserves of the Reserve Bank, the banking sector, and the Central Government.

^{3/} Liabilities related to reserves include all foreign short-term liabilities of the Reserve Bank and other banking institutions and short-term foreign loans to the Central Government by foreign banks and authorities.

Table 24. South Africa: Quarterly Balance of Payments, 1993-95

(In millions of U.S. dollars)

	1993				1994				1995			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
(Seasonally adjusted figures)												
Nongold exports, f.o.b.	3,924	4,436	4,171	4,744	4,364	4,258	4,613	5,063	5,704	5,425	5,565	5,62
Net gold exports 1/	1,686	1,738	1,816	1,566	1,645	1,604	1,720	1,411	1,402	1,326	1,600	1,22
Imports, f.o.b.	4,571	4,452	4,475	4,021	4,830	4,908	5,674	6,057	6,624	6,708	6,951	6,82
Trade balance	<u>1,039</u>	<u>1,722</u>	<u>1,512</u>	<u>1,489</u>	<u>1,179</u>	<u>954</u>	<u>650</u>	<u>416</u>	<u>482</u>	<u>42</u>	<u>213</u>	<u>1</u>
Net services and transfers	-952	-828	-1,056	-1,144	-1,080	-842	-1,041	-866	-1,093	-1,058	-1,046	-1,02
Current account balance	<u>2</u>	<u>21</u>	<u>36</u>	<u>28</u>	<u>8</u>	<u>2</u>	<u>-31</u>	<u>-36</u>	<u>-49</u>	<u>-81</u>	<u>-67</u>	<u>-2</u>
(Actual data, not seasonally adjusted)												
Current account balance	289	1,058	217	242	118	11	-540	-205	-657	-1,093	-908	-82
Long-term capital, net	<u>-162</u>	<u>322</u>	<u>-281</u>	<u>18</u>	<u>-305</u>	<u>-362</u>	<u>330</u>	<u>1,318</u>	<u>162</u>	<u>1,018</u>	<u>755</u>	<u>1,59</u>
Public sector	-170	-155	-86	-464	-567	62	312	1,329	-107	346	299	54
Private sector	7	507	-195	483	262	-424	19	-10	269	672	456	93
Short-term capital, net	<u>-1,149</u>	<u>-1,342</u>	<u>-591</u>	<u>-1,441</u>	<u>-87</u>	<u>-286</u>	<u>1,137</u>	<u>-261</u>	<u>1,375</u>	<u>364</u>	<u>287</u>	<u>53</u>
Public sector	84	-5	83	8	6	4	18	506	54	-499	-12	3
Monetary sector 2/	-576	-386	193	-275	699	386	732	-855	512	1,181	258	52
Other 3/	-657	-955	-868	-1,173	-792	-676	387	88	809	-318	42	-2
Total capital movements	<u>-1,312</u>	<u>-925</u>	<u>-872</u>	<u>-1,422</u>	<u>-392</u>	<u>-648</u>	<u>1,468</u>	<u>1,057</u>	<u>1,537</u>	<u>1,382</u>	<u>1,042</u>	<u>2,03</u>
Change in net reserves (on a transactions basis) 4/	-1,024	64	-655	-1,181	-273	-637	927	852	880	289	134	1,20
Change in liabilities related to reserves 2/	393	-161	301	1,688	4	505	-570	62	-320	-358	-124	-37
SDR allocations and valuation adjustments	92	314	-12	107	52	-45	17	-42	12	23	-33	-
Change in gross reserves	<u>-539</u>	<u>217</u>	<u>-367</u>	<u>613</u>	<u>-217</u>	<u>-177</u>	<u>374</u>	<u>922</u>	<u>572</u>	<u>-246</u>	<u>-23</u>	<u>82</u>

Source: South African Reserve Bank, Quarterly Bulletin; and staff calculations.

1/ Net foreign sales of gold plus changes in the gold holdings of the Reserve Bank and other banking institutions.

2/ Excluding the Reserve Bank.

3/ Private nonmonetary sector including unrecorded transactions.

4/ Gold and foreign exchange reserves of the Reserve Bank, the banking sector, and the Central Government.

5/ Liabilities related to reserves include all foreign short-term liabilities of the Reserve Bank and short-term foreign loans to the Central Government by foreign banks and authorities.

