AN EXTERNAL

ECONOMIC POLICY FOR SOUTH AFRICA

1. *Introduction*:

In a world of rapidly changing economic and political conditions, it is necessary to review the external economic policy of a country from time to time. On the one hand, we in South Africa should take note of the economic and political development taking place at such a rapid pace in Africa, and on the other hand, we should also pay attention to the modern tendency to form international trade blocs. The present state of affairs not only calls for protection and development of our international economic interests, but also for thorough planning of our future economic growth and development.

With all this in mind this paper intended to show that external trade and payments policy can assist us in achieving certain economic and non-economic ends or targets generally accepted as desirable, to show what these ends are, and finally to show that our present policy cannot be seen as an optimum policy for achieving such ends. In other words, this is an attempt to show that we can change our present external economic policy better to suit our aims.

First of all, it is necessary, however, to review briefly the various policy instruments at our disposal, and then we can attempt to define the desirable targets for such a policy. It will then also be possible to show in what way our present external economic policy should be changed.

2. *Policy instruments*:

This is merely an attempt to make an over-all survey of the available policy instruments. Any detailed account of the functioning of these instruments will take us too far afield.

If we take account of institutional circumstances, the various policy measures which could possibly be applied almost unlimited, but in principle it is possible to divide all these measures into two main categories, namely (a) indirect and (b) direct measures.

(a) *Indirect measures*:

By indirect measures we mean any external economic measures which will have an influence on the market circumstances and market conditions for international economic transactions, namely measures which will have an indirect qualitative influence on the international supply and demand for goods, services or capital. We may divide these measures into two types, namely general and selective measures, and each of these can be further subdivided as follows:

General measures consist of (i) measures which will influence the internal purchasing power and therefore the demand for imports; (ii) measures which will influence the propensity to import and to consume; (iii) measures which will have a direct influence on relative prices, for example, exchange rate manipulations, wage rate manipulations and import and export subsidies and taxes; (iv) global production and investment policies.

Selective measures consist of measures in respect of definite products, for example, national propaganda, multiple exchange rates and any form of taxes and/or subsidies; and measures relating to specific countries, for example, national propaganda (which we are at present experiencing) and taxes and/or subsidies.

(b) *Direct measures*:

By direct measures we mean all external economic measures which will have a direct influence on the market mechanism, namely any economic measures which will bring about a direct quantitative restriction on demand and/or supply with regard to international transactions. These include (i) direct import and export control measures which may be divided into quotas and exchange monopolies, (ii) direct production and consumption restrictions such as production or consumption permits, and (iii) the volume of direct, autonomous, state trading with foreign countries. This restriction can also be used as general and/or selective.

The interested reader will be able to find more detailed discussions of the functioning of these instruments in various text books on international economic relations.[1])

3. *An optimum external trade policy.*

Any attempt at defining an optimum policy requires a value judgement. Although I do not hold the view that value-judgements fall outside the scope of economics, I have to admit that the inter-personal comparison of utility, which is necessary for arriving at an optimum policy, has not yet been satisfactorily solved. Nevertheless, is is not the intention of this paper to formulate an optimum external economic policy for South Africa, but merely to indicate a few policy targets or ends that could be accepted as being generally desirable.

4. *Policy targets.*

The targets at which any economic policy aims can either be economic or non-economic. It is not the intention to discuss the non-economic ends, such as national defence or social justice, etc., because this will lead us very far from our actual aim. Nevertheless, it must be borne in mind that aspects of practical policy can never be isolated in this way. Practical policy should be viewed as an integrated whole with economic ends and economic policy as inseparable aspects. But then it should be remembered that practical policy is an art and not a science. However, as any scientifically founded practical policy should be built on theoretical knowledge, it is necessary to make some simplifying assumptions as is customary in theoretical analysis.

