SOUTH AFRICA'S EXTERNAL DEBT CRISIS

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In London on 20th February 1986, an extraordinary meeting of bankers approved, in principle, terms for outstanding debts owed by South Africa to foreign bankers. Since the end of the 1970s the world has seen many countries enter into such negotiations on outstanding debts and agree 'rescheduling' terms with their bankers, but this meeting fully deserved the special attention it received for South Africa's debt crisis is unique.

Its outstanding special feature is the dominant role played by political developments; the impasse of apartheid, the fragmentation of the forces that traditionally bolstered it, and the prominence of the anti-apartheid forces. Most countries' debt negotiations involve some political element and are shaped by the interplay of domestic and international political forces. In some cases these have been very prominent. The rescheduling of Argentina's debt after the Malvinas (Falklands) war and of Poland's after the announcement of martial law have been the most notable precedents. The negotiations over Brazil's, Peru's, Mexico's and other countries' external debts in the first half of the 1980s have also been strongly influenced by political developments in those countries. Nevertheless, the exceptional significance held by political developments makes South Africa's debt crisis a special case.

Since the problem became acute in the summer of 1985, the politics of black township revolts, black trade union unrest, ANC actions, Botha's contradictory stance on reform and anti-apartheid sentiment in the US and Europe determined its course. In October 1985 the Sunday Times reported 'Businessmen and bankers inside and outside South Africa are united in believing that the crisis and its resolution are political not economic' [2] and they appeared largely correct, at least regarding its immediate causes. In 1985 the debt crisis emerged not because of an immediate shortage of export earnings with which to service the debt, as with many other economies, but because of foreign creditors' reactions to the State of Emergency declared in July.

A second special feature of the crisis was the nature of the debt itself. When third world countries have been forced to reschedule their liabilities, the debts at the core of the problem have commonly been 'sovereign debt', the direct or indirect liabilities of the state, and most have been medium term loans that, as a result of economic circumstances, the state has found it difficult to service. By contrast, South Africa's problems centred on the renegotiation of credit to private enterprises and a high proportion of this credit was short term credit arranged through foreign banks lending to South African banks. The significance of this type of debt over recent years had, in turn, arisen largely as a result of political pressures against more'regular' credit facilities.

The third unusual feature of South AFrica's debt crisis has been the appointment of an 'intermediary' to produce a solution (at least a temporary one) instead of the usual negotiating machinery. This, too, was prompted by the political sensitivity of the issue, although some bankers now feel that it may become a model for other countries with debt problems.

Although South Africa's debt problems are unique in these ways, there are, too several elements that are common to many countries' experience. Although (following austerity measures in 1984) the current account of the balance of payments has been in surplus, the economy has suffered a severe recession like that which has compounded the difficulties of other debtor nations. Although the international banks have been subject to pressure from their shareholders and depositors against supporting apartheid, they have largely been as much influenced by normal considerations of banking prudence. And although their central banks are sensitive to political and diplomatic problems, their concerns in the debt negotiations have been to prevent disruption to the international banking system.

In this paper I describe the development of the debt crisis over seven months, from July 1985 when South Africa declared a State of Emergency in the face of black rebellion to the end of February 1986 when the leading banks met the'mediator' in London to agree a temporary solution. I then consider the relative roles of the characteristics political and economic factors and conclude with on assessment of the future role of the debt problem.

ECONOMIC IMPACT OF STATE OF EMERGENCY

On 20th July 1985 the government of South Africa declared a State of Emergency under which it detained hundreds of anti-apartheid activists (who claim to have been tortured in many cases), banned independent media coverage of clashes and gave carte blanche to security forces. It was an attempt to quell the unrest in which some 450 people had been killed by police, rioters and ANC militants in the previous ten months. Above all it was an attempt to break the multi-racial United Democratic Front, a broad-based front of popular organizations generally supporting similar aims as those of the ANC.

Similar political crises had had dramatic economic effects; the 1960 State of Emergency imposed after Sharpeville was followed by a severe, but temporary outflow of foreign capital and drop in reserves and the 1976 Soweto riots also led to an outflow, especially of short-term capital. But in this case the authorities took the view, at least in public that the emergency would have no financial effects : the Governor of the Reserve Bank (central bank) Gerhard de Kock 'said he did not think the [emergency] measures would materially affect the economy . He did not see a net increase in capital outflow' (3) This public confidence was misplaced, for a financial crash developed in the following days. It was prompted by the twin shocks of the State of Emergency and the French government's announcement a few days later, of restrictions on French investment in South Africa.

The crash was felt principally on the Johannesburg Stock Exchange and the foreign exchange markets as investors switched money out of the country. In the week after the emergency measures were announced the market value of shares on the Johannesburg Stock Exchange fell by 11 billion rand with brokers describing the wave of selling, principally from the US, Britain and France, as a 'bloodbath'. (4) In particular there appeared to be a big move out of gold shares into similar investments in Australia and Canada (although this was moderated by the fall in the exchange rate of the rand which bolstered the profit expectations of gold companies). The gold mines share index fell 72 points in a week to a three year low of 332. The panic gathered during the week with increasingly hectic selling; the number of bargains struck was estimated at some 3½ million per day at the start of the week but at over 5 million on Thursday and Friday.(5) The flow of money out of the country pushed the exchange rate of the rand down to 43.5 US cents by the end of July from the price of 52 US cents at which it had stood at the beginning of the month.

The sharp sales on the stock market and foreign exchanges were not themselves mainly withdrawals of foreign loans, credit from abroad. But they were stimulated by fears that the political crisis signalled by the State of Emergency and the French measures would lead major banks to withdraw lines of credit from businesses in South Africa. A large proportion of international banks' loans to South African industry was due for repayment at the end of August and the panic in the last week of July was fuelled by rumours that Chase Manhattan, Citibank, and some others would refuse to renew those loans.(6) These rumours accentuated the fall in the rand as firms rushed to buy dollars (sell rands) forward for delivery in a month expecting they would need the dollars to repay their unrenewable loans. Indeed, the truth of the rumours was quickly proved when Chase Manhattan confirmed it would not roll over its loans to the private sector (several years previously the same bank had withdrawn from lending to the South African state). Other banks followed, with Barclays announcing in mid August that it planned to reduce its South African interests.

