



South Africa: Economic Trends and Their Implications for Racial Tensions

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An Intelligence Assessment

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South Africa: Economic Trends and Their Implications for Racial Tensions

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was coordinated with the National Intelligence
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ALA,

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**South Africa: Economic Trends
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Key Judgments

Two salient features of South Africa come to mind when casual observers think of that country: its glittering mineral wealth and its brooding racial problem. Even transit passengers passing through Johannesburg's bustling Jan Smuts airport are struck immediately by the contrast between the brisk business being done by duty-free kiosks selling gold Krugerrands and the omnipresent and sullen black maintenance staff. 25X1

The linkages between the South African economy and relations between its racial groups are more than superficial. South Africa's history and apartheid policies have shaped its economy, dividing it into a modern industrial sector and a rural subsistence sector and creating enormous socioeconomic disparities within the population. These disparities have added to racial tensions resulting from the white minority's refusal to share political power with nonwhite groups. 25X1

This paper examines the linkages between economic performance and racial tensions, projects trends in both areas through 1985, and discusses the implications for South Africa and for the United States. Its findings are fairly pessimistic:

- Living conditions for urban blacks have improved significantly over the past 12 years as the result of steady economic growth and the government's adoption of a strategy of building a nonwhite middle class as a buffer against revolution. But the gap between white and nonwhite standards of living remains enormous.
- Because the South African economy is so vulnerable to fluctuations in world gold prices and because these prices cannot be counted on to rise above \$500 an ounce before the end of 1985, we estimate that real economic growth will hover at 2 percent or less in 1983 and remain below 5 percent in 1984 and 1985.
- Pretoria acknowledges that 6-percent annual growth is necessary just to provide jobs for black entrants to the labor force. Moreover, because South Africa's tax base is small, resting almost exclusively on the

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has been used in the preparation of this report.*

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business and personal incomes of the minority (17 percent) white population, the government will be unable to increase spending significantly on programs to improve the socioeconomic status of nonwhites.

- Consequently, the pace of improvement in black housing and education and in nonwhite living standards in general is likely to slow, and the pool of unemployed and underemployed blacks will probably swell. Even if economic growth is a notch higher than we predict, the black unemployment rate is unlikely to dip below 20 percent.
- We believe, therefore, that the potential for major racial disturbances will increase over the next several years, with the country's industrial centers becoming the most likely trouble spots.

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A leveling off of South African economic growth along the lines we anticipate will by itself have mixed consequences for the United States over the near term. Stepped up foreign borrowing by Pretoria to offset current account deficits, for example, will broaden lending opportunities for US commercial banks, and this will help to offset reductions in earnings and expansion opportunities for US firms doing business in South Africa. Inasmuch as they heighten the potential for a major racial upheaval, however, recent and prospective economic events undermine the US objective of preventing racial conflict in South Africa from jeopardizing US economic and strategic equities there.

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Development and Structure of the South African Economy

The discovery of gold in 1886, in what is now the Johannesburg area of Transvaal province, shaped the early development of South Africa's modern economy. European and American capitalists poured in money and technology, tying South Africa into the Western economic system in the process. Development of gold mining paved the way for the exploitation of many other minerals, such as chromium, manganese, and uranium. Gold mining stimulated the formation of the engineering and explosives industries. Demand for electric power for mining and refining led to exploitation of major coal deposits in Natal and Transvaal provinces, and the recruitment of blacks to work the mines helped create the nonwhite labor force that now also serves the manufacturing, services, and commercial agriculture sectors.

Gold made the Pretoria-Johannesburg area the country's major industrial center and fostered the growth of three other areas—the Western Cape around Cape-town; the Port Elizabeth-Uitenhag-East London area of the Eastern Cape; and the Durban-Pinetown district in Natal. Each possesses a major port, and plays a key role as an entrepot for goods going to and from Pretoria and Johannesburg. Today, the four areas provide over 80 percent of South Africa's industrial output and employ nearly 80 percent of its modern work force.

The manufacturing sector of the modern economy was first stimulated by South Africa's enforced isolation during World War I, but was hurt by the depression in the 1930s. It gained new vitality during World War II, when it was temporarily shielded from foreign competition yet pressed to provide the Western powers with supplies of all kinds. During the 1960s, increased investment by Japanese and Western businesses eager to get an early share of the small but growing southern African market provided an added boost to the manufacturing sector.

Nevertheless, the limited purchasing power of the black population in South Africa—and in neighboring states—as well as the country's distance from major Western markets have stunted development. In the late 1970s, manufacturing output was only \$18 billion more than in 1950, compared, for example, to a growth of \$28 billion in manufacturing in Canada (a country of about equal population) during the same period. South African manufacturing accounted for only 12 to 14 percent of total employment in the modern economy by the end of the 1970s (less than 10 percent of black employment), compared to almost 20 percent in Canada.

Commercial agriculture in South Africa has followed the pattern—on a much smaller scale—of agricultural development in the United States. Beginning with the ruggedly individualistic Afrikaner Boer farmers and herders of the early days, agriculture has evolved into large, family-owned agribusinesses. It is rapidly incorporating modern technologies and is turning to heavy machinery instead of cheap, but inefficient, black labor. As a result, South Africa is self-sufficient in food production and has large surpluses for export. Agriculture, however, accounts for only 7 percent of GDP and less than 10 percent of exports.

The mineral sector is today both the greatest strength of South Africa's modern economy and the source of its greatest weakness. Mineral exports account for about 75 percent of export earnings; gold alone represents 66 percent of mineral exports. South Africa earned over \$13 billion from gold sales in 1980. The modern economy, however, is so heavily oriented toward mineral exports that its health has long been hostage to fluctuations in world mineral prices and to the capability of the mining industry to increase output. For example, the decline in South Africa's gold output by a third after 1970—as the richest ore veins were exhausted—was largely responsible for a drop in the country's average annual growth in GDP from 5.1 percent during 1951-70 to 3.7 percent during 1971-81.

