

Blumenfeld, Jesmond

Article — Digitized Version

The economics of South African sanctions

Intereconomics

Suggested Citation: Blumenfeld, Jesmond (1987) : The economics of South African sanctions, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 22, Iss. 4, pp. 190-198, <https://doi.org/10.1007/BF02932252>

This Version is available at:

<https://hdl.handle.net/10419/140088>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

The Economics of South African Sanctions

by Jesmond Blumenfeld, London*

The present debate on economic sanctions against South Africa reveals that, despite a long history of the threat and use of economic sanctions in international relations, there still prevails a wide array of misconceptions regarding the nature, mechanisms and consequences of such a policy. This article examines some of the economic aspects of the way in which sanctions can impact on a target country and assesses their implications for the South African case.

For almost thirty years now, opponents of apartheid have been striving to secure the imposition of international economic sanctions against South Africa.¹ Their campaign has been intensified over the years and has recently registered some limited successes.²

The threat and use of economic sanctions in international relations is neither new nor rare.³ Yet, neither the political nor the economic nature, mechanisms and consequences of a policy of sanctions are well understood even among those who advocate and employ them. Indeed, public pronouncements reveal a bewildering and often contradictory array of misconceptions and false presuppositions on all these issues. The purpose of this article is to examine some of the economic aspects of the way in which sanctions can impact on a target country and to provide a brief assessment of their implications for the South African case.⁴

The Nature of Economic Sanctions

Economic sanctions are clearly a foreign policy tool. Their effectiveness must therefore be judged in relation to the policy objectives.

On occasion, the adoption of sanctions by one country against another may constitute little more than a political or diplomatic gesture by the "injured" party, the primary purpose of which is to satisfy domestic demands for action of some kind without incurring the significant costs, or courting the dangers, inherent in more substantial actions.

* Lecturer in Economics, Brunel University, West London and Convenor, Southern Africa Study Group, Royal Institute of International Affairs (Chatham House). The work upon which this article is based forms part of a larger project being undertaken by the author on the political economy of economic sanctions.

In general, however, the employment of economic sanctions implies some hope or expectation of inducing the target country to cease or amend certain "offending" policies. These may range from specific economic or trade policies (as in the 1987 US sanctions in response to alleged Japanese violation of an agreement on exports of micro-chips), to specific political policies (as in the 1986 Western sanctions on account of Libyan support for international terrorism), to entire socio-political systems (as in the case of South Africa).⁵

Economic sanctions therefore constitute an attempt to achieve a political end, namely a change in policy, via an economic means, namely alterations in trade,

¹ The first major international conference on South African sanctions was held in London in 1964. See Ronald Segal (ed.): *Sanctions Against South Africa*, Penguin, 1964.

² Resumes of the sanctions hitherto imposed are contained in J. P. Hayes: *Economic Effects of Sanctions on Southern Africa*, Thames Essay No. 53, Trade Policy Research Centre/Gower, 1987, Ch. 2; and in "Sanctions and the South African Economy", ODI Briefing Paper, Overseas Development Institute, December 1986, p. 2.

³ Case studies of more than one hundred instances of sanctions since 1914 are presented in Gary Hufbauer, Jeffery Schott: *Economic Sanctions Reconsidered: History & Current Policy*, Institute for International Economics, 1985.

⁴ For more general surveys of both the political and the economic aspects of sanctions against South Africa, see Jesmond Blumenfeld: *Economic Relations and Political Leverage*, in: James Barber, Jesmond Blumenfeld, Christopher R. Hill: *The West and South Africa*, Chatham House Paper No. 14, Royal Institute of International Affairs/Routledge, 1982, Part 2; also Jesmond Blumenfeld: *Economic Sanctions and Southern African Peace and Security: A Cautionary View*, in: *Southern Africa in Crisis: Regional and Inter-Regional Responses*, Report No. 28, International Peace Academy/Martinus Nijhoff (forthcoming).

⁵ On the importance of defining limited and specific objectives in economic sanctions, see Gary Hufbauer, Jeffery Schott, *op. cit.*, p. 79 et seq. On the objectives of South African sanctions, see Jesmond Blumenfeld: *Economic Sanctions and Southern African Peace and Security*, *op. cit.*

investment and other economic relationships. This raises two distinct sets of questions, the first concerning the appropriateness and efficiency of the economic measures employed, and the second concerning the impact of the economic consequences upon the pursuit by the target country of the policies at issue. In both instances, the issues are far more complex than is generally acknowledged. As already noted, the discussion which follows is limited largely to consideration of the first of these two sets of questions.⁶

The "Leakages" Problem

Before considering the economic-theoretic effects of sanctions on a target economy it is worth noting that any attempt to impose sanctions must confront the problem of "leakages". Three general points are relevant:

□ It should be self-evident that, on purely practical grounds, *total* elimination of a target country's international economic relations will be feasible only where its borders can effectively be sealed (including the cutting-off of all transport links with the rest of the world).⁷ Outside of a military blockade, such an outcome is likely to be fairly elusive.