Whether or not the government believed its public pronouncements that the State of Emergency would have no economic effect there is no doubt that the financial crisis was severe. Business and other interests combined to press for action to be taken to prevent it worsening. Three options were under discussion: a moratorium on debt repayments; exchange controls on outflows of capital and price disincentives in the form of a two-tier exchange rate; ~~and political of capital in the form of a two-tier exchange rate~~; and political reforms to satisfy foreign bankers. The first two were strongly out of favour with banks and business because, to different degrees, they would reverse the recent years' trends toward increased freedom for markets. All hopes were pinned on the third option, political reforms. As a result, the speech President P.W. Botha was to make on 15 August assumed great significance, but in the end it was inadequate and the least favoured options (debt moratorium, controls and two-tier exchange rate) had to be adopted.

FROM RUBICON SPEECH TO DEBT FREEZE

Mr. Botha's speech on 15th August was widely promoted beforehand as an announcement of major reforms beginning the dismantling of apartheid, a 'crossing of the Rubicon'. Since a large proportion of short-term foreign credit to the private sector was due for renewal at the end of August it was expected to attempt to offer enough reforms to satisfy those bankers. In the event, it made no real offer of significant political progress, it was strongly criticised by business interests and the discrepancy between the expectation and the outcome precipitated a second phase of the financial crash that had started at the end of July.

The immediate effect of the 'Rubicon' speech was that early the following morning the rand fell by 20 per cent on the Johannesburg foreign exchange. It declined from 45.3 US cents to 38.5 cents before recovering to 42 US cents. Financial interests remained strongly opposed to controls over outflows of money or a debt moratorium arguing that exchange controls would be ineffective and that if there were restrictions on debt repayments 'this country's credit rating would dive and the capital we need to process the raw materials we produce and sell abroad would dry up.' (7)

Business and finance continued to see some type of reform as the main solution and were strongly critical of the President's failure to deliver even serious promises of any. In a joint statement the two largest business associations, Die Afrikaanse Handelsinstituut and the South African Federated Chamber of Industries expressed regret that 'at this time of crisis, the state president, in addressing the world at large, was not more specific in pointing the nation more positively in the direction of reform and national reconstruction.' The financial newspaper Business Day's editorial argued that if Mr. Botha 'cannot perform better than this ... then we believe the time has come for him to depart.' (8) Many observers felt that these developments had 'effectively ended the close alliance between government and business forged by Botha soon after he came to power in 1978' (9)

In the absence of reforms it became clear that the debt due for renewal at the end of August would not be renewed and in the absence of financial controls this led to a further flight of money out of the Rand and into foreign currencies. By 27 August the Rand had reached a record low of 34.8 US cents (closing at 35.6). In the third quarter of 1985, a large increase was recorded in divided payments abroad by foreign controlled companies repatriating past, undistributed profits, and, after having been reduced in the second quarter, net capital outflows returned to and exceeded the high levels of the first quarter of 1985.

The government was left with no alternative but to take actions which appeared to be panic measures but, upon closer examination seem to have been carefully prepared. On 27 August the authorities suspended all trading on the Johannesburg Stock Exchange and all foreign exchange dealing until 2 September. The next day the Governor of the Reserve Bank flew to London, New York and Washington with no announcement of the purpose of his trip. It was believed that he wanted to obtain the support of the Bank of England and the Federal Reserve Board for special credit facilities, in particular a swap of dollars for gold (10) although such a swap arrangement could only raise some $750 million while the short-term debt falling due for renewal was estimated at $14 billion. No such deal was arranged, nor was the trip successful in persuading commercial bankers to renew credit lines. The flight only served to emphasise the isolation of the South African government if it did not seriously reform apartheid, or, at least, the difficulties that its allies in the US and UK had in supporting it. But the authorities sought to hide this by claiming subsequently that the journey's purpose was only to explain to the UK and US what steps the government and Reserve Bank themselves intended taking.

These emergency steps were announced on 1st September and consisted of a debt moratorium or temporary freeze and a two-tier exchange rate supported by foreign exchange controls.

DEBT FREEZE AND EXCHANGE CONTROLS

The emergency measures attempted to stem the flight of the two main types of international capital in South Africa, bank loans and money invested in the stock exchange. Bank loans were to be subject to a moratorium or debt freeze. An exodus of investment funds was to be discouraged by establishing a two-tier exchange rate supported by exchange controls. (11)

The debt freeze halted all repayments of capital on foreign loans for four months (until the end of 1985) but interest payments would continue to be made. The Minister of Finance Mr. du Plessis said that the relevant interest payments amounted to no-more than 6 per cent of the country's annual export earnings and could be met easily.

The debt freeze applied to loans through the banks, suspending repayment of $14 billion of short-term bank debt. It extended as far as preventing repayments of loans by the foreign branches and subsidiaries of South African banks. This was especially significant because some South African banks, in particular Nedbank, the third largest, had been actively operating in New York and other foreign centres.

It is notable that the debt freeze was focussed on bank loans while repayment of other types of loans was unrestricted. These included repayments on maturity of South African public sector bonds quoted on foreign stock exchanges or privately placed notes; debts to international financial agencies; debts guaranteed by foreign governments and their export credit agencies; and the foreign debts of the Reserve Bank including those arising from gold swaps.

The exchange-rate and exchange-controls distinguished between current account and capital account foreign exchange transactions. Current account imports and exports of goods and services would occur at a 'commercial rand' exchange rate which the Reserve Bank itself would manage. Sellers of shares or other assets, on the other hand, would only be able to convert the rand proceeds into foreign currencies at the 'financial rand' exchange rate. That rate would be determined by free market forces or, in other words, the outflow of money from the stock market seeking safety abroad (net of any inflow) without the authorities attempting to manage the rate. Controls would be administered to ensure that foreign exchange required for capital export was not acquired at the commercial rate.

