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South Africa: Assessing Economic Vulnerability

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An Intelligence Assessment

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ALA 86-10035
August 1986

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South Africa: Assessing Economic Vulnerability

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An Intelligence Assessment

This paper was prepared by [redacted] the Office of African and Latin American Analysis with contributions from analysts in the Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, South Africa Branch, Africa Division, ALA

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South Africa: Assessing Economic Vulnerability

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Key Judgments

Information available as of 15 July 1986 was used in this report.

The use of tough economic sanctions as a lever to promote change in South Africa would have risks and few likely rewards in terms of influencing Pretoria's policies. On the one hand, the impact of sanctions on South Africa would be blunted in large measure by Pretoria's successful efforts over more than two decades to reduce its economic vulnerability to external pressures. We believe that these preparations have insulated the domestic economy fairly well from the sharpest impacts of a wide variety of possible sanctions, but at a high cost to the economy's growth potential. On the other hand, the fluid internal situation, the unresolved issue of the country's short-term debt, and the comparative ease and speed with which Pretoria could damage the economies of neighboring states or withhold valuable strategic minerals from the West raise disturbing uncertainties about the ultimate impacts of external economic pressures. Moreover, South Africa is still economically vulnerable to widespread and sustained labor unrest or sagging domestic business confidence—internal dynamics that could be triggered and reinforced by tough Western sanctions.

South Africa is well endowed with natural resources and must import relatively few basic raw materials, aside from oil and bauxite, but it relies heavily on imported capital equipment. An intense program of import substitution, sanctions busting, and stockpiling has enabled Pretoria to protect itself for the most part from the potential impacts of an oil-import cutoff and—with somewhat less success—from cutoffs of other key imports, such as capital equipment and chemical products.

South Africa's ability to import goods has been limited so far primarily by the amount of foreign currency at its disposal rather than by embargoes. Pretoria has taken steps that restrain a rapid loss of foreign currency, and thus limit disinvestment as a source of vulnerability. Western sanctions banning new loans and investment probably would have little immediate impact either, as the country, in any case, is unlikely to receive substantial capital inflows until the domestic unrest subsides. Moreover, South Africa remains vulnerable to an erosion of its trade position if widespread boycotts are directed against its exports of diamonds, coal, steel, and agricultural goods.

The economy, however, is heavily dependent on black workers, who constitute nearly 70 percent of the economically active work force. Domestic production could be seriously disrupted by a lengthy general

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strike by blacks or a widespread industrial sabotage campaign. Government and business policies have reduced this threat somewhat by making these tactics obviously risky for black workers and their unions. We have no doubt that the South African Government would move, as it has in the past, to crush black labor activism, and, if necessary, to seal off black townships from food and water supplies.

A package of tough but limited Western economic sanctions could eventually result in slower growth, though perhaps with an initial growth spurt as further import substitution took place. We estimate that a gradually tightened Western boycott of coal, steel, gold coins, and agricultural exports would trim South Africa's economic growth potential by 2 or 3 percentage points. We believe that the burden of reduced economic growth would fall most heavily upon black South Africans and on the economies of neighboring black-ruled countries. In addition, we believe that Pretoria would actively shift more of the burden of sanctions to neighboring black states. Within South Africa, Pretoria could shift the burden of foreign sanctions toward nonwhites by cutting planned social spending, reimposing sales taxes on foods, and reducing government employment of nonwhite workers. On balance, these measures probably would succeed in limiting the impact of sanctions on whites.

Short of a precipitous and sustained fall in the world price of gold, we foresee no external pressures that—taken in isolation—would produce a rapid economic collapse. On the other hand, a severe economic dislocation in South Africa could result from some combination of very tough sanctions and unanticipated internal developments. Moreover, a very strong external action—such as a widely supported ban on all trade—probably would have important psychological effects on domestic investment, and also might embolden black workers to launch longer general strikes or widespread industrial sabotage in the expectation of a quick end to minority rule.

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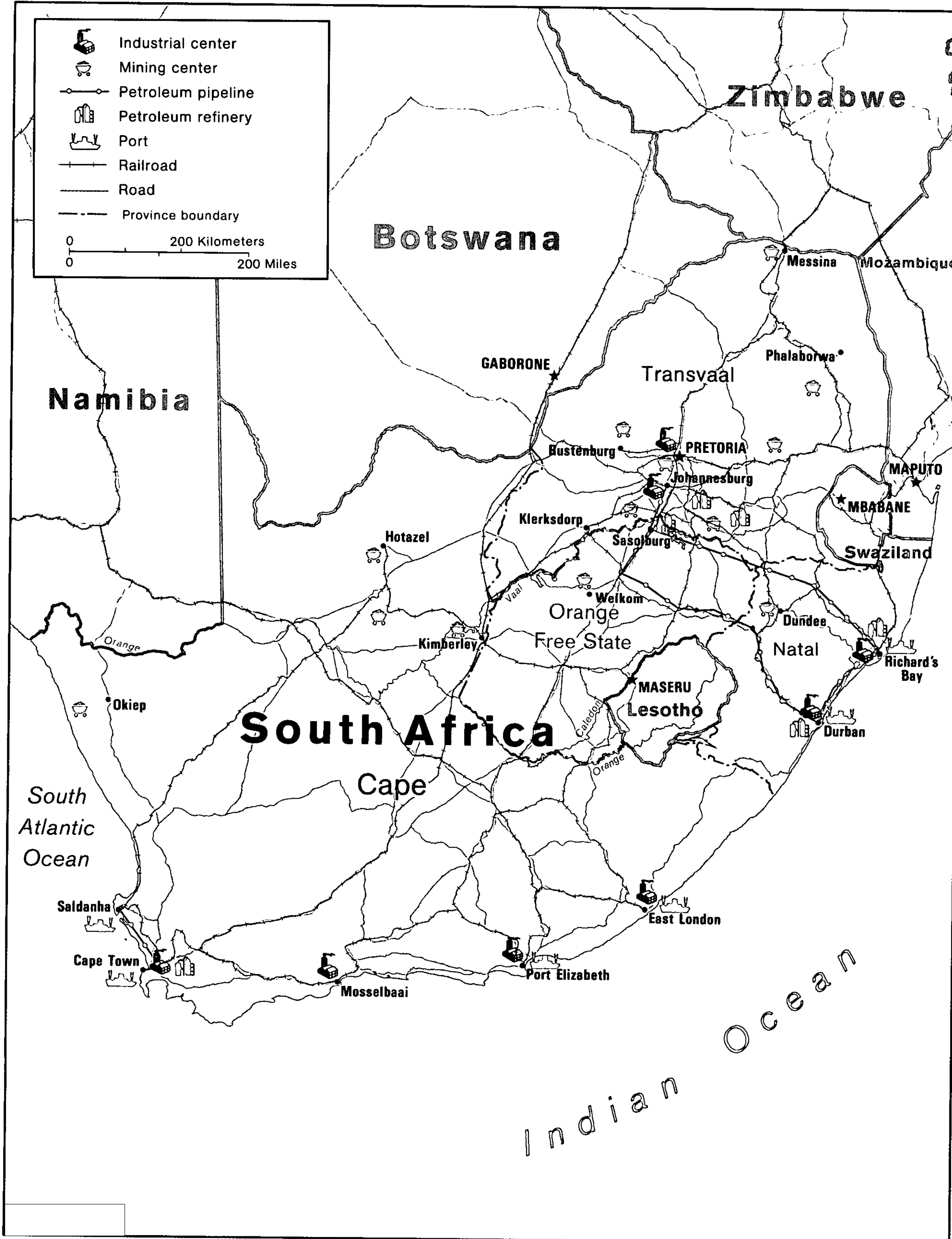
Figure 1
Economic Activity in South Africa



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South Africa: Assessing Economic Vulnerability

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Introduction

Most analyses of South Africa's economic vulnerability conclude that the country is relatively well insulated from Western economic sanctions. Pretoria, it is argued, has long promoted self-sufficiency and built counterleverage through strategic mineral sales and the economic dependence of neighboring black-ruled states on South Africa. While in large measure correct, this perspective is too narrow, in our view, and ignores major sources of economic vulnerability, particularly those stemming from internal disturbances such as strikes and sabotage. Moreover, as the recent debt crisis clearly shows, the anxieties of foreign and domestic businessmen and consumers can magnify the cumulative impact of even relatively small pressures on the economy.

This assessment treats the South African economy from a systems perspective, viewing it as an organism that may be affected by a range of external or internal pressures. We begin with a brief overview of the vulnerability question, then—adopting the perspective of the South African Government—assess the country's preparations to minimize specific vulnerabilities. Finally, the paper concludes with an overall assessment of South Africa's economic vulnerability and implications for the United States.

An Overview of Economic Vulnerability

In our view, most economies are vulnerable to embargoes on specific vital imports, to internal disruption from strikes or sabotage, and to an array of pressures that would undermine access to foreign currency, such as foreign disinvestment or boycotts of the country's exports. The extent of these economic vulnerabilities varies widely and depends—among other things—on the natural resources, trading patterns, and labor force characteristics of the particular economy.

By its natural endowments, South Africa appears fairly well placed to weather embargoes on basic raw materials. The country's extraordinary mineral wealth includes virtually all of the essential natural resources needed for a modern industrial state, lacking only commercially viable crude oil and bauxite deposits. Varied agricultural conditions allow for a remarkable degree of food self-sufficiency, with surpluses produced for export in most years of beef, mutton, poultry, eggs, corn, wheat, sorghum, potatoes, citrus, deciduous and subtropical fruit, grapes, sugar, cotton, and oilseeds. [25X1] about half of the country's extensive fish catch is exported. Of the few imported agricultural products for which ready domestic substitutes are not available, only the loss of natural rubber would be damaging, according to academic studies. The South African economy, in our judgment, is somewhat more vulnerable to effective embargoes on imports of machinery, equipment, and other manufactured goods, but—aside from oil, weapons, and other security-related systems—few trade restrictions have been placed against such imports.

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Historical experience with economic embargoes imposed on other countries has shown that isolating an economy from international markets usually is extremely difficult. Foreign companies and countries are attracted by the resulting new possibility of earning a premium price and often participate in subterfuge trade or the illicit transshipment of goods to the target country. In some cases, the country of origin of a transshipped good may not even be aware of the ultimate consumer.

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South African Economy in a Nutshell

Despite having many components of a modern economy—including an advanced telecommunications system, well-developed transport infrastructure, and a wide array of consumer goods—South Africa is still an industrializing nation with most of the characteristics associated with developing economies, such as a sharp division between modern and traditional sectors, a dependence on commodity exports, and a legacy of heavy government intervention. (With a population of 33 million and a GDP of $54 billion in 1985, the South African economy is roughly comparable for size and per capita income to South Korea and Argentina, according to IMF data.) Unlike many Third World countries, however, the South African economy also has a relatively dynamic private sector.

