A Crucial Point for Financial Sanctions on South Africa

by John Lind of CANICCOR

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Financial sanctions have been the most effective sanctions for slowing South Africa's economy and challenging South Africa politically. In a certain sense, South Africa brought them on itself because of financial mismanagement by the South African banks. In September 1985, this mismanagement, combined with riots in the black townships, led to a crisis precipitated by the U.S. banks. South Africa then refused to repay principal on much of its debt for six months until an interim agreement to repay about 5 percent of the principal by June 30, 1987. As that date drew near another interim arrangement covered three years to June 30, 1990 during which a little less than 5 percent is being paid back each year.

As a result U.S. banks, which had lent about $5 billion in South Africa by late 1984, have reduced their exposure to about a half of that amount by the end of 1988. (See Table 1 .) This significant decrease of U.S. bank exposure equals the value of all direct investment by U.S. corporations at the height of investment in the early 1980s. It is also equal to about one fourth of all credits necessary for imports to South Africa.

Two factors make this a crucial moment for financial sanctions: Under the present agreement, $3.5 billion of the $11 billion, which was to come due on June 30, 1990, has been converted into ten year exit loans, reducing the economic pressure in 1990. Secondly, a new agreement is being negotiated this summer between the banks and South Africa.

Religious groups are pressing the thirteen banks (from five countries), which are on the negotiating committee with South Africa, to refrain from converting debt into ten year exit loans and to drive a hard bargain for repayment under the next interim agreement. In the U.S. they have suggested a one-year agreement, repayment of 15 percent of the original amount in that year, i.e. $1.65 billion.

The Early 1980s

The process started in 1980 when the price of gold shot up and peaked at over $800 per ounce, the international economy expanded rapidly and international banks began vigorous lending to South Africa. Gold represents over 40 percent of South Africa's exports. This lending picked up as the world debt crisis broke in 1982 and banks sought new markets for their funds which had previously been lent to less developed countries. South African banks began borrowing massively in the interbank market through their London and New York offices. Though borrowing was short-term, the South African banks, especially Nedbank, often relent long term to South African industry, including the Electricity Supply Commission, for capital expansion.

From Boom to Bad Credit Rating

However, by mid 1984 the economy had declined, unemployment had risen and the black townships had erupted in riots. Unrest and persistent antiapartheid pressures led U.S. banks to start reducing their exposure in South Africa in the fourth quarter of 1984, as shown in Figure 1. Simultaneously many cities, including New York City, in which the major lending banks reside, passed ordinances requiring banks that do business with the city to cease lending to the South African government. Some U.S. cities even excluded lending to private sector borrowers in South Africa.

As pressures mounted, U.S. banks reduced exposure rapidly through the first half of 1985 because most of their lending to South African banks was short term. However, South Africa found it increasingly difficult to pay off the debt, since much of it was in long term projects. At the beginning of August, Chase Manhattan reportedly refused to roll over any of its short term loans, sparking a run on South Africa during August.

One month later on the first of September, South Africa called a moratorium on the payment of principal on all debt immediately falling due except for bonds and debt insured by foreign governments. South Africa ceased to have a good credit rating. Almost no new conventional loans have been made by banks since the moratorium.

Interim Repayment Agreements and New Lending

By March 1986 a committee of banks had worked out an interim arrangement to cover South Africa's debt payments through the middle of 1987. The agreement covered about $10 billion of South Africa's $23.5 billion foreign debt. All debt falling due during this period was covered except for bonds, IMF borrowings, credits insured by foreign government insurance agencies, certain South African government insured debts and trade credits provided after January 1, 1985. In return South Africa agreed to repay 10 percent, mostly up front, of this $10 billion of principal. In March 1987, the interim agreement was renewed for the three year period from July 1, 1987 through June 30, 1990 covering about $13 billion.