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The Setting

The Gains of the 1970s

South Africa's gross domestic product is only about a third as large as Canada's, even though their populations are roughly equal.¹ Yet, South Africa's 4.6 million whites enjoy one of the highest living standards in the world. Most of its 25.6 million nonwhites lead lives of grinding poverty. Roughly half of the 22 million blacks engage in traditional agricultural practices in rural "homelands," where conditions are not much different from those in the poorest African countries. Most of the other 11 million blacks, along with the 3.5 million Asians and Coloreds (people of mixed race), provide cheap labor for the modern economy.

Living conditions for many South African blacks, nonetheless, improved significantly during the 1970s. These improvements reflected economic expansion averaging almost 4 percent annually, the related growth in the size of the black urban population, and government encouragement of improved conditions for blacks as part of its policy of building a nonwhite middle class. The incidence among blacks of nine serious diseases—infective encephalitis, small pox, trachoma, typhus fever, meningitis, puerperal sepsis, scarlet fever, leprosy, and diphtheria—declined sharply, for example. Although health services are still poor for most blacks, the availability of doctors and modern health care facilities for nonwhites in South African urban areas is a notch ahead of those in the rural homelands. Moreover, although the share of black children enrolled in school remained constant at 47 percent through the 1970s, those staying in school to acquire a secondary education grew from 15 percent to almost 25 percent of total enrollment. Both primary and secondary educational facilities are more readily available to blacks in urban areas, and compulsory education was introduced for urban blacks in some locales in 1981.

¹ Except where otherwise indicated, the statistics in this paper were derived from official South African Government publications.

Table 1

South Africa: International Role, 1981

Category	Size
Gross domestic product	\$82 billion 30 percent of Canada's 35 percent of Mexico's
Population	29 million people 121 percent of Canada's 42 percent of Mexico's
Public and publicly guaranteed foreign debt ^a	\$6 billion \$1 billion held by the United States
Foreign direct investment, stock ^a	\$12 billion \$2 billion US exposure
Exports	\$21 billion 29 percent of Canada's 86 percent of Mexico's
Imports	\$21 billion 30 percent of Canada's 84 percent of Mexico's
Gold production	645 metric tons 60 percent of world total 72 percent of non-Communist total

^a Data are estimated.

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The expansion of the economy between 1970 and 1981 opened the way to greater nonwhite participation in the modern sector. Black employment in mining, manufacturing, and other sectors of the modern economy grew by 25 percent to 2.8 million workers during the period.² Real wages for blacks in

² These data exclude the approximately 4.5 million black workers who were unemployed or working as subsistence farmers in the homelands, employees on white-owned farms, domestic servants, and part-time workers holding odd jobs.

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these jobs climbed by an impressive average annual rate of 5.7 percent, a significantly higher pace than that achieved by whites. Nonetheless, the spread between the average annual current income of whites and that of blacks grew from about \$3,730 in 1970 to \$9,500 in 1981. [redacted]

Other factors contributed to the progress realized by blacks:

- The replacement of white minority regimes in Angola, Mozambique, and Zimbabwe with black-ruled governments hostile to South Africa induced South African mining companies to halve their employment of low-wage foreign migrants in favor of more domestic black workers. The steady rise in gold prices beginning in the early 1970s enabled gold mining companies, which account for two-thirds of total mining employment, to maintain profitability despite increasing labor costs. As a result, real mine wages for blacks grew at 11 percent annually during 1971-81, outpacing black wage gains in all other sectors and bringing black wages in mining roughly into parity with those in the rest of the economy.³
- Blacks moved steadily into higher paying semi-skilled and skilled jobs left open by shortages of white workers. The growth of skilled job openings outpaced the expansion of the white labor force both because of demographic factors—white population expansion equaled only 1.5 percent a year during 1971-81—and because of military conscription that forced practically all young white males to delay their entry into the labor market. [redacted]

The Role of Governmental Reform

Changes that occurred in the government's overall approach to racial issues during the latter part of the 1970s reinforced economic and demographic pressures for change—and raised nonwhite expectations. The rethinking of racial policy by Pretoria was set in motion principally by the riots in Soweto in 1976 and the subsequent wave of racial disorders in other nonwhite South African communities. Adding to the

³ Despite these gains, earnings for black miners average just \$240 per month, compared to \$1,400 for white miners. [redacted]

pressures for a change in government racial policies were the emergence of hostile black regimes in Angola and Mozambique, an economic downturn in 1976-77, and increased Western activism against apartheid. [redacted]

Viewing itself threatened by, in its words, a "total onslaught" of hostile internal and external forces, Prime Minister John Vorster's administration sought to rationalize and orchestrate foreign and domestic policies in order to develop a more coherent strategy for maintaining white control. Government initiatives and statements after mid-1976 reflected a change in approach from one of actively seeking to reduce the black population in urban areas and to limit black involvement in the modern economy to one of creating a stable black work force enjoying improved living conditions. Although Vorster refused to grant meaningful political rights to nonwhites, he made plain through statement and action that his goal was to create a nonwhite middle class with enough of a stake in the existing system to want to defend it, alongside whites, against outsiders and, if necessary, against less privileged South African blacks. [redacted]

As part of this effort and with considerable public fanfare, the government relaxed apartheid restrictions in such areas as sports, urban black residency, job discrimination, and the segregation of public facilities. Pretoria also began to increase spending on black education, housing, and health care. It also stepped up its effort to bring the salaries of black civil servants—whose numbers doubled to about 500,000 between 1970 and 1981—up to the level of their white counterparts. [redacted]

