SOUTH AFRICA LOAN WAS IMPROPER, IMF OFFICIALS ARGUE

The International Monetary Fund's recent $1.1 billion loan to South Africa did not meet the standards of conditionality that the IMF imposes on all other borrowers, five IMF executive directors charged at a closed-door meeting on November 3, 1982.

Also, South Africa did not really need the loan, these directors argued, citing IMF predictions of a $1.6 billion trade surplus in 1983.

The loan was "poorly constructed," said A. S. Jayawardena, alternate executive director for India, Bangladesh, Sri Lanka and Bhutan. It had a "weak economic justification," charged executive director Ghassem Salekhkhou of Iran. South Africa was "taking advantage of the Fund's cheaper resources" instead of borrowing commercially, said Yusuf A. Nimatallah, representing Saudi Arabia. "No convincing case had been made for the need of South Africa to draw," added Mohamed Finaish, representing fifteen other Arab nations.

IMF officials also made these points:

--The November loan was "likely to be the first of a series." South Africa would "approach the Fund again."

--"Adverse publicity for the Fund" resulting from the loan "could have serious repercussions for years to come." The IMF should take its relationship with the United Nations more seriously. Approval of the loan "would not be consistent with the spirit of international cooperation," said executive director Salekhkhou.

--The executive board should have postponed consideration of the South Africa loan, consistent with its "informal practice of accepting an executive director's request for a postponement when the request did not prevent the board from fulfilling its duties," said N'Faly Sangare of Guinea, representing seventeen black African countries.

--The loan package was dangerously front-loaded, with South Africa getting 80 percent of its $1.1 billion before having to fulfill any conditions at all.

--The IMF had secretly sent a team to South Africa without telling
Third World executive directors about it, which the Saudi delegate complained was a "cause of some embarrassment."

South Africa’s fiscal, monetary and exchange rate policies were "disconcerting, regrettable and, indeed, unacceptable," argued executive director Jayawardena in summary. South Africa had made "no progress in dealing with the labor market constraints" generated by apartheid, he added. "The problem is deep-rooted and serious and calls for fundamental corrective measures."

Altogether, seven executive directors representing sixty-eight countries refused to support the loan, and nine called for a postponement. However, executive directors representing the United States, Canada and Western Europe backed the loan. Because of the IMF’s system of voting weighted according to contributions, the Western countries prevailed with 52 percent of the vote.

Even some Western representatives criticized the content of the loan program, however. "The proposed measures are unlikely to eliminate the root causes of the current economic problems," said Giovanni Lovato, representing Italy, Greece, Portugal, and Malta. He eventually said he could "go along" with the loan, despite "strong reservations" about its lack of conditionality and South Africa’s "structural rigidity" that had "prevented an efficient functioning of the labor market." He added that Greece and Malta, among the countries he represented, did not favor the extension of any credit to South Africa.

Ireland also stated for the record that it had "strong reservations" about the IMF loan and wished to abstain.

Lack of adjustment
"Lack of satisfactory adjustment" was a complaint raised by a majority of executive directors who spoke at the November 3, 1982 board meeting on South Africa. Executive directors complained of government overspending; inappropriate fiscal, monetary and exchange rate policies; and the "complicated structural imbalance in the labor market"—i.e., apartheid. Together these misguided policies had landed South Africa into its recent difficulties and there was no sign of correction of any of these problems, especially the "structural" one.

Government overspending. Speaking for India, executive director Jayawardena said the South African authorities, riding the gold price boom of 1979-80, had gone in for "greatly increased budgets" which, along with other inappropriate policies, caused a marked deterioration in the balance of payments. Then the price of gold had dropped. But this price drop was not the factor most responsible for the reversal in South Africa’s economy, Jayawardena contended. More important were the "remarkable expansion in government expenditure" along with other problems.

Jayawardena warned against taking South African promises of cutbacks at their face value. Pretoria had made those promises before, yet "expenditures had considerably exceeded the original intentions," and "there was little reason to be optimistic about South Africa’s ability to maintain with ease the planned expenditure constraint."
Jayawardena also criticized South Africa's expensive government subsidies to various sectors. The price of coal was kept at a third of its international price. "In the light of South Africa's dependence on oil imports, its policy of subsidizing domestic energy prices was surprising."

**Fiscal adjustment.** Saudi executive director Nimatallah said he "failed to see where the adjustment was to be made." IMF programs normally required a decline in the ratio of the budget deficit to gross domestic product. However, an analysis of the data showed that in South Africa "the ratio of the budget deficit to GDP in in 1982/83, the year of fiscal adjustment, would be same as in 1981/82, the year without adjustment. Hence, it seemed incorrect to conclude that the proposed program called for adjustment on the fiscal front."