By late 1986 South Africa again began to receive new loans in the form of trade credits, whose repayments were exempt from the interim agreement and were paid on time. Since then these trade credits, mostly from European banks, have been the primary form of lending. Trade credits are specifically tied to export items to South Africa and such credits do not provide the flexibility of the former general capital lending.

While the U.S. Comprehensive Anti-Apartheid Act of 1986 permits trade credits as the only form of lending by U.S. banks to South Africa, few U.S. banks have provided such credits. Exposure of U.S. banks in South Africa has decreased 14 percent between the end of 1985 and mid 1988. In contrast the exposure of British banks actually increased 2 percent with the banks in other countries falling between the extremes of the U.K. and the U.S. Total exposure of all the banks in five countries with the major bank lenders has decreased about 9 percent in that thirty month period.

Table 1
Estimates of U.S. Bank Exposure in South Africa
as of September 30, 1988
(in millions of dollars)

N.B.: John Lind estimates based on *Country Exposure Lending Survey*, FFIEC Statistical Release, January 11, 1989.

TOTAL U.S. BANKS: $2,725

MONEY CENTER BANKS:	
Citicorp	$670
BankAmerica	125
Chase Manhattan	340
Manufacturers Hanover	210
Morgan	195
Chemical NY	135
Bankers Trust	170
First Chicago	10
Continental	175
Money Center Total	$2,030
OTHER 13 BANKS:	
Security Pacific	$160
Irving (Bank of NY)	165
Republic (NY)	50
Others**	119
Total other 13	$494
REMAINDER:	
NCNB	$65
American Express	70
Others	68
Remaining total	$203

**When First Republic, formerly Republic Bank (TX), was sold to NCNB, the disposition of an estimated $90 million of South African loans was uncertain.

Conversion to Long Term Loans Eases Other Debt Pressures

South Africa's debt outside the interim agreement requires large payments in 1990 and 1991, dominating its immediate financial future. Principal and interest due in those two years amounts to over $2 billion each year. These debts are bond issues, medium and long-term guaranteed loans and trade credits, etc. To ease the repayment squeeze with this debt, South Africa would like to pay back as little as possible of formerly frozen debt under the next interim agreement in 1990 and 1991.

Hoping to reduce payments in these two years, South Africa built into the second interim arrangement of 1987 an option for banks to convert their debt into ten year exit loans with a five year grace period on the payment of principal. Principal would not start to be paid until after the fifth year of the loan, thus exempting these loans from payment of principal for these two crucial years. In return the banks would receive a slightly higher interest rate and a guarantee that the loans would be repaid on schedule. Banks could gamble on more rapid repayment under the next interim agreement or convert to ten year exit loans with a higher interest rate and a later but definite repayment schedule.

Banks Take the Bait

In late 1988 the financial press suggested that perhaps $3 billion of the $11 billion, which would have fallen due under the interim arrangement on 1 July 1990, had been converted into ten year exit loans. In January 1989, Citicorp revealed it no longer had any exposure under the interim arrangement, having converted all its South African outstandings (about $660 million) into ten year exit loans. In fact federal bank statistics at the end of 1988 suggest that U.S. banks had converted the following amounts: money center banks, which hold three-fourths of the South African exposure—$720 million; the "other thirteen" regional and smaller banks—$120 million; and the remainder—about $20 million. The grand total is about $860 million with Citibank holding about three-fourths of it. Manufacturers Hanover converted a small part of its debt portfolio.

The graph at the bottom of Figure 1 shows that Citibank started converting its debt immediately after the second interim agreement took effect. This graph shows the rapid rise in the amount of long term debt held by U.S. banks beginning in the third quarter of 1987. By the end of 1988, fully one third of all the remaining U.S. bank exposure had been converted into ten year exit loans.

British banks appear to have converted $400 to $500 million with the other $1.6 billion having been converted by continental and Japanese banks. Finally, another half billion was converted in the first quarter of 1989, leaving only $7.5 billion under the interim agreement.

