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South Africa: Implications of Falling Gold Production

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An Intelligence Assessment

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South Africa: Implications of Falling Gold Production

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An Intelligence Assessment

This paper was written by [redacted] ALA, with a contribution by [redacted] OGI. Comments and queries are welcome and may be directed to the Chief, Regional Issues Branch, Africa Division, Office of African and Latin American Analysis, on [redacted]

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South Africa: Implications of Falling Gold Production

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Key Judgments

Information available as of 2 April 1984 was used in this report.

The confidence of white South Africans has long been sustained by their trust in the fundamental economic strength of their country. Gold has been the key to South Africa's economic growth because massive foreign exchange earnings from gold sales pay for up to half of total annual imports, including capital goods critical to economic growth. The country's gold production has been declining fairly steadily for more than a decade, however, slipping from a high of 1,000 metric tons in 1970 to less than 700 tons last year.

The long-term decline in gold production has weakened South Africa's economy by:

- Shrinking the contribution of gold mining, the most important industry in the country, to real GDP.
- Reducing the amount of foreign exchange available for the purchase of imports as compared with what would have been earned had gold production continued to rise.
- Inducing the government (because of this foreign exchange constraint) periodically to adopt fiscal and monetary policies that deliberately sacrifice economic growth to curb demand for imports.

We believe that Pretoria's conscious policy of periodically stifling demand for imports as a means of reducing massive current account deficits was a principal cause of the decline in the average rate of South African economic growth from 5.7 percent in the 1960s to 2.8 percent since 1970.

Rising gold prices cushioned the impact of the fall in gold production on the economy but did not offset it because of substantial increases in the cost of imports and net services. Even though annual gold earnings averaged over $10 billion in 1980-83, as compared with only $1.8 billion in 1970-73, the average annual cost of imports and services jumped from $5 billion to nearly $21 billion.

We expect gold production to rise slightly this year and in 1985—as it did in 1983—but we believe production will begin to decline again in 1986 and sink below 600 tons by the early 1990s. We base this projection on an apparently irreversible depletion of ore reserves and the unlikelihood of major new discoveries.

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We believe that Pretoria will continue to constrain economic growth periodically because of foreign exchange shortages. South Africa cannot count on increases in the price of gold to offset the decline in production and the increases in the cost of imports that we expect. Pretoria has only two other options for avoiding chronic current account deficits—increasing substantially its borrowing from Western banks or trying to accelerate the growth of nongold exports:

- South African policymakers will be unlikely to undertake heavy foreign borrowing because that would clash with their conservative tenets and longstanding practices and would—in Pretoria's perception—provide a potential source of leverage to foreign critics of the government's racial policies.

- Pretoria clearly regards the expansion of nongold exports as the most desirable alternative, but while prospects for the key ones—coal, diamonds, platinum, corn, metallic ores, and ferroalloys—are fair to good, foreign demand will not be strong enough to pick up the slack.

As a result, we expect that the country's average rate of economic growth will bump along at no more than 2.5 or 3 percent during the remainder of the 1980s.

We have not been able to establish a causal link between South Africa's economic performance and the level of racial tension. Slow growth will, however, have some other predictable effects:

- The financial burden of extensive military activities, such as those South Africa has undertaken in Angola, and of maintaining administrative control over Namibia will become more onerous. We doubt, however, that economic considerations alone will lead Pretoria to withdraw from Namibia.

- Pretoria will also have fewer resources to spend on domestic social and economic reforms.

- Business opportunities for the 400 US firms that have subsidiaries, branches, and affiliates in South Africa will be reduced, although US banks may find increased opportunities for making commercial loans to South Africa.

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We doubt that South Africa's economic predicament will give Washington much leverage over the way Pretoria conducts its domestic or regional policies. The ruling National Party's leaders have never allowed economic constraints to stop them from protecting those things they regard as vital to their country's security or to Afrikaner political control. We believe the pinch on Pretoria's budget and on the white standard of living will engender a sense of insecurity among the Afrikaners, who tend to become more aggressive when they believe their backs are against the wall.