To finance the fiscal deficit, "resources were being misallocated by being diverted from the private sector to the public sector," Nimatallah charged. As a result, the amount of credit expansion to the government in the year of adjustment was to be almost the same as that in the year in which the government's policies "clearly had not been designed to achieve adjustment."

**Monetary policy.** If fiscal adjustment was nebulous, South Africa's monetary policy was also a "cause for concern," Nimatallah said. Tight monetary policy is usually a major feature of an IMF adjustment program, yet South Africa had just lowered its reserve requirements. This decision, together with the recent decline in interest rates, "raised doubts about the effectiveness of South Africa's adjustment program."

Executive director Jayawardena criticized what he called an "extraordinarily accommodating monetary policy." South Africa had lowered the reserve requirement, "and the additional liquidity created by lowering the requirement could be considerable." The thrust of monetary policy was not appropriate, he charged.

**Exchange rate and import surcharge.** South Africa maintained a dual exchange rate regime contrary to IMF precepts, and executive director Jayawardena assailed what he called the Fund's "benign neglect" of the issue. The recent levy of a 10 percent import surcharge was "even more disconcerting." "Import levies greatly distorted prices and trade," and there were better domestic fiscal measures available to raise money. He noted that in 1976 several executive directors had criticized the import surcharge. South Africa had then also claimed it was temporary, but had left it in effect for some time.

**Structural adjustment.** This is the euphemism used by executive directors at the November 3 discussion to refer the problem of apartheid. The IMF staff's analysis had "completely ignored the important need for structural adjustment in South Africa," Saudi director Nimatallah said. "Rigidities in the labor market" caused widespread shortages of skilled labor that pushed up labor costs, thereby fueling inflation. Removing these bottlenecks should be a part of the IMF program, he argued.

Executive director Mohamed Finaish, representing fifteen Arab countries, took the same position. The staff had "ignored the impact of South
Africa's chronic structural constraints resulting from its labor policies." He noted that even tighter controls over labor mobility were likely to result from a new draft bill entitled "Orderly Movement and Settlement of Black Persons." He called on the IMF to carry out a "comprehensive appraisal of the structural constraint of labor immobility and of the administrative and budgetary costs of the resultant rigidities." There was no clear evidence that that fundamental issue was being seriously addressed by the South African authorities," he concluded.

Executive director Jayawardena recalled that the IMF had taken up this issue with South Africa in 1976, when it had borrowed $464 million. "Despite the assurances that remedial measures would be taken, there had clearly been no progress in dealing with the labor market constraints." He went on:

Serious discouragement of labor mobility had created considerable and critical labor shortages that had encouraged capital-intensive production, something that was very unfortunate in an economy with considerable unemployment. Although unemployment among the so-called white workers was less than 1 percent, unemployment among black workers was at least 8 percent and in all likelihood was well above 10 percent.

Since the South Africans had reneged on their 1976 promises, "mere expression of similar hopes at the present stage should be regarded as totally inadequate."

**South Africa's real need**

Another major objection to South Africa's request was its degree of need for IMF help. The staff had reported that South Africa had nearly exhausted its potential for short-term private loans. Executive director Nimatallah found that claim implausible, and doubted that South Africa had actually tried to raise further loans. It "had the capacity to borrow further from the private capital markets--on both a short- and long-term basis--without straining its economy, as its credit rating was favorable, its debt service burden remained very small, its reserve position was relatively strong, and its per capita income was relatively high."

"Many developed and developing countries faced balance of payments problems, had adopted adjustment programs that were much stronger than South Africa's, and had not sought to use the Fund's resources. Instead, they had borrowed from the private capital markets; they had understood that the Fund's resources were under strain and they had unselfishly decided to leave the Fund's resources to the countries that had limited access to private capital markets. South Africa should have followed their example," the Saudi director argued.

Executive director Mohamed Finaish, representing fifteen Arab countries, cited an IMF staff report that forecast a $1.6 billion trade surplus for South Africa in 1983. "That appraisal of the immediate prospects of the South African economy underscored the temporary nature of the present difficulties and cast serious doubt on South Africa's need for financing by the Fund," Finaish said. The loan program was based on an assumption that the average price of gold would not rise above $315 an ounce, the staff had also noted. Finaish cited another staff prediction that the price of gold could well remain significantly above the $315-an-ounce level for the program period.
"The availability of market financing for South Africa could be gauged by, among other things, the debt service ratio, which was estimated at 7.9 percent in 1982 and was expected to fall to 7 percent in 1983," Finaish went on. "That ratio was much smaller than the ratios in member countries of similar size and with comparable resources." With a more flexible policy, "financing could easily be made available to deal with the present short-term problem," he said.