□ Attempts by the target country to circumvent sanctions will give rise to incentives for intermediaries to break embargoes and will generally ensure that a proportion of prohibited trade and financial relations will continue, albeit covertly.⁸

□ The ability to impose effective sanctions will be constrained to a greater or lesser extent by the fact that there are also costs to the imposing countries. This is a consequence not only of the fact that trade is mutually beneficial⁹ but also of the fact that effective monitoring and policing of embargoes involves potentially significant resource costs. On both counts, it can be

anticipated that a decision to implement sanctions will encounter political opposition from those required to bear the costs.¹⁰

There can be no doubt that each of these leakages represents a serious constraint on the prospects for total sanctions against South Africa. First, South Africa's sheer physical size of 1.22 million sq. kms. (larger than the combined areas of the Federal Republic of Germany, France, Italy, Belgium and the Netherlands) and its 3000 kms. of continuous coastline alone militate against any suggestion that the country can be easily isolated.¹¹ Secondly, South Africa has already made substantial use of intermediaries in circumventing existing sanctions, especially on oil and arms imports (see below). Moreover, neither the South African government nor South African producers regard the possibility of further sanctions with equanimity, and strenuous covert efforts are being made by both to secure continued access to export markets and continued supplies of imports. Among the many sanctions-busting devices employed are relabelling of goods in transit, falsification of certificates of origin and destination, and re-routing of goods through a third country. In the case of re-routed exports, if some value can be added en route this can often be sufficient to make the last port of call (rather than South Africa) the "country of origin". Thirdly, the costs of imposing sanctions – and particularly of finding alternative sources for the strategic minerals which emanate from Southern Africa – have always represented one of the main inhibitions for South Africa's major trading partners.

All three of these leakages are reflected in the position of South Africa's northern neighbours, particularly Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Zambia and Zimbabwe, many of whose extensive trade and other economic relations with South Africa are virtually indispensable.¹² Several of these countries have publicly acknowledged their unwillingness and/or inability to impose sanctions; others have threatened to impose them but have done conspicuously little to implement them.¹³ For as long as

⁶ See Jesmond Blumenfeld: *Economic Sanctions and Southern African Peace and Security*, op. cit., and *Economic Relations and Political Leverage*, op. cit., for analysis of the political impact of economic sanctions on both South and Southern Africa.

⁷ Apart from the problem of illicit smuggling, international economic relations would still exist in so far as a stock of foreign resources – capital, labour and technology – remained in the target country. See below for problems associated with withdrawal of foreign capital ("disinvestment").

⁸ For a brief account of the scope of "sanctions-busting" activities in the Rhodesian case, see Robin Renwick: *Economic Sanctions*, Harvard Centre for International Affairs, 1981, p. 39.

⁹ In some instances, especially where the target country is a low-cost supplier of a product to world markets, producers in both the imposing countries and in "third party" countries may gain from the sanctions through increased market shares. For example, both Australian and Canadian producers might be expected to benefit from sanctions against competitive South African mineral exports.

¹⁰ Attitudes to sanctions do not, of course, depend only upon cost-benefit calculations about trade gains and losses. Other factors, such as broad ideological or geo-political considerations are also relevant.

¹¹ Jill Nattrass: *The South African Economy*, Oxford University Press, 1981, p. 1.

¹² These relations are detailed in Stephen R. Lewis, Jr.: *Economic Realities in Southern Africa* (or, *One Hundred Million Futures*), IDS Discussion Paper No. 232, Sussex University Institute of Development Studies, June 1987. For brief overviews, see Jesmond Blumenfeld: *The Darker Side of Sanctions*, in: *International Correspondent Banker*, September 1986, pp. 53-54; and Jesmond Blumenfeld: *Economic Sanctions and Southern African Peace and Security*, op. cit.

¹³ J. P. Hayes, op. cit., pp. 18-19.

this remains the case, not only will it be impossible to seal South Africa's northern borders, but these countries, whether wittingly or unwittingly, will also be conduits for illicit trade in many embargoed imports and exports.

The possibility that sanctions may none the less turn out to be very extensive naturally cannot be ruled out. However, leaving aside more explicitly political issues, the leakages alone provide reasons why such an eventuality must be judged to be improbable, except in rather special circumstances.

The Economic Theory of Sanctions

The economic impact of sanctions hinges on the capacity of the imposing country (or countries) to inflict economic "damage" on the target country via embargoes, boycotts and other restrictions on the target's international economic relationships.¹⁴ The damage will be manifest in a variety of effects such as increased costs, reduced revenues, lower output, lower incomes, higher unemployment and reduced economic welfare compared with pre-sanctions levels.