Although P. W. Botha had a reputation as a hardliner on racial issues when he became premier upon Vorster's resignation in 1978, he quickly embraced Vorster's approach, pushing it further and faster in some areas. Botha has boosted spending on black education and housing to unprecedented levels, further rolled back or amended regulations prohibiting black entry into skilled occupations, and eased travel and other restrictions on urban black jobholders. In addition, he has initiated programs to provide electricity, street

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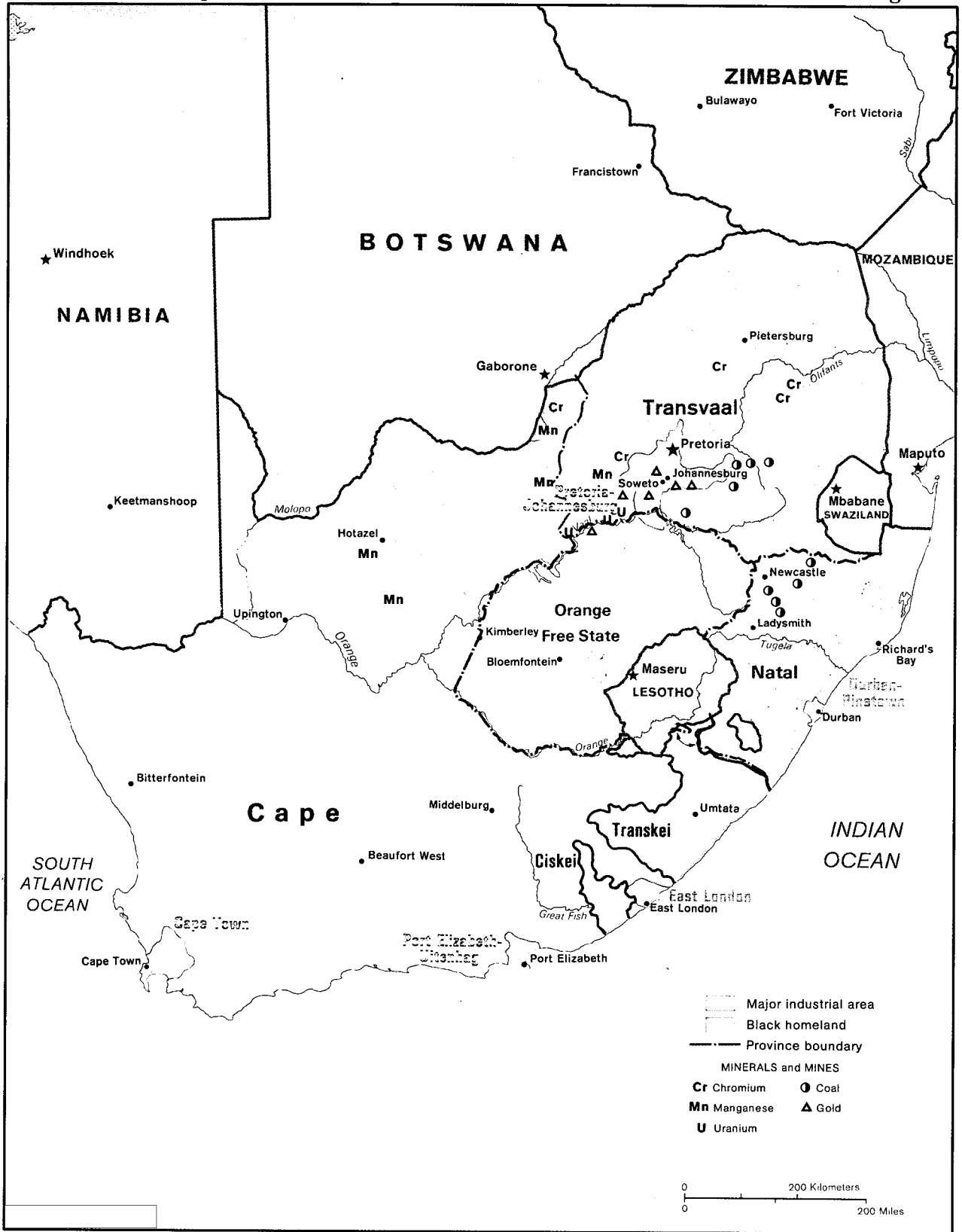
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South Africa: Major Industrial Areas and Black Homelands

Figure 1



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and sidewalk paving, sewerage, and shopping centers to Soweto and some other major black townships. Finally, Botha has encouraged private involvement in such sectors as housing and industrial training and has tried to inject new life into development projects in the homelands through a number of stimulative measures including tax concessions. [redacted]

Recent Economic Patterns and Prospects

Initially, Botha's efforts were facilitated, indeed made possible, by an economic boom that began in 1979 and lasted through 1981. Economic growth at the peak of the boom exceeded the 6-percent rate the government acknowledges is necessary to absorb new black job entrants into the nonagricultural, modern sector. The surge in government revenues from what journalists dubbed the "golden harvest" provided the money for the increased spending on education and housing for blacks. The boom also shaped government calculations about the reaction of the white electorate to racial reform; reports from the US Embassy and from journalists make it plain that Botha and other reform-minded officials assumed a fairly high white tolerance for their program because the government could increase spending on social projects and roll back restrictions on black economic activity without affecting the well-being of whites. [redacted]

The Boom of 1979-81

Upside. Robust economic growth was fueled by the jump in world gold prices that began in 1979. The business cycle peaked in 1980 with banner growth of 7.3 percent in real GDP. The unprecedented gold price boost improved the terms of trade sharply, producing record current account surpluses of more than \$3.5 billion in both 1979 and 1980. Import volume, led by an increase in finished consumer goods, jumped 15 percent in 1980 alone. Large quantities of capital equipment and machinery, raw materials for domestic processing and assembly, and crude oil—which accounted for more than half of total imports—also flowed in to fuel the rapid domestic expansion. [redacted]