He noted that certain countries had argued against India's 1981 loan from the IMF on the grounds that it could have borrowed privately. The United States voted against the India loan. South Africa was "a fairly developed country with much better access to the capital markets than the poorer developing countries," Finaish argued.

The $689-million Compensatory Financing Facility loan to South Africa, the largest in the Fund's history, "was a serious cause for concern," executive director Jayawardena argued. This facility had been set up to help raw materials exporters insulate their fragile economies from the vagaries of international trade, which effectively confined it to low-income developing countries who had little or no access to capital markets. Given its large GDP and high per capita income of nearly $2,400, South Africa should not draw on this facility, argued Jayawardena, "thereby preempting resources that were meant for more disadvantaged and deserving countries."

Executive director Salehkhou also argued that Fund policy was increasingly to limit the use of its resources to member countries facing difficulties in securing loans from private markets. "South Africa's creditworthiness, low debt service ratio, and large reserves did not place it in the category of needy member countries."

Center analysis
The above review of the IMF's decision-making on the South Africa loan makes it clear that there was a compelling technical as well as humanitarian case against the loan, and that the two are related.

This evidence casts doubt on the widely spread impression, repeated in State Department press briefings and editorials in the New York Times and Washington Post, that South Africa qualified technically for the massive loan and that the case against the loan rested solely on moral objections to apartheid.

In fact, in contrast to IMF treatment of other countries, the loan program required no meaningful adjustment by South Africa. Its budget deficit in relation to gross domestic product in 1983, the year of adjustment, was no smaller than in the previous year. The IMF program required no structural adjustment—that is, no correction of labor market rigidities caused by apartheid, although a majority of executive directors including the U.S. representative, Richard Erb, criticized labor market immobility as a source of inflation and balance of payments problems. Here the technical and humanitarian arguments intersected.

Furthermore, South Africa did not really need the IMF's emergency assistance, according to five executive directors. The IMF predicted a
$1.6 billion trade surplus for 1983. IMF officials stressed that South Africa had access to private bank loans, and, counting gold, had a high level of reserves.

In an analysis published in 1980 the Center for International Policy predicted, "If past policies are a guide, South Africa is likely to approach the IMF sooner rather than later in the event of any future financial pinch." The Center noted "the high value placed by the South African authorities on any form of international cooperation." (Jim Morrell, "International Institutions and Economic Sanctions on South Africa" [Geneva, 1980], page 8.) IMF loans conferred an aura of international approval that the South African authorities used to convey to their opponents at home and abroad that criticism of apartheid was futile, and that United Nations calls for economic sanctions were meaningless posturing.

Statements by Third World directors at the IMF meeting reflected careful research on the South African economy and the history of its relations with the IMF.

Equally significantly, the decision-making record revealed that the November loan, large as it was, could be only the first of a series of loans. Both the Italian and Indian directors predicted an early South African return for loans which, judging by their description and South Africa's current status, could reach between $700 million and $1 billion. Former Center fellow David Gisselquist, who predicted last May that South Africa would borrow a billion dollars from the IMF in 1982, anticipates South Africa's next request will also be for a billion dollars because any lower amount would not be worth the trouble of overcoming Fund resistance.

During October the Treasury Department received three congressional letters—one from the chairman of the House subcommittee on Africa, one from the Congressional Black Caucus, and one from the Ad Hoc Monitoring Group on Southern Africa—pleading for U.S. opposition to the loan. The letters cited various technical as well as moral objections to the loan.

In his November 1, 1982 reply to these letters, Treasury Secretary Donald T. Regan argued, "It is a basic point that efforts to undermine members' rights in the IMF—in the present case, the right to have financing requests judged on the basis of economic and financial criteria applicable to all—would rapidly undermine members' willingness to meet their obligations in the IMF." The objections raised by five executive directors were precisely on this issue—that South Africa failed the tests of degree of adjustment and balance of payments need imposed on all other members of the IMF.

The congressional letters also asked the administration to move for a postponement of the discussion. IMF custom allows a single executive director to ask for a brief postponement if the request does not prevent the executive board from fulfilling its duties. In the event, nine executive directors asked for a postponement. Far from supporting them, U.S. executive director Richard Erb argued against a postponement on the grounds that the executive board had received all the information it needed to make the loan.