There would appear to be a number of different theoretical mechanisms through which interferences with a target country's foreign trade and financial relations could lead to such economic damage. These include

- ☐ elimination of (or reduction in) the gains from trade through general trade embargoes;
- ☐ exploitation of inflexibilities in the production structure through selective embargoes on imports of specific "critical" commodities;
- ☐ withdrawal of part or all of the existing stock of foreign-owned capital (disinvestment);
- ☐ impairment of productive efficiency by increasing the cost, and disrupting the availability, of tradable goods; and
- ☐ reductions in the rate of economic growth as a result of lower investment rates on the part of foreign or domestic investors (or both).

In principle, each of these five approaches separately affords significant, if varying, scope for inflicting damage upon the target economy, with the extent of the impact in each instance depending upon the specific nature of the underlying economic and technical relationships and structures. In practice, however, all the necessary conditions for achieving the maximum impact may not be met, with the result that, to a greater or lesser extent,

the damage actually inflicted is likely to fall short of the full potential.

Some of the theoretical and empirical possibilities and limitations of each of these cases can be illustrated in relation to South African sanctions.

General Trade Sanctions

Proponents of economic sanctions against South Africa frequently argue for a general trade embargo, many demanding total and comprehensive bans on all trade with the country.

In a state of autarky, a country's capacity to consume is limited by what it can produce, i.e. its feasible consumption set coincides with its feasible production set.¹⁵ Standard international trade theories lead to the conclusion that, provided the necessary preconditions exist, trade is mutually advantageous to all participants both because it extends each country's consumption set beyond its production set, and because it increases economic welfare. Other things equal, therefore, a complete cessation of trade would totally reverse these advantages; a partial cessation would reduce them. General trade sanctions must therefore be interpreted, in principle, as an attempt to eliminate, or at least reduce, the gains from trade enjoyed by the target country.

The potential damage from general trade sanctions will obviously depend in the first instance upon their scope. However, as will be apparent from the earlier discussion of leakages, there is little that can be said a priori about the scope of sanctions except that this will depend upon a host of practical political, economic and organizational factors. A further general consideration which will determine the potential damage is the extent of the target country's gains from trade – in popular parlance, the degree of trade "dependency".¹⁶ Clearly, the greater the gains from trade, the greater the potential losses.

In economic-theoretic terms, however, the impact of sanctions must be measured primarily through their effect on the relative prices of foreign and domestic goods and hence on resource allocation. In general, by restricting the supply of imports to, and reducing the

¹⁴ Where this capacity to inflict damage is, in fact, substantial, the mere threat of imposing economic sanctions may, in certain circumstances, prove sufficient to achieve the objectives.

¹⁵ Strictly speaking, the analysis in this section is predicated upon a situation of continuously full employment of all resources. The target country is therefore assumed to be on its transformation curve both before and after the imposition of sanctions. For the case where unemployment exists prior to the imposition of sanctions, see the analysis of the "cost-raising approach" below.

¹⁶ Trade dependency is usually measured as the combined ratio of imports and exports to GDP.

demand for exports from, the target country, sanctions can be expected to raise the prices of the former and lower the prices of the latter for the target country and so induce a reallocation of resources away from production of exportables towards production of importables.¹⁷ Thus the extent of the losses, particularly when measured in terms of economic welfare, will depend upon the size of this relative price effect. This, in turn, will depend upon more technical considerations such as the degree of flexibility in the domestic production structure and the degree of substitutability between foreign and domestic goods in consumption – the relevance of the latter arising from the fact that the relative price changes will also result in import substitution in consumption, the extent of which will be determined by the flexibility of consumer preferences.¹⁸

Potential Vulnerability

There is no doubt that South Africa's potential vulnerability to wide-ranging trade sanctions is very great. In general terms, South Africa's gains from trade are very substantial. The ratio of exports (including non-factor services) to annual GDP typically exceeds one-third; the corresponding ratio for imports fluctuates fairly widely around one-quarter.¹⁹ In addition, it could be argued that there is only limited flexibility in the production structure, for two reasons: first, that resources employed in the major export sectors – especially minerals (including gold) and agriculture – tend to be highly activity-specific; and second, that import substitution is already relatively far advanced – consumer goods (excluding motor vehicles and accessories) now account for only about 10 % of total imports.²⁰

More specifically, on the export side, if it were politically and practically possible to impose effective embargoes on South Africa's major categories of exports, the risk of very significant losses of export volumes, and hence of export earnings, would be considerable.²¹ What could reasonably be expected to happen in such circumstances? In the short term, governmental assistance in the form of price supports

and fiscal reliefs for export-producing enterprises would almost certainly be forthcoming. The scale of assistance will largely determine both how much the earnings losses will be translated into reductions in output and employment and how much the current rate of output can be maintained, with the produce being warehoused (or, in the case of perishable goods, processed).

In the longer term, and assuming that the embargoes are perceived to be permanent, there will undoubtedly be policies designed to stimulate domestic demand for exportable output, whether as final or as intermediate goods. This will include (further) processing of agricultural products and beneficiation of minerals, and will be assisted by import replacement policies (see below). However, with exports concentrated in mining and agriculture,²² there will be clear limits to demand-side substitution. Thus, the decline in the return to export activities must ultimately bring substantial allocative consequences.

