

Research summary PNR42+

## Economic Sanctions against South Africa and the Importance of Switzerland

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In 1986 – about 40 years after the beginning of Apartheid – South Africa's most important trading partners (the USA, the EC, and Japan) imposed economic sanctions. During the course of the 1985 debt crisis, the time seemed to have arrived to finally force the Apartheid regime to its knees by economic sanctions. Switzerland did not abide by the sanctions. The study examines if the fact that Switzerland did not take part in official economic sanctions delayed the political transformation of South Africa.

### Economic Sanctions against South Africa

#### Sanctions imposed

The economic sanctions covered trade and finance. In the trade sector, the EC and Japan sanctioned import of the Kruger rand and certain steel and iron products, whereby Germany and Great Britain in part merely made recommendations and imposed no binding sanctions. The USA too embargoed importing the Kruger rand and certain steel and iron products. The sanctions also covered import of products from partially state-controlled enterprises, uranium, coal, textiles, agricultural products, and food as well as export of petroleum products. The most crucial trade sanction was OPEC's oil embargo, though it also had loopholes.

One must distinguish between direct, portfolio, and other investments (credits/loans) in regard to financial sanctions. Foreign direct investments were defined by their goal: establishing a long-term relationship with the target firm abroad and assuring an important influence on business. If the shares held exceed 10%, investments qualified as FDI. Those below 10% count as portfolio investments. Other investments included credits in particular. The EC sanctioned new direct investments but left it to member states to declare if the sanctions would be binding. The two major investors (England and Germany) failed to impose binding sanctions. The USA also sanctioned new direct investments and was the only country to impose sanctions on portfolio investments and credits/loans.

In general, sanctions imposed against South Africa were very limited and indicate numerous loopholes and exception clauses. One reason for the limitation surely lay in the fact that the heads of government in Britain, the USA, and Germany did not regard sanctions as the correct means of prompting political change in South Africa. Since the "constructive engagement" approach favored by them (stabilizing South Africa, which would strengthen the will of South Africa

to reform) but did not lead to ending Apartheid for many years, advocates of sanctions could ultimately prevail.

The economists' public-choice theory argued for this reason that economic sanctions often have so minimal an impact because they are selected primarily to suit the economic interests of the sanctioning countries and only secondarily consider the costs on the country sanctioned. In the case of South Africa, the choice of sanction sectors confirmed this thesis. In the USA, for instance, there were interest groups that profited from sanctions on South African coal and food. Accordingly, these sectors were sanctioned by the USA, but not by the EC or Japan. For its part, the EC sanctioned steel. Since this was one of the EC's most highly protected sectors, sanctions helped European producers get rid of one of their strongest competitors at the same time.

#### Switzerland's position

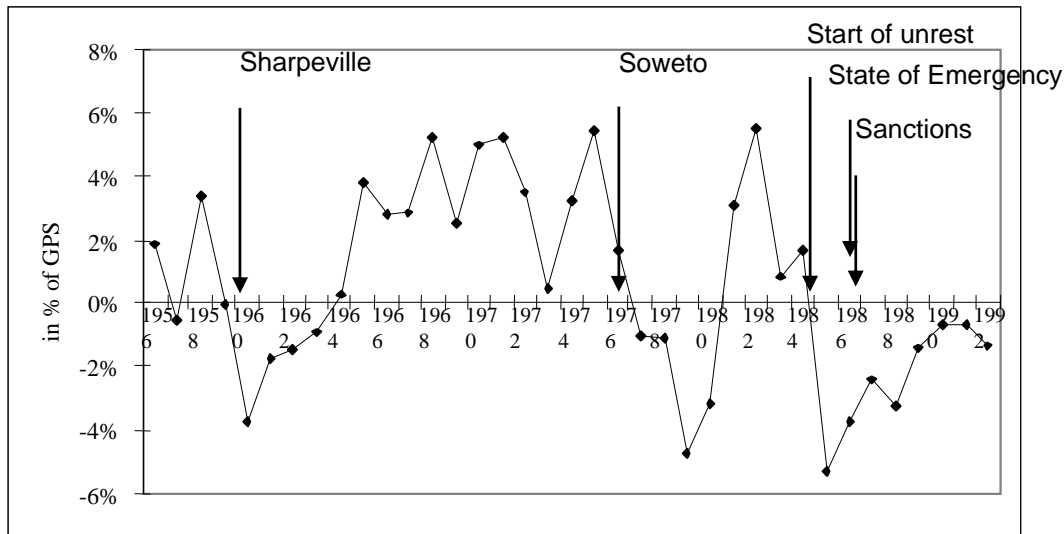
Switzerland maintained its basic stance of rejecting sanctions in the case of South Africa as well. The 1986 position of the Federal Council stated that it disapproved of economic measures to achieve political goals. Nevertheless, politics also intervened in economic ties. A ban on public loans to South Africa was enacted in 1978. From 1974 on, the government set a ceiling on certain capital exports requiring licenses. During the course of other countries' economic sanctions, statistical monitoring also took place from 1986 on. In addition to monitoring capital exports, it covered all sectors in which the most important industrialized countries enacted congruent economic sanctions. Sectors were also statistically monitored in which converging sanctions had not been imposed or were at least subject to heated dispute (e.g., direct investments). These measures were intended to have prevented Third States from circumventing sanctions through Switzerland.