The availability of low-interest funds on the domestic capital market enabled the private sector and public corporations to repay many foreign loans in 1979-80,

and this reduced South Africa's foreign indebtedness. Meanwhile, South Africa built its foreign exchange reserves up to the equivalent of a comfortable five months' worth of imports. [redacted]

Soaring income tax revenues created by the broad-based economic expansion allowed Pretoria to increase selected consumer subsidies and cut tax rates on personal income and retail sales in late 1979. Despite increased government spending for both defense and social programs, the sharply higher revenue intake reduced the budget deficit to below 2 percent of GDP in 1980. [redacted]

The tax cuts, along with the easing of interest rates, produced a sharp increase in private spending. Purchases of consumer durables—such as furniture, appliances, and automobiles—surged by 26 percent during 1980. Improved business expectations increased domestic and foreign direct investment in plant and equipment, and inventories bulged. [redacted]

The increases in consumer and industrial demand spurred a rise of over 11 percent in manufacturing and in wholesale trade. Construction followed closely with 8-percent growth. Bumper summer crops also brought a 13-percent increase in real farm output despite a decline in winter crop production and stagnating meat output. [redacted]

Monetary discipline slipped in the intense boom, however, setting the stage for accelerated inflation. The relaxed credit controls and low interest rates led to a \$4.2 billion increase in commercial bank lending to the private sector in 1980. These factors and rising gold and foreign exchange holdings pushed the money supply up by more than 27 percent in 1980. Only the existence of excess industrial capacity at the beginning of 1980, the surge in imports, and the movement of larger numbers of blacks into higher paying skilled positions contained inflation to about 14 percent for the year. [redacted]

Downside. Bumping into limits on their ability to take on more credit, South African consumers began to reduce spending by early 1981. This slowdown in growth of private consumption marked the start of the

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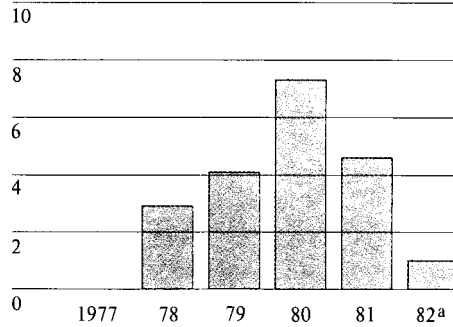
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Figure 2

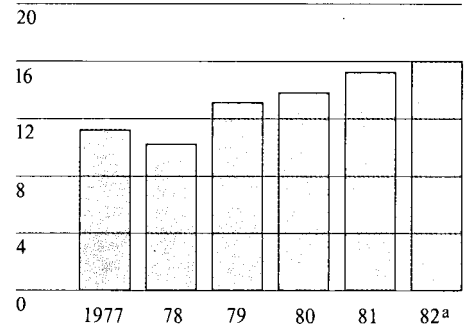
South Africa: Selected Economic Indicators

Note change in scales

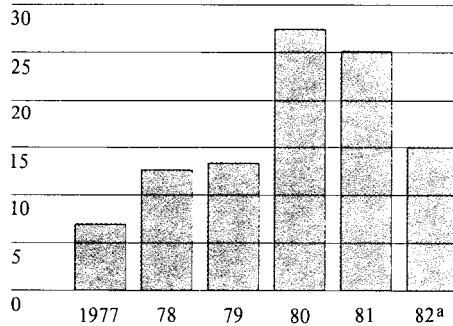
Growth of Real Domestic Product
Percent



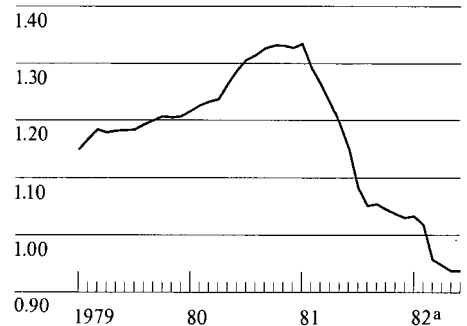
Increase in Consumer Prices
Percent



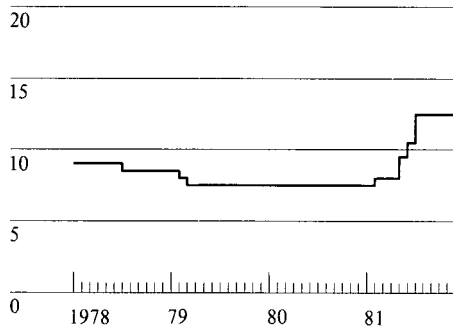
Growth of Money Supply
Percent



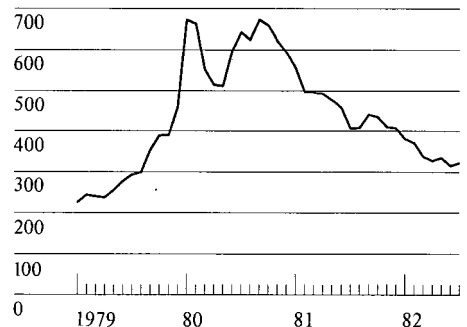
Exchange Rate
US \$/Rand



Reserve Bank Discount Rate
Percent



Gold Price^b
US \$/Ounce



^aProjected.

^bLondon average daily fixing price.