With few exceptions, labour can be expected to be relatively mobile as between sectors and activities, though perhaps less so as between occupations. The obvious problems lie with capital and with natural resource endowments, especially in mining and, to a lesser extent, in agriculture. However, as the Rhodesian experience with sanctions demonstrated, even in agriculture, a surprising degree of resource mobility is possible: whereas tobacco production accounted for well over 50 % of the value of all agricultural output immediately prior to UDI, within five years it had fallen to around 15 % of total sales (with the volume of tobacco production more than halved), while maize, wheat, cotton, soya and cattle production and sales had all increased very substantially.²³ It is noteworthy that all of the substitute activities were far more suited than tobacco for use in satisfying domestic demand for final and intermediate goods.

¹⁷ A "perverse" effect could result if economic sanctions were to raise, rather than lower, the prices of some of the target's exports. This could arise if the target is a major supplier of a commodity to world markets. (See note 21, below).

¹⁸ These are reflected respectively in the concavity of the target country's transformation curve and in the convexity of its community indifference curves. R. C. Porter, 'International Trade and Investment Sanctions', in: *Journal of Conflict Resolution*, Vol. 23, No. 4, December 1979.

¹⁹ South African Reserve Bank: *Quarterly Bulletin*, March 1987, Table S-115.

²⁰ Republic of South Africa (Central Statistical Service). *South African Statistics 1986*, Table 18.16.

²¹ In some of its major export markets, South Africa faces a relatively inelastic demand curve. In these cases, which include gold and several "strategic minerals", unless significant stockpiles were available in the consuming countries, restrictions on South African exports would be likely to raise their international prices and hence mitigate the effect on export earnings, until such time as assured alternative sources become available. On the debate over the importance of South Africa's strategic minerals, see Hanns W. Maull: 'South Africa's Minerals: The Achilles Heel of Western Economic Security', in: *International Affairs*, Vol. 62, No. 4, Autumn 1986, pp. 619-626, and the further references therein.

²² Apart from gold, which typically accounts for at least 40 per cent of South Africa's total merchandise export earnings, precious and base metals, and mineral, vegetable and animal products together account for almost two-thirds of non-gold merchandise export earnings. See South African Reserve Bank: *Quarterly Bulletin*, March 1987, Table S-65; and South Africa: *An Appraisal* (Second Edition), The Nedbank Group, Johannesburg 1983, Table 65, p. 118.

²³ Robin Renwick, *op. cit.*, Table X, p. 103, and E. G. Cross: 'Economic Sanctions as a Tool of Policy against Rhodesia', in: *The World Economy*, Vol. 4, No. 1, March 1981, pp. 69-78.

On the import side the main cause for concern lies with sanctions against capital and intermediate goods (including spare parts) and raw materials (see below for the special cases of oil and arms imports). In the short term, the impact of sanctions will depend primarily upon working capital inventory levels (again including spare parts). Given the threat of sanctions, it is probable that inventory levels among South African producers would, in any event, be higher than for corresponding enterprises elsewhere. In addition, the legislative and administrative machinery for ensuring that adequate stockpiles are maintained has long been in place.²⁴ It can therefore be anticipated that, even in the face of severe restrictions on supplies, a wide range of productive activities will be effectively cushioned from the worst effects for a substantial period of time.

Substantial Capacity for Adaptation

Again, however, if the embargoes were to persist, longer-term adjustments would be unavoidable and, given both price and policy signals, inevitable. Two kinds of adaptation behaviour will ensue. First, there will be direct import replacement through domestic production of capital goods previously imported. Since one of the biggest constraints on any domestic capital goods sector is the size of the domestic market for final goods, this process will almost certainly be both accompanied and aided by measures to expand the domestic market. Since this, in turn, will be highly dependent upon the capacity to expand employment among the black population, it will be closely linked to the second consequence, namely the development of more labour-intensive production technologies to replace existing import-dependent and more capital-intensive methods.

In both respects there are obvious limitations. The domestic production of many capital goods, both of the traditional heavy industrial and the modern high-technology type, will simply be beyond the capacity of an economy as small as that of South Africa. Equally, leaving aside the availability of sufficient entrepreneurship, technical skills and research and development activities, technical indivisibilities in production will preclude the substitution of labour for capital in a number of sectors. But there are also significant possibilities. South Africa already produces capital equipment for mining and it is a world leader both in deep-level mining and in synthetic fuels technologies.

²⁴ The National Supplies Procurement Act of 1970 gave the government sweeping powers to "control and direct the manufacture, acquisition, and supply of any goods and services . . . deemed to be necessary or expedient for the country's security". See Murel Horrell (compiler): *Laws Affecting Race Relations in South Africa 1948-1976*, South African Institute of Race Relations, 1978, p. 443.