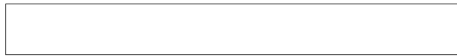

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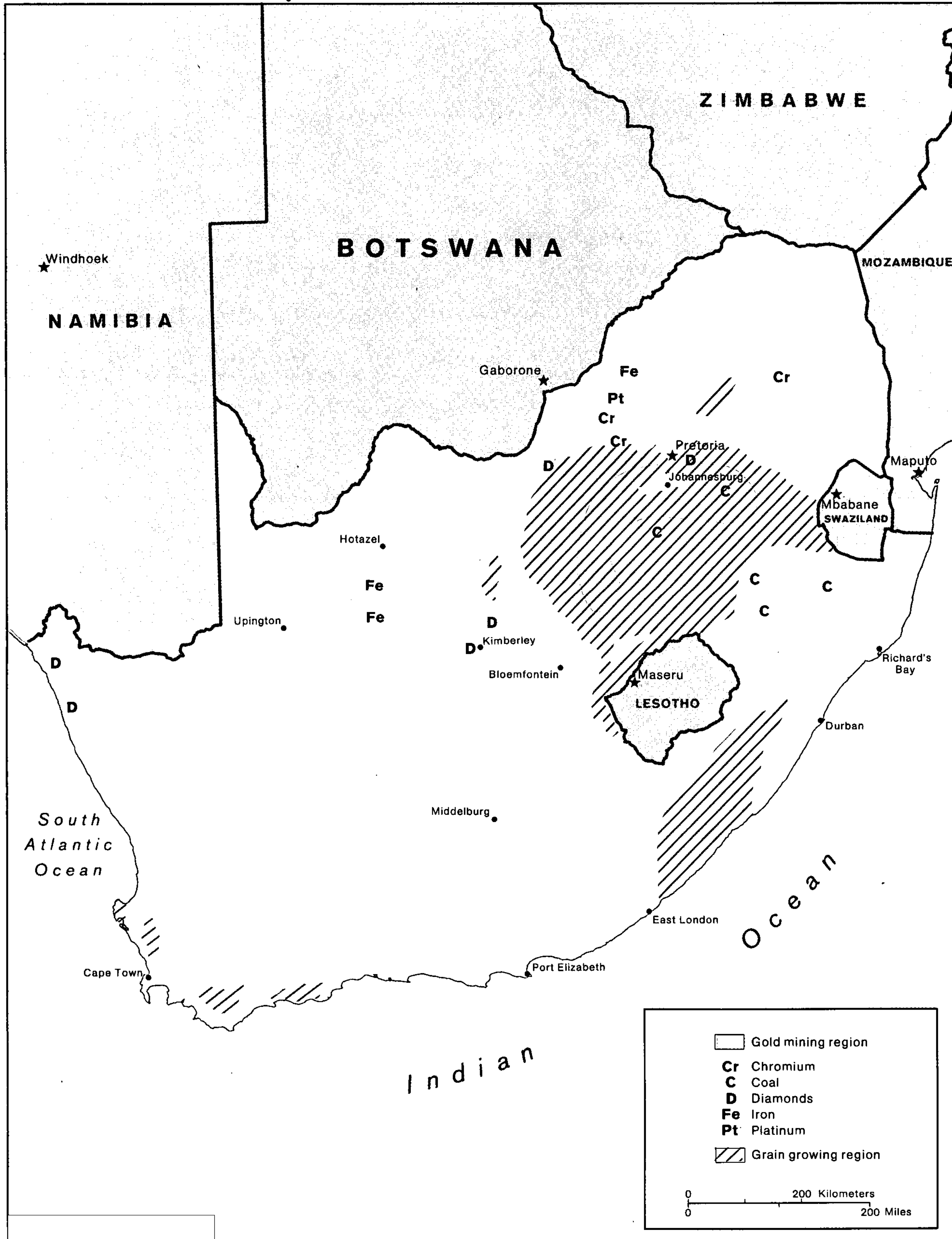
Figure 1
South Africa: Economic Activity



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South Africa: Implications of Falling Gold Production

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Introduction

Gold mining has been a major, and perhaps the key, factor in South African economic development since the discovery of large reefs of gold in 1886 along the Witwatersrand (the Rand), the area around which Johannesburg has developed. For years South Africa has produced at least half of the world's newly mined gold and generally exported its entire annual output. In an economy in which exports account for about a fourth of GDP, gold sales usually make up a third to a half of total annual export earnings.

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South African gold production peaked in 1970 and has declined by more than 30 percent since then. Although gold production increased slightly last year and we expect similar rises in 1984 and 1985, annual gold output will, according to our analysis, continue its long-term downward trend thereafter, dipping below 600 tons annually by the early 1990s (see box). We base this projection on what South African mining journals and the financial reports of South African mining companies indicate has been an irreversible depletion of reserves of gold ore and on the judgment of mining experts that it is unlikely that vast new deposits will be discovered (see table 1).

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This paper examines the impact of declining gold production on South African economic growth, Pretoria's options for reducing its reliance on gold, and obstacles to the expansion of South Africa's nongold exports. We assess how falling gold production will affect South Africa's longer term economic prospects and the implications for the United States.