Table 25. South Africa: Quarterly Balance of Payments, 1993-95

(In millions of rand)

	1993				1994				1995			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
<i>(Seasonally adjusted figures)</i>												
Mongold exports, f.o.b.	12,252	14,162	14,071	16,027	15,003	15,380	16,642	17,926	20,338	19,747	20,299	20,606
Net gold exports 1/	3,264	5,548	6,120	5,289	5,654	5,793	6,204	4,996	5,000	4,827	5,836	4,490
Imports, f.o.b.	14,273	14,213	15,099	16,204	16,603	17,728	20,471	21,440	23,619	24,420	25,357	25,047
Trade balance	<u>2,243</u>	<u>2,497</u>	<u>2,100</u>	<u>2,091</u>	<u>4,054</u>	<u>2,445</u>	<u>2,375</u>	<u>1,474</u>	<u>1,719</u>	<u>154</u>	<u>779</u>	<u>49</u>
Net services and transfers	-2,972	-2,644	-3,562	-3,064	-3,713	-3,043	-3,750	-3,066	-3,898	-3,851	-3,816	-3,792
Current account balance	<u>271</u>	<u>2,853</u>	<u>1,538</u>	<u>1,167</u>	<u>341</u>	<u>492</u>	<u>-1,382</u>	<u>-1,592</u>	<u>-2,179</u>	<u>-3,696</u>	<u>-3,037</u>	<u>-3,743</u>
<i>(Actual data, not seasonally adjusted)</i>												
Current account balance	902	3,379	732	816	407	38	-1,949	-727	-2,341	-3,979	-3,314	-3,022
Long-term capital, net	<u>-510</u>	<u>1,124</u>	<u>-948</u>	<u>62</u>	<u>-1,049</u>	<u>-1,307</u>	<u>1,191</u>	<u>4,660</u>	<u>577</u>	<u>3,706</u>	<u>2,754</u>	<u>5,480</u>
Public sector	-532	-495	-290	-1,569	-1,950	223	1,124	4,705	-383	1,258	1,091	2,072
Private sector	22	1,619	-658	1,631	901	-1,530	67	-37	960	2,448	1,663	3,408
Short-term capital, net	<u>-3,500</u>	<u>-4,222</u>	<u>-1,925</u>	<u>-4,067</u>	<u>-298</u>	<u>-1,032</u>	<u>4,104</u>	<u>-924</u>	<u>4,993</u>	<u>1,324</u>	<u>1,047</u>	<u>1,942</u>
Public sector	263	-16	200	26	22	14	64	1,791	192	-1,817	-45	114
Monetary sector 2/	-1,799	-1,233	652	-929	2,404	1,394	2,642	-3,026	1,826	4,298	940	1,930
Other 3/	-2,052	-3,050	-2,927	-3,964	-2,724	-2,441	1,398	311	2,085	-1,157	152	-102
Total capital movements	<u>-4,098</u>	<u>-3,175</u>	<u>-2,943</u>	<u>-4,003</u>	<u>-1,347</u>	<u>-2,340</u>	<u>2,295</u>	<u>2,744</u>	<u>5,400</u>	<u>5,030</u>	<u>3,801</u>	<u>7,422</u>
Change in net reserves (on a transactions basis) 4/	-3,196	204	-2,211	3,989	-940	-4,302	3,346	3,017	3,139	1,051	487	4,400
Change in liabilities related to reserves 5/	1,226	-514	1,014	3,701	15	1,824	-2,058	210	-1,140	-2,030	-451	-1,371
SDR allocations and valuation adjustments	200	1,002	-40	360	179	-161	63	-149	42	82	-119	-4
Change in gross reserves	<u>-1,662</u>	<u>692</u>	<u>-1,237</u>	<u>2,972</u>	<u>-746</u>	<u>-632</u>	<u>1,351</u>	<u>2,086</u>	<u>2,041</u>	<u>-897</u>	<u>-83</u>	<u>2,025</u>

Source: South African Reserve Bank, *Quarterly Bulletin*.

1/ Net foreign sales of gold plus changes in the gold holdings of the Reserve Bank and other banking institutions.

2/ Excluding the Reserve Bank.

3/ Private nonmonetary sector including unrecorded transactions.

4/ Gold and foreign exchange reserves of the Reserve Bank, the banking sector, and the Central Government.

5/ Liabilities related to reserves include all foreign short-term liabilities of the Reserve Bank and short-term foreign loans to the Central Government by foreign banks and authorities.