Dual Economy*. Academic studies and government data underscore the fact that the country's nearly 6 million whites enjoy an average per capita income and lifestyle similar to that of Western Europe. By contrast, most of the 27 million nonwhites lead lives of grinding poverty. For the 13 million blacks who live in the rural "homelands," conditions generally are not much different from those in the poorest African countries. Most of the other 10 million blacks, along with the 4 million Indians and mixed-race Coloreds, provide cheap labor for the modern economy, and have an average per capita income closer to that found in middle-income countries such as Turkey. The differences between living conditions in the modern and traditional sectors are reflected in infant mortality rates that are seven times higher for blacks than for whites, according to government data.*

A rising unemployment rate among semiskilled and unskilled workers coexists with a shortage of skilled manpower, according to an IMF study of South Africa. In mid-1985, registered unemployment among whites, Coloreds, and Indians was relatively low—for example, white unemployment was less than 2 percent—and was limited largely to the semiskilled. On the other hand, a number of academic studies have estimated that black unemployment is running at 25 to 30 percent; and, in parts of the eastern Cape Province, US Embassy sources believe the figure exceeds 50 percent.

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Dependence on Commodity Exports*. According to official trade statistics and our estimates, South Africa depends heavily upon raw mineral and agricultural exports, which together with semiprocessed minerals and food products account for 86 percent of the country's export revenues. In particular, the mining industry is the backbone of the South African economy, as gold alone accounts for nearly half of total revenues. Processing of minerals—particularly the production of ferroalloys—has progressed significantly, and now accounts for some 40 percent of nongold mineral exports by value.*

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Although the agricultural sector makes a much smaller contribution to GDP and export earnings than does mining, academic studies note that South Africa is one of a handful of African countries that are food self-sufficient in nondrought years, and that it supplies grains to much of southern Africa. South African farmers, however, do face significant problems. Rainfall is unreliable, and the country suffers from recurring and prolonged droughts.

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Legacy of State Intervention*. The South African Government openly advocates market-oriented principles and is decidedly anti-Communist, yet its actions demonstrate a penchant for statist solutions to the country's social and economic challenges. This interventionist approach is notorious for the limits it has placed on black economic activity, but white businessmen, farmers, and consumers also have been affected. For example, according to South African data, state-owned companies dominate several industries and hold some 15 percent of the country's physical capital. The South African Transport Services (SATS) operates the country's railroads, major airline, largest road freight service, and harbors. The South African Broadcasting Corporation (SABC) and post office dominate the communications field, operating television, radio, telephone, and postal services. The Iron and Steel Corporation (ISCOR) is by far the largest producer in its market. Other monopolies owned wholly or partially by the government include ESCOM (electricity), SOEKER (oil exploration),*

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SASOL (coal-to-oil conversion), UCOR (uranium enrichment), FOSKOR (phosphate), ALUSAF (aluminum), Atlantis Diesel Engines, and ARMSCOR (weapons).

Even when government companies do not dominate an industry, the US Embassy reports that Pretoria often sets the price or markets the product. Some academic studies have estimated that approximately one-third of South Africa's consumer price index consists of prices controlled by the government or its companies. Pretoria also is the sole overseas purchasing agent for South African oil companies, and regulates domestic energy prices. Some 70 percent of farm output is sold to 29 agricultural marketing boards. The central bank markets gold overseas on behalf of the mining companies, and is heavily involved in the local foreign currency market. Overall, we estimate that Pretoria sells more than half of the country's exports, and buys more than one-quarter of its imports.

Healthy Private Sector. *Despite significant government intervention, academic studies and IMF reports indicate that the economy has a healthy private sector with a small, but reasonably sophisticated, financial market. The Johannesburg Stock Exchange is dominated by a handful of corporate groups, most notably Anglo American Corporation, South African Mutual, and Sanlam, which are involved in South African mining, property, manufacturing, and insurance. Foreign-based multinational corporations also play an important role in the economy, often in joint ventures with local corporations.*

Pretoria in the past has exhibited an ambivalent attitude toward business, in part a reflection, we believe, of the dominance of English-speaking rather than Afrikaans-speaking South Africans in major companies, and the importance of foreign, often British, corporations. Public statements suggest this attitude has changed somewhat in recent years as more Afrikaners have moved up in South African business, and as the ruling, Afrikaner-dominated National Party has sought business-sector support for its racial reform program. Nonetheless, a mutual wariness is still the norm in government-business relations.

After more than two decades of experience in skirting embargoes on oil and arms, South Africa, in our view, is well equipped for such covert trade. So far, South Africa's ability to import goods has been limited primarily by the amount of foreign currency at its disposal rather than by embargoes. Since countries obtain foreign currency from exports and new loans and investment, any repayment of old loans or withdrawal of foreign investments clearly reduces the foreign currency available for imports. In addition to new hard currency inflows, South Africa could dip into its gold and foreign currency reserves. Gold and foreign currency reserves, however, presently are at near-record lows relative to trade, according to IMF data, and thus afford little buffer against pressures that would cut into export earnings or trigger a massive capital outflow (see table 1).[2]

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South Africa's narrow export base increases its economic vulnerability, in our judgment (see figure 2). For example, at current rates of production, a $50 per ounce drop in the world gold price would cost South Africa about $1 billion per year, or about 6 percent of total export earnings. Export revenues, thus, are potentially very sensitive to factors that would reduce mineral or agricultural production, or restrict South Africa's ability to sell these goods abroad.

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Assessing Pretoria's Preparations

A review of US Embassy reporting and the open press shows that since 1960, when international attention first seriously focused on apartheid, Pretoria has laid the groundwork for weathering economic embargoes by pursuing import substitution, circumventing the sanctions imposed on imports of oil and military supplies, and building up strategic reserves of critical materials.

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[2] Except where otherwise noted, all data are from South African Government publications.

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Table 1
South African Balance of Payments, 1980-86

Billion US $

	1980	1981	1982	1983	1984	1985 [a]	1986 [b]
Current account balance	3.6	−4.6	−3.0	0.2	−0.7	2.2	3.0
Merchandise trade balance	−5.6	−9.8	−7.3	−5.1	−5.7	−1.2	−1.0
Merchandise exports	12.6	11.0	9.4	9.3	9.1	9.1	9.4
Merchandise imports	18.6	20.8	16.6	14.4	14.8	10.3	10.4
Net gold exports	13.0	9.6	8.0	8.9	8.1	7.1	7.5
Net services and transfers	−3.8	−4.3	−3.7	−3.6	−3.1	−3.7	−3.5
Long-term capital movements	−0.6	0.6	2.2	−0.4	1.9	−0.1	
Other capital movements [c]	−1.0	0.4	0.7	−0.5	−0.6	−2.9	
Total reserves, yearend [d]	**7.7**	**4.3**	**4.0**	**4.1**	**3.1**	**2.3**	

[a] Estimated.
[b] Projected, based on 1- to 2-percent real growth.
[c] Includes changes in valuation of reserves, errors, and omissions, and supplier credits.
[d] Total reserves are not the sum of changes in reserves and the previous year's total reserves because of year-to-year changes in exchange rates.

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South African leaders have been similarly conscious of internal vulnerabilities. For example, Pretoria's concern over the potential implications of South Africa's heavy dependence on black labor predates even its longstanding worries about Western economic sanctions. Under classic grand apartheid schemes, South Africa tried to prevent the growth of a permanent urban black population, preferring to deal instead with nonunionized "foreign migrants" from the homelands. The first crack in this apartheid scheme came in 1979 when Pretoria granted black labor unions legal recognition, an implicit acknowledgment that a large and partly settled urban black labor force was a permanent fixture on the South African scene.

We believe the government hoped that by recognizing black unions it could channel black labor activism into structured collective bargaining processes that would reduce the country's vulnerability to politically motivated strikes or industrial sabotage. Meanwhile, one constant element in government strategy has been a reliance on a powerful internal security apparatus.

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Against this backdrop, Pretoria's preparations to reduce its specific economic vulnerabilities can be organized broadly around a number of general areas—key imports, foreign finance, domestic economic pressures, and foreign sales. In each area, notable differences can exist in the potential and duration of any disruption, the range of options Pretoria can consider, and the remaining vulnerabilities for South Africa (see figures 3 and 4).

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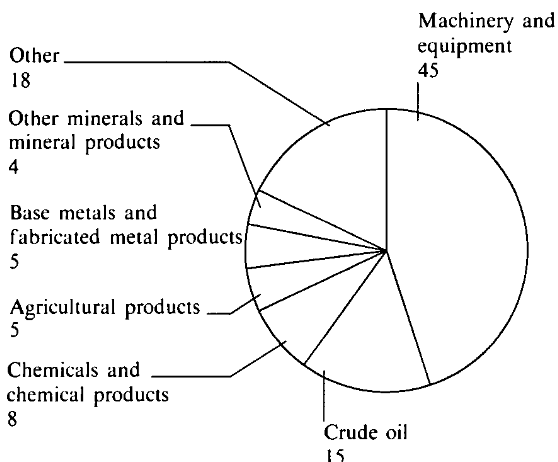
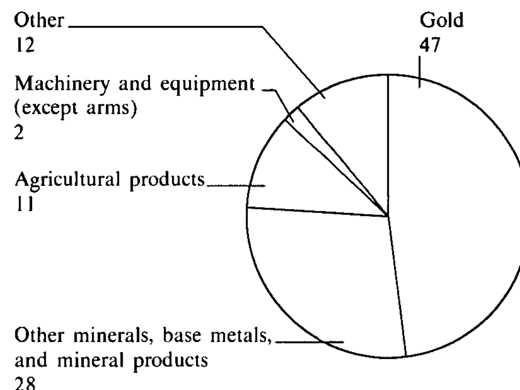
Figure 2
South Africa: Imports and Exports, 1984

Estimated Imports by Commodity Group
Percent



Estimated Exports by Commodity Group
Percent



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Key Imports
Although South Africa's dependence on imported crude oil is often highlighted by antiapartheid activists, we believe that Pretoria also is vulnerable to restrictions on imports of machinery, equipment, and esoteric chemical products and catalysts. Indeed, it is on the nonfuel side that Pretoria has the greatest potential problems since most government efforts have focused on oil availability.

Liquid Fuels. Pretoria has devoted much effort—successfully, in our judgment—to insulate itself from the potential impacts of an oil-import cutoff. We believe their oil stockpiles are adequate to cover a five-year embargo. we estimate that South Africa has accumulated a strategic oil reserve of some 200 million barrels of crude oil. On the basis of our estimates of South African energy consumption, this would last three years under normal use and at least five years with strict conservation measures, accelerated construction of a fourth coal-to-oil facility, and the proposed Mosselbai gas-to-oil conversion plant.