#### **Costs of trade and financial sanctions imposed on South Africa**

##### Capital outflow and its causes

During the sanctions period (4th quarter 1986 – 1st quarter 1991) South Africa suffered a net capital outflow of 16.2 billion rands, which corresponded to an annual average of 2% of GNP. However, the net outflow of foreign investment had already begun before introduction of the sanctions. South Africa suffered its greatest net capital outflow, which led to the moratorium on debt, in 1985, one year before imposition of economic sanctions.

Illustration 1: Net capital flow in % of GDP



Source: South Africa's balance of payments 1946-2000, South Africa's national accounts 1946-1998

The massive outflows of capital could be traced to three factors in particular:

- Political unrest

Already in the past the Sharpeville massacre of 1960 and the Soweto unrest of 1976 had led to far-reaching and long-term outflow of capital (see Illustration 1). The political unrest that led to the National State of Emergency (20 July 1985: Partial State of Emergency; 12 June 1986: National State of Emergency), was traceable on one hand to the struggle of the domestic anti-Apartheid movement; on the other hand, there was also unrest between competing black groups. The unrest reduced investor confidence in the country's future.
- The poor economic situation

South Africa found itself in a recession between 1984 and 1985, and even after 1986 the GNP increased less than the population. An important cause for economic weakness was economic policy, which was closely linked to Apartheid ideology. South Africa had high and increasing government outlays based on high defense costs among other factors. It pursued economic self-sufficiency, yet this limited South Africa's long-term competitiveness and thus stemmed the flow of foreign investment as well. The country also had to cope with high inflation, scarce currency reserves, and mounting short-term debt.
- Pressure from the anti-Apartheid movement

Foreign and South African anti-Apartheid groups demanded an end to business ties with South Africa and withdrawal of firms active in the country. The American anti-Apartheid movement had the greatest success. A few American states and cities exerted strong economic pressure on the firms, which resulted in their withdrawal. However, the overall impact of disinvestment on the balance of payments was comparatively minor. It was rather small and unprofitable firms that withdrew from the market. Moreover, there were unintended profiteers. Particularly the large South African conglomerates benefited from American and British sales, since they could acquire divisions of firms at favorable prices.

### The costs of financial sanctions

Officially imposed financial sanctions had comparatively little impact on capital outflow. Or, as the president of the South African central bank, De Kock, put it in 1986: “The EEC and US sanctions packages on bank loans and investments do little more than change a de facto into a de jure situation”. From South Africa’s vantage point, financial sanctions hardly prevented flow of capital that would have been transacted without sanctions.