What then can be regarded as economic ends? Perhaps the best known examples of economic ends for the purpose of economic policy are maximisation of the national income, full employment, balance of payments equilibrium and maximum long-period benefit from international trade. All these ends can be grouped under two broader aims, namely (i) an optimum satisfaction of human wants with the available economic means, and (ii) the realisation of an equilibrium rate of growth, namely a rate of over-all economic growth which shows no fluctuations in the course of time and not necessarily a rate of growth which shows no fluctuations between the various sectors of the national economy.

The first aim embraces a manipulation of the level of national income, an optimum distribution of that income, full employment of the factors of production and a long-run maximisation of the gains from international trade. The second aim embraces balance of payments equilibrium and also a constant level of employment.

By an optimum satisfaction of human wants by means of the available economic means, we understand a situation where no economic subject has any motive to change his dispositions. It can be shown that such a position arises when the economic system, and therefore international trade, is wholly competitive. In this case the price ratios of goods (and services) will correspond to their marginal utility ratios and to their marginal cost ratios and thus each factor of production will be remunerated according to its marginal productivity. This optimum situation is of a relative nature, however, because the level of income and its distribution have to be taken as given. At any specific moment such an assumption is perhaps not too unrealistic but it cannot hold in the long run. The level of income (and production) as well as the mode of its distribution are continually changing. To give a definition of an optimum position in this regard is more difficult than appears at a first glance. The highest possible level of income at any given time is, for instance, not always the most desirable as it could easily happen that such an income could lead to a lower average income in the long run. What we must actually aim at is to get an optimum rate of growth in the long run. Explained in greater detail this means that the national economy should be developed at the highest possible rate by means of available factors of production. In my opinion one could take it for granted that the potential demand for any article having any utility at all is almost unlimited. Therefore, the limits to economic development are set by the availability of the factors of production in a suitable combination to achieve the highest possible production and standard of living. Thus, although the ultimate aim of economic policy is to attain the highest possible equilibrium rate of economic growth, or, even more remote, to obtain the highest possible satisfaction of our wants (economic and non-economic) as determined by the norms adhered to by us, our immediate aim should be to make the most of the available factors of production. *Our economic policy, internal as well as external, must therefore be aimed at ensuring the best long-run use of our factors of production.* But there is something more to this: our policy must also be aimed at attaining a level of purchasing-power which will enable the demand for consumer goods to be at least as high as the supply of such goods.

If we apply this as our main criteria for any policy measures, it will be possible to test the adequacy of our present external economic policy.

First of all, however, we must make sure what these criteria would amount to in terms of external trade relationships. When will the long-run use of our factors of production be improved by our external economic relationships? Are there any indicators by which we can prove that a change is for better or for worse? The only indicator which could be of any use in measuring productivity of the factors of production would be the single factorial terms of trade. In other words, an indicator of a change in the volume of imports which we receive in return for one unit of factor input.[2]) These factorial terms of trade multiplied by the change in the units of factor input will serve as an indicator of the change in the real income resulting from any new policy, if the effect of such a policy could be isolated.

This indicator should be supplemented by the commodity terms of trade and the favourable or unfavourable position of the balance of payments. These two indicators are necessary to give an idea of the change in the level of the nominal national income as a result of the external trade and payments position of the country. While the factorial terms of trade give an idea of changes in the real productivity of the country with regard to external economic relationships, the last-mentioned indicators give some idea of international price movements, of the import purchasing power of one unit of exports.

One word on a point of procedure will now be in order. While testing the present policy measures recommendations will immediately be made as to how these measures could be changed better to suit our aims.

5. *Present policy and recommendations.*
a) *General policy.*

Any historical survey of the development of the external economic policy of the Union of South Africa during the past ten to twelve years [3]) will show a marked change from a policy whereby external balance was achieved by means of exchange rate manipulations and import controls, to a policy where this result is aimed at by influencing the propensity to import, the purchasing power and the volume of exports. There can be no objection to this policy change in general as far as the propensity to import and the volume of exports are concerned, but I am afraid that this is not the case with the use of purchasing power manipulations to achieve external equilibrium. The reason for this is obvious. A change in purchasing power is par excellence a measure whereby internal balance may be achieved, but it is obvious that internal balance cannot always, especially not in the short run, be compatible with external balance. It is possible that, under some special circumstances, the two aims could be achieved simultaneously by means of one policy instrument, but this would be an exception to the rule.