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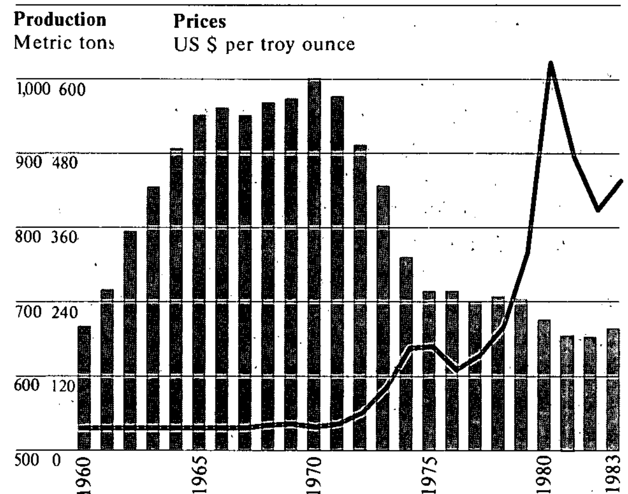
Impact of Declining Gold Production on Economic Growth

The fall in South African gold production since 1970 casts a shadow on the country's economy:

- The decline in the output of gold has shrunk the contribution of mining to real GDP from 18 percent in 1970 to 11 percent in 1983, even though production of minerals other than gold increased by three-fourths.

Figure 2
South Africa: Gold Production and Prices, 1960-83



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- The fall in gold production has reduced the amount of foreign exchange available for the purchase of imports, including capital goods critical to economic growth, as compared with what would have been earned had gold production continued to rise. Earnings from gold sales nevertheless continue to play a crucial role, enabling South Africa to import at about twice the level possible without gold.

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- This foreign exchange constraint has induced the government periodically to adopt fiscal and monetary policies that deliberately sacrifice economic growth to stifle demand for imports.

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The Outlook for South African Gold Production

According to South African mining experts, most of the easily mined ores in the country were exploited long ago; remaining ores are largely at extreme depths and of low grade. Average yields dropped from 11.2 grams per metric ton of ore in 1970 to 6.4 grams in 1982 (see table 1), and we expect that ore grades will continue to decline. Mining experts do not foresee any major new discoveries.

Production rose slightly last year and will probably do so again this year and in 1985, but we believe this is only a temporary development (see figure 1). The decline in gold prices since 1980 has induced companies to bypass lower grade ores that could have been mined profitably at higher prices in order to concentrate on dwindling veins of relatively high yield ore. In addition, the price surge in 1980 induced several companies to expand their capacity to mill ores and led to the development of one additional mine—including a new shaft and ore processing complex—that is just now coming on stream.

The Mines. *The top dozen South African gold mines, which include all of those that produced over 25 tons of gold in 1982, account for nearly two-thirds of the country's gold production. Nine of these are more than 20 years old and beyond their peak productive years, but they are still working fairly rich and extensive ore deposits and should be able to keep producing—albeit at a lower rate—for the next 10 to 30 years.*

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Ore bodies have been substantially depleted and ore grades are falling rapidly in almost all of South Africa's other 28 gold mines. We estimate that of these at least 12, accounting for about one-seventh of total production, will be closed by the early 1990s.

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Unless gold prices regain high levels—$800 an ounce or more—for a sustained period, we estimate that the level of new investment in South African gold mines will decline. New projects are becoming increasingly expensive to bring into production. Projects scheduled for startup over the next several years consist primarily of extensions to existing mines. Moreover, the depletion of the richest ore reserves is inducing the mining industry to shift its attention from gold to coal, according to the South African Chamber of Mines.

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Foreign exchange shortages caused by the fall in gold production would have been much more severe had there not been steep, speculative increases in the price of gold. Increased earnings from gold sales—from an average of $1.8 billion a year in 1970-73 to over $10 billion annually so far in the 1980s—offset slightly more than half of the increase in the average annual cost of imports and net services from $5 billion in 1970-73 to nearly $21 billion in 1980-83 (see table 2).

To meet severe current account deficits in 1970-71, 1975-76, and 1981-82, economic policy makers in Pretoria followed essentially the same pattern of behavior each time: initially selling gold from the government's stock,[1] then using monetary and fiscal tools—higher interest rates and reduced government spending—that constrained economic growth in order to reduce demand for imports (see box).

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In our judgment, Pretoria's conservative financial policies indicate that it places higher priority on year-to-year balances than on longer term performance. Figure 3 illustrates how peak years of economic

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[1] Although Pretoria generally exports its annual production of gold to maintain a reputation as a reliable supplier to the international market, it also allows sales to exceed production when necessary to help reduce current account deficits. Pretoria has drawn down its stock of gold in government vaults by 60 percent, or 350 tons, since 1970 (see table 3).