The possibility that infant industry potential exists in a number of sectors cannot be ruled out, especially under an altered relative price ratio for capital and labour.²⁵ Moreover, both the current high level of black unemployment and the concentration of purchasing power in white hands clearly suggest that there is much scope for an employment-oriented growth strategy.

In short, while significant trade sanctions would undoubtedly be very disruptive of existing productive activities in South Africa, the capacity for adaptation under the dual impact of sanctions-induced relative price changes and governmental policies should not be underestimated.

Selective Trade Sanctions

The debate about South African sanctions has often focused on the question of "selective" embargoes, especially against the country's oil and arms imports, rather than on general trade sanctions, on the grounds that these commodities are of "critical" importance to the South African economy and/or to the maintenance of apartheid.²⁶ A mandatory embargo on arms sales to South Africa was imposed by the UN Security Council in 1977, while the Arab and African oil-producing states officially have operated an embargo on oil sales since 1973.

In theoretical terms, the case for selective sanctions must rest on a presumed minimum and indispensable requirement for an imported commodity for which there are no – or insufficient – domestic substitutes, at least in the short term. The argument is clearly a powerful one, especially if the commodity in question is one which, like oil, is widely used as an input in production. An effective and extended interruption of supplies would therefore severely disrupt domestic production without permitting the reallocative process which would arise from relative price changes under general trade sanctions. Consequently, the welfare losses would be significant.²⁷

South Africa has no indigenous oil supplies and is – or at least was – therefore potentially very vulnerable to oil sanctions. But the opportunity for the international

²⁵ For an analysis of the factors affecting import substitution potential in Rhodesia at the time of UDI see Timothy Curtin, David Murray: *Economic Sanctions and Rhodesia*, Research Monograph No. 12, Institute of Economic Affairs, 1967. A brief account of the subsequent effects of sanctions on industrial diversification and import substitution is provided in Donald L. Loman: *International Economic Sanctions: The Cases of Cuba, Israel and Rhodesia*, University of New Mexico Press, 1979, p. 111-112.

²⁶ It is only by focusing on such 'critical' commodities that the notion of selective sanctions can be distinguished conceptually from measures which are simply scaled-down versions of a general trade embargo.

²⁷ This is because the target economy's production point would be pushed well back inside its transformation curve.

community effectively to exploit this "Achilles Heel" has almost certainly been lost. The South African government recognised this vulnerability at an early stage in the sanctions campaign, and has worked over the years to reduce it by pursuing a three-pronged programme of stockpiling, import substitution and, to a lesser extent, end-use substitution.²⁸

Paradoxical Consequence

Although specific vulnerabilities do still exist, especially in respect of certain specialized fuels and oils, the reality is that South Africa has built a very substantial cushion against the possibility of an effective oil embargo. Consequently, in order to have any chance of achieving real and widespread damage and disruption now, a virtually leak-proof embargo would be required and would have to be maintained for an extended period, probably exceeding several years. Even without the problem of the significant incentives which undoubtedly would exist for evading it, effective and sustained policing of such an embargo would be a difficult and costly task. There is also no doubt that during the embargo period the push towards self-sufficiency would be intensified, thus effectively defeating the embargo.

This paradoxical consequence, whereby the attempt to deny a target access to critically important goods merely leads (given a sufficient time-lag) to their domestic production and hence deprives the imposing countries of one of their most powerful weapons, applies equally to the arms embargo on South Africa.²⁹ Since the imposition of mandatory UN sanctions some 10 years ago, South Africa has significantly expanded its armaments production industry and is reportedly exporting arms on a substantial scale.³⁰

It is, of course, true that domestic development and production of all forms of weaponry, and especially of large-scale hardware (particularly for the navy and air force) is not feasible. To date, it has been possible to fill some of these gaps through breaches of the embargo. These include the use of intermediaries to procure replacement supplies in world markets, illegal

acquisition of blueprints, and covert cooperation with other small-scale arms producers, such as Israel.³¹ Consequently, a more effective embargo would probably lead to increasing shortages in some areas in the long term. It is, however, difficult to envisage these effecting crucial reductions in South Africa's domestic or regional military capacities, unless they are accompanied by radical improvements in the corresponding military capacities of the Front Line States.

Disinvestment

In many respects, it has been the demands that multinational corporations should disinvest from South Africa – and the highly publicised withdrawals by several major investors – rather than trade sanctions, which have attracted most attention in the Western debate.

Since foreign resources augment domestic resources they naturally extend the target country's feasible production set and increase economic welfare. It therefore follows logically that withdrawal should have the reverse effect. In practice, however, withdrawal may not actually be possible, and where it is possible it may result in substantial losses for the foreign investors.