Table 26. South Africa: Volume and Unit Value of Exports and Imports, 1991-95
(Percentage change from previous period)

	1991	1992	1993	1994	1995	1994 1/				1995 1/			
						I	II	III	IV	I	II	III	IV
Volume of exports													
Goods and nonfactor services	-0.1	1.1	6.0	0.4	0.4	-3.8	-0.3	4.0	1.6	6.4	-4.7	6.0	-3.2
Nongold goods and nonfactor services	-0.7	2.7	6.7	4.0	14.7	-3.9	-0.9	3.3	6.9	0.0	-3.9	3.0	1.4
Volume of imports													
Goods and nonfactor services	2.1	3.4	7.0	16.2	17.0	2.6	-0.3	10.9	4.3	6.3	-0.6	4.7	-1.6
Unit value of exports 2/													
Goods and nonfactor services	4.9	4.2	9.6	12.0	6.6	3.0	2.3	2.2	-0.6	3.4	2.3	0.2	-0.1
Nongold goods and nonfactor services	4.7	6.3	7.3	11.2	7.3	3.7	2.9	3.6	0.4	3.3	1.6	0.3	-0.2
Unit value of imports 2/													
Goods and nonfactor services	6.4	3.3	0.9	7.6	7.3	0.4	3.3	3.3	-0.1	2.7	2.8	-0.4	-0.1
Terms of trade 3/													
Including gold													
Index 1990 = 100	98.6	97.4	98.1	102.0	101.3	103.3	102.3	101.3	100.0	101.4	100.9	101.6	101.3
Percentage change	-1.4	-1.2	0.7	4.0	-0.7	3.3	-1.0	-1.2	-0.3	0.6	-0.5	0.7	-0.1
Excluding gold													
Index 1990 = 100	98.4	99.4	98.1	101.3	101.3	101.7	101.7	101.1	101.6	102.2	100.9	101.6	101.3
Percentage change	-1.6	1.0	-1.3	3.3	--	3.4	--	-0.6	0.5	0.6	-1.3	0.7	-0.1
Memorandum items:													
Effective exchange rate (IFS)													
Nominal	-6.2	-6.0	-0.9	-10.1	-0.0	-1.2	-7.0	-3.3	1.1	-2.2	-6.2	2.3	1.0
Real 4/	3.0	3.0	-2.6	-4.1	-2.3	0.3	-6.1	-0.7	3.1	-0.6	-4.7	2.2	2.1
Trading partners (GEE)													
Total domestic demand	0.4	0.6	-0.3	2.9	2.0	...	...	...	...	...	...	...	...
Non-oil import demand	4.6	6.0	1.6	9.1	10.3	...	...	...	...	...	...	...	...
Domestic demand (incl. exports) 5/	-0.4	-0.6	2.3	4.7	6.4	-0.2	0.3	2.9	2.1	2.1	0.4	1.3	-0.1

Sources: South African Reserve Bank, Quarterly Bulletin; International Monetary Fund, International Financial Statistics; and staff estimates.

1/ Seasonally adjusted quarterly data, except for memorandum items.

2/ In rand.

3/ Goods and nonfactor services.

4/ Relative consumer prices adjusted for exchange rate changes (depreciation -); period average.

5/ Quarterly data are seasonally adjusted.

Table 27. South Africa: Services and Transfers, 1990-94

(In millions of dollars)

	1990	1991	1992	1993	1994
Services					
Receipts	<u>4,385</u>	<u>4,486</u>	<u>4,668</u>	<u>4,446</u>	<u>5,062</u>
Freight	295	246	364	353	381
Other transportation	926	962	1,024	1,017	1,020
Travel	956	1,103	1,182	1,327	1,569
Investment income	549	775	838	716	891
Interest	132	165	147	129	188
Dividends and profits	352	518	598	501	602
Taxes	65	92	94	87	102
Other income 1/	1,658	1,400	1,259	1,033	1,202
Payments	<u>9,163</u>	<u>8,444</u>	<u>8,821</u>	<u>8,570</u>	<u>8,933</u>
Freight	1,016	1,059	1,205	1,241	1,363
Other transportation	1,103	1,097	1,094	1,010	1,166
Travel	1,118	1,155	1,545	1,870	1,847
Investment income	3,810	3,281	3,136	2,831	2,824
Interest	2,463	2,078	1,890	1,905	1,877
Dividends and profits	1,179	1,084	1,148	825	827
Taxes	167	120	98	101	120
Other payments 2/	2,117	1,851	1,840	1,619	1,731
Net	<u>-4,778</u>	<u>-3,957</u>	<u>-4,153</u>	<u>-4,124</u>	<u>-3,870</u>
Freight	-720	-813	-841	-887	-983
Other transportation	-176	-134	-69	7	-146
Travel	-162	-53	-363	-543	-279
Investment income	-3,261	-2,506	-2,298	-2,115	-1,933
Interest	-2,331	-1,913	-1,743	-1,777	-1,690
Dividends and profit	-827	-565	-551	-324	-226
Taxes	-103	-28	-4	-14	-18
Other	-459	-451	-581	-586	-529
Net transfers	<u>71</u>	<u>73</u>	<u>105</u>	<u>131</u>	<u>45</u>
Private	-33	-27	32	68	-29
Central Government	104	100	73	64	74
Net invisibles	<u>-4,707</u>	<u>-3,884</u>	<u>-4,048</u>	<u>-3,993</u>	<u>-3,825</u>
(In percent of GDP)	(-4.4)	(-3.5)	(-3.4)	(-3.4)	(-3.1)