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business-cycle decline. More restrictive monetary policies designed to cool the overheated economy contributed to the slowdown as the year progressed. Only record harvests kept real GDP growth at 4.6 percent last year. Unemployment among urban blacks, which—according to South African Government statistics—dropped 1 percentage point to 8.1 percent in 1980, began to increase rapidly in 1981, and real incomes of nonwhite groups began to decline.⁴ [redacted]

We believe that these domestic trends would have had only a moderate impact if they had not been accompanied by two major developments on the international economic front: the plunge in gold prices and the onset of the recession in the United States and in other Western countries. Gold prices slid steadily from an average of \$560 an ounce in January to just \$400 by the end of 1981, cutting foreign exchange earnings by \$3.5 billion. Rising US interest rates, which induced international currency traders to switch from gold to dollars after mid-1980, and increases in Soviet gold sales were largely responsible for the slide. [redacted]

Nongold export earnings dropped 14 percent in response to the recession in the West. Falling diamond prices cut proceeds from diamond exports alone by over \$400 million in 1981. Although import volume flattened, world inflation and a fall in the value of the rand against foreign currencies drove the value of imports up 14 percent. As a result, South Africa was forced to step up short-term borrowing from European currency markets and to draw down gold and foreign exchange reserves by \$1.8 billion to cover a record \$4.5 billion current account deficit for 1981. [redacted]

Increasingly worried about inflation, Pretoria sharply tightened its freewheeling monetary policies in the first three quarters of 1981. The South African Reserve Bank boosted domestic interest rates and tightened bank reserve requirements, forcing a contraction in domestic credit. The result was a drop in

⁴ The employment statistics exclude blacks in the homelands, where unemployment stayed high in the 1970s and remains so. The overall black unemployment rate probably rose to about 20 percent in 1980 despite the modern sector's absorption of 215,000 new black workers. [redacted]

the growth of the money supply (at annual rates) from 46 percent in first quarter 1981 to 10 percent in the third quarter. In October and December, the Reserve Bank made two well-publicized gold "swaps" with West European commercial banks for \$1.2 billion to help stem the foreign exchange drain without undermining Pretoria's anti-inflationary policies.⁵ Despite these measures, constraints on skilled manpower and industrial capacity, a slip in monetary discipline in the fourth quarter, and increases in some government administered prices (such as rail rates) kept inflation above 15 percent in 1981. [redacted]

Near-Term Economic Outlook

Unless gold prices rise significantly above current levels, we estimate that South Africa's rate of economic growth will not exceed 1 percent in 1982. Financial losses already have become so great that some marginal gold mines subsidized by Pretoria may soon be forced to close. Contractionary fiscal and monetary policies aimed at further squeezing private demand for imports, restraining the national budget deficit, and curbing inflation will inhibit manufacturing, construction, and commercial activities. Moreover, drought has considerably dimmed the likelihood of another good harvest this year. [redacted]

Meanwhile, Pretoria's international payments problems will deepen. In our judgment, Pretoria cannot cut imports enough this year to offset the slide in foreign exchange earnings caused by falling gold prices. Since the beginning of 1982, the price of gold has fallen to a weekly average of less than \$350 an ounce. Although possible reductions in US interest rates and inflation may ease downward pressures on gold prices later this year, their average is unlikely to reach \$400 an ounce. Pretoria already has begun sales of 99.9-percent pure, 400-ounce gold bars (up from

⁵ Following a pattern established in the mid-1970s, Pretoria sold gold at discount prices with a commitment to repurchase the gold in the future at a premium. The "swaps" covered more than one-fifth of the government's gold stock. We assume that Pretoria hoped in this manner to avoid the expansion of domestic banking liquidity that would have ensued from increased foreign borrowing. Pretoria's repurchase commitments moderated the pressures that outright gold sales from stocks would have had on already falling prices. [redacted]

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Table 2

Million US \$

South Africa: Balance of Payments

	1977	1978	1979	1980	1981	1982 ^a
Merchandise trade balance	-676	-655	-1,100	-5,866	-10,160	-9,800
Merchandise exports, f.o.b.	7,237	8,566	10,467	12,395	10,718	10,700
Merchandise imports, f.o.b.	7,913	9,221	11,567	18,261	20,878	20,500
Net gold output	3,214	4,443	7,129	13,035	9,580	8,000
Net services	-2,109	-2,370	-2,696	-3,909	-4,380	-4,700
Net transfers	45	112	194	378	425	500
Current account balance	474	1,530	3,527	3,638	-4,536	-6,000
Long-term capital movements	340	6	-1,216	-781	410	
Change in liabilities related to reserves ^b	-240	-562	-476	1	2,102	
Other short-term capital movements ^c	-975	-931	-1,816	-2,174	867	
Gold valuation adjustments and SDR allocations	287	1,617	2,418	1,258	-624	
Change in gross gold and other foreign reserves	-114	1,660	2,437	1,942	-1,781	
Total reserves, yearend	906	2,566	5,085^d	7,446^d	4,877	

^a Projected on the basis of an average gold price of \$375 an ounce, 1981 average exchange rates, and 1-percent real growth.

^b Liabilities related to reserves are short-term foreign liabilities of the South African Reserve Bank and short-term foreign obligations of the central government and commercial banks.

^c Includes supplier credits and errors and omissions.

^d Total reserves are not the sum of change in reserves and the previous year's total reserves because of year-to-year changes in exchange rates.

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99.5 percent) in an effort to boost flagging export earnings. Even so, the current account deficit soared to \$1.4 billion in the first quarter of 1982 and will likely balloon to a record of nearly \$6 billion this year.

South Africa is borrowing heavily abroad to finance imports and to replenish its foreign exchange reserves. The South African Reserve Bank already plans to borrow \$3 billion from overseas lenders this year, according to Western banking sources. In addition, Pretoria has withdrawn \$130 million from its reserve account in the International Monetary Fund. Despite these measures, we believe South Africa will again draw down its foreign reserves by \$1.5-2.0 billion to help meet foreign payments needs in 1982.