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Resource statistics show that South Africa has ample domestic coal reserves to feed its three existing government-financed coal-to-oil conversion plants that produce some 30 to 40 percent of the country's liquid fuel requirements, according to our estimates of consumption rates. The first small coal-to-oil plant began operation in 1955, with two larger plants coming on line in 1980 and 1982. On the basis of current technology, we believe that a fourth plant could be built in as little as two or three years, if needed, although without foreign participation construction time might be somewhat longer. In addition to public-sector efforts, two private South African companies are considering building smaller coal-to-oil

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Figure 3
South Africa: Summary of Major Economic Vulnerabilities

O Low vulnerability (neglible effect on national economy)
⊖ Medium vulnerability (could dampen economic growth)
○ High vulnerability (could cause severe economic dislocations)

Vulnerability	Importance to economy: Short disruption	Importance to economy: Long disruption	Pretoria's response	Remaining vulnerability
Key imports				
Liquid fuels	○	○	Stockpiles Covert trade Coal-to-oil plants Conservation	O
Capital goods	O	⊖	Import substitution Covert trade	⊖
Chemical products	⊖	⊖	Import substitution Stockpiles	⊖
Foreign finance				
New loans and investments	O	⊖	Promote domestic savings	⊖
Disinvestment	⊖	○	Foreign currency controls	⊖
Technology and personnel	⊖	⊖	Could hire commercially government-sponsored research	O
Domestic economic pressures				
Strike activity	⊖	○	Mass dismissals Internal security apparatus	⊖
Business confidence	⊖	○	Domestic economic policies	⊖
Infrastructural sabotage	○	○	Internal security apparatus	O
Industrial sabotage	○	○	Internal security apparatus	⊖

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facilities, according to press and Embassy reporting, but these would not be operational before the early 1990s.

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Despite adequate overall liquid fuel, South Africa could face problems achieving the right product mix. The existing coal-to-oil plants produce insufficient diesel fuel to meet South African needs, according to press reports. We believe that Pretoria has placed a high priority on increasing the production of diesel fuel, and that the Mosselbaai gas-to-oil facility is intended in part to address this imbalance.

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Capital Goods. In many ways, effective sanctions on South African imports of capital equipment could prove more bedeviling to Pretoria than liquid fuel disruptions. Despite some 25 years of high-priority attention and substantial progress in selected industries, South Africa's import substitution drive, in our view, has not freed the economy from heavy dependence on foreign capital equipment and machinery.

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Figure 4
South Africa: Vulnerability of Key Exports

O Low vulnerability (little impact on sales)
⊖ Medium vulnerability (moderate impact on sales)
○ High vulnerability (major impact on sales)

Export	Approximate percentage share of export earnings	Production vulnerabilities	Suitability for foreign boycotts	Comments
Gold	47	⊖		Market could be undermined by large Soviet or US sales from reserves.
Bullion			**O**	
Kruggerand			○	
Coal	9	⊖	○	South Africa is lowest cost producer.
Steel	9	**O**	○	Country produces some very valuable specialty steels that probably could skirt boycotts.
Strategic minerals	9	⊖	**O**	Few ready substitutes; platinum mostly mined in nominally independent Bophutatswana
Agricultural products	11	**O**		
Intraregional trade			⊖	
Elsewhere			○	
Textiles	3	⊖	○	
Diamonds	2	⊖	**O**	South African firm based in London dominates market.

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Indeed, South Africa imports almost all of its capital equipment—with domestic industry essentially providing only the buildings in which it is housed, according to an academic study. We believe that South Africa's heavy dependence on imports of machinery and equipment reflects the constraints imposed by a small domestic market and limited technological innovation. As a result, South African companies lack the scale of operation enjoyed by high-volume foreign producers.

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The vulnerability to an effective embargo on capital goods might not be readily apparent; we estimate that the initial effect of such an embargo would be a spurt of GDP growth as domestic resources mobilize to build new facilities to produce capital goods. We believe, however, that this "miniboom" would dissipate as inefficiencies resulting from small production volumes began to be felt. Local production of capital goods probably would drive up costs and would need

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to be offset by government subsidies or passed on as higher prices. We also expect that product quality and quantity would suffer as foreign-made capital equipment gradually was replaced with less efficient domestic substitutes.

On the basis of industrial and academic studies of South African technological capabilities and existing plant and equipment, we believe that producing computers and other sophisticated electronic devices wholly from domestic resources probably is beyond current South African capabilities. However, most of the vital components not produced domestically are small enough to be smuggled in, making an effective embargo difficult. Moreover, South Africa has made significant progress in semiconductor fabrication. As in the case of oil and arms procurement, we have little doubt that Pretoria would employ clandestine means to obtain computer and electronic equipment.

Companies are already making provisions for possible embargoes of electronic equipment.

South Africa's motor vehicle and motor vehicle component industry appears fairly well positioned to weather a lengthy embargo, though at a substantial cost. Local content rules—which require 60-percent local content by weight—do not specify which parts of the vehicle are to be manufactured domestically. Since manufacturers have implemented these rules quite differently, an academic study concludes, most of the components needed to make automobiles, trucks, and light-to-medium weight tractors are produced somewhere in South Africa. South Africa, however, may face considerable difficulties in gearing up technologically to produce aircraft engines and heavyweight tractors.

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Chemical Products. Despite advances toward self-sufficiency in chemical products, reports in the South African financial press indicate that some 25 to 30 percent of the raw materials used by the chemical industry are still imported. According to these press accounts, dependence is greatest in the pharmaceutical and pesticide industries—where imports include 80 percent or more of the active ingredients—and least in the production of fertilizers, paint, and explosives.

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Outside the chemical industry, many sophisticated catalysts and other chemical compounds vital to mining, agriculture, and manufacturing are used in insufficient quantities to justify local production For example, soda ash imports—which are used in the manufacture of glass, in vanadium extraction, and in the production of detergents—could be replaced by a synthetic substitute.

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Other Imports. South Africa buys numerous other foreign goods, but, according to academic studies disruption of most of these imports would have little impact on the national economy. The loss of bauxite imports, for example, would close the country's aluminum smelter with some loss of employment, but aluminum could be replaced with domestic copper in most applications.

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We have little data on the size, composition, or quality of stockpiles of specific nonoil items. Embassy sources report Pretoria spent some $2 billion building and maintaining nonmilitary strategic stockpiles, but oil reserves reportedly accounted for 80 to 90 percent of the cost. A private South African firm estimated a few years ago that government stocks total about one year's consumption of spare parts and other items considered critical to industry and commerce, according to a US Embassy contact. Among the items that

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The Demand for Foreign Investment

Although South Africa, on average, has been a net capital exporter in recent years, there have been years of significant capital inflows. This dependence probably was greatest in 1975 when net capital inflows represented 22 percent of domestic fixed investment, according to government data. Our analysis of past episodes of heavy foreign investment and borrowing indicates that large capital inflows have served principally to fund major infrastructural projects or to cushion the impact of reduced export earnings at times when the gold price has declined:

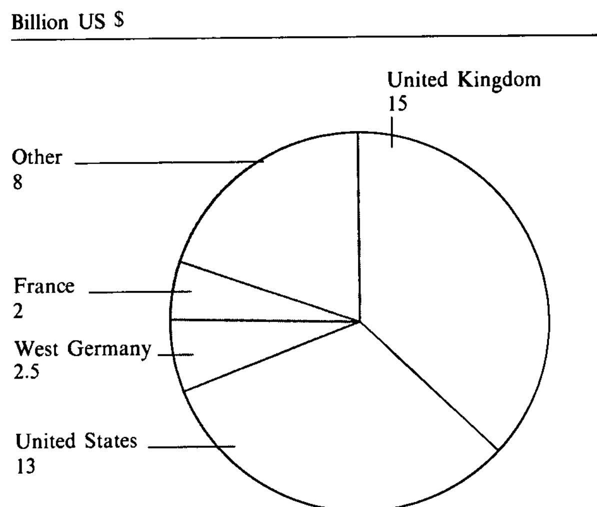
- *In the mid-1970s, state-run corporations undertook major capital projects such as port development and improvements, expansion of iron and steel plants, establishment of television service, and more rapid electrification that required foreign funds.*
- *By contrast, 1981 and 1982 were years of little new investment, but South African banks and the central government borrowed abroad to finance current account deficits totaling $7.5 billion; gold prices had fallen from an average of $608 per ounce in 1980 to $460 in 1981 and $376 in 1982, according to IMF data.*

On the basis of academic studies and government development plans, we believe that South Africa is likely to experience a heavier than normal demand for foreign funds over the next few years, which will increase slightly its vulnerability to investment and loan restrictions. We judge that South Africa will need new foreign investment to help fund envisaged expenditures on synthetic fuel projects, black education, and improvements to economic infrastructure, and to sustain even a modest economic recovery, once existing productive capacity is fully utilized.

South Africa reportedly has stockpiled are synthetic rubber, urea, carbon black, and ferro-titanium.

Figure 5
Total Foreign Investment in South Africa by Country, 1985

Billion US $



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Foreign Finance

Pretoria's external dependencies extend beyond critical imports into the foreign financing arena. Foreign investment in South Africa totaled about $40 billion in 1985, on the basis of South African Government statistics and scattered reporting from various US Embassies. These liabilities included direct investment, foreign-owned shares on the Johannesburg Stock Exchange, other types of equity investment, and overseas debt. Half of these liabilities reportedly were to countries in the European Community, especially Great Britain and West Germany (see figure 5). Against these liabilities, South Africa had about $12 billion in foreign assets, much of it invested in mining operations in southern Africa, the United States, and South America. During 1985, net foreign liabilities fell by nearly $4 billion as the result of disinvestment, loan repayment, and capital flight.

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South Africa's Debt Crisis

Origins of the Debt Crisis. *Pretoria has long practiced conservative foreign debt management to assure continued access to credits in spite of foreign criticism of its racial policies. The country's economic record shows that on several occasions the government has clamped down hard on growth to reduce import demand. In 1983, however, misplaced expectations of higher gold prices and an end to the southern African drought led Pretoria to allow a rapid expansion of consumer purchases funded by short-term overseas borrowing.*

Although the amount of debt relative to GDP during the 1983-84 miniboom was not unprecedented, South Africa's vulnerability to a cutoff in foreign credits increased substantially. Bank for International Settlements data indicate that the maturity of the foreign commercial debt shifted from 38 percent short-term debt in 1979 to 66 percent in 1984—a trend which meant that a larger fraction of the debt needed to be paid off or reborrowed each year. Meanwhile, Pretoria's foreign currency and gold reserves fell relative to imports. Whereas these reserves were sufficient in 1980 to pay for five months of imports, by 1984 they could buy less than three months' worth.