The plan was that in the circumstances of 1985 the financial rand would be lower than the commercial rate; the current account surplus combined with Reserve Bank purchases of rands to support their price would make the exchange rate of the commercial rand relatively high while the flight of capital would depress the price of the financial rand. The low financial rand would discourage the flight of capital for it would lower the foreign exchange value of each rand obtained by selling shares. Some believed that by the same token making shares 'cheap in terms of foreign currencies, the measures should encourage a new inflow of capital eventually.' (12)

These foreign exchange measures were a return toward a system of controls and restrictions that had been relaxed only two and a half years earlier. In February 1983 South Africa had abolished exchange controls on transactions by non-residents and ended the distinction between the commercial and financial rand. In previous years, the financial rand had fluctuated at a discount of between 2 per cent and 40 per cent below the commercial rand. They were unified partly as a general move, supported by business and bankers, toward greater 'normalisation of South Africa's position in the world economy and partly as a result of pressure toward increased market freedom from the IMF which had agreed stand-by credit and other credit up to SDR 1 billion in 1982. The unified Rand began at 88 US cents in February 1983 with the Reserve Bank managing the rate, and it was allowed to float in September 1983, falling to well below half its initial value by the time the new restrictions were imposed.

DEBT NEGOTIATIONS AND ATTEMPTED STABILIZATION

When the foreign exchange market reopened on 2 September the new measures appeared to have halted the panic which had pushed the Rand down to around 35 US cents. The exchange rate rose sharply in 'euphoric' trading. But after having climbed to over 41 US cents it crashed back to 37 US cents on Thursday 5 September. The violent ending of a major strike at Gold Fields of South Africa had undermined the precarious confidence of the markets.[13] This was a graphic illustration that, of the three types of measure that had been under discussion in financial circles since the July State of Emergency (controls on capital outflow including debt moratorium; two tier exchange rate; and political reform) political stabilization was the fundamental pre-requisite for financial stabilization. It was unlikely that political reforms could bring political stability but Botha's Rubicon speech had not even promised a serious attempt at reform.

The problem of South Africa's foreign debt was even more strongly dominated by political considerations than the stability of the foreign exchange market was. The overseas banks whose assets had been frozen by the debt moratorium were not willing to be seen to negotiate directly with South Africa over repayment of existing debt. Political pressures in the United States, such as the decision of several bodies to withdraw funds from banks that lend to South Africa, had precipitated the decision of Chase Manhattan and others not to renew loans falling due at the end of

August, and the same pressures prevented them from negotiating a solution with South Africa. Following the discussions Mr. de Kock held with the Bank of England, Federal Reserve, and commercial banks at the end of August, South Africa's debt freeze package included a measure designed to surmount this difficulty. Instead of direct negotiations or the alternative of simply stating its terms to the bankers on a 'take it or leave it' basis South Africa would appoint an 'independent mediator' to devise a plan for eventually repaying the debt.

The person named to this past was Dr.Fritz Leutwiler who in June 1985 had become head of the Swiss industrial multinational, Brown Boveri. His strong credentials for the task stemmed from his record as the former President of Switzerland's central bank and chairman of the Basle based Bank for International Settlements, an international body which in many respects acts as the central bank to central bankers. Most important was the experience he had gained in third-world debt negotiations. The people with which Dr. Leutwiler had to deal were, on one side, Dr. Chris Stals (Director-General of South Africa's Reserve Bank) who chaired South Africa's Standstill Coordinating Committee and, on the other, the representatives of thirty major international banks with loans outstanding. In addition, another 230 banks were smaller creditors and any proposals had to take them into account too.

The mediator's round of discussions, (calling them negotiations was abjured) did not produce results within the four month period of the freeze. The South Africans wanted the banks to accept a long repayment period for outstanding short-term loans, effectively transforming them into medium term credit. Several leading banks wanted immediate repayment of outstanding debt and no commitment to future loans. Above all, the banks wanted a commitment to political reforms although these were not specified, a lifting of the State of Emergency and the release of Nelson Mandela were believed to be critical measures of that commitment.

Lack of progress became apparent relatively early. Although it was clear that the lack of new credit facilities from banks as a result of the freeze was causing a severe liquidity squeeze on industry (with importers, unable to obtain their usual 90 day credit having to pay cash with their orders).(14) on 15th November South Africa let it be known that it expected to extend the debt freeze.(15) The Governor of the Reserve Bank, Dr. de Kock, admitted that tangible evidence of political reform was a pre-condition for debt re-scheduling. He 'hinted that this message had finally reached the Government after direct warnings from Dr. Fritz Leutwiler' and predicted there would be 'political and constitutional reforms that would go far enough to win the support of moderate opinion, black and white' in South Africa and some African states.(16) Whatever reforms were envisaged their preparation required time and on 10 December South Africa formally extended the debt freeze until the end of March 1986.

The extension to the freeze was due not only to the time needed to prepare a political package, for the two sides seemed to remain a long way apart over the technical, financial details. At that stage South Africa had put forward proposals for converting the $14 billion short-term debt due the previous August into medium term debt. No repayments would begin on it until phased instalments started in 1990 and the repayment date on other debt (which had not yet fallen due) would also be put back several years. As part of its moves to strengthen control over foreign exchange it transferred the frozen loans from the commercial banks to special accounts in the Reserve Bank and it paid interest of only ½% above the international rate (LIBOR) on them(17) While many of the foreign banks said they wanted immediate repayment, they also wanted a higher interest rate as long as their funds were blocked, and with more general objections too they rejected these proposals.(18)

RUBICON II AND PARTIAL AGREEMENT ON DEBT

During the extended debt freeze the President, opening parliament on 31 January 1986, did make a major speech in an attempt to meet the requirement for political reforms and it was followed on 20th February by a meeting that appeared to yield some agreement on technical financial terms. But neither of these developments has proved to be completely enough to settle the debt crisis.