Anticipating increased budget deficits, Finance Minister Owen Horwood announced in February a 10-percent surcharge on imports and an increase in the general sales tax from 4 percent to 5 percent. The government originally estimated these measures would yield \$1.2 billion in additional revenue during the fiscal year that began on 1 April. Horwood's budget, presented in March, also included a \$625 million increase in other taxes to help offset a \$1.3 billion fall in tax revenues from gold mining because of the drop in gold prices. Even with these adjustments, the budget called for a slight decrease in real spending this year to just over \$18 billion and a budget deficit up slightly from last year to \$2.4

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billion. Pretoria, however, did not expect the price of gold to drop as low as it has during this year. Consequently, lower-than-expected revenues from gold could still increase the deficit. In this case, pressures would mount for Pretoria to enact new revenue measures to contain both the deficit and inflation—which is already running at a 16-percent annual rate. [redacted]

The Longer Term

We believe that as long as US interest rates are high and inflation is contained, international speculative pressures are likely to keep gold prices below the \$500 to \$600 range. Gold prices need to reach this plateau to permit the level of import growth in South Africa necessary for more rapid economic expansion. Without increased gold income, we estimate that South African growth probably will continue to bump along at 2 percent or less through 1983. The government is likely to maintain tight constraints on imports in order to control the international payments deficit and on public spending to reduce inflationary pressure. Depressed consumer spending, inventory reduction by businessmen, and reduced investment in plant and equipment by both public and private firms can all be expected to act as brakes on growth from the demand side. [redacted]

By 1984 the economic picture will improve somewhat in South Africa, although world conditions mitigate against South Africa's regaining export opportunities like those of the 1979-81 boom period. OECD and private business forecasters, judging that most of Europe and Japan are now essentially out of the trough and that the US economy is likely to pick up late this year or in 1983, currently project economic recovery in the Western industrialized countries to be spread over the next 18 months.⁶ This recovery should be sufficient to lift demand for South African exports. In addition, business analysts see a recovery in South African domestic spending on consumer durables based on product life and observed cycles. [redacted]

Economic growth in 1984 and 1985, therefore, may well regain the 1970s average of 3 to 4 percent annually, even with little or no improvement in gold

⁶ These forecasters also project that long-term growth in the developed countries will fall short of that achieved during the late 1960s and early 1970s for some time to come. [redacted]

prices and continued tight monetary and fiscal policies. Were there to be good rainfall and bountiful harvests, the growth rate might exceed 4 percent by—at most—1 percentage point. On balance, we estimate that the average annual growth rate will, for the foreseeable future, be below the 5.1-percent rate achieved in the 1950s and 1960s. [redacted]

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If gold prices rebound to levels higher than we anticipate, South Africa will benefit accordingly. In our judgment, gold prices of \$500 to \$600 an ounce would return economic growth to 4 to 5 percent in 1983 and provide a platform for growth of 6 to 8 percent in 1984 and 1985. Each \$100 rise in gold prices would boost export receipts by about \$2.1 billion, or 11 percent over earnings we project for 1982. In turn, replenished revenues from taxes on renewed gold mining profits would enable the government to ease the tax burden on personal incomes, thereby stimulating consumer spending. Increased earnings from gold sales alone would allow sufficient increases in imports to accommodate this demand. Rising gold income would have a cumulative effect because it would enable the government to forge ahead on delayed investment projects and permit mining companies to revitalize development of relatively low-grade gold deposits. [redacted]

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Implications for South Africa and the United States

Challenges for the Mid-1980s

Botha has stuck to his limited racial reform program despite the economic slowdown and the rightwing political backlash reflected in the results of the election in April 1981. The budget tabled in March 1982, for example, increased allocations for the Department of Cooperation and Development (which funds administration and development of Soweto and other black townships) by one-third to \$1.2 billion, while budgeting for black education and training was increased by 29 percent to \$476 million.⁷ These gains came at the expense of allocations to other areas. Defense spending was held to a nominal 8-percent rise to \$2.7

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⁷ Spending per black pupil, nevertheless, remained at about \$175 a year, compared to more than \$1,000 for each white student. [redacted]

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billion. Although the only actual cuts were in agricultural programs—down \$109 million—the overall budget was austere. [redacted]

A leveling of economic growth along the lines we anticipate, however, will inevitably undermine Botha's ability to continue raising spending on social programs. The steep drop in gold profits and stagnation in white incomes, which together are the sources of half of government tax revenues, will put a cap on revenue unless tax rates are raised again. We believe Botha is unlikely to increase tax rates or further divert funds from other uses because such moves would give political ammunition to his rightwing critics. The splitting away of the right wing of the National Party in March 1982 and the response to political stumping over the past few months by both Prime Minister Botha and the leader of the new Conservative Party, Andries Treurnicht, reflect strong white opposition to the whole Botha reform program. The negative reaction of many whites indicates they believe they are being asked to foot the bill for programs that, in the end, will erode their privileged position—and they resent it. [redacted]

Consequently, we anticipate that spending constraints and demographic trends—primarily the annual growth of roughly 3 percent in the black population and steady increases in black urbanization—through 1985 will undermine the government's goal to create a nonwhite middle class that would be a buffer against racial upheavals. No plausible economic growth scenario, for example, is likely to reduce either the black unemployment rate below 20 percent or the number of unemployed blacks, now totaling about 1.5 million, over the next few years:

- Assuming economic growth averages less than 2 percent during 1982 and 1983, stagnation in nonagricultural, modern sector employment and the emergence of new black jobseekers will push black unemployment in the modern sector toward 2 million.
- Economic growth of 3 to 4 percent annually during 1984 and 1985 would again be likely to produce slow growth in black employment. The ever-increasing numbers of black labor force entrants, however, would continue to swell the pool of unemployed at only a slightly lower rate than in 1982-83.