As in the past, Pretoria reined in the 1983-84 miniboom with austerity measures to reduce inflation and overseas borrowing by cutting import demand. These measures, however—which included a record 25-percent prime lending rate and restrictions on consumer borrowing—contributed initially to a continued runup of the country's short-term debt. South African banks profited from the high domestic rates by borrowing cheaply abroad to relend domestically. In many cases, according to US Embassy sources, the banks misrepresented the loans to foreign creditors as short-term trade finance and relent them at higher long-term rates.

Foreign Banks Pull Back. *Growing international nervousness over South African domestic political uncertainties led some foreign banks to curtail their credit lines in the first half of 1985, causing significant downward pressure on the rand. With floating exchange rates, the rand plummeted as South African companies scrambled for foreign currency commitments to cover future transactions in the self-fulfilling expectation of further declines. From an average of $1.30 in the first quarter of 1980, the rand sank to $0.40 in the third quarter of 1985. Political events, such as riots outside of Pollsmoor prison in February 1985, the killing of 20 blacks by security police in Uitenhage in March, the declaration of a state of emergency in major black townships in July, and a hardline speech by President Botha in August, triggered near-panic runs on the rand.*

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Pretoria suspended trading on South African foreign currency and stock markets for four days on 28 August 1985, pointing publicly to the slide in the value of the rand, an acceleration of the withdrawal of foreign credit lines, and a bunching of foreign debt repayment commitments as key reasons behind the decision. Pretoria then announced on 1 September a four-month suspension of principal repayments on $14 billion of South Africa's $24 billion in foreign debts. Foreign currency controls also were tightened in an effort to slow the capital outflow, reversing a previous policy of economic liberalization.

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Fragile Resolution. *Initial talks among Pretoria, major commercial bank creditors, and Swiss debt mediator Fritz Leutwiler to resolve the debt crunch were inconclusive, and Pretoria extended its moratorium through March 1986 to gain additional time to negotiate. After an abortive proposal in December by South Africa to delay repayments of the frozen debts until 1990, Leutwiler presented a compromise debt deferral plan that formed the basis for an agreement in principle reached in March. Under this plan, the moratorium will be extended through June 1987, and South Africa will make a 5-percent downpayment this year against the blocked debts. Creditors are to review the country's financial position in April 1987 to consider further repayments.*

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The debt accord is vulnerable to financial pressures. As a result of the impact of the recession on import demand, we expect a current account surplus this year of about $3 billion. With $3.6 billion in debts outside the moratorium falling due this year—in addition to the agreed downpayment of some $400-500 million—Pretoria is counting on creditors to continue rolling over expiring loans.

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From Pretoria's perspective, foreign investment restrictions could take the form either of bans on new investment or loans, or the forced sale of existing assets. Such measures would have a direct effect on the balance of payments—assuming that foreign currency could be withdrawn from South Africa—and an indirect effect on economic growth, access to foreign technology and personnel, and domestic business confidence. The magnitude of such effects, however, will depend on which countries adopt measures and on the vigor with which they are enforced. In addition, South Africa has at its disposal some countermeasures—such as allowing the value of the South African rand to fall or imposing tighter foreign currency controls—to blunt at least short-term balance-of-payments impacts of investment restrictions. 25X1

New Loans and Investment. We believe that many studies overstate South African economic vulnerability to foreign restrictions on new loans and investment, although we are convinced that widespread restrictions would reduce long-run growth potential. South African investment has not depended heavily on foreign funds: net capital inflows accounted for only 9 percent of domestic fixed investment between 1963 and 1980. Since 1980, capital outflows have exceeded capital inflows by an average of $400 million per year, and investment has been funded from internal corporate savings. A portion of these internal funds have come from subsidiaries of foreign companies, but, to date, bans on new investment have not applied to reinvested profits. 25X1

Even without foreign loan and investment restrictions, however, we do not expect South Africa to receive substantial capital inflows until the domestic unrest subsides. The recent debt crisis—triggered by a loss of foreign confidence in South Africa—clearly indicates investor concern over domestic political and economic uncertainties. On the basis of investor behavior following widespread black unrest in 1960 and 1976, we believe that investor confidence would return only gradually, even in the unlikely event that the unrest ended quickly. 25X1

Pretoria has manipulated domestic policies to offset to a limited extent the effects of restrictions on new foreign investment and loans. For example, Pretoria recently has streamlined its monetary policies to encourage greater domestic savings and investment. Similarly, interest rates in the past have been boosted to attract foreign loans from countries still offering new loans to South Africa, or—as was done recently—lowered in the hope of stimulating a domestic economic recovery to partially restore lost investor confidence. 25X1

Disinvestment. In our judgment, a substantial reduction in existing foreign loans and investments might once have cut deeply into economic growth, but Pretoria has taken several steps that largely offset this vulnerability. From an investor standpoint, we would have expected a massive selloff of foreign investments to have caused prices on the Johannesburg Stock Exchange to fall—but domestic interest rates to rise—as South African companies scrambled to purchase foreign interests at bargain prices. As far as economic performance is concerned, a sustained capital outflow would have left less foreign currency for purchase of vital imports, which would have constrained domestic growth if local substitutes could not have been found. Pretoria, however, has limited the potential loss of foreign currency:[3] 25X1

- South Africa moved in the late 1970s from a fixed exchange rate to a "managed float," in which the exchange value of the rand has been chiefly determined by supply and demand. Many academic studies note that allowing the exchange rate to move freely encourages investors to keep the proceeds of any disinvestment in South Africa since a massive withdrawal of foreign capital would depress the value of the currency and of proceeds from the sale of South African assets. 25X1

- In response to the debt crisis, foreign currency controls were reimposed last year that further discourage the sale of assets in South Africa by using a penalty exchange rate for such transactions. In addition, the currency controls specify that companies may repatriate funds from the sale of assets only if another foreign company is willing to buy the rand generated from the sale. 25X1

[3] As early as 1961, foreign currency controls were used to stem a large capital outflow following the killing by police of 69 black protestors at Sharpeville. 25X1

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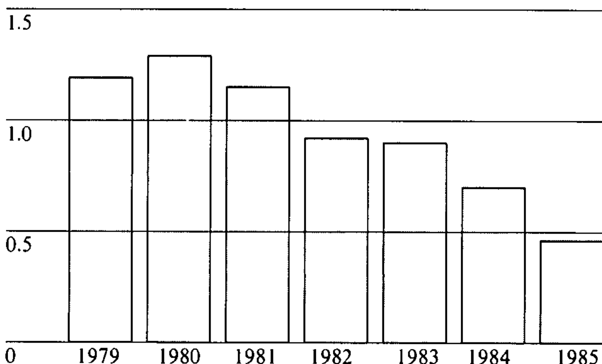
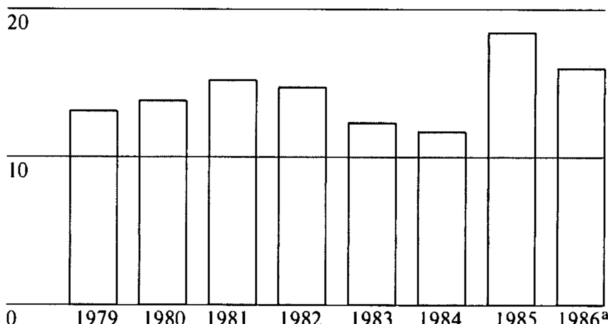
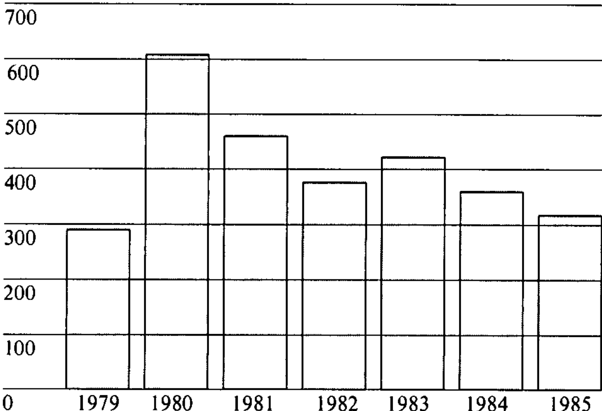
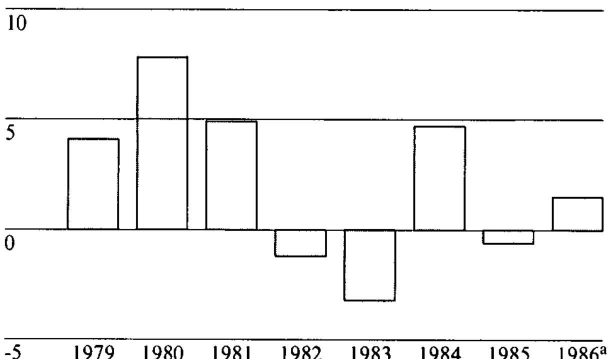
Figure 6
South Africa: Selected Economic Indicators









[a] Projected.

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- Additional controls empower the government to restrict foreign debt repayment. 25X1

These currency controls reduce the potential impact of foreign disinvestment or loan repayment on the balance of payments and, thus, on domestic economic growth. If necessary, Pretoria could take further steps by blocking all capital outflows and requiring these funds to be invested in government bonds. One South African diplomat recently went so far as to imply that Pretoria would renounce its foreign debt obligations in the event of severe Western economic sanctions, according to press accounts. 25X1

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Financial controls can stem a massive financial drain, but they are neither costless nor completely effective. A falling exchange rate adds to domestic inflation by raising the local cost of imported goods. Likewise, while domestic substitutes could be made available, they would come with a higher price tag than foreign goods. Moreover, foreign currency regulations can be skirted to some extent by foreign subsidiaries that can overpay a parent company for imports and inflate dividend remittances.

Foreign Technology and Personnel. We believe that Western bans on direct investment in South Africa would merely raise its cost for obtaining new technology and skilled foreign labor. Foreign companies facilitate the transfer of technology and skilled personnel to South Africa that would otherwise be available only on a more costly commercial basis, according to academic studies. These studies indicate that, except for underground mining technology, there are few machines, techniques, or advanced developments that are uniquely South African. Instead, South African research efforts have focused on improving and adapting foreign processes to local conditions. Even the much-vaunted coal-to-oil conversion plants are simply a commercial application of foreign technology. South Africa devotes less than 1 percent of its GNP to research and development, compared with 2.5 percent in the West, according to press reports.