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Table 1
South Africa: Falling Gold Yields, 1963-82

Mine	Date of Startup	Ore Grade *(grams per metric ton)* 1982	1963	Production in 1982 *(metric tons)*
Top 12 gold mines				
Vaal Reefs (North/South)	1956	8.6	9.4	78.7
Driefontein Consolidated (West)	1952	14.4	14.1	41.5
Western Holdings	1953	4.8	14.4	40.2
Western Deep Levels	1962	11.3	7.1	39.5
Driefontein Consolidated (East)	1972	12.5		35.3
Harmony	1954	7.8	8.0	31.8
Hartebeestfontein	1955	10.2	9.2	29.9
Kloof	1968	15.0		27.8
Buffelsfontein	1957	8.6	8.6	27.5
Randfontein	1974	5.0		27.1
Free State Geduld	1956	8.0	20.6	25.4
President Brand	1954	7.4	14.6	25.1
Others				
President Steyn	1954	6.3	7.1	24.9
Blyvooruitzicht	1942	8.8	12.6	20.0
Western Areas	1961	4.5	5.0	16.9
St. Helena (St. Helena Section)	1951	6.8	8.5	14.6
Windelhaak	1958	6.3	6.8	13.1
Stilfontein	1952	7.3	9.1	12.5
Doornfontein	1953	7.4	8.9	10.8
E.R.P.M.	1894	4.0	5.1	10.7
Libanon	1949	6.4	6.1	10.7
Kinross	1968	5.9		10.0
Unisel	1979	7.2		8.6
Durban Deep	1898	3.6	3.7	8.4
Elandsrand	1978	5.3		8.1
Loraine	1955	5.0	7.9	8.1
Grootvlei	1938	4.1	4.0	7.1
Deelkinal	1980	5.0		6.8
Venterspost	1939	4.4	7.2	6.5
Leslie	1962	3.4	6.2	3.9
West Rand Consolidated	1908	1.8	2.2	3.8
Bracken	1962	3.4	8.4	3.3
Barberton	NA	7.4	NA	1.2
Marievale	1939	2.3	4.8	1.1
Wit Nigel	1940	3.2	4.4	0.9
St. Helena (Beisa Section)	NA	1.5	NA	0.6
Vaal Reefs (Afrikander)	NA	1.8	NA	NEGL
Anglo-American—Orange Free State joint metallurgical production	1977			3.6

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Table 2
South Africa: Current Account, 1970-83

Million US $

	1970	1971	1972	1973	1974	1975	1976
Imports	−3,615	−4,087	−3,697	−5,127	−8,492	−9,212	−8,559
Nongold exports	2,034	2,169	2,885	3,635	4,658	4,991	5,622
Net services and transfers	−806	−849	−816	−1,139	−1,412	−1,727	−1,682
Current account before gold sales	−2,387	−2,767	−1,628	−2,631	−5,246	−5,948	−4,619
Gold sales [a]	1,617	1,578	1,341	2,572	4,004	3,774	3,495
Current account after gold sales [b]	−770	−1,189	−287	−59	−1,242	−2,174	−1,124
	1977	**1978**	**1979**	**1980**	**1981**	**1982**	**1983 [a]**
Imports	−7,913	−9,222	−11,569	−18,200	−20,809	−16,702	−15,000
Nongold exports	7,237	8,566	10,469	12,553	11,006	9,350	9,800
Net services and transfers	−2,064	−2,259	−2,503	−3,535	−4,032	−3,412	−3,500
Current account before gold sales	−2,740	−2,915	−3,603	−9,182	−13,835	−10,764	−8,700
Gold sales [a]	3,761	4,374	6,862	11,902	11,012	8,530	8,925
Current account after gold sales [b]	1,021	1,459	3,259	2,720	−2,823	−2,234	225

[a] Estimated.
[b] The current account after gold sales was balanced by net capital flows, changes in foreign exchange reserves, and net errors and omissions.

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growth (5.3 percent in 1970, 7.1 percent in 1974, and 7.8 percent in 1980) were followed chronologically—and we believe causally—by substantial current account deficits and how the elimination of these deficits was accompanied chronologically—and we also believe causally—by sharp declines in economic growth. We believe that the apparent symmetry in the cycles of rising economic growth followed closely by severe current account deficits, on the one hand, and economic recession immediately preceding current account surpluses, on the other, largely reflects the success of Pretoria's policy of allowing economic growth to fall to levels in keeping with prudent management of the country's foreign exchange balance.