- Only in the unlikely event that economic growth exceeds our expectations and averages 6 to 8 percent during 1984 and 1985 would conditions for blacks improve in a fashion akin to that of the late 1970s. Ironically, the initial phases of this sort of boom could present their own problems. We believe, for example, that another boom would substantially increase pressures from black workers for higher wages and better working conditions. Moreover, the expansion of job opportunities would bring many blacks from the homelands to the urban areas and would lead many marginally employed blacks—domestic servants, part-time workers doing odd jobs, and the like—to begin hunting full-time jobs in the modern sector. In the short term, this could seriously strain limited public services and add to unemployment of the unskilled. [redacted]

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Likely Patterns of Response

Because there are no large-scale unemployment or welfare programs for blacks in South Africa, many of the unemployed urban blacks will be forced to fall back on family members already living at or near subsistence levels in the homelands if growth continues to be slow. Households in the homelands can expect little increase in the \$300 or less a year in cash they are now able to secure to supplement farm production. Indeed, this small amount comes principally from remittances from migrant workers employed in mining and modern sectors, some of whom will lose their jobs at the slower growth rates. [redacted]

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We do not believe that rural development projects will pick up slack or otherwise cushion the problems of the unemployed. The economic downturn has made businessmen even more reluctant to invest in projects in the homelands. As a result, we believe the urban-rural gap will widen, adding to the tensions in overall black-white relations. [redacted]

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In the absence of economic growth greater than we anticipate, frustrations are likely to rise even among employed black industrial workers and others among the relatively well-to-do nonwhite community. These nonwhites are already feeling the immediate impact from the slowing in the growth in earnings for black urban workers. Income growth will in all likelihood slow sharply between now and 1985. [redacted]

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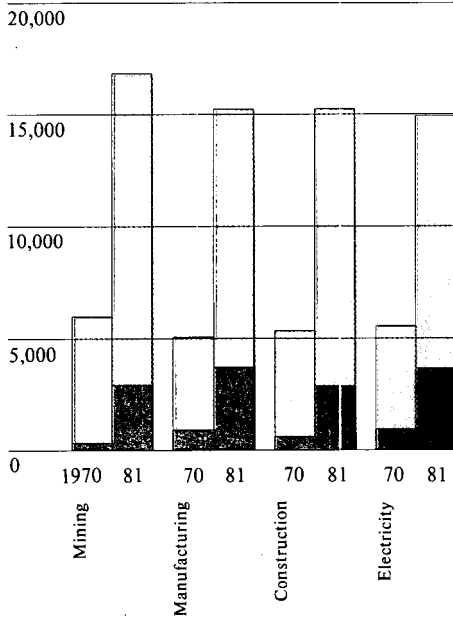
Figure 3

South Africa: The Black/White Wage Gap

Annual Wages (US \$)

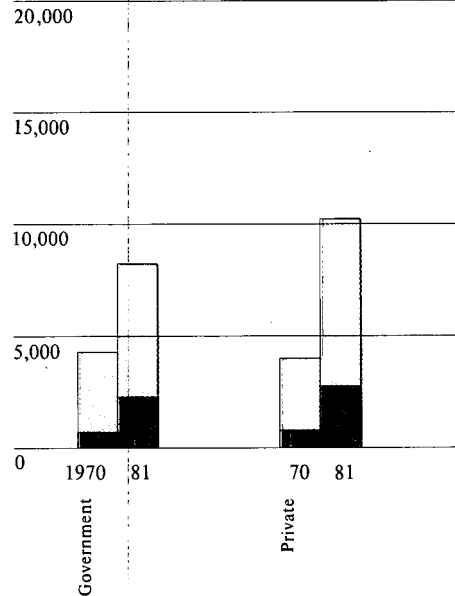
Basic Industries

1.8 Million Blacks
0.5 Million Whites



Services

1.1 Million Blacks
0.9 Million Whites



Whites
Blacks

587349 8-82

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This, in our view, will give impetus to the growth in size and militancy of black labor unions. Following legalization of collective bargaining rights for black unions in 1979, black union membership accelerated steeply from about 70,000 in 1979 to more than 200,000 currently. Labor retrenchments and increased management resistance to wage increases this year because of the economic slowdown have led to strikes in many plants and to serious rioting at four gold mines. Because inflation still exceeds 15 percent, pressure for wage hikes is increasing.

Budgetary constraints and the business downturn will act increasingly as a drag on programs to upgrade education and housing, which are of particular importance to the nonwhite residents in urban areas. Because it is such an emotional issue among whites, the government has been reluctant to take the one step in

the area of education that might yield quantum results—abandoning the separate education systems for the various races in favor of a unified, multiracial school system. A government-commissioned study published in 1981 found that because of the vast disparities between the white and nonwhite systems, Pretoria would need to earmark \$5.5 billion annually for an indefinite period to bring the nonwhite systems up to par with the white system. This compares with the \$476 million budgeted for nonwhite education this year.⁸ Faced with economic hard times, business

⁸ South Africa today spends about 5 percent of GDP on education, a level comparable to that in many Western countries. Bringing nonwhite education up to current white standards—which would entail massive programs for improving the quality and numbers of nonwhite teachers and schools, making textbooks available to individual nonwhite students, and the like—would involve staggering costs that might absorb as much as 20 percent of GDP.