Botha's speech contained promises of future reforms which, since they were presented as moves toward the dismantling of apartheid, led to it being called Rubicon II, the second attempt at a step that was balked in August. In fact, the promised reforms were seen as too qualified to be meaningful. Blacks were to be offered an advisory role in legislation through a new 'national statutory council', but this would never be accepted by the African National Congress, the United Democratic Front or other anti-apartheid organisations and was irrelevant to the demands of the black population. The 'pass laws' or 'influx control' mechanism which had been a cornerstone of apartheid were to be repealed, but they were to be replaced with new legislation to police people's movements through identity cards. The speech promised to release Nelson Mandela, but only on condition that the USSR released Scharansky (which it did soon after, apparently as a result of quite separate negotiations already in progress) and Angola released a South African soldier.

The promises of Rubicon II had been relayed in advance to leading bankers and enabled them to say that they could negotiate a temporary 'informal' rescheduling of the $14 billion debt frozen the previous August. However, they were insufficient to allow them 'to drop their opposition to a full scale re-scheduling of the country's foreign debt.[19] In other words they could not be seen to renegotiate the rest of the outstanding debt (even that which falls due in 1986) or to arrange significant new credits. But the sign of some progress toward regularising the $14 billion frozen debt was enough to satisfy the markets. Whereas August's

Rubicon I was followed by panic on the foreign exchanges, after this speech the Rand closed unchanged at 43.8 US cents and within a few days had risen to 45 US cents, and maintained its strength in the following month.

The ability of Rubicon II to provide the bankers with a strong enough prospect of reform was, however, soon jeopardised by events. After a few days for analysis, Western commentators assessed that the promised reforms were not fundamental.(20) Their weakness was underlined by the rapidity with which Botha criticised his Foreign Minister for saying that apartheid was being dismantled and a black President was foreseeable. It was demonstrated most effectively by the continuing violence, rebellion and repression that marked the country under the State of Emergency. And the political impasse was heightened by the call the ANC and Bishop Tutu made on the bankers to refuse to bail out the government. But despite this the banks and the South African government became sufficiently close on their attitudes toward the debt freeze to enable the mediator to put new proposals to a London meeting of the leading banks on 20th February.

The London talks established a 'broad consensus' between South Africa and those banks (which themselves had advanced some 70 per cent of the country's international bank credit). The plan agreed in broad principle had three key features. First, there would be a further year's extension before repayment of some $10 billion of frozen short-term debt was required. Thus, the repayment of that amount of debt, originally due in August 1985, would be delayed by at least one year and seven months, and higher interest rates would be paid on it. Second, South Africa would make a down payment of $½ million starting in April 1986 in respect of the credit it owed. Third, the plan was to be seen as a 'short-term interim solution'; there would be a review of South Africa's economy in Summer 1986 and full scale discussions in February 1987 with a view to a full restructuring of South Africa's debt.

The Leutwiler plan was agreed in broad principle and a technical committee of twelve banks was established to work out the details.[21] By the beginning of March, however, it was clear that there was disagreement on the details and there would be difficulties in achieving afull agreement by the end of March deadline. Some leading banks wanted a greater immediate repayment than the $\$\frac{1}{2}$ billion proposed. Even before the London meeting they had argued that the recent fall in the price of oil and rise in the gold price would double South Africa's surplus on current account in 1986 from the $1.5 billion Pretoria estimated to almost $3 billion and this would permit a larger downpayment. Others wanted the Leuwiler plan to be agreed for longer than one year, presumably to delay the necessity of a review and contentious negotiations. Most problematic of all was the fact that unlike most countries' rescheduling agreements, the Leutwiler plan was to be implemented through each bank making an agreement with each debtor on a bilateral basis. This raised the possibility that one creditor may arrange a more advantageous deal than its competitors.

Even if the 30 leading banks could agree a detailed plan overcoming these problems, there was little time available to persuade the other 230 smaller creditor banks to accept the terms before Pretoria's unilateral debt freeze expired at the end of March.

Whether or not an agreement was in place by the end of March it was not any sort of end of the problem; even for the most optimistic bankers it was an interim step. Under white minority rule, South Africa's debt crisis would reappear time and again in future months, for it had been forced into the open by two continuing but opposing forces, international bankers' difficulty in supplying new credit while under pressure from shareholders and depositors, and South Africa's need for foreign credit because of its modern economic integration with the international economy. The debt crisis has become a key and recurring element in the political and diplomatic manoeuvering around a weakened apartheid. In order to judge its future significance it is necessary to consider its present character. The most important question concerning the crisis that unfolded from Summer 1985 are first whether the crisis was wholly political rather than also reflecting underlying economic factors, and second to what extent were the banks' actions determined by political pressure rather than financial considerations. I discuss these questions in the following paragraphs, arguing that, although political factors were important in each respect more traditional economic and financial considerations had a strong effect. The many commentaries that presented the problem in political terms alone are misleading.

ECONOMIC DETERMINANTS OF THE CRISIS

The crash of the rand and of stock exchange prices initiated the crisis in July 1985 and it turned into a debt crisis when banks refused to renew the credit expiring in August. These were both cases of investors dramatically attempting to switch funds out of South Africa and much emphasis has been placed on their character as responses to political events. The imposition of a State of Emergency, the impact on sentiment of the French government's restrictions, the political pressure on US banks and UK banks arising from shareholders and from depositors such as New York State withdrawing funds from pension funds and banks with South African business have all played important roles, which, in turn, derived from the fact that the liberation struggle inside the country had reached a new stage. But South Africa's economic problems were growing and, although the country in 1985 was not running balance of payments deficits which made debt servicing impossible (as were Latin American borrowers) the imbalances in the economy predisposed it toward the financial crisis that occurred and, at one level, caused it.