Sources: South African Reserve Bank, Quarterly Bulletin; and staff calculations.

1/ Income from nonmerchandise insurance and other foreign earnings.

2/ Payments for nonmerchandise insurance and other foreign payments.

Table 28. South Africa: Net Capital Movements, 1991-95

(In millions of dollars)

	1991	1992	1993	1994	1995 prelim.
Long-term capital	-627	-530	-83	987	3,452 ^a
Public sector	381	1,102	-883	1,156	1,113
General government	422	744	51	991	443
Public corporations	-42	358	-935	165	670
Nonbank private sector	-962	-1,390	819	218	2,048
Direct investment, net	-194	-613	-172	-100	493
Nondirect investment, excluding net purchases of securities	75	19	131	208	135
Net purchases of securities by nonresidents	-843	-796	860	110	1,345
Banking sector	-45	-242	-19	-387	366
Short-term capital	664	878	-1,555	1,392	1,808
Public sector	-151	-14	169	533	-429
General government	--	--	--	485	-474
Public corporations	-151	-14	169	48	45
Nonbank private sector	-134	-268	-712	-102	-243
Direct investment	198	-191	-130	295	-357
Nondirect investment	-333	-77	-582	-397	113
Banking sector	949	1,159	-1,013	962	2,480
Errors and omissions	-818	-1,636	-2,960	-871	734
Net capital movements	-780	-1,288	-4,598	1,508	5,993 ^a

Source: South African Reserve Bank; and staff calculations.

Table 29. South Africa: External Debt, 1987-95

	1987	1988	1989	1990	1991	1992	1993	1994	1995 ^{4/}
<u>(In millions of U.S. dollars)</u>									
Debt outstanding (at year-end)									
Medium- and long-term ^{1/ 2/}	11,464	9,377	8,585	8,504	8,941	8,342	8,145	11,444	12,228
Public sector ^{3/}	6,881	6,292	5,347	5,248	5,735	5,260	5,481	6,197	6,735
Private sector	4,583	3,085	3,238	3,256	3,206	3,082	2,664	5,247	5,493
Short-term ^{2/}	11,154	11,808	12,012	10,879	9,188	8,959	8,545	7,203	8,428
Public sector ^{3/}	4,409	3,828	3,575	3,732	2,926	3,200	3,731	2,684	1,508
Private sector	6,745	7,980	8,437	7,147	6,262	5,759	4,814	4,519	6,920
Total external debt	<u>22,618</u>	<u>21,185</u>	<u>20,597</u>	<u>19,383</u>	<u>18,129</u>	<u>17,301</u>	<u>16,690</u>	<u>18,647</u>	<u>20,656</u>
Public sector	11,290	10,120	10,922	8,980	8,661	8,460	9,212	8,881	8,243
Private sector	11,328	11,065	9,675	10,403	9,468	8,841	7,478	9,766	12,413
<u>(In percent)</u>									
Memorandum items:									
Total external debt (in billions of rand)	43.7	50.3	63.5	67.0	70.3	83.2	86.7	98.8	75.2 ^{1/ 4/}
Debt/GDP	27.6	24.0	27.3	24.5	22.8	22.7	21.6	22.9	...
Debt/Exports of goods and nonfactor services	89.9	86.9	95.1	93.7	93.3	96.2	88.5	93.8	...
Share of short-term debt in total debt ^{1/}	58.0	58.2	59.8	56.0	50.7	51.8	51.2	38.6	40.8 ^{1/ 4/}
Interest payments/Exports of goods and nonfactor services	8.4	8.4	8.5	8.8	7.5	6.7	6.6	6.3	...