This had several reasons. The EC and USA sanctioned new direct investments, though the EC’s two largest investors, Germany and Great Britain, only enacted voluntary sanctions. Yet, due to the poor economic situation at the time, new direct investments were hardly transacted anyway. More crucial was reinvestment of profits, and this most important possibility of FDI was exempted from the sanctions. More than 80% of all FDI in South Africa during that period originated from reinvested profits. The existence of reinvested profits also increased during the sanctions era by about 3 billion rands. This showed that the investors had maintained a certain trust in South Africa and also expected no sharpening of sanctions. At the same time, repatriation of profits due to the USA’s lifting of the dual-taxation agreement was not very attractive for American firms in a business sense.

Only the USA sanctioned other investments (portfolio investments as well as credits and loans). This capital is more mobile and volatile, and the lack of a supplier can usually be compensated for without a problem. During the sanctions era, capital was indeed only available in South Africa under difficult conditions – i.e., at high costs. However, this was primarily attributable to unrest and the poor economic situation.

All in all, therefore, the costs of the officially imposed financial sanctions for South Africa were minor. Based on a study by Hufbauer et al. (2001), we estimate the annual cost at less than 0.25% of South African GNP.

### Costs of trade sanctions

The costs of trade sanctions were greater than those of financial sanctions. The various trade sanctions triggered a range of high costs. The oil embargo represented the most painful measure for South Africa, even if there were significant loopholes. The oil embargo raised the price of petroleum and thus impacted the total population. The large trading partners’ import sanctions proved less costly. Either South Africa was able to gain other countries as new or additional customers (steel and coal) or production could be adapted (gold bars instead of Kruger Rands). Various other exceptions existed (or were introduced later), which reduced the impact of sanctions. The cost of import sanctions especially affected the black population in the form of unemployment. The cost of trade sanctions against South Africa overall were estimated by one study at an annual 1.3% of GNP.

Along with the cost of financial sanctions, the cost of economic sanctions against South Africa is estimated to have approximated 1.5% of GNP. Those affected were largely unqualified blacks. Even after 1990 the unemployment rate among whites remained insignificant.

### Impact of sanctions’ cost on political transformation

A power shift occurred at the outset of 1989 owing to the heart attack of President P.W. Botha. It forced him to give up chairmanship of the National Party. Chosen as his successor was the former education minister, F.W. de Klerk. One year after entering office, de Klerk delivered a speech

on 2 February 1990 clearly recognizing the need for rapid and far-reaching policy reforms and introducing the political changeover.

Did the economic sanctions directed against South Africa influence political opinion among the white population to the point that the political transformation was possible or accelerated decisively. Well-known economists assume that this was not the case.

“Even in the absence of sanctions, apartheid ultimately would have collapsed due to the economic stresses of a hugely inefficient system. Although sanctions may have speeded this process, they were not the driving force behind it. ... The fall of apartheid was not engineered by foreigners, nor was it primarily precipitated by foreign sanctions” (Lowenberg and Kaempfer, 1998, 9).

“Economic sanctions can be credited with, at best, a modest contribution” (Hufbauer et al., 2001b).

Economic sanctions did not trigger the political transformation. The costs brought about by the sanctions were too meager for that. Yet the question remains open whether stiffer sanctions with higher costs would have had the desired impact. In any case, de Klerk was not under pressure from the white population to give in to the sanctioning countries’ demands. One finding resulted from a survey on the impact of economic sanctions directed against South Africa (i.e., besides the economic sanctions the debt crisis leading to the credit freeze of 1985, the disinvestment campaign, as well as the foreign boycott of South African products – especially farm products) that the population still refused to scuttle Apartheid in 1989 despite these measures. Nor did a majority want to bow to stronger economic sanctions.

The reduction in economic growth triggered by sanctions was less essential for the political transformation than the fact that the country’s economic development made the original ideology of Apartheid impossible. Apartheid’s ideology foresaw a geographically separated development of various population groups (the so-called “homelands” policy). Already in 1950 the so-called Tomlinson Commission found that a middle-of-the-road option was impossible, and the country would have to choose between complete segregation and integration. Yet the high economic growth of the 1960s and 1970s created high demand for workers that could only be satisfied by the influx of black employees to the big cities. The government faced the problem of how to cope with this urbanization.