Some general consequences can be expected to apply to all disposals of foreign-owned investments, whether direct or indirect, in the target country. If the purchasers are other non-residents, the transactions will simply involve a change in the distribution of ownership of foreign assets in the target country. If the purchasers are residents, then the stock of foreign investment will fall, but the total capital stock remain intact. In this latter case, however, and assuming that the proceeds of the sale are repatriated, there will be balance of payments consequences in that the transactions will culminate in an increased demand for foreign currency and an outflow of long-term capital.³² In short, the real assets which are the counterpart of the target country's liability to foreign investors remain within the target, even when the financial liability has been discharged. Moreover, if the target country operates foreign exchange controls, even the financial capital may have to remain.

These considerations suggest that, in general, withdrawal by existing foreign investors, even on a relatively large scale, is unlikely to have a marked direct impact on the "real" economy – i.e. on current domestic

²⁸ The oil embargo issue is discussed at length in Jesmond Blumfield: *Economic Relations and Political Leverage*, op. cit., pp. 53-57. The proposed Mossel Bay oil-from-gas conversion project will further extend South Africa's capacity to withstand oil sanctions. See *Financial Mail*, Johannesburg, 27 February 1987.

²⁹ In strictly economic terms, armaments do not fall into the same category as oil, since they are clearly not a crucial productive input. They are, however, widely – and correctly – seen as crucial to the maintenance of political power.

³⁰ See, for example, Graham Leach: *South Africa* (Revised Edition), Methuen, 1987, pp. 281-2; and *Southern Africa Report*, Johannesburg, Vol. 5, No. 11, 20 March 1987.

³¹ *Southern Africa Report*, Johannesburg, Vol. 5, No. 5, 6th February 1987.

³² However, there will be a compensating – and possibly non-negligible – reduction in the outflow of profits and dividends on the current account of the balance of payments.

output and employment levels – in the target country.³³ To the extent that it generates substantial capital flows, however, disinvestment is likely to have far greater repercussions on the target's financial markets, including the exchange rate, and hence indirectly on real variables.³⁴

Impact on Capital Markets

In respect of the impact on financial markets, distinctions must be drawn between the effects of withdrawal of foreign loan, equity and direct investments. In the case of equities, disinvestment will have a direct impact on the equity market similar to that generated by any large-scale disposal of stocks. In the case of foreign lending to, and direct foreign investment in, the target, the impact on the domestic capital markets will be less direct. Recall of foreign loans, whether to the private or the public sectors, will generally necessitate some recourse by borrowers to alternative sources of credit. The externalities inherent in the advance and recall decisions of major lending institutions are likely to make substitute foreign sources of funds less easy to obtain and hence more expensive. An increase in on-shore borrowing can therefore be anticipated, with consequent implications for domestic interest rates. Disposals of direct foreign investments can affect the equity and other capital markets to the extent that the investments are acquired by domestic residents, thereby generating additional portfolio adjustments.

If foreign loan recalls are successful, the investments will normally retain their capital value. In all other cases, however, large-scale disinvestments – especially if they involve “forced” sales – are likely to result in capital losses for the sellers by reducing the realizable market prices of the relevant assets. In addition, in all cases (including loan recalls), repatriation of the proceeds will have adverse effects upon the exchange rate (again assuming that repatriation is possible).

Consequently, large-scale disinvestment can be expected to lead to potentially significant capital losses for the departing asset-holders. Moreover, in contrast

with the effects on domestic economic actors, which (with the possible exception of loan recalls) are likely to be widely dispersed – perhaps even largely dissipated – through the markets, the effects on departing foreign investors will be highly concentrated.³⁵

Psychological Impact

Considerations of space preclude detailed discussion of the consequences of the growing incidence of disinvestment from South Africa in recent years. Suffice to say that all the above effects have been observable in greater or lesser measure. Of particular importance has been the psychological impact upon domestic economic actors. As the disinvestment process gathered pace, especially from mid-1985, involving both substantial disposals of foreign equity holdings and substantial recalls of foreign loans, the country's financial markets were initially thrown into considerable disarray.³⁶ Predictably, the exchange rate bore the brunt of the pressures.³⁷

Subsequently, however, a significant degree of stability was reimposed mainly as a result of the re-introduction in September 1985 of the dual exchange rate, which had been abolished in February 1983, and of the declaration of a moratorium on repayment of almost three-fifths of the total foreign debt. Although these developments naturally have had (and will continue to have) profound economy-wide consequences, it remains true that the direct impact of disinvestment on the real economy has been limited.³⁸

A similar process of adjustment and adaptation accompanied the surge in withdrawals by major multinational corporations, especially in 1986. Once again there was unsettling initial apprehension about the consequences. However, realization soon began to dawn that the hurried withdrawal of foreign corporations implied the availability at highly favourable prices of productive assets, the acquisition of which could be very beneficial to domestic enterprises. The result was that some of the concern about the longer-term consequences of reduced access to foreign resources (see next section) began to give way to enthusiasm for its short-term benefits.³⁹

³³ However, future output and employment levels may well be more seriously affected. See the discussion of measures designed to lower the rate of growth (below).

³⁴ To the extent that a process of withdrawal of existing foreign investment causes a reduction in the inflow of new foreign investment, the impact on the real economy will be correspondingly larger. The two phenomena are, however, conceptually distinct. For a discussion of the effect of reduced new investment see below.