To use this policy instrument for achieving both ends virtually amounts to trying to achieve internal and external balance simultaneously under a gold standard without the necessary internal flexibility of wage rates. As long as the money-flow within a country is dependent upon balance of payments equilibrium alone, and vice versa, there is no hope of attaining a long run optimum equilibrium rate of economic growth. It is clear that only where external disequilibrium is the result of grave inflationary tendencies in the internal economy, will it be possible to curb the inflation and at the same time restore external balance. But even in this case it is possible that the policy could meet with no success if a change in the volume of money-flows should lead to a grave deterioration in business expectations. In the case of a high degree of disequilibrium in the balance of payments, which the authorities are set to curb by means of deflation, this would surely occur because the marginal propensity to import would probably be higher than the average propensity. If to this is added other signs of a decline in world demand and prices, and if the demand for the staple exports of the country concerned is highly sensitive to price changes so that there is a decline in the value of exports, a policy to achieve external balance by means of a decline in purchasing power would be most harmful to internal economic development.

The experience of South Africa in 1957/58 serves as an example of our argument in this connection. The monetary authorities of the Union at that time enforced a cut in purchasing power by their most forceful instrument, namely a change in cash reserves required by the Reserve Bank from the commercial banks. The chief aim of this policy was to obtain greater external balance and at the same time curb internal inflationary tendencies. The policy met with reasonable success with regard to the first aim, but the resultant contraction in the internal economy was clearly too extensive because of this policy and other changes in the international economy. If this policy had been consistently pursued as originally planned, it could have been disastrous.

It must be obvious therefore that for the system to be stable and for a reasonable chance of success the number of instruments should at least be the same as the number of targets to be achieved.

On the other hand, it is equally clear that we cannot return to the policy previously pursued. To maintain external balance by means of import controls is at best a short-period measure because it will call for retaliatory measures in the long run; furthermore, it is diametrically opposed to the present views on international economic development and co-operation. Above all, however, it is also unsound policy if guaged according to our agreed policy aims, for it will not result in the greatest possible satisfaction of needs.

Exchange rate manipulation is even more difficult than import control in that it is effective only within certain limits. Even if effective, it is a most delicate instrument which should be handled with the utmost care and discretion.[4])

What then will be the right line of approach to this problem? The answer to this question cannot be given in a single slogan.

First of all, it is necessary to review some of our present trade agreements and to get a clear picture of our place in present integrative tendencies in the international economic sphere. The next step is to see what we can do by means of external economic policy to raise our productivity and the volume of our exports, and also to see how our imports could be lowered in a way which would not deprive us of the benefits of free trade, which would not call for retaliatory measures and which would not lead to internal disequilibrium. At the same time, however, we should also make sure that the composition of imports and exports is such that we would derive the greatest possible advantage from international trade. Next we wish to say a few words about the influencing of capital flows.

(b) *Trade agreements.*

The only general trade agreements of importance to us for policy purposes are the system of Imperial Preferences (I.P.) and the General Agreement on Tariffs and Trade (G.A.T.T.). South African is a signatory to both these agreements.

(i) *Imperial Preference.*

The present policy of the system of I.P. was formulated mainly at the Ottawa Conference in 1932. But even before 1932 we have a long history of the same policy. It has been inherited from two sources, namely on the one hand, the British Mercantilism of the seventeenth century and, on the other, the British desire to build a political empire — a desire dating from the same period. It is, however, not the intention to make an historical survey of the development of the system or of its historical merits or demerits as far as South Africa is concerned.[5])

It is the intention to reply to only two questions: 1. Is our membership of the I.P. system to our best advantage? 2. What do the advantages really amount to? We will reply to the last question first.