Unrest and strikes were a visible sign that separation of the population would lead to ever greater difficulties. The unrest and strikes resulted in high spending on security, reduced investor confidence, and triggered the 1985 debt crisis among other things. The rapidly growing population strata would have exacerbated the problem further. Finally the Eastern Bloc’s communist regime collapsed in 1989. Thus the danger of a communist power takeover in South Africa was reduced for both the West and South Africa itself.

Particularly these developments ultimately triggered the political transformation.

## **The importance of the Swiss position**

### Trade sanctions

Did Switzerland’s behavior reduce the impact of the economic sanctions? As far as trade sanctions were concerned, Switzerland was hardly an important trade partner for South Africa. And, from Switzerland’s viewpoint, the volume of trade with South Africa also amounted on average to 0.7% of total Swiss trade (excluding gold, a commodity actually not sanctioned with the exception of the Kruger rand). However, the trade sanctions of other countries benefited Switzerland. It had

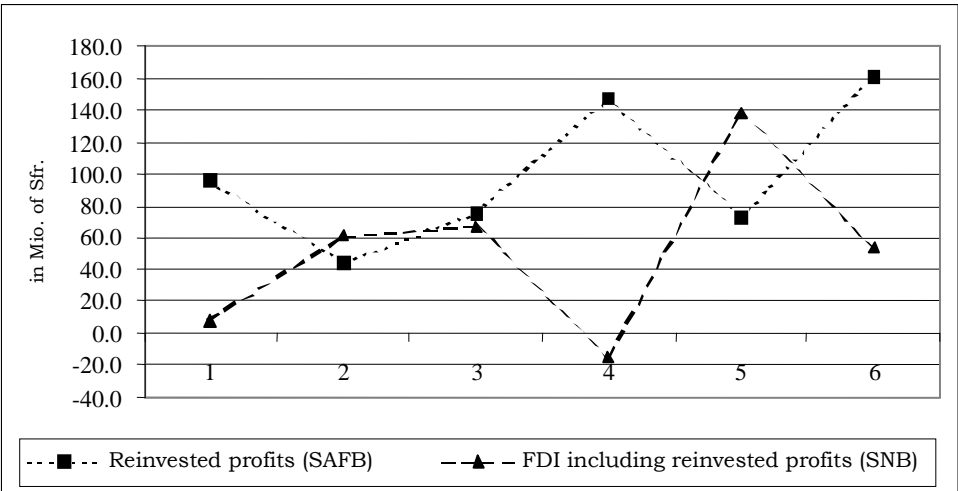
profited, for instance, from lower South African coal prices owing to the coal sanctions as well as generated additional income from the expanded oil trade. The sanctions' impact was somewhat weakened by this. From South Africa's viewpoint, however, the additional income from increasing trade with Switzerland's small economy was relatively minor. There is also no evidence that suggests significant third-party dealings over Switzerland. South Africa was able to develop far larger new markets in other countries.

Financial sanctions

While Switzerland played a subordinate role in trade of goods, its importance in the investment sector was considerably greater.

First, it must be asked if Switzerland transacted important new direct investments. Based on the material available to us, we find that this was not the case. Illustration 2 shows the net size (i.e., inflows in FDI discounting outflows) of direct investments based on Swiss National Bank (SNB) figures. Since we know of no important disinvestments at the time, they can be equated roughly with gross inflows in FDI. But the problem is that these figures contain reinvested profits that were not subject to sanctions. The reinvested profits were identified by the SARB, but the figures are not easily compared to those of the SNB. The reinvested profits noted by the SARB tend to be too high in comparison to the SNB figures. However, it can be concluded that the major portion of the FDI at the time consisted of non-sanctioned reinvestment of profits.