South Africa also depends heavily on foreign management and training to run its economy, according to a variety of economic publications. The country has good higher level technical training for whites, but, in proportion to its entire population, the educational system does not produce as many graduates in scientific, managerial, and technical fields as most Western countries, according to an academic study. Thus, while the United States has one professional, scientific, or managerial worker for every nine people, South Africa has one for every 50 people. The study notes, for example, that major breakdowns of machinery often must be repaired by foreign technicians.

On balance, however, we do not believe that South Africa's limited research and development base and small skilled labor pool present serious vulnerabilities so long as needed technologies can be purchased commercially and skilled labor hired abroad. Open source material and Embassy contacts report numerous cases of foreign technology obtained by South African companies under a variety of arrangements that involve no direct foreign investment:

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- Japan has long banned direct foreign investment in South Africa, but South African–built models of Japanese cars increasingly dominate the domestic automobile market. The South African–owned companies making these cars purchase technology and parts on a licensing basis.
- One of the coal-to-oil conversion plants was built under contract by a US firm using West German and French technology.
- A proposed gas-to-oil conversion plant at Mosselbaai is to be built with foreign technology purchased commercially.

In addition, on the basis of our assessment of past efforts to deprive South Africa or other countries of new technologies or skilled personnel, we believe that a ban on all technology transfer and skilled expatriate labor would be extremely difficult to enforce.

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Domestic Economic Pressures

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In our judgment, the South African economy at present is far more vulnerable to internal disruption than to foreign economic reprisals. Among the major damaging factors, the most dramatic—but probably least important economically—are bombings of economic targets by the African National Congress (ANC). Of potentially much greater economic consequence is the growing incidence of industrial sabotage and work boycotts by black workers. In addition, white business confidence is sensitive to these various external and internal pressures.

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Sabotage. In our judgment, the South African economy is not now seriously vulnerable to insurgent attacks, given opposition capabilities, redundancies in

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economic infrastructure, and Pretoria's security strengths. Isolated ANC bombings sometimes have caused extensive property damage, but press and Embassy reports indicate that the installations usually have been quickly repaired. We believe that repeated bombings of key installations sufficient to physically hamper the national economy are beyond current ANC capabilities. The impact of sabotage to date—aside from the psychological and propaganda effect on the South African political scene—has been localized and short term.

We believe that the economy can withstand all but a carefully orchestrated and technically demanding series of bombings of key economic installations, because the infrastructure associated with energy, mining, and transport is widely dispersed (see figure 1):

- Energy infrastructure—a favorite ANC target—is spread among numerous installations. The most important potential targets, in our judgment, probably are the oil pipelines from Durban to Johannesburg, and the coal-to-oil conversion plants. Pretoria has been increasing security around these facilities. Moreover, with significant oil stockpiles and the alternative of road transport, temporary loss of even these facilities most likely would be only an expensive inconvenience from an economic standpoint, albeit an important psychological blow against whites.

- gold is mined at more than 30 sites, none of which produces over 12 percent of the total output. For other metals, however, production tends to be more concentrated.

- South Africa's extensive road and rail network provides numerous alternative routes between any two major destinations.

Moreover, many key economic installations, such as oil refineries, can be readily repaired following most attacks, unless critical components that are only produced abroad are destroyed.

Although we doubt the ANC can physically cripple the economy, we believe an ANC campaign against selected subsidiaries of foreign corporations could scare off parent companies by drawing attention to their involvement in South Africa and raising the costs of doing business in the country. ANC officials have threatened—but not yet adopted—this tactic, possibly fearing it would cost the group some Western political and financial support.

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The threat of black workers turning to industrial sabotage on a large scale also has long concerned South African policymakers, as several academic studies have argued that worker sabotage generally is much easier to carry out effectively than a bombing campaign by outsiders, for whom access to facilities can be more easily denied. So far, we have seen no evidence of workers adopting sabotage on a widespread basis

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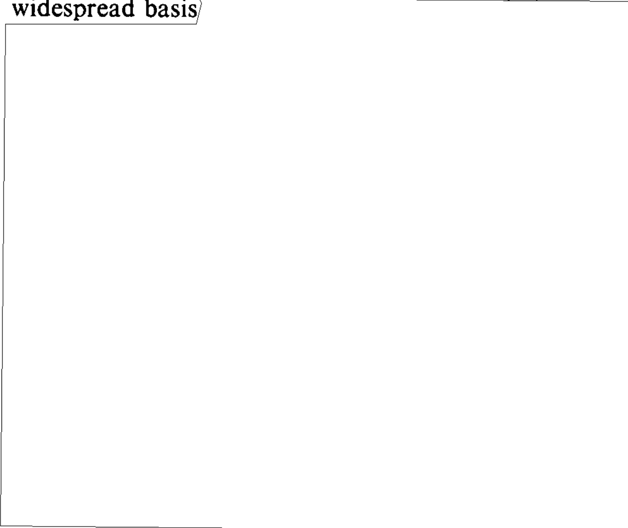

black anger over domestic developments has been reflected in declining worker productivity, work slowdowns, and factory sit-in strikes geared to disrupt production.

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South Africa's powerful internal security apparatus, of course, acts to suppress the threat of sabotage. The backbone of this security system is the South African Police, a nationwide paramilitary organization with

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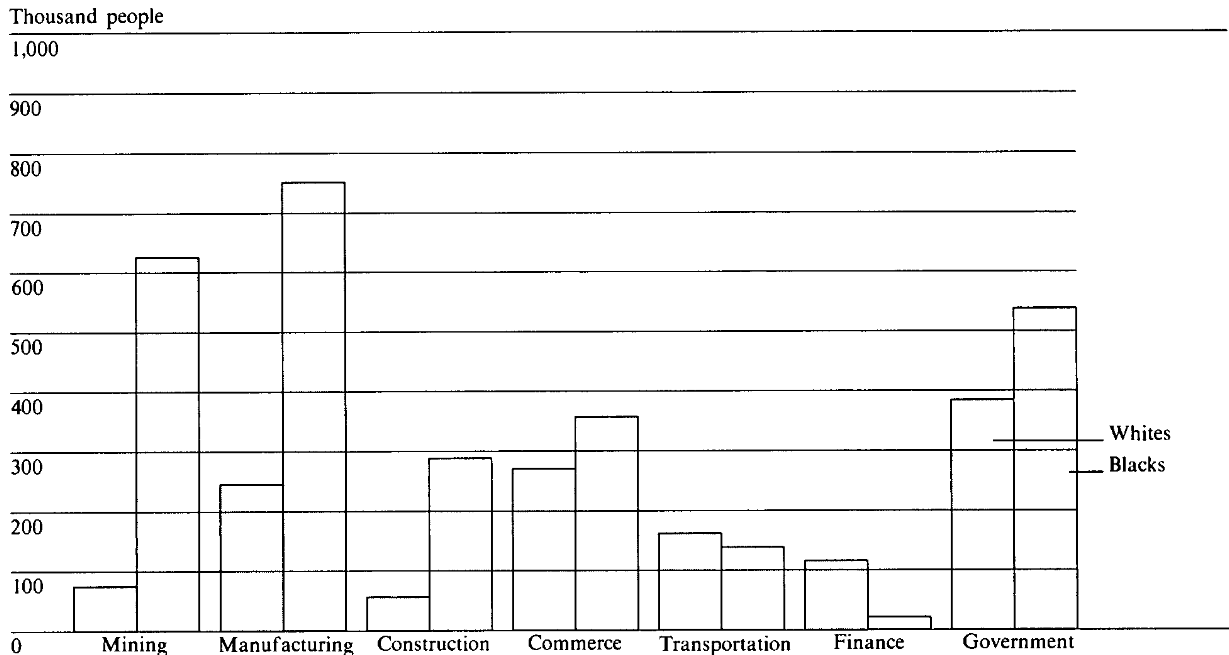
Figure 7
South Africa: Employment by Race, 1984



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over 40,000 members. It is supplemented in its internal security role by the military and an extensive private security industry employing some 250,000 people.

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The security forces have strong political backing. Security legislation permits detention without trial and wide powers of search and seizure. Moreover, the South African Parliament has enacted special legislation to protect important economic installations through the National Key Points Act of 1980, which empowers the Minister of Defense to declare as a "national key point" any place or area in the country that he deems of strategic importance. The Act requires the owners of key points to adopt and maintain security measures. Those owners who fail to comply with the provisions of the Act can be fined up to $26,000 and imprisoned for up to five years. Key points are protected by personnel from private security firms or by Industrial Commando units made up of military personnel, according to press sources.

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Strikes. The South African economy is heavily dependent upon labor provided by black workers, who constitute nearly 70 percent of the economically active work force, and are especially important in mining, manufacturing, and construction, according

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Black Consumer Boycotts

Consumer boycotts have been revived as a tool for black economic leverage, but, in our view, they do not represent a major source of vulnerability for the national economy. Since 1979, several black consumer boycotts have been directed against particular companies in efforts to win reinstatement for workers fired in labor disputes. More recently, localized consumer boycotts of all white-owned shops have been called in most major urban areas to protest South African racial policies, according to press and Embassy reporting. These protests generally have had broad political goals—such as freeing jailed African National Congress leader Nelson Mandela—as well as specific local demands.

Consumer boycotts tend to be local, affect only a relatively small segment of the white population, and have little direct impact on the national economy. The effect on local economic conditions or small businesses catering to blacks undoubtedly has been quite pronounced in many cases, and press reports indicate that, during several of the more successful boycotts, white-owned shops have lost most of their usual sales, with some businesses going bankrupt under the twin pressures of recession and boycotts.

to government statistics (see figure 7). Domestic production, thus, could be disrupted severely by a lengthy general strike by black workers. Recent organizational advances by black labor unions that are committed to using economic leverage for political gain make general strikes more viable.

The potential economic implications of a lengthy general strike are staggering, far outweighing the consequences of any plausible economic sanctions scenario, in our judgment. In sharp contrast to sanctions and black unrest to date, which have had little direct economic impact on whites, a lengthy nationwide general strike would—at a minimum—cut the disposable incomes of the vast majority of whites, and disrupt their normal patterns of life and business.

Mineral and mineral product exports, in our view, are particularly vulnerable to strike activity. Without black labor, whites probably could not sustain significant mineral and mineral product exports. 25X1 25X1 white employees at the Palabora copper mine failed in their efforts to sustain production during a 1 May work boycott this year, and a white supervisor was killed accidentally while attempting to use mining machinery with which he was unfamiliar. Members of the major black miners' union in South Africa have staged three major legally sanctioned strikes and numerous small strikes, and have demonstrated the capability to suspend production simultaneously in most major gold and coal mines. An extended strike that shut all gold and coal mines would cost the country each week about $200 million, or about 1 percent of total projected export earnings for 1986. Short of a nationwide black miners' strike, a rash of small mine strikes already has hurt export earnings marginally, and this trend appears likely to continue.