South Africa's economy is dominated by gold mining and manufacturing. Although other sectors, particularly agriculture, are very large and account for a high percentage of employment, gold and manufacturing are the key sources of profit and the most sensitive links between South Africa and the world economy. Moreover, their fortunes relate directly to urban conditions and organised black labour. In the first half of the 1980s the earlier strength of both these sectors collapsed. The world price of gold dropped from its record of $850 per ounce to below $300 at one point in early 1985. The index of the manufacturing sector's output collapsed from 135 at the start of 1982 to 117 during that year (recovering slightly in 1983) as South AFrica's exports, despite the low prices achieved through using cheap black labour, were slowed by the world recession. As a consequence of falling gold prices, world recession, and, in the early 1980s, high oil prices, the balance of payments was severely in deficit in 1981, 1982, and 1984. In 1985 the balance of payments current account moved into a substantial surplus following austerity measures taken in August 1984 when the authorities increased bank interest rates from 22 per cent to 25 per cent and imposed controls on hire-purchase and other credit. The severity of the squeeze was indicated by the high cost of credit in real terms for inflation was then at 12 per cent.

The austerity measures helped the balance of payments but further depressed manufacturing output and increased unemployment. It was estimated that in 1985 black unemployment was approximately three million. From the point of view of stock exchange investors holding shares in manufacturing, or foreign creditors having lent to those firms, confidence was shaken by the effect of the squeeze on company profits and liquidity. This was one of the factors causing an accelerated outflow of capital in the first half of 1985 and it was pushing foreign banks toward refusing to renew their short-term loans even before the political situation worsened.

A related economic factor was that South Africa's international debt had become highly unbalanced and difficult to sustain even under the most neutral financial criteria. Since the beginning of the 1960s the proportion of loans to equity investments had increased sharply and of these loans a high and increasing proportion were short-term bank loans. Thus, whereas the ratio of interest payments to dividend payments abroad was 17 per cent in 1965-1969, it had risen to 81 per cent in 1980-83 and at the end of 1984 40 per cent of the interest-bearing foreign debt was short-term. A high proportion of the debt was accounted for by bank debt and at the end of June 1984 66 per cent of these liabilities to banks were short term (compared with an estimated ratio of 44 per cent for 'comparable developed countries') The most telling statistic was the Reserve Bank's estimate that at the end of 1984 short term debt (with an original maturity of less than one year) was $14.0 bn. while longer term loans outstanding were $10.3 bn.

Many third world countries also borrowed considerable amounts from banks in the late 1970s and early 1980s which became unsuitable for balance of payments reasons) but their predominant form of credit was medium-term rather than short-term and South Africa was particularly unusual in that its bank borrowings were not contracted by the state (or state guaranteed). The high proportion of short-term debt was mainly incurred in the 1980s by South African banks borrowing dollars on the essentially short-term international inter-bank market converting them to rand and lending them to local companies. At the end of 1984, private borrowers accounted for about 60 per cent of the foreign debt. (22) and $6 billion From the point of view of Western banks, 'lending to South Africa through the interbank market provided near perfect disguise' (23) for transactions on the inter-bank credit markets are never published. But it also meant that South Africa's debt structure was highly unstable and increasingly so; the short term/long term ratio of 14/10.3 at the end of 1984 was worse than the 1983 ratio of 12.9/11.1.

This debt isntability combined with the Reserve Bank's policy toward the foreign exchange market to increase the volatility of the exchange rate. Since 1983 when the rand had been allowed to float, the Reserve Bank had operated a spot-swap technique for buying and selling dollars on the forward market. The fall in the rand (by 47 per cent) in 1984 made this policy expensive, and it also made the Reserve Bank seek a new policy in order to support the rand. Thus, in January 1985 it changed the operation of the forward market by also carrying out outright purchases and sales at different rates from the spot-swap rates. This new system, however, created many problems, one of which was that it could increase the instability of the spot rate by increasing the Reserve Bank's spot purchases of dollars at crucial times to meet its forward obligations.[24] When the foreign exchange panic broke in mid 1985 this was an additional source of ibstability; from a longer term point of view the unsatisfactory nature of the techniques adopted under a system of floating exchange rates comprised a strong economic pressure toward adopting a two-tier exchange rate with a managed commercial rate.

BANK PRUDENCE AND FINANCIAL CRITERIA

Although the economic developments I have outlined have interacted with political events it is commonplace to see the debt crisis as essentially political. This broad judgement is open to several interpretations. One is that the international banks, subject to political pressure from depositors and shareholders, and, perhaps, wanting to establish their good standing with a future ANC government in South Africa, have taken an essentially political stance. On this view the banks have cut their loans in order to speed apartheid's end, and statements by bankers themselves have supported this interpretation.

In announcing Barclays' results for 1985, the group's chairman 'said the bank wanted to see "changes which confirm an end to the bankrupt policy of institutionalised racial discrimination" ...[and] added that one of the requirements it would consider a sign of good faith from the republic would be the release of the imprisoned black leader, Nelson Mandela.'[25] In an earlier report London's Guardian had quoted 'a considerable consensus' among British bankers and business leaders typified by the statement that 'Political rights for Africans are now on the agenda. In the past you could have talked about social rights or human rights alone. That is no longer enough.'[26] In fact, though, this view is misleading. The banks' behaviour has been consistent with the pursuit of their normal financial criteria rather than political objectives.

Banks as institutions have not seen it as their business to push for political reforms for reform's own sake. In following financial criteria bankers have had two immediate objectives: first, to protect their own assets; second, to safeguard the delicate mechanisms of the international financial system. In order to do this the banks have cooperated with Pretoria and South Africa has cooperated with them while maintaining their different perspectives on political reform. This has led to a view that the banks' statements on reform are empty. At the time of the 20th February meeting, Bishop Huddleston, president of Britain's Anti-Apartheid Movement said agreement showed that 'the banks have decided to come to South Africa's rescue...[in] a political act. ... Dr. Leutwiler is little more than a mouthpiece for Botha'and Neil Kinnock, Leader of the Opposition, argued that a 'decision to allow South Africa to postpone repayments would be of great assistance and encouragement to President Botha.' [27]

The first financial criterion, of protecting their own assets, was easily executed by the banks and other financial institutions. The deterioration in the economy, the distorted debt structure and increased political isntability led them to reassess the riskiness of their investments according to the criteria, well established since the early 1970s, of political risk analysis. When the State of Emergency was declared, it was reported that 'Frost Sullivan, the New York political risk consultancy, has dropped South Africa from ranking as one of the safest of the world economies to 'a par with some of the higher risk Third World countries' [28] Following normal criteria banks and investors responded by withdrawing funds and refusing to renew credits. At a more general level their concern for reform was an attempt to protect assets by achieving stabilization of South African society, but I shall argue below that such hopes were misplaced.