We believe that Pretoria's policy of periodically stifling growth compounded the effect of the fall in gold production and was the principal cause for the decline in the average rate of South African economic growth from 5.7 percent in the 1960s to 2.8 percent since 1970. Moreover, in our judgment, Pretoria's short-term reactions made it all the more difficult for South Africa to adjust to the peaks and troughs that have wrenched the world economy since the early 1970s. If figures for the past three years—when the South African economy reeled under the combined impact of worldwide recession and severe drought—are factored out, the average annual rate of South African economic growth (1971-80) was still less than 4 percent. Even that figure paints an artificially rosy picture of the economy's capabilities, however, because that level of growth would not have been attained without steep, fortuitous increases in gold prices in 1974 (when the average price jumped by two-thirds to $160 an ounce) and 1980 (when prices

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Pretoria's Method of Dealing With Current Account Deficits

In our judgment, South African economic policymakers try to balance their quest for high economic growth against the obligation they feel to manage the country's foreign exchange balance prudently. They followed essentially the same pattern of behavior in redressing severe current account deficits in each of the following periods:

- *Pretoria at first opted to cover the* ***1970-71*** *current account deficit by supplementing gold exports from current production with sales from the government's stock of gold. After selling nearly two-thirds (626 tons) of its total gold holdings, Pretoria in 1971 clamped down on economic growth by increasing domestic interest rates and cutting government spending to reduce demand for imports. This halved economic growth in 1972, which led to a reduction in the volume of imports by 15 percent. The resulting decline in the current account deficit, aided by a one-third increase in nongold exports in 1972, ended the foreign exchange hemorrhage.*

- *This pattern was repeated during* ***1975-77*** *following a 40-percent jump in the volume of imports by 1974 associated with the spurt in economic growth, which in turn was made possible by the increase in foreign exchange earnings stemming from the jump in the price of gold. After gold prices flattened out in late 1974, the government sold a total of 266 tons of gold from its own stock over the next three years and cut government spending and increased interest rates. These policies depressed real growth to zero by 1977, with the result that the volume of imports slid back by 40 percent to about the same level as in 1972 and the current account recorded a surplus.*

- *The current account deficit in* ***1981-82*** *was given a vicious twist because the gold price boom, which had peaked at $850 an ounce in 1980, was followed by worldwide recession. The boom had enabled South Africa to increase its volume of imports in 1980 by one-third more than would have been possible at the gold price level of 1979 without incurring a current account deficit. The decline of gold prices by 1982, however, forced Pretoria to take particularly severe contractionary measures—in addition to selling 143 tons of gold from stock—at a time when gold production dropped by 25 tons and nongold exports fell by one-fourth. According to sketchy data, the volume of imports was down by 40 percent or more in 1983 as compared to 1980 and the contraction has had the intended result: the current account appears to be in surplus.*

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doubled to an average of more than $600 an ounce). Without the relief that those two price surges provided for the foreign exchange constraints on Pretoria, the annual rate of South African economic growth during the period 1971-80 would in all likelihood have been less than 3 percent.

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South Africa's Options

So long as the long-term trend in South African gold production continues to be downward, we doubt that Pretoria will be able to avoid similar balance-of-payments predicaments in the future. Apart from hoping for large new gold discoveries, which we and South African mining experts believe to be highly improbable, or for large, sustained gold price increases, which would be strictly fortuitous, South Africa, it seems to us, has essentially only two options to its established policy of periodic clampdowns on growth: heavy borrowing from Western banks or trying to accelerate the growth of nongold exports.

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The first option—increasing substantially public and private borrowing from Western banks—probably already is a source of concern to economic decision makers in Pretoria; South Africa's foreign debt increased from about $7 billion in 1980 to $15 billion in mid-1983, according to statistics published by the

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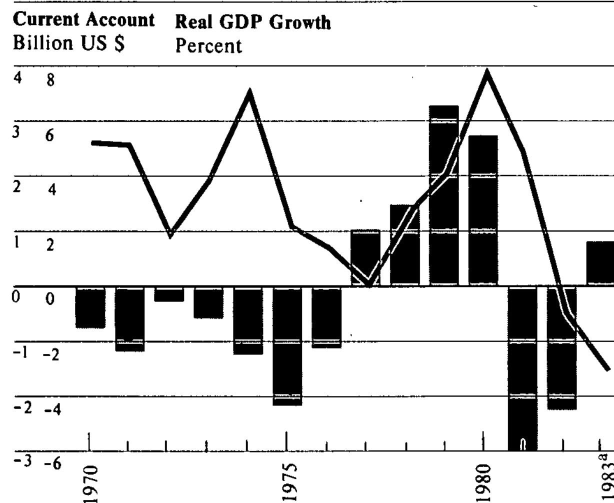
Figure 3
South Africa: Current Account Trends and Real GDP Growth, 1970-83



a Estimated.