³⁵ These losses must however be weighed against the alternatives. One of the major driving forces behind the recent disinvestment process from South Africa has been the threat to international corporations' non-South African revenues and profits from the “divestment” and “procurement legislation” campaigns, especially in the United States. In many instances, these potential losses would dwarf the costs of withdrawing from South Africa.

³⁶ See Jesmond Blumenfeld: South Africa: Economic Responses to International Pressures, in: *The World Today*, Vol. 41, No. 12, December 1985, pp 218-221.

³⁷ Since there were domestic and external political and economic pressures on market sentiments it is difficult to distinguish their effects. Indeed, it is clear that the external pressures both fuelled, and were fuelled by, their internal counterparts.

³⁸ See Jesmond Blumenfeld: *Economy Under Siege*, in: Jesmond Blumenfeld (ed.): *South Africa in Crisis*, Royal Institute of International Affairs/Croom Helm, 1987, p 22 et seq.

Against all this, the capital losses suffered by foreign investors have undoubtedly been substantial. Apart from depressing the market prices of foreign-owned assets,⁴⁰ by contributing to the decline in the exchange rate, disinvestment has undoubtedly also inflicted severe foreign exchange losses on departing investors.⁴¹

The Cost-raising Approach

The view is frequently expressed that sanctions would have the effect of raising the cost to South Africa of continued pursuit of its apartheid policies and hence of inducing a shift away from those policies.

At one level, this argument is indistinguishable from the general trade sanctions case already outlined. On the reasonable assumption that the target country is likely to be a price-taker in most world markets, especially for its imports, the source of exogenous price changes is immaterial: resource allocation will simply adjust to changing relative prices (after appropriate allowances for time-lags). However, this implicitly assumes the maintenance of relatively full employment or, equivalently, a very high degree of price flexibility.

In practice, of course, persistent conditions of unemployment and inefficiency may well exist in the target country as a result of both price inflexibilities and resource immobilities. In these circumstances, where an economy is already operating well within its feasible production set, there are real possibilities that, by raising the resource cost of its participation in international trade, sanctions could further impair productive efficiency and reduce economic welfare.

Thus, the existence of market imperfections may well inhibit adjustment in the face of the adverse impact of sanctions on output and employment, and hence on unit cost and profit levels, in the affected sectors. For example, sustained difficulties in obtaining imported spare parts or other productive inputs could disrupt production; and the need to circumvent embargoes through middlemen and/or more circuitous transport routes could raise the supply prices of such goods. On

the export side, reduced foreign demand could result in increased storage costs for unintended inventories; export revenues could also be reduced as a result of enforced discounting to maintain market shares. Evidence from the Rhodesian case suggests that the latter effect can be particularly important.⁴²

There are, however, two factors which could reduce market imperfections and hence mitigate these effects. Both arise from the fact that – contrary to the assumption which often appears implicit in arguments for sanctions – economic actors in the target country will not stand idly by in the face of the external pressures. To begin with, the government can be expected to adjust its fiscal and monetary policies both to compensate for the reductions in aggregate demand and the income redistributions induced by sanctions, and to direct resources towards activities hitherto eschewed by the markets. In addition, there is no *a priori* reason why, in an already non-optimal situation, the effect of sanctions should not be to improve (rather than worsen) resource allocation decisions, if only by making all economic actors more aware of the scarcity and opportunity cost of resources. Again, there is evidence that, at least in a number of instances, allocative efficiency in the Rhodesian economy improved under the impact of sanctions.⁴³

Questions About Efficiency

Except for the oil and arms embargoes, South Africa's experience of significant trade sanctions is still too recent and too limited to permit proper evaluation of the allocative implications of domestic market imperfections in relation to sanctions-induced increases in costs. However, the fact that the sanctions hitherto imposed, and the threats of further sanctions, have generated a search for new export markets and forced both users and sellers of tradable goods to re-examine the nature of their operations, suggests that at least some improvements in efficiency and some reductions in cost may materialise. Against this, it is clear that the external pressures in general, and disinvestment in particular, have resulted in an even greater degree of industrial concentration which may well lead to reductions rather than improvements in efficiency. In addition, the notion that the already large share and role of the state in spending and allocation decisions should be increased must raise further questions about efficiency.⁴⁴

³⁹ *Ibid.*, p. 25. On some of the political contradictions of disinvestment, see also Anthony Robinson 'Disinvestment From South Africa: Inside, Doubt Takes Root', in: *Financial Times*, London, 16th June 1987.

⁴⁰ In the case of General Motors, in order to facilitate a management buy-out, the American parent reportedly had to inject additional capital to liquidate debts, in effect implying that the corporation had to buy itself out of, rather than sell off, its South African investment. See *Financial Mail*, Johannesburg, 7th November 1986, p. 87.