Illustration 2: Swiss FDI (size of flow)



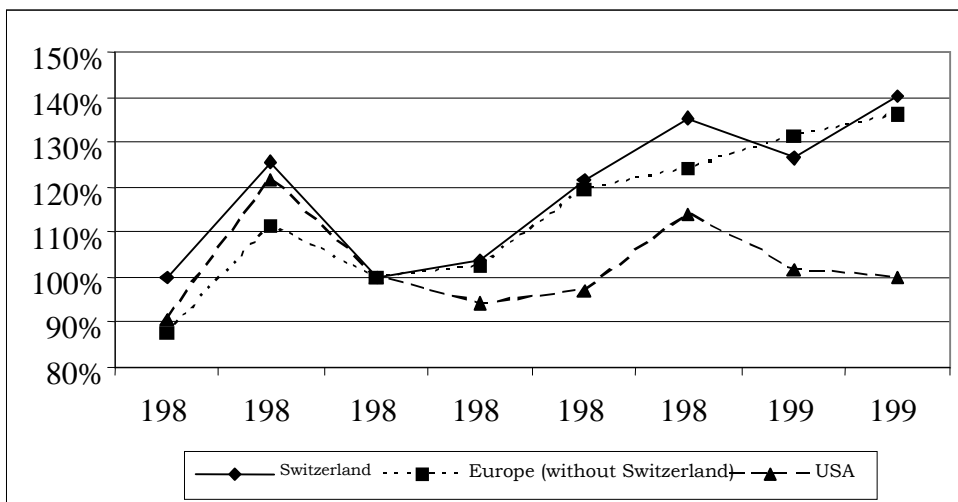
Sources: South Africa's balance of payments 1946-1992 (SARB, 1993), SNB (on request), personal calculations

Analysis of stockholdings shows that Swiss firms managed to transact certain new investments nevertheless. However, we cannot ascertain the extent to which this observed increase is attributable to new direct investments or, say, non-sanctioned purchase of stocks from withdrawing American firms.

### Other investments

Regarding the extent to which Switzerland undermined the impact of official economic sanctions, it should still be noted that the other investments (portfolio investments and credits/loans) were only sanctioned by the USA. The comparison with the EC (Illustration 3) shows that Switzerland conducted itself similarly to the EC in not imposing sanctions. The USA's obligations developed less intensively than those of Europe. However, at least part of these developments can be traced to the substantially weaker development of the dollar against the rand in contrast to the European currencies. Thus the USA's increase in investments tends to be too low, while developments in Switzerland's case appear too high, due to the Swiss franc's strong price earnings. At the same time, however, economic pressure of American cities and states on USA firms may in effect have caused increased capital withdrawals. Owing to insufficient data, it cannot be stated with certainty if and by how much the American capital outflows were greater than those of the EC and Switzerland.

Illustration 3: Non-direct investments (situation 1986=100%)



Source: South Africa's balance of payments, 1946-2000 (SARB, 2001)

It can be established in general that Switzerland's economic conduct during the sanctions period did not vary significantly from that of the EC. The sanctions indicate numerous loopholes and also gave other countries the opportunity to invest if needed. Crucial for the investor's behavior was the weak economic situation in South Africa, and this made investments no more attractive for the Swiss than for other countries. The USA behaved somewhat differently, but this was attributable to the disinvestment campaign and not to the official economic sanctions.

### **Outlook**

The study intentionally confined itself to the official economic sanctions. Considering the very limited teeth of these sanctions, it can be concluded that Switzerland's failure to take part in the official economic sanctions did not prolong Apartheid. This can be explained not least by the ineffectiveness of the economic sanctions. One question remains open: What would have happened if the other countries had imposed stricter sanctions and Switzerland had not taken part. One can still dispute the degree to which economic sanctions can affect political transformation –

if at all. Economists are rather skeptical in this regard. Experiences to date also show that economic sanctions practically never summon the necessary pressure for major political changes (as the example of Iraq indicates). Economic sanctions often punish the wrong party, as also occurred in South Africa, where black workers especially had to bear the brunt of the cost. In South Africa's case the debt crisis had already shown that exerting economic pressure would not bring about political reforms. It was also feared that the liberal white population with British passports would leave the country in case of a prolonged economic crisis, while the Boers – usually supportive of Apartheid – had no second homeland and would also tend to resist outside pressure on historic grounds. Finally South Africa's economic collapse would presumably have led to an economic crisis for all southern Africa.

In conclusion, it must be noted that precisely South Africa's economic development and industrialization in and around the whites' major cities ultimately made the Apartheid system impossible and led to its fall.