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Table 3
South Africa: Gold Holdings, Production, and Sales, 1970-83

Metric tons

	Gold in Government Bank Vaults [a]	Gold Production	Gold Sales	
			Total	From Stocks
1970	592	1,000	1,399	399
1971	365	976	1,203	227
1972	558	910	717	0
1973	591	855	822	0
1974	568	759	782	23
1975	552	713	729	16
1976	394	713	871	158
1977	302	700	792	92
1978	304	704	702	0
1979	312	703	695	0
1980	378	673	607	0
1981	289	656	745	89
1982	235	652	706	54
1983	242	664	657	0

a End of year.

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Bank of International Settlements. Further increases—particularly large ones that might threaten South Africa's solid international credit rating—are unlikely, in our judgment, for three reasons:
- They would mark a significant departure from the pattern of economic fine-tuning that the government has carried out since the decline in gold production began.
- They would clash with the Calvinist-based tenets of the government's Afrikaner leaders, who tend to view heavy debt as immoral.
- Heavy foreign debt would, in the perception of South Africa's leaders, provide a potential source of leverage to foreign critics of the South African racial system.

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Policymakers in Pretoria have long recognized that their second and most desirable option would be to increase nongold exports enough to offset the loss of the economic boost that steadily rising gold production once provided. About 98 percent of South Africa's nongold exports consist of raw and intermediate goods. Six product groups—coal, diamonds, platinum group metals (PGM),[2] metallic ores, ferroalloys, and corn—normally account for about 40 percent of the total (see table 4). South Africa has found it cheaper and easier to increase exports of raw and intermediate goods than to produce and market finished consumer goods abroad.

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The long-term performance of South Africa's nongold exports has been good but not good enough to make up for the combined effects of the fall in gold production and inflation in import prices. The country's nongold exports grew by an average of 20 percent annually during the period 1971-80—about the same rate as that of total export growth in the United States, the United Kingdom, and Japan. This was well behind the export performance of such fast-growing LDCs as Singapore and South Korea, however, which achieved average annual export growth of

[2] The composition of available ores in South Africa dictates that PGM production consists of about one-half platinum and about one-fourth palladium, with the remaining one-fourth, rhodium, iridium, osmium, and ruthenium.

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Table 4
South Africa: Major Exports

Million US $

	1970	1980	1983 [a]
Total	**3,651**	**24,455**	**18,725**
Gold	1,617	11,902	8,925
Nongold	2,034	12,553	9,800
Of which:			
Coal	16	932	973
Diamonds	274	1,622	1,184
Platinum group metals [a]	NA	900	700
Metallic ores	132	716	463
Ferroalloys	48	503	358
Corn	75	538	162

[a] Estimated.

31 percent and 34 percent, respectively, in the same period.

Moreover, South Africa's nongold exports have declined by one-fifth since 1980. This decline—the first in 25 years—resulted from a combination of factors:
- Reduced demand for South Africa's nongold exports because of economic recession in the country's principal markets: Western Europe, the United States, and Japan.
- Severe drought in 1983, which halted corn exports.

Although prospects for coal and South Africa's other five major nongold exports in foreign markets are fair to good, we doubt that they will be outstanding enough to make up for the loss of the growth stimulus that rising gold production formerly provided (see appendix).

Long-Term Prospects for Economic Growth

In our judgment, the South African Government will continue to restrict economic growth from time to time in order to minimize current account deficits caused by fluctuations in gold earnings and by the inability of nongold exports to take up the slack to pay for the level of imports that would be required by a high rate of economic growth.

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We believe that the main determinant of the timing of such actions will be speculative swings in the price of gold. An increase of $100 an ounce in gold prices, for example, would raise the value of annual gold production by $2.1 billion at the current rate of output, assuming that the price increase was sustained over a full year. In addition to easing foreign exchange constraints on the purchases of imports, this price increase would provide a temporary stimulus to growth in several ways:

- Rising foreign exchange reserves would increase the domestic money supply, which in turn would tend to reduce interest rates, stimulating both investment and private consumption.

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- The companies would be encouraged to increase expenditures on prospecting and development of lower grade ores.

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- The government's revenues from taxes on gold mining profits would rise by about $400 million in the first year of higher prices but would taper off afterward as rising outlays for wages and capital investment ate into mining profits.[3]

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Decreases in the price of gold are equally likely and would have the opposite effect:
- Reduced foreign exchange available for the purchase of imports would be likely to induce the government to impose fiscal and monetary constraints.
- Reduced foreign exchange reserves would cut the money supply and lead to higher interest rates.
- The mining companies would lose the incentive to spend on prospecting and development.
- The government's revenues would drop.