Source: South African Reserve Bank, Quarterly Bulletin; data provided by the South African authorities; and staff estimates.

^{1/} Excluding rand denominated debt.

^{2/} The distinction between short-term and long-term debt is not based on the original maturity structure, but on the schedule of repayments, i.e., short-term debt comprises all amortization payments due over the next year.

^{3/} Central Government, local authorities, public business enterprises, public corporations, and debt of the monetary sector that is not affected by the debt standstill.

^{4/} At end-June 1995.

Table 30. South Africa: External Reserves, 1991-95

(In millions of U.S. dollars: end of period)

	1991	1992	1993	1994	1995	1994				1995			
						I	II	III	IV	I	II	III	IV
Gross external reserves	3,574	3,670	3,252	3,980	4,987	2,962	2,647	3,091	3,980	4,496	4,193	4,155	4,987
Gross official reserves ^{1/}	2,972	2,982	2,676	3,130	4,300	2,281	1,941	2,263	3,130	3,352	3,407	3,233	4,300
Gold, national valuation ^{2/}	2,074	1,992	1,658	1,445	1,481	1,694	1,467	1,299	1,445	1,518	1,619	1,569	1,481
SDRs	2	--	12	1	5	19	5	3	1	2	5	6	5
Other foreign exchange	896	990	1,006	1,684	2,815	568	469	962	1,684	1,833	1,782	1,658	2,815
External liabilities	3,519	4,806	5,678	6,531	7,503	6,196	6,767	7,287	6,531	6,636	7,176	7,106	7,503
Official liabilities relating to reserves ^{3/}	26	305	2,366	2,216	759	2,251	2,581	1,765	2,216	1,803	1,201	1,129	759
Net external reserves ^{4/}	3,548	3,366	887	1,764	4,228	710	66	1,326	1,764	2,693	2,992	3,026	4,228
Net official reserves ^{4/}	2,946	2,677	311	914	3,542	29	-640	498	914	1,549	2,206	2,105	3,542
Memorandum items:													
Gross official reserves													
In millions of rand	8,152	9,104	9,092	11,087	15,680	7,934	7,084	8,061	11,087	12,030	12,382	11,793	15,680
In millions of SDRs	2,078	2,169	1,948	2,143	2,892	1,614	1,339	1,541	2,143	2,147	2,170	2,145	2,892
In millions of dollars, excluding gold	898	990	1,018	1,684	2,818	586	473	963	1,684	1,833	1,786	1,662	2,818
In months of imports ^{5/}													
Gross official reserves	1.7	1.7	1.4	1.4	1.6	1.2	1.0	0.9	1.3	1.3	1.2	1.1	1.6
Net official reserves ^{4/}	1.7	1.5	0.2	0.4	1.3	0.0	-0.3	0.2	0.4	0.6	0.8	0.7	1.3

Sources: International Monetary Fund, International Financial Statistics; and South African Reserve Bank, Quarterly Bulletin.^{1/} Holdings of the Reserve Bank and Central Government.^{2/} Gold reserves are valued at 90 percent of the average of the last ten London fixing prices during the month.^{3/} Includes December 1993 CCFP drawing (SDR 614 million).^{4/} Gross reserves less official liabilities relating to reserves.^{5/} Imports of goods and nonfactor services.

Table 31. South Africa: Exchange Rate and Gold Price Developments, 1988-96

(Average data)