The Negotiating Banks

The original bank negotiating committee for the South African interim agreement consisted of fourteen banks, three of them U.S.-Citibank, Manufacturers Hanover and Morgan Guaranty. Citibank has removed itself by its debt conversion. The other banks are U.K.—Barclays, Standard Chartered and National Westminster; Switzerland—Union Bank of Switzerland, Swiss Bank Corporation and Credit Suisse; Germany—Dresdner Bank, Deutsche Bank and Commerzbank; France—Credit Lyonnaise and Banque Indosuez.

What Is Being Done?

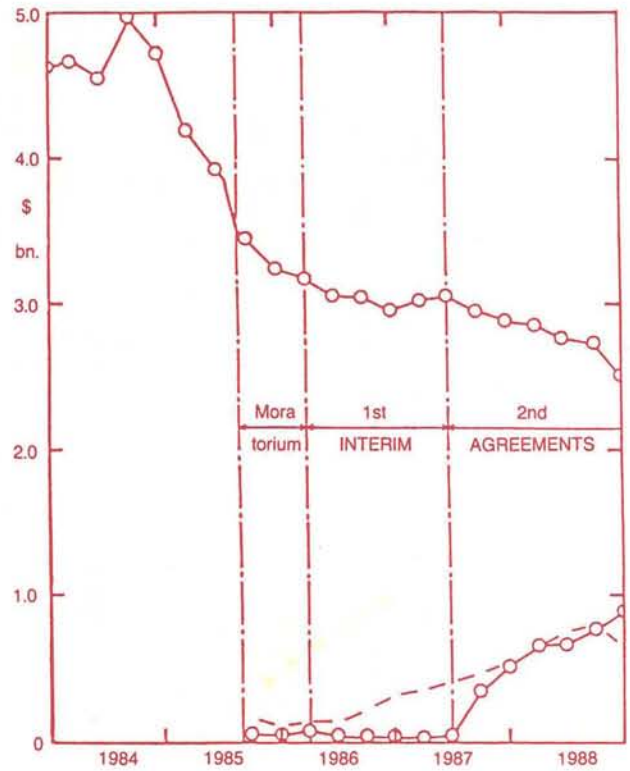
Religious organizations, coordinated by ICCR, have protested Citibank's conversion of its South African debt and have suggested that it violates the spirit, if not the letter, of the antiapartheid legislation of 1986. Pressure is building in the Congress to impose stronger financial sanctions on Pretoria and the committees of the House and Senate soon will hold hearings. Religious stockholders will also file resolutions with banks that have significant lending under the interim agreement to urge that they not convert more of these loans to ten year exit loans.

Simultaneously, U.S. religious groups, the British Council of Churches, the Protestant Church Federations of Germany and France and the Swiss Dialogue Committee (a joint committee of the Swiss Protestant Federation and the Swiss Bishops Conference) are contacting their banks on the debt negotiating committee. This international campaign was proposed by CANICCOR (led by John Lind) through ICCR. With individual variations, these religious institutions seek meetings with their banks, urging the banks to convert no more of South Africa's debt into ten year exit loans, that the next interim agreement call for as rapid as possible a payback of the debt and that the banks exclude or minimize trade credits. Some also are suggesting that South African gold be separated on the Zurich and London markets.

In the U.S., J.P. Morgan has indicated it will seek maximum repayment in the new interim arrangement with South Africa. Faith communities are now writing South Africa's major credit banks to urge they cease converting South Africa's debt into ten year loans. Finally, to increase pressure on the Swiss banks, which are the staunchest supporters of South Africa, religious groups are writing U.S. customers of Union Bank of Switzerland requesting that they seek other underwriters for their issues of bonds and notes.

For the first time, there is a coordinated international effort to pressure bank negotiations with South Africa. The success of this effort will be apparent before the end of 1989. ■

Figure 1



Total exposure of U.S. banks in South Africa (upper graph). Exposure of U.S. banks with a maturity of over 5 years (lower graph with data points).