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In our judgment, it is unlikely that the net result of speculative gold price swings will provide the wherewithal for a return in this decade to the healthy pace

[3] Taxes and lease earnings from gold mines are second only to the general sales tax as a source of revenue.

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of economic growth that was achieved in the 1960s. Our inability to predict gold prices with any degree of confidence and the uncertainties caused by weather-related crop fluctuations and swings in world demand for minerals stand in the way of practicable year-to-year projections. We believe, nonetheless, that South Africa's annual rate of real economic growth in 1984-90 will average no more than 2.5 to 3 percent.

Implications for the United States

It has long been an article of faith among observers of South Africa that economic hard times increase the potential for the kind of racial upheaval that would jeopardize US economic and strategic equities in South Africa and open the door to wider Soviet involvement in the region.[4] The acceleration of unemployment during periods of slow economic growth has been viewed as a particularly potent trigger to violence, especially among urban black youth. Similarly, slow growth has been seen as fueling the militancy of the black labor union movement and limiting the funds available for government spending on housing and other programs important to nonwhites.

Despite the undeniable logic of this argument, it has not held up well in the face of the actual pattern of racial unrest in South Africa. Although the Soweto riots in 1976 occurred during an economic downturn, they were triggered by noneconomic factors, particularly student grievances over forced instruction in the Afrikaans language. The extraordinary spurt in economic growth in 1980, on the other hand, was accompanied by a notable increase in major acts of protest including an upsurge in strikes, school boycotts, and riots. By contrast, during the severe economic contraction of 1982 and 1983, outbreaks of racial violence were relatively few in number and small in scope.

As a result, we believe that economic growth projections will by themselves remain unreliable indicators for predicting the timing or magnitude of racial unrest in South Africa. We believe the potential for major racial disturbances will remain high under almost any economic circumstances. Indeed, racial unrest—including the small-scale labor strife and violent crime that occur practically every day in South Africa—may even become more common and extensive during periods of rapid economic growth that tend to intensify black frustration and resentment over fundamental social and political disparities that cannot be alleviated by short-term economic gains.

In our view, the long-term leveling off of economic growth that we expect will have some other predictable, albeit from the US standpoint, mixed effects:

- The financial burden of extensive military operations in the region, such as those South Africa has undertaken in Angola, and of maintaining administrative control over Namibia will become more onerous; we doubt, however, that economic considerations alone will lead Pretoria to withdraw.

- Pretoria will also have fewer resources to spend on domestic social and economic reforms.

- Business opportunities for the 400 US firms that have subsidiaries, branches, and affiliates in South Africa will be reduced, although US banks may find increased opportunities for making commercial loans to South Africa.

- Pretoria will be likely to seek balance-of-payments assistance periodically from the IMF.

- Neighboring southern African countries may seek additional aid from the United States and other foreign donors because of reduced growth in South African demand for imports of manufactured goods (important to Zimbabwe) and for migrant labor (from Lesotho, Mozambique, Botswana, and to a lesser extent Swaziland and Zimbabwe).

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We doubt that South Africa's economic predicament will give Washington much leverage over the way Pretoria conducts its domestic or regional policies. The ruling National Party's leaders have never allowed economic constraints to stop them from protecting those things they regard as vital to their country's security or to Afrikaner political control. Even so, we believe the pinch on Pretoria's budget and on the white standard of living will engender a sense of insecurity among the Afrikaners, who tend to become more aggressive when they believe their backs are against the wall.

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Appendix

Prospects for Nongold Exports

South Africa's major nongold exports have fair to good prospects for growth—but not outstanding enough to offset the decline in gold exports.

Coal

Coal exports will probably increase over the next few years, but they are unlikely to match the surge of the past several years. That rapid growth resulted from the completion of expanded bulk loading facilities at the South African port of Richards Bay during the same period that domestic unrest in Poland caused a sharp drop in its coal production and exports. South African coal exporters are now engaged in an international price war because of renewed competition by Poland at a time that world demand for coal is depressed and supplies of oil at attractive prices are ample. Industry observers doubt South Africa will be able to fully use the large additional coal loading capacity scheduled for completion at Richards Bay in 1987, according to reporting by the US Consulate in Johannesburg. Tokyo's Electric Power Development Company, the largest Japanese importer of South African coal, has announced it will cut imports of South African coal by 40 percent, according to press reports.

