INTERNATIONAL BANK
FOR RECONSTRUCTION AND DEVELOPMENT.

VARIATION REPORT
of the

EIGHTH SPECIAL MEETING
of the

EXECUTIVE DIRECTORS
OF THE BANK

held in

COUNCIL ROOM "C"
at

The Bank of France, Paris,
on

Wednesday, September 13, 1950,
at

4.30 p.m.

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MR. EDWARD R. BLACK, President of the Bank,
in the Chair.

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(From the Shorthand Notes of
E. J. GUNN, SONS & FURMALL,
30, Victoria Street,
Westminster, London, S.W.1.)
I would like to take up the memorandum which I sent to you in the last few days about the union of South Africa. I would like to ask Mr. Iff to give you the background of this subject.

Mr. Iff: Mr. Chairman, as the Board will remember Mr. Garner visited South Africa in the spring of this year. After his return an invitation was received from the Government of the union for a bank mission to go to South Africa to examine the general financial and economic position of the union, to take a look at the union's development programme and to discuss the possibilities of working out a loan in the event of the Union of South Africa deciding to approach the Bank.

The mission was headed by Mr. Burland of the Loan Department, and with him went Mr. Rosen and Mr. Coiller of the Economic Department, also Mr. Spottwood of the Bank's Engineering staff. They arrived in South Africa on the 28th July, and they spent about a month in the union.

Further conversations have taken place with the Minister of Finance of the Union Government while he has been in Washington, and as a result of those conversations the Union Government have indicated to the Bank that they
would desire to contract a long-term loan with the Bank to finance part of the import requirements over the next two years of the import programme of the South African railways and of the South African Electricity Supply Commission. The total import requirements for the railways over the next two years are estimated at approximately forty-one million dollars - that is, the equivalent of forty-one million dollars. The needs of the Electricity Supply Commission over the next two years are estimated at approximately forty-five million dollars. So the total import programme for both over the two years is approximately the equivalent of eighty-six million United States dollars. Of that about nine million dollars would be in hard currencies, and the remainder, approximately the equivalent of seventy-seven million dollars, would be in non-dollar currencies. The South African Minister of Finance indicated to us that he would be interested in negotiating with the Bank a loan of the order of sixty million dollars, or the equivalent in other currencies, to meet part of the cost of the import programme that I have just mentioned.

/Contract commitments---
Contract commitments have already been entered into for the full amount of the electricity commission programme and for more than half of the railway programme. No amounts, however, have yet been paid, and the South African Government has indicated its desire to include these past orders in the loan. Paragraph 9 of the President's memorandum which has been circulated to the Board draws attention to certain currency questions connected with the proposed loan, which would have to receive further consideration during the negotiations.

I should now like to say a word about the general investment programme of the Union. Since the War a large proportion of the total investment, both Government and private, has been financed directly or indirectly partly from the inflow of foreign capital into South Africa and partly from the liquidation of South African exchange reserves. The size of the investment programme both in the public and the private sectors which the Union Government would wish to maintain over the next few years is greater than can be financed from local savings and from private capital imports from abroad.

It is because the Government cannot obtain the necessary investment resources by borrowing either at home or abroad and because they do not wish to run down their foreign exchange reserves that they desire to borrow from the International Bank; so that the contribution of a Bank loan would in fact be that of enabling South Africa to carry out an investment programme at a greater speed and at a higher level than would otherwise be possible, whilst simultaneously enabling her to maintain her exchange reserves at approximately the present level.

The traditional pattern of the South African balance of payments has been one of substantial deficits on
current account made good by an inflow of capital mainly from London. In 1948 this flow came to a temporary halt, mainly, it is felt, because of political developments in the Union. The result was that from early in 1948 up to the end of September, 1949, the gold and foreign exchange holdings of the Reserve Bank of South Africa suffered a very heavy decline. Then, late in 1948, under the pressure of this sharp fall in the Central Bank's reserves, South Africa began to introduce severe restrictions on imports.

The effect of these restrictions was slow to appear, especially because the sterling imports were only gradually brought under control. However, up to the last quarter of 1949, owing to these restrictions on imports and to an increase in the sterling value of gold exports which resulted from devaluation, the balance was restored in South Africa's current account and that balance has been maintained during the first half of 1950. Meanwhile, the inflow of private capital that had suffered some interruption for the reasons I have mentioned had resumed, and there was also some official overseas borrowing, and the result has been that South Africa has been able to recoup part of its previous gold and foreign exchange losses.