As will be seen from Table 1, South Africa enjoyed contractual preferences from the United Kingdom in 1957 on products worth £43 million. This, however, accounts for only 29 of the 67 items on which contractual preference is accorded. In other words, 38 of these items may be considered as being of less importance with a money value of £2.2 million. If we assume that all duties would be payable by the exporters in the absence of I.P. (which is highly improbable), the calculated benefit amounts to less than £4 million. According to the table, the 29 items included — with only one exception — consist of agricultural and forestry products for which our own demand, in some instances, is outstripping our suply.

With the exception of South African fresh fruit, the abolition of I.P. will probably not even influence the volume of trade with the United Kingdom, since it is either produce for which a world demand exists or else it is produce in the production of which we have a comparative advantage with regard to the quality and availability of raw material.

In the case of our fresh fruit, exporters have come to rely on the United Kingdom market to such extent that they did not take enough trouble to develop other markets, but it does not follow that it is impossible to do so now.

The only other benefit from I.P. which cannot be denied, is that the long history of trade and political contacts between South Africa and the United Kingdom enabled the Union to build up a substantial and valuable goodwill in the United Kingdom market.

In order to be able to answer our first question, we must enumerate against these advantages all the disadvantages of the I.P. system to South Africa.

Probably the greates disadvantage of the system is that South Africa is dependent on a market which may collapse at any

TABLE I.

Imports from South Africa by the United Kingdom, of the most important items on which a preference is accorded to S.A. and other Commonwealth Countries during 1957.

(Contractual preferences only

U.K. Tariff Item	Description	Value of Imports from South Africa £	% of Total Imports	Calculated value of benefit to S.A. £
(1)	(2)	(3)	(4)	(5)
04.03	Butter	273,274	.27	15,735
04.05	Eggs in shell	345,768	17.8	15,029
03.03	Crawfish, canned	165,562	100.0	16,556
10.05	Mealies, flat white	3,511,322	73.3	351,132
11.01	Mealie Meal	2,548,227	78.1	254,823
08.02	Oranges, sweet, fresh	8,261,820	39.2	412,890
08.06	Apples, fresh	2,394,558	16.6	109,580
08.04	Grapes, fresh	2,342,930	46.0	187,419
08.07	Peaches, etc., fresh	117,004	13.7	11,700
08.06	Pears, fresh	1,481,720	30.6	75,163
08.12	Apricots, dried	80,696	22.2	2,412
08.07	Plums, fresh	193,005	26.9	11,490
08.04	Raisins and sultanas	149,505	1.6	11,610
20.06	Apricots, canned	1,390,340	69.3	166,840
20.06	Peaches, canned	3,856,614	51.3	462,794
20.06	Pears, canned	1,130,992	19.5	135,719
20.06	Pineapples, canned	2,162,907	30.4	84,864
20.06	Fruitsalad, canned.	678,259	56.9	17,858
20.07	Grape juce	133,935	39.8	13,394
20.07	Fruit juice, other	262,796	38.1	26,279
11.08	Maize starch	253,346	10.2	19,000
17.01	Sugar, unrefined	4,785,207	3.0	413,364
22.05	Wine, light	61,070	1.1	13,535
22.05	Wine, heavy	776,019	9.3	240,743
24.01	Tobacco, unmanufact.	105,955	.10	44,533
12.01	Groundnuts	1,725,250	9.6	172,525
25.24	Asbestos, crude	1,590,138	15.9	159,014
15.04	Sperm oil, unrefin.	379,381	30.1	37,938
32.01	Wattle bark, extr.	1,899,583	85.3	189,985
		43,057,183		3,673,897

Column (5) as a percentage of column (3): 8.5%.

Sources: (1) *Annual Statement of the Trade of the United Kingdom with Commonwealth Countries and Foreign Countries*, 1957, Volume II.

(2) *Trade Agreement between the Union of South Africa and the United Kingdom*, Treaty Series, No. 11 (1932), Pretoria, 1934.