The second financial criterion, protecting the delicate mechanisms of the international financial system, was particularly relevant for Dr. Leutwiler, the Bank of England, Federal Reserve and other central banks, but it also affected the creditor banks themselves. At its heart was the problem of ensuring that the inter-bank credit market was not permanently damaged. And more widely its aim was to ensure that despite the debt crisis, South Africa's large economy with its control over gold production was not cut off from the Western world's financial system.

The inter-bank market for credit is both crucial for the international financial system and usually regarded as delicate and easily disrupted. It links all major banks across the world enabling them to lend funds which are temporarily in surplus to other banks at a profit. It is informal and enables banks to borrow very large sums from other banks for short periods varying from overnight loans up to one year loans. Its survival depends on all borrowers borrowing their huge debts and upon lenders not panicking and withdrawing their liquid loans.(29) South Africa's short term bank debt consisted to a large extent of such inter-bank credits and they were a threat to the whole system because, instead of being made on the usual rotating basis to balance the surpluses and deficits different banks have in their liquid resources, these were contracted as an indirect means of providing core finance to companies. Ultimately they became a real problem for the inter-bank market because South Africa froze repayments, and this was a unique shock.

In 1982 it became apparent that Brazil and other Latin American countries had also used the inter-bank market to obtain core finance; in those cases to provide the state, through the banks, with finance to cover the balance of payments deficit. When Mexico virtually defaulted on its other debts in 1982 the inter-bank market suffered a severe shock as bankers themselves withdrew their money from the vast loans to banks such as Brazil's. In South Africa in 1985 the bankers did not actually withdraw funds but the shock to the market came from the state freezing repayments. Neither Dr. Leutwiler nor the banks knew whether this new type of disruption would critically damage the inter-bank market; their task was to minimise such damage. Although many countries had agreed debt reschedulings with their bankers in recent years, inter-bank credits were generally excluded from these arrangements. When South AFrica's leading bank creditors agreed in principle to the Leutwiler package bank technicians saw this as the first major rescheduling of inter-bank debt and it appeared that the negotiations had succeeded in ensuring that the world's inter-bank market could continue to function smoothly.

To avoid totally distrupting the inter-bank market it was necessary for re-scheduling to be achieved in a manner which 'normalised' the positions of both borrowers and lenders. Each needed to reach a solution which offered a realistic prospect of predictable repayments of capital and payments of interest. For the banks an additional requirement was that the liquidity of their outstanding debt should be restored as far as possible (for the inter-bank market's value has been the liquidity it offers lenders). That problem was not solved at the February meeting although the possibility of converting the outstanding debt into certificates which could be bought and sold between banks was discussed and viewed favourably in that context. But both Pretoria and the banks had a mutual interest in achieving a realistic agreement on a predictable payments schedule.

An illustration of the common interest of central bankers in South Africa and other countries in ensuring that the debt issue did not put the international financial system at risk was the restraints placed on Nedbank's New York operations. This bank had taken the lead in establishing its own business abroad, borrowing actively through its New York office. There were concerns about this activity in any case, but after the debt freeze they became acute. The American authorities were concerned about the bank's ability to meet its commitments and possible repercussions on the stability of the money markets. Sharing this concern for the system the South African authorities acted to secure Nedbank's US business and management changes followed Pretoria and leading bankers also shared a desire to ensure that South Africa was not cut off from all sources of new credit. Mr. du Plessis' announcement of the debt freeze in 1985 was careful to leave several areas of international finance where 'business as normal' would be the order of the day. By excluding from the moratorium state debt and finance obtained under export guarantee schemes, Pretoria left a window through which foreign credit could be obtained in future. The leaders of the international financial system share that interest in maintaining normal provision of credit and avoiding the isolation of the country, for cutting off all its sources of finance would disrupt all the economic relations it has with the UK, US and Europe . It is not yet possible to assess the extent to which new lending continued after the debt freeze. There were net repayments of these credits according to the Reserve Bank, but they were not large and the inflows within the total are not known. As well as reports that some firms have had difficulty in arranging trade finance newspapers have reported that new credits have been arranged both for industry and for bodies such as the Urban Foundation which are presented as politically liberal institutions.

ASSESSMENT AND PROSPECTS

Although South Africa's debt crisis is often seen in wholly political terms it arose from the interplay of political and economic developments. Its future course, too, will depend on the same factors although the more acute South Africa's political crisis becomes the more politics affects financial matters. The other side of the coin is that the debt crisis has had a significant effect on South Africa's politics, hastening the break up of the ruling block's consensus, heightening the conflicts of interest within white society, and injecting a new destabilising factor into South Africa's diplomatic relations with the Western powers.

To reach an assessment of the debt issue we have to judge the way in which economics and politics affect it and are affected by it. Doing so leads to the conclusion that the regime's debt poroblems will have a continuing importance and be a recurring flashpoint. It would be a mistake to see negotiations such as those under Dr. Leutwiler as being aimed at achieving a 'settlement'. There is no sense in which a re-scheduling or restructuring can be achieved which would put the apartheid economy's external debt onto a new and sustainable footing. Instead, any agreement can only be seen as a temporary and fragile intermission; although finance is a mundanely materialist issue, bankers' agreements on it are best seen as stations of the cross for apartheid.