	U.S. dollar/ Rand	U.S. dollar/ Financial rand 1/	Discount	Effective exchange rate 2/		London gold price 3/ In rand In U.S. dollars	
	Level	Level		Nominal	Real 4/	Level	Level
				Index 1990=100			
1988	0.440	0.261	37.9	116.1	96.7	991.6	437.1
1989	0.381	0.279	28.9	105.9	97.1	998.9	381.5
1990	0.386	0.295	24.2	100.0	100.0	991.9	383.6
1991	0.362	0.315	13.5	93.8	103.8	999.5	362.2
1992	0.351	0.206	37.2	88.2	107.8	980.0	343.7
1993	0.306	0.233	20.9	80.3	105.0	1,176.7	359.7
1994	0.282	0.246	12.9	72.3	100.7	1,363.4	384.0
1995	0.276	...	...	66.4	98.4	1,393.5	384.2
1992							
Jan.	0.360	0.291	18.1	89.9	106.1	986.3	354.5
Feb.	0.355	0.263	24.9	90.3	107.6	996.9	353.9
Mar.	0.347	0.285	18.0	90.3	108.1	992.5	344.5
Apr.	0.347	0.290	16.5	90.0	108.4	974.5	338.6
May	0.351	0.291	17.6	89.5	108.2	959.6	337.1
June	0.356	0.266	26.2	88.9	108.6	957.2	340.8
July	0.363	0.259	28.5	87.9	108.3	971.1	352.6
Aug.	0.362	0.269	26.4	86.7	107.5	949.3	343.3
Sep.	0.357	0.246	30.9	86.1	107.1	966.4	345.4
Oct.	0.347	0.230	32.1	86.1	107.3	994.3	344.3
Nov.	0.334	0.210	36.3	86.8	108.6	1,003.9	335.0
Dec.	0.332	0.206	37.2	86.1	107.7	1,007.8	334.6
1993							
Jan.	0.326	0.216	33.7	85.8	108.3	1,009.9	329.0
Feb.	0.321	0.221	30.7	85.4	108.1	1,028.1	329.3
Mar.	0.315	0.220	30.1	83.4	106.8	1,049.0	330.0
Apr.	0.316	0.219	30.7	81.3	105.9	1,083.9	342.0
May	0.313	0.217	31.0	80.8	105.4	1,162.5	366.4
June	0.309	0.213	29.3	79.9	104.9	1,204.6	371.9
July	0.298	0.224	24.2	78.9	103.8	1,312.6	392.1
Aug.	0.297	0.213	28.1	78.2	103.0	1,274.2	378.9
Sep.	0.293	0.239	17.9	75.8	100.2	1,211.0	355.3
Oct.	0.295	0.236	20.7	77.0	102.4	1,233.2	364.1
Nov.	0.297	0.223	25.0	78.9	105.6	1,257.7	373.9
Dec.	0.296	0.233	20.9	78.8	105.7	1,293.9	383.4
1994							
Jan.	0.293	0.225	23.1	78.7	106.6	1,319.5	387.0
Feb.	0.290	0.212	26.5	77.2	104.8	1,316.9	381.8
Mar.	0.290	0.204	29.2	76.1	103.9	1,326.9	384.1
Apr.	0.279	0.217	23.2	73.3	100.1	1,355.6	377.6
May	0.276	0.211	23.8	71.5	98.2	1,383.3	381.3
June	0.276	0.213	22.3	70.8	97.9	1,399.6	385.7
July	0.273	0.217	20.4	68.5	95.4	1,413.6	385.5
Aug.	0.278	0.222	20.2	69.9	98.5	1,368.8	380.4
Sep.	0.281	0.234	16.3	70.1	100.0	1,392.0	391.5
Oct.	0.283	0.249	12.8	69.5	99.5	1,379.3	390.0
Nov.	0.284	0.242	14.1	70.4	101.3	1,354.0	384.4
Dec.	0.281	0.246	12.9	70.9	102.3	1,351.0	379.6
1995							
Jan.	0.283	0.244	13.9	70.5	102.4	1,339.9	378.8
Feb.	0.281	0.256	7.7	69.4	101.4	1,341.1	376.7
Mar.	0.278	...	...	66.3	97.5	1,374.3	382.0
Apr.	0.278	...	...	64.8	96.0	1,409.8	391.2
May	0.273	...	...	64.5	95.8	1,409.8	385.2
June	0.273	...	...	64.1	95.2	1,418.3	387.6
July	0.275	...	...	64.5	95.8	1,405.5	386.2
Aug.	0.275	...	...	66.3	98.2	1,396.6	383.5
Sep.	0.273	...	...	67.0	99.2	1,402.6	383.0
Oct.	0.274	...	...	66.3	98.6	1,398.6	383.2
Nov.	0.274	...	...	66.6	99.7	1,405.8	385.3
Dec.	0.273	...	...	66.9	101.0	1,419.4	387.4
1996							
Jan.	0.275	...	...	66.1	103.5	1,453.2	399.1

Sources: South African Reserve Bank, Quarterly Bulletin; and International Monetary Fund, International Financial Statistics.

1/ End-of-period.

2/ The difference between the commercial and the financial rand as a percentage of the commercial rand.

3/ IMF estimates.

4/ Relative consumer prices, adjusted for exchange rate changes.

5/ Average daily fixing price per fine ounce.