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Government and business policies have reduced the threat of a lengthy strike by making these tactics obviously risky for black workers and labor unions. As in the past, companies almost certainly would threaten—and quickly carry out—mass dismissals of participating workers, a credible threat in most industries, given high black unemployment. Even when a company makes use of massive dismissals, however, the time and expense involved in replacing workers can hurt company profits and—in some cases—cost South Africa some export earnings, as the dismissal of 23,000 striking platinum miners in January 1986 indicated. According to Embassy and press reporting, mining companies anticipating strikes often have stockpiled ore on the surface, but the black miners' union has countered successfully in several cases by involving surface workers in strikes.

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Pretoria has responded in the past to growing political activism in the black labor union movement by cracking down hard on participating unions. Indeed, each of four past waves of black labor activism has ended abruptly with the government arresting labor leaders

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Four Waves of Black Labor Activism, 1918-76

1918-30. The first significant black union, the Industrial and Commercial Union (ICU), is formed and calls unsuccessful dock strike over wages. Membership reaches 100,000 by 1927 as ICU becomes increasingly political. ICU founder Clements Kadalie is arrested in 1930, and black union activity effectively collapses.

1938-46. Trade Union Coordinating Committee is formed as a loose black labor federation, and gives way to the more formal Council of Non-European Trade Unions in 1942. Union membership grows rapidly, reaching 158,000 by 1945, as labor movement again becomes increasingly political. Illegal strike by 74,000 black miners results in arrests that significantly weakens the black labor movement.

1954-61. South African Congress of Trade Unions (SACTU) formed in 1954 as labor wing of Congress Alliance, claiming a peak membership of about 100,000. A smaller politically oriented black labor federation, the Federation of Free African Trade Unions of South Africa (FFATUSA), is formed by black nationalists in 1959. SACTU functions briefly in the early 1960s as the front for the African National Congress and the South African Communist Party following the banning of the ANC. The arrest and banning of activist union leaders and the burden of repressive legislation contribute to effective collapse of SACTU and FFATUSA in early 1960s, though remnants of SACTU continue to survive in exile.

1972-76. The Trade Union Advisory Committee, a black labor coordinating body, is formed in Natal Province in 1972. A spontaneous outburst of strikes in Natal the following year adds to black organizing efforts as six new black unions emerge. Total membership in black unions reaches a peak of nearly 60,000 in 1975. Following the riots that began in Soweto in 1976, however, Pretoria cracks down on black political activism, banning the activities of 26 individuals involved in the black labor movement.

and, in several cases, banning major unions. Government security forces have considerable discretion in detaining labor organizers, and security legislation affords the government ample latitude to ban unions or other groups. If needed, security forces could seal off townships to prevent food and other goods from reaching striking workers. With little in the way of strike funds or stores of food, black workers probably could not sustain a lengthy siege.

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Even if mass dismissals and security measures failed to break a strike or end industrial sabotage, not all production in South Africa would grind to a halt. As the economy moved to a near-war footing, we would expect Pretoria to carefully allocate resources between various sectors of the economy. Most state-run companies traditionally have hired a disproportionate number of Afrikaners, and probably could continue to operate without black labor. This would allow many basic services, such as electricity and transport, to continue, although probably at reduced levels. Pretoria might move available white mineworkers to those collieries producing for domestic coal-to-oil conversion plants, sacrificing mineral exports to secure domestic energy production. Highly mechanized production processes, including much of the modern agricultural sector and oil refining, would continue largely unaffected. Pretoria undoubtedly also could mobilize many white teenagers and housewives to fill relatively unskilled positions in industry and commerce.

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Business Confidence. With control over the country's physical capital concentrated in the hands of a few hundred South African whites, attitudes among this group determine the investment climate. In particular, three major mining and industrial groups have controlling interest in 30 of South Africa's 50 largest publicly listed companies, according to reports in the financial press. Official data reveal that, since 1960, over 90 percent of investment has been funded from domestic savings. These statistics further indicate that foreign control of South African companies generally is modest outside of banking and heavy industry.

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Figure 8
South Africa: Real Fixed Domestic Investment, 1979-85

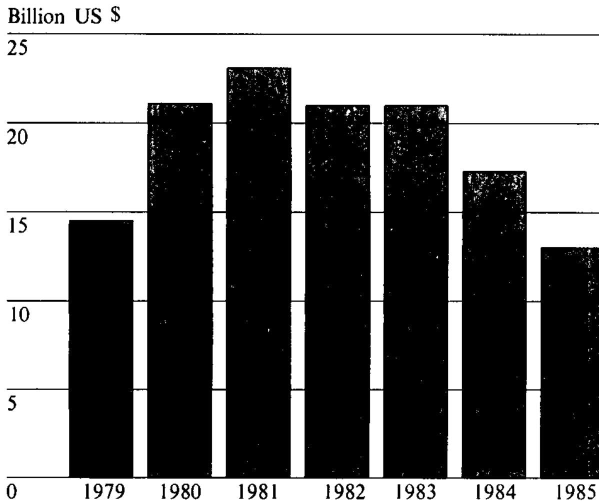

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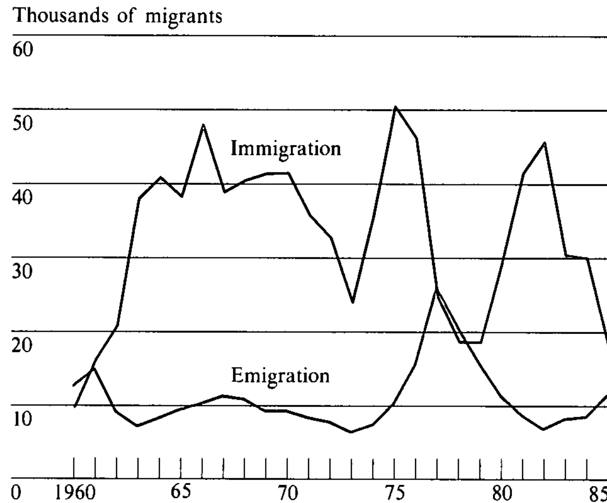
Figure 9
South Africa: Immigration and Emigration, 1960-85



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As with investors everywhere, local white businessmen base their investment decisions on expectations about future sales and profitability. In making these calculations, businessmen factor in both the economic and political outlook. The historical record of the past 25 years suggests to us that these expectations are sensitive to outbreaks of black protest activity or limited foreign economic sanctions.

Businessmen have responded to South Africa's economic and political uncertainty by reducing real fixed investment, which has fallen 50 percent below what it was in 1981 (see figure 8). Finance Minister du Plessis has stated publicly that, after making allowance for investment expenditures for depreciation, real fixed investment probably will be negative in 1986, indicating that the country's real capital stock is declining. Du Plessis also has blamed business pessimism for the failure of the economy to respond to heavy government economic stimulation.

Nervousness over political and economic uncertainties also promotes capital flight and white emigration.

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For many professionals with marketable skills, employment opportunities outside of the country will be attractive, as indicated by a recent survey of whites, in which 12 percent stated that it was likely or fairly likely they would emigrate within the next decade. Emigration already has risen in response to domestic uncertainties, and during the second half of 1985 it exceeded immigration for the first time since 1978, according to government statistics. Many of those leaving are engineers and doctors whose skills already are in short supply in South Africa, but less than 1 percent of professional, technical, and managerial workers left in 1985. Historical data indicate that

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similar brain drains occurred during earlier periods of significant black unrest and poor economic performance (see figure 9). Pretoria has sought to discourage emigration by restricting emigrants to taking at most 100,000 rand from the country—worth about $40,000 at current exchange rates.

Foreign Sales

In our judgment, widespread foreign boycotts of South African products could have a significant, but probably not crippling, impact on export earnings. Such boycotts could include official trade sanctions, decisions by foreign governments or companies to switch to less politically sensitive sources of supply, and actions launched by foreign dockworkers refusing to handle South African trade. Our analysis of past trade boycotts against South Africa and other countries leads us to believe that such actions are most likely to be effective when the goods involved are easily traceable to country of origin, have a low value-to-weight ratio (which makes smuggling less attractive), and substitutes are readily available at similar prices from other sources of supply. This would affect exports of coal, steel, agricultural exports, and Krugerrand gold coins, but these goods account for less than one-third of total South African export earning (see figure 4). By contrast, we believe that boycotts of gold bullion, diamonds, and platinum—which account for some 60 percent of export earnings—would be difficult to enforce as they are readily marketable, easily transshipped, and difficult to trace, according to academic studies An Embassy contact reports that, in an effort to circumvent possible trade sanctions, some exporters of mineral commodities already are laundering forwarding documents to disguise South African origin.

For many commodities, foreign sales probably are under much greater threat from internal strike activity that could disrupt production than from foreign boycotts. Aside from a lengthy general strike, an upsurge in narrower strike activity—including short politically motivated work boycotts, wildcat strikes, and legally sanctioned labor disputes—could seriously affect export production.

Pretoria's Counterlevers

Pretoria probably believes that it has been partially shielded from tough economic sanctions by Western reliance on South Africa's strategic mineral exports and by concern over the region's economic dependence on South Africa. Because mineral sales and regional economic ties have promoted South African economic development, they are less obviously defensive measures than is stockpiling. Nevertheless, oft-repeated threats to embargo mineral sales to the West or cut economic ties to neighboring black African states clearly indicate the significance that Pretoria attaches to these counterlevers. Moreover, Pretoria has hinted openly that it would retaliate for tough Western economic sanctions by damaging the economies of neighboring black states and cutting strategic mineral sales to the West. We believe that both of these threats are credible, but that Pretoria most likely would begin with a measured response and only raise the stakes gradually as it perceived its other options to be narrowing. A rash reaction, of course, cannot be ruled out.

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Regional Economic Ties

In our judgment, South Africa could cause considerable economic dislocation and hardship to regional economies at a relatively minor cost.[5] South Africa dominates a regional economic network that provides significant economic benefits to all of its neighbors except Angola (see figure 10). According to Embassy reporting, official publications, and open source information:

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- South Africa has 75 percent of the region's rail network and the most efficient ports, making transportation Pretoria's greatest source of economic leverage over its neighbors.