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leaders are unlikely to expand their involvement in industrial and vocational training. Given the magnitude of the problem and the hesitant pace at which the government and the private sector are proceeding, we believe that no perceptible increase even in black literacy is likely until well after the mid-1980s. []

The prospect for any easing in housing shortages for urban blacks is equally bleak. Although, under this year's budget, allocations by the Department of Community Development for urban housing construction were increased by 20 percent, the number of units completed will be only a fraction of the 150,000 to 200,000 needed. The quality of government housing, moreover, will probably remain far below standards sought by blacks who are beginning to move up the economic ladder. Public housing construction remains locked into a pattern of row after row of box-like units, each with four barracks-like rooms. The government has only begun to provide electricity and indoor plumbing and to pave sidewalks and streets. []

As with education, private-sector involvement in non-white housing is likely to be held back by the projected slow pace of economic recovery. A 99-year leasehold scheme enacted in December 1978, which provides urban black residents many of the rights of property ownership, has failed to spur home construction by individual nonwhites or to attract private mortgage financing. According to the government itself, applications from black families under this plan so far have totaled 2,500—of which only 1,200 have been approved. In our view, this response reflects:

- Lack of discretionary income by blacks for home construction and improvement.
- Perceptions among blacks that they are as well off with the government footing the bill for housing.
- General unattractiveness of home ownership in the dreary townships.
- Pervasive uncertainty among blacks about their status in white urban areas after decades of government policy to reduce permanent residence. []

Nonwhite pessimism over the prospects for improvements in housing, education, and wages was reflected in recent surveys by private South African organizations and universities, which found that the majority of urban nonwhites already believe that their living conditions are deteriorating and their prospects for advancement are declining. []

Implications for Racial Unrest

We believe the potential for serious racial unrest in South Africa will remain high through 1985 under the best of economic circumstances. Socioeconomic disparities between whites and nonwhites are such that it would take decades for even the most reform-minded government to close the gap significantly, and nonwhites' expectations for change have been raised by the progress they have made in recent years. In the meantime, black frustrations over the white minority's reluctance to share political power will continue to reinforce black impatience with the scope and pace of economic and social change. The politicization of the nonwhite communities and the activities of terrorist groups such as the African National Congress will compound the problem.⁹ []

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Continued economic stagnation along the lines we anticipate will increase the probability of racial violence. Rising black unemployment alone will broaden the pool of idle urban youths, who are particularly prone to give violent vent to frustrations over their political and social status and the inability to achieve goals in education, jobs, and living standards. Economic hard times will also contribute to the increasing militancy of the black trade union movement. As a result the white authorities between now and 1985 will probably be faced simultaneously with two distinct forms of racial discontent—actions by laborers and nonwhite consumers aimed at improving economic conditions, and more violent, less focused demonstrations by militant nonwhite youths, including students, seeking more fundamental reforms. There may be increasing linkages among these groups and between them and terrorist organizations. []

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We believe that the Eastern Cape, which is one of the most economically depressed areas in the country and which has a highly politicized black population, is likely to become a major trouble spot. Black labor unions have grown rapidly in this area since 1979 and receive support from the growing pool of unemployed. The proximity of the industrial centers to the impoverished Ciskei and Transkei homelands coupled with a government drive to relocate many unemployed []

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blacks to these homelands and increased ANC activities in the area have created a volatile mix. The potential for racial disturbances is only slightly less high in the Pretoria-Johannesburg area—particularly in Johannesburg's black township of Soweto—and in the Western Cape with its increasingly restive Colored population. [redacted]

Implications for the United States

In our view, South Africa's continuing recession, its economic vulnerability to fluctuations in world gold prices, and fundamental constraints on rapid improvements in nonwhite living standards have profoundly worrisome implications for long-term US interests vis-a-vis South Africa. Recent socioeconomic trends cut against theories that economic growth in South Africa will sop up the pool of unemployed or that movement toward a racially integrated economy will create evolutionary pressures for the dismantling of the segregated political system. In this sense, we are bothered less by the fact that white tolerance for change has not kept pace with nonwhite aspirations than by the fact that growth in the economy except under the best of circumstances has not kept up with basic demographic trends. The heightened potential for a racial upheaval that flows from slow socioeconomic progress for nonwhites undermines the basic US objective of preventing racial conflict in South Africa from jeopardizing US economic and strategic equities there and from creating openings for the Soviets throughout the region. [redacted]

We doubt, however, that serious threats to US overall interests will materialize soon. Although the economic realities of the region add to the potential for racial violence, the white government in Pretoria is firmly in control and will remain so for some years. Its commitment to reform notwithstanding, the Botha government has not hesitated to use whatever force is necessary against violent opposition. Over the near term, we believe the pattern of racial unrest will remain one of spontaneous disturbances over specific local grievances, both economic and political; harsh police action will assure that antigovernment groups continue to lack overall leadership and organization. [redacted]

We believe South Africa's economic recession will, by itself, have mixed consequences for the United States in other areas over the near term:

- On the one hand, it will cut profits and expansion opportunities for most of the 400 South African subsidiaries, affiliates, and branches of US firms. Moreover, even though their labor standards are generally high in comparison to South African businesses, US-based firms will remain primary targets for strikes because of their perceived susceptibility to pressure. 25X1
- On the other, increased foreign borrowing by South Africa to offset current account deficits broadens lending opportunities for US commercial banks at little economic or political risk. [redacted] 25X1

The near-term effects on US regional interests will also probably be mixed. Because of Pretoria's economic links with its neighbors, the recession in South Africa will hurt some black states. Zimbabwe, for example, which has a thriving manufacturing sector and which normally exports one-fourth of its finished goods to South Africa, will be hurt by the drop in consumer demand. Likewise, Lesotho and other black states that earn important foreign exchange from the remittances of "guest workers" they send to South Africa will feel the pinch as Pretoria lowers ceilings on the numbers of foreign workers in order to provide jobs for unemployed South African blacks. Such developments will compound the economic problems many of these black states are experiencing and will lead them to look to the West—especially the United States—for more economic aid. On the other side of the coin, however, budgetary constraints have made Pretoria acutely sensitive to the \$1 billion it spends annually to prop up the white administration in Namibia. This is, in our judgment, a significant, although not dominant, factor in South Africa's decision to step up the pace of independence negotiations. [redacted]

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In specific policy dealings with the South Africans, we believe the United States will continue to encounter pleas from Pretoria for ever greater amounts of patience and understanding of South Africa's gradualist approach to racial reform. This will derive, at least partly, from fundamental economic constraints on rapid or significant change.

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