(3) *H. M. Customs and Excise Tariff of the United Kingdom*, London, 1958.

(4) *The British Commonwealth, Commonwealth Preference and the Sterling Area*, Federation of British Industries, London, 1958.

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moment. Recent developments as regards the integration movement in Western Europe make it quite clear that Britain will be forced to choose between the Commonwealth — especially the I.P. system — and Europe. As it is, „the United Kingdom seemed to be Mr. Facing-both-ways, looking towards the Commonwealth and to Europe, not knowing which road to take".[7]) Economic as well as political reasons will, however, force the United Kingdom to choose Europe. Thus, the sooner we become accustomed to the idea of competition without the I.P. aid, the better it will be for us.

But not only should we keep in mind the shock South African economy would experience if this market were to collapse, but that the I.P. has some most important indirect disadvantages to our economy. The sheltered markets enjoyed by some of our industries under the system of Imperial Preference have led to a distortion of our economic structure. Because of the special benefits which could be derived in the protected industries, factors of production which could have been employed for the production of truly competitive products, were lured away to this ostensibly beneficial employment. This is the case with our wine, wattle bark and pulp and hardboard industries. Take, for example, the case of the South African wine industry. Production patterns in this industry were of the long-run type, and according to the preferences granted during the period 1932—1939, a large heavy-wine industry was developed. In 1939 to 1947 the preferences changed in favour of light wines and from 1949 to 1958 this changed pattern was accentuated to an even greater extent. This resulted in long-run production surpluses of heavy wines and it could also happen in other industries. Any change in the United Kingdom policy with regard to preferences could result in large South African surpluses. This distortional effect can disturb our whole national economy and cannot be tolerated.

Worse even than the disadvantages mentioned so far, is the fact that I.P. has hampered the formulation of an independent external economic policy. This is brought about in two ways. The first is an indirect impediment, namely that our leaders became accustomed to the idea that

Britain would negotiate on our behalf if necessary or, in any event, that Britain would protect our interests. The second is a direct impediment. I.P. in general creates the impression of discrimination against third countris. Let us, for instance, take the long list of 67 items to which preferences are accorded although not more than 29 amount to anything worth-while. To be more specific, we are unable, as a result of I.P., to bargain for our own interest with international blocs such as the European Economic Community. We are also unable to adopt a more aggressive trade policy towards independent countries. In other words, we are not allowed — out of our own free will — to make the most of our bargaining position in the international economic world.

Our bargaining position with regard to Britain is particurlarly good. We have a very large trade deficit with the United Kingdom, so that we would be able to benefit in almost all aspects of any new agreements which could be entered into with them. Negotations would in any event result in a net benefit to South Africa.

A very grave and real disadvantage, moreover, is the fact that exportation to a sheltered market would almost certainly reduce our compentitiveness in the short run and that could spell complete ruination in the long run if competition were suddenly to be forced upon us.

From the foregoing arguments it should be clear that the sooner we break away from the I.P. system, the better it would be for our economy. (To break away from the I.P. system will not be so difficult now because we are na longer a member of the Commonwealth). By breaking away we would surely be better able to attain the economic ends desired by us.

(ii) *G.A.T.T.*

It is common knowledge that this agreement is based on the principle of the "most-favoured-nation treatment" and that it aims at a reduction or elimination of tariffs on a reciprocal basis.

South Africa, as member of this agreement, is forced to comply with its articles. Consequently it exerts a considerably influence on our present external economic policy.

The free-trade principle which is the main principle of the G.A.T.T. philosophy is, however, not successful under the present world economic conditions, mainly as a result of the difference in the level of development of the economies of the member countries. A country with a low level of economic development can hardly stimulate industrial development without applying tariffs or other discriminatory measures. For that matter, free trade is possible only if the following conditions are satisfied:[8])

1. If a co-ordinated monetary and cyclical policy is followed between the countries concerned, because this would be the only long-run possibility for balance of payments equilibrium.