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- About 350,000 workers from the neighboring states are legally employed in South Africa, and their remittances are estimated to support an additional 3

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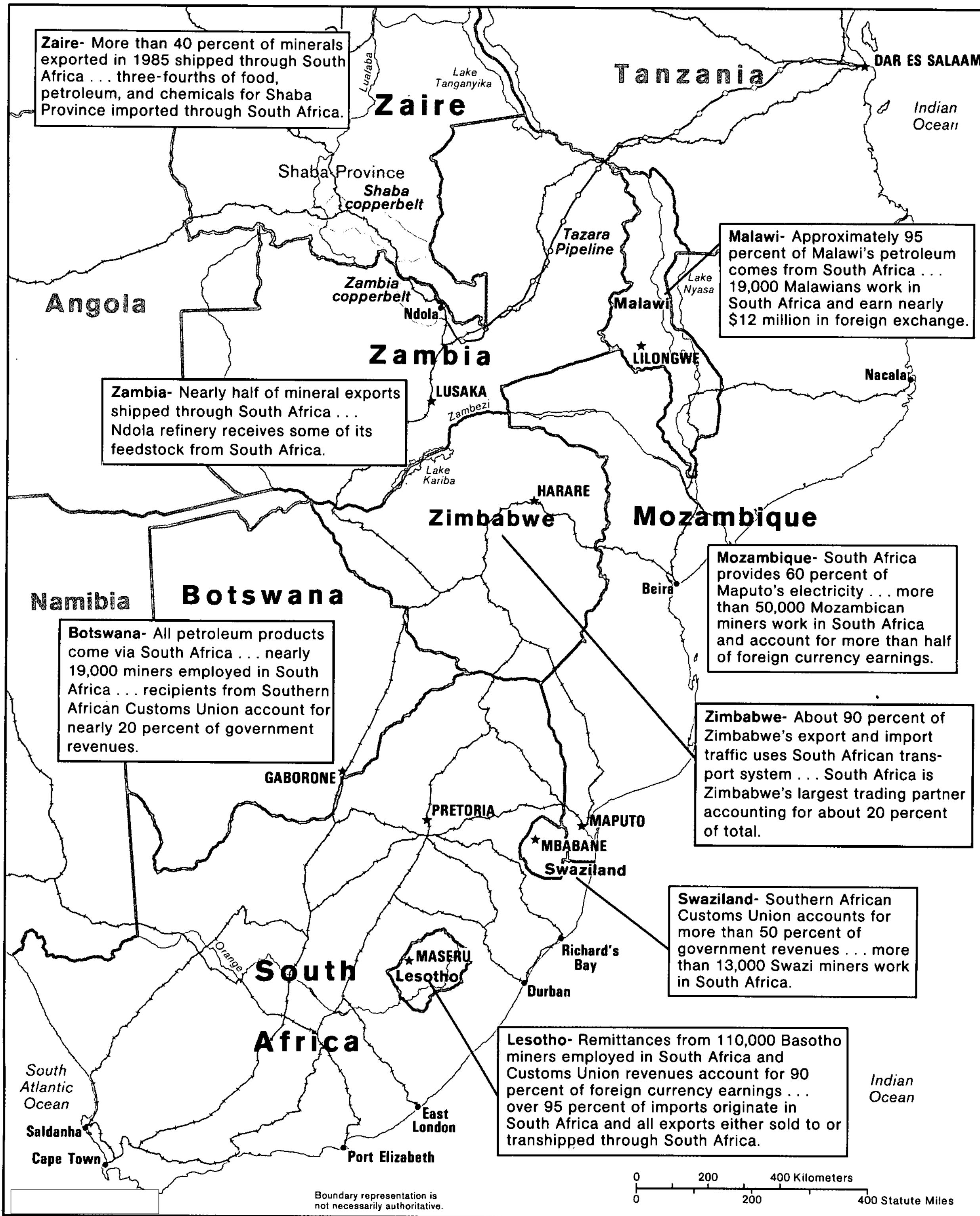
Figure 10
Economic Links With South Africa



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million people in neighboring countries. One estimate also indicates that between 200,000 and 700,000 illegal migrants work in South Africa. During 1984, official data showed that the 195,000 foreign black workers employed in gold and coal mines remitted over $200 million to their countries of origin through savings programs run by the mining companies.

- Receipts from the South African–dominated Southern African Customs Unions (SACU) account for between 50 and 70 percent of the government revenues of Lesotho and Swaziland, and over 20 percent of Botswana's.

Nonetheless, Pretoria's initial response to economic sanctions would be limited, in our judgment. Past actions and public statements indicate that Pretoria recognizes the value of maintaining—and even expanding—its regional economic relations, which we estimate yield South Africa about $1.2 billion per year. Moreover, we believe Pretoria would prefer to reserve tough economic measures against its neighbors as a lever for reducing the presence of ANC guerrillas in those states. In the event of tough sanctions, we believe that Pretoria would take selective actions designed to showcase its regional economic muscle and indicate to the West the cost of sanctions to the region. In particular, we would expect Pretoria to expel selected foreign workers and disrupt some rail links. At the same time, the government would threaten to respond in kind to further Western sanctions.

We cannot, of course, rule out a harsher reaction. Pretoria could choose to cut all rail ties to its neighbors and expel all migrant workers. Such moves would cripple the economies of Lesotho, Mozambique, Swaziland, and Botswana, and cause severe economic dislocation for Malawi, Zambia, Zaire, and Zimbabwe. These countries undoubtedly would seek increased Western aid. Balance-of-payments assistance to compensate for the loss of all exports currently funneled through South Africa would total nearly $2 billion per year.

Table 2
Strategic Minerals: South African and Soviet Production, 1985 [a]

Percent

	South Africa		USSR
	Share of Western Production	Share of World Production	Share of World Production
Chromium	53	31	31
Manganese	29	15	43
Platinum group	86	43	50
Vanadium	58	42	31

[a] Estimated.

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Strategic Mineral Sales

Concerns that South Africa would use its vast mineral wealth as a political lever against the West have surfaced each time Western economic sanctions have been suggested or imposed. South African officials themselves have publicly hinted that a strategic mineral cutoff might be used in retaliation. What makes the threat appear credible is the heavy dependence of many Western countries on a variety of South African minerals and the relatively small contribution these minerals make to South African foreign exchange earnings (see tables 2 and 3):

- South Africa is the West's leading producer of chromium, manganese, platinum-group metals (PGM), and vanadium, accounting for 30 to 90 percent of Western output. These metals are critical in making some industrial products and sophisticated military equipment. Only the Soviet Union can compete with South Africa in terms of volume of production and reserves.

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- Western import dependence for these four strategic minerals varies from 50 to 100 percent for the United States, 90 to 100 percent for the European Community, and 95 to 100 percent for Japan. South Africa is the key supplier for most of these markets.

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Table 3
Strategic Minerals: Critical Uses and Alternatives to South African Supplies, 1985 [a]

	Share of US Consumption Supplied by South Africa (*percent*)	Strategic Applications	Best Short-Term Alternatives
Chromium	56	Stainless steel and specialty alloys for tanks, ships, military aircraft, and naval nuclear propulsion systems	Increased imports from India, Philippines, Turkey, USSR, and Albania; substitute other materials in noncritical applications.
Manganese	39	Steel for ships, tanks, and other vehicles	Increase imports from Gabon and Australia
Platinum	45	Catalysts for petroleum and fertilizer production	Increase imports from USSR
		Electrical contacts for jet aircraft engines and lasers	Increase recycling—particularly from spent catalytic converters
Vanadium	38	Steel and titanium alloys production and for oil pipelines and jet engines.	Increase US imports from China

[a] Estimated.

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- For South Africa, these industries earn no more than 9 percent of total export earnings and employ only 1 percent of the labor force—equivalent to about 5 percent of all miners—making the costs of a cutoff relatively low for South Africa unless it resulted in an even tougher Western response. 25X1

It is clearly in South Africa's best economic interest to continue to export strategic minerals. Any deliberate supply cutoff would tarnish South Africa's reputation as a reliable supplier, and a portion of its market could be lost even if the embargo were later lifted. In addition, a supply cutoff would undoubtedly trigger accelerated substitution and recycling efforts, encourage competing producers to increase production, and possibly lead to use of Western stockpiles.

Should Pretoria choose a total embargo as a political gesture, however, we believe that Western countries could adjust—at some cost—by encouraging alternate producers to restart idled capacity, increasing purchases from the Soviet Union, using stockpiled materials, intensifying recycling efforts, and, if necessary, reducing civilian usage. The Soviet Union would probably benefit substantially by increasing exports and charging higher prices. A partial embargo—which we judge somewhat more likely—initially would be far less costly to both South Africa and the West. South Africa would lose little of its trade volume in the short run as it reoriented sales away from targeted countries to other markets. Over the long run, however, even a partial embargo would encourage substitution. 25X1

Overall Assessment of Economic Vulnerability

Pretoria's public statements and past actions suggest that the prospect of tougher Western economic sanctions is of considerable concern to the South African Government, but that it believes it can do little to stop an eventual tightening of the sanctions net. Instead, government strategy appears geared toward publicizing its reform program and the regional costs of sanctions in hopes of delaying—as opposed to preventing—the adoption of tougher measures. Nonetheless, recent actions against neighboring states and a harsh internal security response to domestic protests clearly indicate that other considerations weigh more heavily in Pretoria's decisionmaking calculus. 25X1

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Economic Prospects in the Absence of New Dislocations

The South African economy has been buffeted in recent years by numerous shocks—drought, lower-than-anticipated export prices, and a debt crisis that has threatened to isolate it from international credit markets. As a result of these shocks, real economic growth has averaged about 1 percent per year since 1981, a rate insufficient to keep per capita income from declining. We believe that the brunt of this mediocre economic performance has fallen on blacks, and, in our view, has contributed significantly to grievances underlying the serious unrest of the past two years.

According to a recent government study, the economy's long-run real GDP growth potential is 3.6 percent in the absence of new foreign capital inflows or a sharp rise in world gold prices. The study held that economic growth will be constrained by stagnant gold production, limited prospects for further import substitution, and only fair-to-good opportunities to increase traditional commodity exports.

We believe concern over the country's mediocre long-term growth prospects has been reflected in Pretoria's efforts since 1979 to liberalize its economic policies in order to promote manufacturing exports and attract new foreign investment. A key element in this strategy has been the removal of selected import and foreign currency controls that were intended to protect high-cost domestic industry from foreign competition. In addition to allowing the rand to float against foreign currencies, the monetary reforms eliminated ceilings on domestic interest rates. Some selective promotion of exports also is envisaged, but, as a signatory to the General Agreement on Tariffs and Trade, South Africa is limited in the types of export subsidies that it can use.

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Even without new economic dislocations, however, our economic model for South Africa forecasts real GDP growth averaging no more than 3 to 4 percent per year through 1991. We believe Pretoria's efforts to boost nontraditional exports probably will have little impact. South Africa's recent dismal economic performance and political uncertainties make it an unattractive target for new investment. Moreover, without some internationally recognized resolution of the country's racial problems, the market for consumer goods bearing the "Made in South Africa" label is likely to be quite small.