Diamonds

Prospects for the diamond industry are poor and are likely to remain so for the next few years. Even though sales of diamond jewelry are now recovering in the principal markets—the United States, Japan, and Western Europe—another inflation-induced boom will be unlikely as long as interest rates are tightly controlled. Industry observers doubt that demand for jewelry will expand enough to absorb output from a large new diamond mine in Australia, which will add 3 to 5 million carats to world gem diamond production by 1985. World production is now about 12 million carats.

Other Minerals and Food

Prospects for exports of **platinum group metals** appear to be brighter than for coal or diamonds. Besides its use in the chemical and electrical industries, platinum is the active component of catalytic converters used to control automotive exhaust emissions. The impact of rising car sales in the United States on demand for these metals may be strengthened over the next year or so by moves in Western Europe to begin installing auto emission controls.

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Exports of **metallic ores** and **ferroalloys** probably will pick up as foreign importers build stockpiles in response to economic recovery. We do not expect a large new increment to exports of metallic ores, however, because no major new South African mining and ore handling facilities are under construction. Similarly, there is substantial excess capacity among South African ferroalloy producers.

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Corn exports will continue to be subject to the vagaries of South African weather. Preliminary reporting indicates that drought this growing season (November 1983 through April 1984) will severely depress harvests in 1984. Although the return of good weather in future years probably will result in exports, prospects for long-run increases in exportable surpluses are poor because of constraints on arable land and limitations of normal rainfall.

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There is no prospect in the foreseeable future that South Africa will develop additional major exports on the scale of gold or the six leading nongold product groups. Continuing surpluses are likely in world supplies of copper, sugar, phosphates, and other commodities in which South Africa could conceivably expand productive capacity. Expansion projects that are on the drawing boards, such as a multimillion-dollar phosphate development scheme scheduled for completion in 1987 by the government-owned Phosphate Development Corporation, are not large enough to add significantly to total nongold exports.

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Finished Consumer Goods
South Africa would benefit from exporting more finished consumer goods, but the outlook is poor. Prospects for growth in Sub-Saharan African economies—currently the principal markets for South African consumer goods—are not strong enough to generate much increase in demand. A breakthrough into Western consumer markets that would be large enough to provide a significant shot-in-the-arm to South African exports is highly improbable for two reasons:

- Consumers in the United States and Western Europe would be likely to react unfavorably to any large-scale promotion of South African products because of the stigma that the government's racial policies gives to the "Made in South Africa" label. South African consumer exports that are currently identifiable by label in Western countries consist almost exclusively of wine, fruit, and a limited number of other food products. Exports of bulk foodstuffs and raw and intermediate mineral products lose their South African identity on the production lines for finished goods in Western countries and Japan.

- South Africa cannot compete effectively for foreign investment dollars in consumer export industries against resource-poor Asian countries, which offer highly motivated and comparatively highly skilled labor forces and a reputation for producing high-quality goods.[1]

[1] The lack of substantial investment in human capital—education, job skills, health, and nutrition—for the vast majority of the people in South Africa hinders the pace of industrialization despite the large supply of cheap labor. A recent CIA analysis argues that investment in human capital has been more important to the pace of industrialization in LDCs than endowments of natural resources, access to foreign aid, or other factors.

Import Substitution: A Drag on Export Growth
Pretoria's policy of import substitution [2] is a major obstacle to the promotion of nongold exports. Import substitution is rooted in Pretoria's fear that the international community eventually will impose trade sanctions against South Africa because of *apartheid*. Pretoria also justifies import substitution by citing the economic stimulus that results from building and operating import substitution industries.

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Pretoria's obsession with import substitution tends to hold back export growth for three reasons:

- Investment in import substitution, which in South Africa is limited essentially to capital goods because most major consumer goods are already produced domestically, increases the cost of capital goods to South African export industries because of the extremely high unit costs of producing such goods for the small South African market.

- Because heavy protection from imports assures South African manufacturers healthy profits in the small domestic market, they have little incentive to cut costs to meet foreign competition or to expand sales abroad in order to achieve economies of scale.

- Import substitution stimulates economic growth only while such industries are being developed. Expansion is limited thereafter because of the inability of protected industries to compete in export markets.

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[2] The policy includes protective tariffs, licensing requirements, steep local-content requirements in the automobile industry, and direct government investment in basic industries such as oil, steel, and chemicals. The government-owned Industrial Development Corporation has invested directly in a wide range of manufacturing industries—including phosphates, aluminum, and heavy diesel engines—that meet the government's requirements for import protection. Pretoria has also invested more than $15 billion in coal liquefaction and gasification and in oil storage facilities.

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The effect of import substitution has been to create a number of powerful vested interests that would resist any dismantling of the government's import substitution policy. Indeed, protection against imports has become critical to the economic health of many major manufacturing industries.

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