The unattainable character of a long term solution results from several factors. First, instead of the main directly involved actors, the South African regime and the banks, having well defined strategies and positions which can be the subject of negotiations each has a strategy and interests with many contradictions and divergent interests within it. Second, the underlying political and economic factors which generated the crisis are likely to intensify. Third, and most significant, the growth of the people's rebellion and the strategic strength of the African National Congress and its military wing, Umkhonto we Sizwe, which have been instrumental in heightening the conflicts of interest and the political and economic crisis, will continue to determine the conditions within which debt is located. In the following paragraphs I discuss the insoluble contradictions in the positions of the banks and the government and consider the relation between debt and the fight against apartheid. As background, I assume that the recession experienced by the South African economy in the first half of the 1980s is a mark of structural economic problems which will continue with high unemployment and reduced profitability. This may be ameliorated temporarily,as it has been in the first quarter of 1986 by international markets' reductions in the price of oil or increases in gold prices, but the structural problems remain (30) and are intensified by the political instability.

The banks lack a clear strategy because at one level they want to regularise relations with South Africa and at another to pull out. In the long term, even if less profitable than previously, the South African economy is such a key element of the West's international economy that banks have a strong interest in regularising its financial position. This finds expression particularly in the central banks of the US, UK and continental Europe, and among the strategically minded policy makers of the major international banks. This tendency produced the bankers' agreement to the broad principles of the Leutwiler plan justifying the anti-apartheid movement's criticism that the bankers were supporting Botha but it is caught up in a number of contradictory forces. Bank shareholders and the supervisory agencies do not favour exposure to an economy which is now judged to be a high credit risk; this affects all banks but is especially important for the 230 or so medium and small banks who are creditors. Some banks are subject to considerable pressure from shareholders and depositors with anti-apartheid concerns. Because of such pressure, lending in the 1980s has been disproportionately at the private sector rather than the South African state, with an exceptionally high proportion being short-term credit through the inter-bank market and for technical reasons this cannot easily be rescheduled on a long-term basis. The inter-bank market's essential characteristics are its informality, liquidity and its short-term loans but a re-scheduling agreement, by its nature, goes against them. It could only exist either as a temporary patching up for want of anything better (an approach that appears to have predominated in February) or, as a longer term basis, if there were substantial and unlikely financial innovations such as the creation of a secondary market in South African short-term debt.

Financial markets' judgements on any economy are based on simple indicators; at any one time indicators such as the money supply, the current account balance, the public sector deficit are treated as key. In this case 'political reforms' have been identified as a crucial measure of creditworthiness. Banks have seen progress on reforms as the one thing that would enable some reconciliation of their desire to regularise South Africa's international finance and their need to reduce the risk of lending to the country. But, in fact, that path toward solving financial problems is not very promising for the banks. One difficulty is that the banks themselves cannot specify a list of political reforms by which they can measure progress. It is indicative that before the 20th February London meeting there was speculation that the banks would consider a document with a political preamble on desirable reforms, but they refused. Similarly, Barclay's chairman, in announcing his group's results and their intention to pull out from South African business, refused to detail desired political reforms apart from the release of Nelson Mandela. (31) Although that demand is a remarkable advance in itself, it has become for many bankers (and politicians) a symbolic demand which substitutes for the detailed political reforms they rightly feel they could not specify. Another difficulty, the main difficulty, with the banks looking for political reforms is that reforms in themselves cannot guarantee the type of political and economic stability sought by the financial community. Indeed, substantial political and social reforms are as likely to open the way to an intensification of the popular struggle against apartheid. On that perspective, social and economic instability is inescapable until majority rule is achieved and reconstruction under an ANC government is under way, so that political reforms themselves could not solve the debt crisis.

If the banks lack a clear strategy, the South African governent's own position on the debt is even more problematic. For them the debt issue is one aspect of their attempt to maintain apartheid in one form or another. Thus, 'what to do about the debt' is inseparable from the questions of what to do on the diplomatic front abroad and political, social and economic reform at home, and the Nationalist government is no longer able to have a clear, unified strategy on those questions.

In the face of each side's complexities and constraints the manner in which the 1985 debt crisis was handled was the most favourable possible for the South African regime, and it offered great advantages to the banks. Although the package was not completely tied up at the February meeting, the agreement on broad principles effectively meant that the major banks had agreed to reschedule South Africa's short-term debt for at least one year (or more than one year after their due date). Since inter-bank debt is not usually re-scheduled this was a considerable achievement for South Africa, giving the regime considerable support. At the same time, the banks gained much to satisfy that element that sought to normalise South Africa's financial relations. Because South Africa appeared to declare the debt freeze unilaterally the banks were able to achieve this while presenting themselves to depositors and shareholders as wishing to pull out of South Africa and being forced into rescheduling aginast their will. This was reinforced by the Reserve Bank's deliberately unrealistic December proposals for a four to five year re-scheduling and the banks' inevitable rejection of it in favour of more modest arrangements. And, as with any re-scheduling, the banks gained increased interest rates.

That was not the only way in which the foreign banks could have reacted to the debt freeze, for another direction which the conflicting tendencies in their strategies could have taken would be to veer toward recovering their assets by pulling out rather than staying in. This did happen to some extent after the debt freeze. The Reserve Bank's Quarterly Bulletin for December 1985 reported that 'After the introduction of the [September] standstill arrangement, large repayments were made on loans exempted from the "standstill" '[32] But since the country's gold and foreign exchange reserves fell by only R1.5 billion in the third quarter of 1985 and much of this was accounted for by leads and lags on the current account, the net withdrawal of credit cannot have been on a large scale. In any case, net repayment of 'exempted' loans was not the heart of the matter, the strongest action to recover the debt would have been to react to the debt freeze by freezing the assets of South Africa abroad. This strategy was proposed by three leading clergymen, Bishop Tutu, Dr. Naude, and Dr. Boesak. They wrote to Dr. Leutwiler on 8th February 1986, proposing 'that the banks should immediately freeze all South African bank balances in their books and refuse to effect any transfer instructions over these accounts' and suggesting 'that the banks should obtain court attachment of aircraft, ships and other SA assets and apply the proceeds against South African indebtedness.' It was reported that by 20th February they had not received a reply.[33] Such asset freezes have been applied elsewhere by foreign governments (most notably by the US against Iran, and by the UK against Argentina). And they could have covered the debt since South Africa's total foreign assets (not including the ships and aircraft mentioned by the clerics) were some $12.4 billion at the end of 1984.[34] The fact that such actions appear not to have been considered is a measure of how far the contradictions in the banks' position were weighted in favour of maintaining relations with the regime.