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In our judgment, the policies that Pretoria has adopted to reduce economic vulnerability have insulated the domestic economy fairly well from the most serious potential impacts of external pressure. For example, we believe it highly unlikely that a campaign of foreign disinvestment or embargoes on the sale of goods to South Africa by itself could cause severe economic dislocation.

We believe, however, that Pretoria's efforts to insulate itself from foreign pressures have come at a significant cost to economic growth potential. Government policies have diverted scarce financial resources to relatively nonproductive uses, such as funding strategic stockpiles and uneconomic import substitution. In our view, Pretoria's industrial development strategies and broader economic policies often have been distorted by the overwhelming primacy of maintaining white rule.

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Pretoria's policies to reduce economic vulnerability also offer the country little protection against a gradual erosion of its foreign trade position in the face of tough Western economic sanctions, in our judgment. Likewise, the economy appears to us to be only moderately well braced to withstand serious and

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Lessons From the Sanctions Against Rhodesia

The Rhodesian Sanctions. *After the Ian Smith government unilaterally declared independence in November 1965, the United Kingdom imposed a wide range of economic sanctions—embargoing arms and petroleum sales, banning new loans, and boycotting major imports from Rhodesia. The United Nations followed suit in 1966 and 1968 with mandatory sanctions banning all trade except medical and educational supplies.*

In several respects, Rhodesia in 1965 appeared an ideal target for sanctions with its heavy dependence on a narrow range of exports primarily to a handful of markets. Tobacco and mineral sales alone accounted for more than half of export revenues. Overall exports totaled a fairly high 34 percent of GNP, according to IMF statistics. Moreover, Britain, Zambia, and South Africa—which together purchased nearly half of Rhodesian exports—were not critically dependent on supplies of raw materials from the country.

Despite these advantages, the sanctions proved difficult to enforce, largely, in our view, as a result of increased South African trade, loans, and investment. South African companies became the dominant force in the Rhodesian business community, buying interest in Rhodesian mining, agriculture, corn milling, food processing, brewing, and other concerns. The embargo also was violated by other African nations—including Portuguese Mozambique (until its independence in 1975), Zambia, Botswana, Malawi, and Zaire—and by almost every major Western country, including the United Kingdom. Subterfuge trade flourished. We estimate that two-thirds of the goods moving from Rhodesia to South Africa ended up in world markets with false documentation.

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A 1978 report sponsored by the British Government accused the two largest UK oil companies of supplying petroleum products to Rhodesia until 1976—first through South African middlemen, then via a complex swap arrangement with a French company in Portuguese Mozambique.

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Among Rhodesia's exports, the most significant impact of sanctions appears to have been on tobacco sales, Rhodesia's largest foreign currency earner. The tobacco was easily traceable to country of origin, making transshipment ineffective. The sharp decline in tobacco exports and the need to boost domestic food production led growers to switch to corn and wheat production.

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In our judgment, the overall effect of the sanctions and South African financial support was to strengthen the Rhodesian economy. Import substitution received a substantial boost, with manufacturing replacing agriculture as the leading sector of the economy. Total domestic investment climbed from 13 percent of GDP in 1964 to 20 percent in the first half of the 1970s. From 1965 to 1974, real GDP growth averaged 6.5 percent per year.

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Rhodesia and South Africa Compared. *In some respects, the South African economy is similar to the Rhodesian economy in 1965. For example, South Africa has a similar heavy dependence on mineral and agricultural exports. On the other hand, the*

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South African economy currently is far larger and more nearly self-sufficient. According to IMF statistics, South African imports equal nearly one-fifth of a GDP totaling $54 billion. Rhodesian imports equaled one-third of a GDP of only $1 billion. Moreover, some 45 percent of South African imports is machinery and equipment that would only gradually need to be replaced. According to our estimates, another 15 percent is crude oil, for which some domestic alternatives exist. By contrast, the Rhodesian economy depended on a much broader array of imports, with machinery and equipment, for example, representing only 32 percent of all imports. Another major difference, however, is that South Africa has no obvious wealthy patron state that could play the same role for it that it played for Rhodesia.

***Implications.** We believe that South Africa is unlikely to prosper under widespread economic sanctions to the same extent that Rhodesia did. For Rhodesia, the essential economic problem posed by sanctions, in our judgment, was to exploit a surge in South African aid and investment to diversify the economy and promote self-sufficiency. Eventually, growth flagged when the civil war intensified and the inefficiencies of very small-scale production accumulated. By contrast, the South African economy already has exhausted most ready opportunities for import substitution. While the imposition of tough sanctions would generate new import substitution possibilities, the primary challenge for South Africa would be to tap years of stockpiling, expertise on subterfuge trade, and past import substitution to sustain the economy more or less on an even keel.*

sustained labor unrest or further sharp declines in domestic business confidence. Some combination of such internal pressures—perhaps in part triggered and reinforced by tough Western economic sanctions—could produce more dramatic economic effects.

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Impact of Recent Limited Sanctions

South Africa has yet to experience the sort of economic siege that Rhodesia faced in the last few years before majority rule. To date, limited Western economic sanctions have reduced slightly South African fruit, gold coin, and coal exports, but left the vast bulk of its foreign trade intact. Declining investor confidence has reduced the country's access to international credit, and many small foreign investments are being withdrawn. Nonetheless, some trade credit still is available, and most major foreign investors remain.

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The most important immediate consequences of the debt crisis, sanctions, and limited disinvestment to date, in our view, probably have been psychological, political, and inflationary. International attitudes toward South Africa are of major concern to the country's top business leaders, making many of them strong advocates of racial change. The inflationary consequences of South Africa's negative international image stem from the declining exchange value of the South African rand—a barometer of domestic and international concern over the country's economic and political problems—which has raised the cost of imports and added to inflationary pressures.

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Impact of Tougher Measures

A package of tougher Western economic sanctions could eventually result in slower growth, though perhaps with an initial growth spurt as further import substitution took place. For example, according to our

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model of the South African economy, the country's economic growth potential is about 3 to 4 percent per year in the absence of new foreign loans and investment. We estimate that a gradually tightened boycott by the United States, the European Community, and Japan of South African coal, steel, gold coins, and agricultural exports would trim this growth potential by 2 or 3 percentage points. From Pretoria's standpoint, such an induced slower growth would only complicate already troublesome demographic trends that foster unemployment.

Distributive Effects. We believe that the burden of zero economic growth would fall most heavily upon black South Africans and on the economies of neighboring black-ruled countries. According to a recent academic study, a real economic growth rate of about 5.5 percent per year would be needed to absorb new jobseekers into formal-sector employment. The study further estimates, in the absence of real economic growth, some 350,000 new jobseekers per year would be unable to find formal-sector work over the remainder of this century. Even with 3-percent real average annual growth, nearly 200,000 new jobseekers would fail to receive modern-sector jobs. In our view, the vast bulk of these new unemployed would be black.

In addition, we believe that Pretoria would actively shift more of the burden of sanctions to neighboring black states, and from white to nonwhite South Africans. In particular, we expect that Pretoria would follow through with its threats to expel illegal migrant workers, as well as some migrant black miners. Pretoria probably also would retaliate for sanctions with short slowdowns at border posts on rail traffic to and from neighboring countries. Within South Africa, Pretoria could shift the burden of foreign sanctions toward nonwhites by cutting planned social spending, reimposing sales taxes on foods, and reducing government employment of nonwhite workers. On balance, these measures probably would succeed in limiting the average impact on whites. A reduction in employment of foreign workers also would offset partially the increased burden on nonwhite South Africans, but we would expect growing inequity in the distribution of incomes between whites and blacks even as most whites faced declining real income.

Political Repercussions. We expect that slower economic growth would add to divisions within the white community as competition rose for increasingly scarce resources. As it is, survey data and Embassy reporting indicate that a sizable minority of the white population already believes Pretoria has moved too rapidly on racial reform at considerable cost to whites. In particular, many Afrikaners fear that President Botha's reform program will jeopardize their future—both as a people and as individuals. Rightwing political parties have achieved some gains in recent byelections, in part by stressing the economic costs of reform, and we believe they probably will make further gains if the economy stagnates.

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At the same time, Pretoria is under pressure from other quarters to accelerate reforms. For example, several representatives of the international banking community have indicated that progress on reforms would facilitate future debt rescheduling agreements. According to press and Embassy reporting, most of the major business organizations—representing English-speaking, Afrikaner, black, or foreign businesses—already have presented the government with individual or joint agendas for reform. Even many small businessmen within South Africa who may not be directly affected by sanctions or the country's international economic difficulties have felt the impact of consumer boycotts and work stayaways, and are lobbying for change. The effectiveness of business-group pressure on the government, however, is questionable. The Afrikaner-dominated government has had generally cool relations with the business community, which is dominated by English-speaking South Africans and foreign companies.

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Hurting White South Africa

Short of a precipitous and sustained fall in the world price of gold, we foresee no external pressures that—taken in isolation—would produce a rapid economic collapse. On the other hand, a severe economic dislocation in South Africa could result from some combination of very tough sanctions and unanticipated internal developments. Moreover, a very strong external action—such as a widely supported ban on all

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trade—probably would have important psychological effects on domestic investment, and also might embolden black workers to launch longer general strikes or widespread industrial sabotage in the expectation of a quick end to minority rule.

Political Repercussions. A sharp economic crisis resulting from some combination of external and internal pressures, in our view, is less likely to divide the white community than a gradually stagnating economy. On balance, we believe the more immediate the security threat appears, the more whites will tend to rally around the government as attention is diverted away from contentious issues—such as negotiation with blacks and reform—toward security issues, where a greater consensus exists. Thus, a very strong set of sanctions or lengthy general strike could increase support for the government, especially if it were to take a hardline response.

Implications for the United States

The use of tough economic sanctions as a lever to promote change in South Africa has risks and few likely rewards in terms of influencing Pretoria's policies. The fluid internal situation, the unresolved issue of the country's short-term debt, and the comparative ease and speed with which Pretoria could damage the economies of neighboring states or withhold valuable strategic minerals raise disturbing uncertainties about the ultimate impacts of external economic pressures. In our view, a cat-and-mouse game of gradually tightening sanctions against Pretoria would fail to force the South African Government to the bargaining table with blacks or prevent it from carrying out military raids against its neighbors to protect its security. Such sanctions might spur some further racial reforms, but even these gains are unlikely to involve major departures from Pretoria's own agenda.

Rapid imposition of harsher sanctions is unlikely to fare much better. In our judgment, under the pressure of strong foreign sanctions, the government would retreat quickly into an economic laager, cutting dividend and profit remittances, pegging the exchange value of the rand, and imposing wage and price controls domestically. We believe that the economy is well positioned to survive in a state of economic siege for as long as three or four years, and much longer under the reasonable assumption that the sanctions could be skirted to a large extent.

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