This balanced current account position of South Africa cannot be regarded as anything but a temporary phenomenon. There you have a developing economy with substantial investment needs, and it is likely that South Africa will continue to import more than it exports, looking to imports of capital to cover the gap.

In appraising the foreign exchange-earning capacity of South Africa, the future production of gold is of paramount importance. In 1950 it is estimated that sales of gold will earn the equivalent of about 400 million dollars and when the new mines in the Orange Free State come
into production gold production should increase by as much as one-third by 1955 to 1960.

As regards the external debt situation of the Union, in 1939 the external debt of South Africa amounted to just over 100 million sterling - wholly in sterling - but by June, 1949, practically the whole of that external debt had been repatriated and the outstanding amount had been reduced to only 15 million pounds sterling. Last year arrangements were made with the United Kingdom authorities for the South African Government to raise £20 million on the London market. Of that only £10 million was in fact issued. That issue was made in November, 1949 and that issue of £10 million brought the Government’s total sterling debt at the present time to around £22 million in sterling. But apart from the sterling debt, there is a small post-war loan from the United States Government for the purchase of surplus property, of which just under 1½ million dollars remains outstanding. Apart from this, the Union Government’s only foreign borrowings outside the London market have been two revolving three-year credits arranged early this year with a group of United States banks and a group of Swiss commercial banks. The amounts were £20 million dollars in the case of the United States banks and 06 million Swiss francs or roughly 9 million United States dollars in the case of Switzerland.

The external debt record of the Union shows no default. Now, despite South Africa’s excellent credit standing, market conditions are such today that she would have difficulty in obtaining a long-term credit for any substantial amount in the New York market. We propose to continue to look at the prospects of her securing additional sterling financing in the London market. As we see it, the basic risk inherent in a Bank loan to South Africa is this:
that, as I have said, the country will probably for some time
to come incur a greater amount of balance of payments deficits
which will have to be met by an inflow of foreign capital and
primarily of private capital.

We cannot have any complete assurance that circum-
cstances may not recur similar to those that stopped the inflow
of capital in 1948. In those circumstances, foreign exchange
reserves would be bound to show a marked downward tendency,
and very strict controls on imports and investments would
probably be necessary to restore the situation. But we feel
that a risk of this kind is inherent in the South African
economy, and it seems to us that it is a risk which the Bank
can reasonably take. Accordingly we have felt, at staff level,
able to advise the President that he should recommend to the
Board that negotiations be undertaken for a loan for South
Africa's import requirements for transport and electricity
development over the next two years of the order of 60 million
dollars or the equivalent in other currencies.

CHAIRMAN: Any questions?

MR HOPPENOT: There is something that is not very clear to me about
the fact that the intended application is for 60 million dollars
or the equivalent in other currencies. It is said somewhere
that the hard currency really needed will be only a small amount.

MR ILIFF: 60 million dollars.

MR HOPPENOT: Yes. Is it the expectation of the Bank that the
difference, which is 51 million dollars, will be actually found
in those other currencies, or is it that part of it will have
to be bought against dollars and in that case be paid in
dollars by the prospective borrower? Have we any ideas on
that point?

MR ILIFF: The question of currency to be provided under this loan,
as I mentioned in the course of my statement, raises questions
which we think will have to be considered and very carefully
considered during the negotiations. I think some of the considerations involved are set out, as I mentioned, in paragraph 5 of the President's memorandum.

MR HOPPENOT: If that question is not clearer than it seems to be, and without having anything against a loan of that importance to be made in sterling to South Africa, which is certainly a good credit, I would not like to think that this Board is exactly committing itself. I would not like to give the impression that I am against the loan, but this is rather a new approach, and I would like to be sure that all questions come before us as a Board without prejudice to the negotiations when we are asked to approve.

CHAIRMAN: Any other questions?

The only point that Mr Illiff failed to mention is that there is a fairly good possibility, in relation to the loan, of interesting the private market in New York in part of this loan. In conversations with the Minister of Finance, we were informed that he would like to have a loan of probably a 15-year maturity, but he did not know at the time, and was not in a position to say, what early amortization payments would be - possibly, he thought, to start somewhere about three years; and I think that there is a very good chance that there might be participation in New York of the earlier part of this loan. We discussed that with the Minister of Finance, and he is very anxious for us to explore that feature. That would be without our guarantee - in other words, it might be a loan made either with the interest of private bankers in New York or we might make the loan and then, in turn, sell part of it without our guarantee. It would probably have to be the latter, because this loan, as I understand, will not be drawn down - if approved - for about three years. It would be drawn upon in the neighbourhood of 20 million dollars a year.

Are there no other questions?