Nevertheless, in the months following the debt freeze, South Africa has made policy pronouncements which attempt to give an appearance of reform. The question is whether, or to what extent, foreign creditors' opinion was responsible for promoting an apparent change of heart and that requires an examination of how significant any changes have been and what their background is.

The most publicised policy statements have been Botha's address on opening the new session of parliament on 31 January 1986, and the annoucnement in March that the State of Emergency was being lifted. The address promised an end to the pass laws and minor constitutional reforms; but the first is a promise of cosmetic changes since the pass laws were to be replaced by other forms of control, and the second proposal a new body which could only be rejected by the ANC. In affect, those items could not be treated as promises of reform. It also announced proposed changes in the education system. These did suggest some movement, building on the 1981 De Lange Report and the 1983 White Paper and going further than the reforms introduced in an Act of 1984. Their announcement was clearly aimed at influencing foreign creditors, but it would be mistaken to conclude that the proposed reforms were basically due to the pressure over debt; in essence they were a response to the school pupils' rebellion.(35) Similarly, the lifting of the State of Emergency in March was a response to several political forces so that the debt crisis can only be seen as a small element within the whole. It was lifted because the riots and military actions had shown that it was ineffective in repressing the movement, because the 'normal' security laws give the State enormous powers, and because it aliented a range potential allies in the business establishment and abroad (of which the banker were only one element).

By March 1986 the economic, political and social system of South Africa was in such turmoil and the diplomatic structure of support for apartheid so undermined that even Chester Crocker, the architect of the system of 'constructive engagement' under which the US had supported South Africa, called the insurgents 'freedom fighters'. In the context of such shifts, bankers' opinions have had only a secondary role.

Nevertheless, the debt problem will re-surface. The short-term debt due in August 1985 is being re-scheduled for one year with a full review before further arrangements are agreed. South Africa's medium-term foreign debt, estimated at $10 billion in 1985, will fall due for renewal; between March 1986 and March 1987 $1.5 billion of it is due for repayment plus the $500 million down-payment on the frozen short-term debt. And even if new arrangements are made on old debts, a flexible profitable economy requires new credits especially if the restructuring set in train by the recession and social changes is to move ahead. When debt is on the agenda it is clear that further pressure from anti-apartheid forces and solidarity movements will attempt to ensure that the South African regime is effectively isolated financially and that financial difficulties become effective financial sanctions.

Laurence Harris

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NOTES

* This article is based on the author's work carried out at the Open University within the Financial Studies Research Group and the Development Policy and Practice Research Group.

(1) Although commentators emphasise the political factors and note that in 1985 South Africa had a surplus on current account enabling it to service its debt, 'normal' economic factors were also significant. The current account had been in deficit over several years and, as outlined below, other economic problems were serious.

(2) Sunday Times, 1.9.1985

(3) Citizen, 23.7.1985

(4) Star 28.7.1985

(5) Cape Times 29.9.1985

(6) London Standard, 31.7.1985

(7) Business Day, 17.8.1985

(8) Business Day, 16.8.1985

(9) Guardian 24.8.1985

(10) Guardian 29.8.1985

(11) Speech by Mr. B. du Plessis, full text in Business Day 2.9.1985

(12) Daily Telegraph 29.8.1985

(13) The separation of the financial rand and commercial rand meant that pure capital flight could not cause the latter to crash, but, as in all such arrangements, current acoount and capital account transactions are not completely separable. 'Leads and lags' are the main way in which current account transactions can disguise short-term capital movements. If, for example, importers expect a fall in the rand (rise in the dollar) they will buy dollars earlier than otherwise while exporters will give longer credit. Such leads and lags were instrumental in the rand's fall at the beginning of September.

(14) Financial Mail 25.10.1985; South African Reserve Bank, Quarterly Bulletin, December 1985, pp. 12-13.

(15) Financial Times 16.11.1985

(16) Financial Times 27.11.1985

(17) Other measures included greater control over current account transactions in order to regulate leads and lags.

(18) Financial Times 11.12.1985

(19) Financial Times 1.2.1986

(20) A. Robinson 'Botha Aims to Modernise Apartheid, Not Kill It' Financial Times 6.2.1986.

(21) The technical committee included the following banks : Barclays, National Westminster, Standard Chartered, Credit Suisse Union Bank of Switzerland, Swiss Bank Corporation, Commerzbank, Deutschesbank, Dresdner Bank, Citibank, Manufacturers Hanover and Morgan Guaranty.

(22) Data from Economic Monitor, Old Mutual, July 1985 and South African Reserve Bank, Quarterly Bulletin, December 1985, p.66.

(23) Daily Telegraph 7.9.1985

(24) R.M. Gidlow, 'Forward Exchange Policy in South Africa', South African Journal of Economics, vol. 53, no. 3, Sept. 1985. It was reported that with the falling rand, the spot-swap system had cost the Reserve Bank R 2 billion losses in the year to March 1985, Star, 22.8.1985.

(25) Guardian 7.3.1986

(26) Guardian 29.8.1985

(27) Guardian 21.2.1986

(28) Sunday Times 28.7.1985

(29) J.Coakley and L.Harris, The City of Capital, Oxford, Basil Blackwell, 1983, pp. 66-67.

(30) See J. Natrass

Gelb, Innes

(31) Guardian 7.3.1986

(32) South AFrican Reserve Bank, Quarterly Bulletin, December 1985, p.12.

(33) Daily Dispatch, 20.2.1986

(34) South African Reserve Bank, Quarterly Bulletin, December 1985, p.66

(35) E. Unterhalter 'Seeking Social Stability : Political Responses to the De Lange Commission Report' unpublished paper, 1986.