⁴¹ Since September 1985, the self-inflicted element in these losses has been enhanced by the operation of the financial rand mechanism to which all capital flows have been confined. See Jesmond Blumefeld: 'South Africa Economic Responses to International Pressures', *op. cit.*, Note 23, p. 22.

⁴² E. G. Cross (*op. cit.*, p. 73) estimates that of the total cost to the Rhodesian economy of lost export revenues over the fifteen years of sanctions, almost one-third was attributable to the discounts necessary to induce buyers to circumvent the sanctions.

⁴³ Donald L. Losman, *op. cit.*, Ch. 5.

⁴⁴ But see E. G. Cross, *op. cit.*, p. 77 for a contrary argument.

Even in the cases of oil and arms, it would be difficult to determine whether, on balance, the defensive development of import replacement industries has improved or worsened allocative efficiency. Certainly, they have been very costly in the scale of resources which they have pre-empted.⁴⁵ On the one hand, therefore, they may be viewed as a severe penalty for the unwillingness to take the political steps which might lead to the lifting of the embargoes. On the other hand, given this policy stance, it must surely be preferable (at least from the authorities' point of view) to incur the resource costs of circumventing the sanctions than of suffering them. Moreover, there can be no doubt that, at the minimum, they have had important positive economic consequences in increasing investment, creating employment and, perhaps most importantly, in promoting technological research and development on a major scale.

Lowering the Rate of Growth

Since many of South Africa's opponents believe that economic growth and apartheid are mutually reinforcing, sanctions – particularly against new foreign investment – have often been advocated as a means of reducing growth.⁴⁶

In principle, if sanctions can reduce either (or both) the demand for, or the supply of, investable resources, a lower growth rate will ensue. Demand for capital depends, *inter alia*, on profit expectations which are likely to be adversely affected by both trade and financial sanctions. The supply of capital can be met from both foreign and domestic sources. In so far as sanctions reduce incomes in the target country, they might be expected to reduce domestic savings. However, income is only one of the determinants of savings behaviour and it is not inconceivable that the domestic supply of capital can be increased under sanctions, especially through fiscal incentives. In addition, a decline in the private demand for capital could be offset by a higher level of public sector investment.

Sanctions against the supply of new foreign resources may also lower the total supply of savings. Although the possibility of a compensatory increase in domestic savings again cannot be ruled out, it is unlikely

that domestic and foreign savings will be perfect substitutes for each other. The main reason for this is that foreign capital often brings with it new technologies which might not otherwise be available.

The crisis of recent years has certainly led to a fall in both the supply of and the demand for long-term capital in South Africa, and hence to a reduction in the rate of growth. Equally certain is the fact that external economic pressures have been one of the contributory factors.⁴⁷ Indeed, there is no doubt that the adverse effects on fixed investment demand and hence on growth represent some of the most serious consequences of the sanctions hitherto imposed.

In the longer term the question marks over the availability of investment capital pose some of the most daunting challenges to South Africa's policy makers.⁴⁸ Of particular importance is the question of access to foreign technology. South Africa's manufacturing industry has traditionally made substantial use of imported technology and, notwithstanding the earlier comments about the possibilities for import substitution based on more indigenous technologies, the growth effects may yet prove irrecoverable. To the extent that foreign technologies can be acquired without being embodied in physical capital, however, these effects may be partially mitigated.

Conclusions

The nature of economic sanctions is far more complex than is generally supposed. Whilst many of the theoretical arguments for sanctions suggest a substantial potential for inflicting damage on the target economy, the conditions necessary for this outcome are often quite stringent and are not always present in empirical situations. Moreover, in the particular case of trade sanctions, whatever the theoretical possibilities for eliminating the target's foreign trade flows, in the real world such efforts are always likely to be subject to considerable leakages.

The case of South Africa amply demonstrates that, while sanctions undoubtedly have consequences for a target country, these are not always or necessarily adverse. Most importantly, it shows that the capacity to adapt to sanctions, as a result both of relative price effects and of governmental policies, can be seriously underestimated.

⁴⁵ The premiums paid to secure oil in the face of the international embargo alone reportedly totalled R22 billion over 10 years. J. P. Hayes, *op. cit.*, p. 40, Note 1

⁴⁶ The relationship between economic growth and apartheid has been the subject of much debate. See Merle Lipton 'Reform: Destruction or Modernization of Apartheid?', in: Jesmond Blumenfeld (ed.) 'South Africa in Crisis', *op. cit.*; also Jesmond Blumenfeld 'Class, Race and Capital in South Africa Revisited', *n. Political Quarterly*, Vol. 57, No. 1, January-March 1986, pp. 74-83.

⁴⁷ Jesmond Blumenfeld 'Economy Under Siege', *op. cit.*

⁴⁸ These problems are discussed at length in Jesmond Blumenfeld 'Investment, Savings and the Capital Market in South Africa', in: John Suckling, Landeg White (eds.): *After Apartheid: Renewing the South African Economy*, James Currey (forthcoming).