2. If competition between the countries concerned is given a free hand.

3. If special aid is granted to under-developed member countries.

4. If a joint policy is pursued with regard to trade with non-member countries and also with regard to competition

between member countries in the outside market.

This is very far removed from the present position in international economic relationships. The United States of America, the most developed and richest of the member countries, has for instance maintained a most restictive and protectionist economic policy. No advancement in the direction of free trade could, however, be expected unless America were to change her internal and external economic policy. America is taking up a very firm stand in connection with the principle of reduction in trade barriers on a reciprocal basis, and as long as this policy is maintained, it would be unfair to countries which initially had a low level of protection.

What is even worse for the South African position is that the great industrial countries of Europe and America apparently have no scruples about violating the spirit of the agreement. We, on the other hand, follow the G.A.T.T. philosophy most meticulously and this is definitely not conductive to our own economic development.

The whole tendency in practical international economic relationships is to move away from free trade and in the direction of bilateral agreements and protection, and any delay on our part to follow suit could only be to our own detriment.

(c) *International integration.*

Today we live in an era marked by international integration movements. What is the position of South Africa in this development? From a geographic point of view it will be difficult for us to integrate with any area in particular, except perhaps with Southern Rhodesia, by reason of the fact that our present political position is not acceptable to growing nationalism in Africa.

Nevertheless, we could benefit from the integration movement in other parts of the world if we are willing to adopt a revised external economic policy. As a single country, we will probably be able to find a more willing ear in future trade agreements than if we were to work through the United Kingdom.

It is of vital importance to us to develop and maintain the closest possible contact with the countries of the Common Market. The developments of the last few months in the Congo, and further evidence of growing nationalism in Africa, will perhaps enable us to make closer contact with this group. It is not impossible to get the European Six interested in the development of our vast raw-material resources to suit their own development plans. Once they are interested it would not be impossible for us to demand, and be accorded, special treatment with regard to their outer tariff, etc. But as we have previously shown, this would call for a revision of our ties with Commonwealth countries to enable us to formulate an independent policy in this direction. Unfortunately, there is a marked tendency amongst South African leaders to depend on the negotiations of the United Kingdom from which we hope to benefit indirectly.

It is also necessary for us to seek more contact with underdeveloped countries in view of the fact that this country is becoming progressively industrialised. In the case of under-developed countries the bilateral agreement, especially agreements of the barter type (which is diametrically opposed to our present policy)[9]) will be welcomed.

d) *Measures to increase productivity and exports.*

One thing that we should try to achieve by all means, is a rise in our internal productivity, for this is the only way of improving our international competitiveness. External economic policy cannot greatly influence our productivity, but the least we can do in this regard, by means of external policy, is to make sure that we export items in respect of which we have a comparative advantage, and to import those things which we can import more cheaply than we can possibly produce them ourselves.

A direct consequence of this is that we must make better use of our abundant supply of raw materials, especially minerals. The least we can do is to refine these materials as far as possible before export, or if the ability of our labour force and the export market permit, to use them as raw materials in the production of exportable consumer or investment goods.

In addition to a rise in productivity, further measures should be applied to stimulate exports. This could be achieved in various ways, but the Government could at least be expected to negotiate for favourable conditions under which orders could be placed.

e) *Selective measures to lower imports.*

As indicated above, it is necessary to have an instrument whereby external balance could be promoted. This is especially true in the case of the influencing of imports. Although it is possible to lower imports by means of propaganda in favour of local substitutes, or at least to allay any prejudice against local products, for example by means of a our bureau of standards, it usually calls for a more direct measure.

We have, however, already pointed out that tariff or direct import control is only acceptable as a short-run measure. The only long-run measure which could be enforced and which is selective enough, is a sales tax on items which are not regarded as necessities. Because this sales tax does not discriminate against imports, it will not evoke retaliation from the countries whose exports are affected.

6. *Conclusion.*

It will suffice to make one concluding remark. One thing is clear from our argument, and that is the necessity to formulate an independent external economic policy capable of being adapted to the rapidly changing international economy.

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