REPORT NO. 595

APPLICATION FOR AN INCREASE IN THE RATE OF CUSTOMS DUTY ON PHOSPHORIC AND POLYPHOSPHORIC ACIDS

The International Trade Administration Commission of South Africa herewith presents its Report No. 595: **Application for an increase in the rate of customs duty on phosphoric and polyphosphoric acids.**

Nzimande

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CHIEF COMMISSIONER

PRETORIA

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REPUBLIC OF SOUTH AFRICA

INTERNATIONAL TRADE ADMINISTRATION COMMISSION OF SOUTH AFRICA

REPORT NO. 595

APPLICATION FOR AN INCREASE IN THE RATE OF CUSTOMS DUTY ON PHOSPHORIC AND POLYPHOSPHORIC ACIDS

Synopsis

The International Trade Administration Commission of South Africa ("ITAC" or "the Commission") received an application from XA International Trade Advisors submitted on behalf of Chemical Initiatives (Pty) Ltd, a Subsidiary of AECI Limited ("Chemical Initiatives"), hereon referred to as the applicant, for an increase in the general rate of customs duty on phosphoric and polyphosphoric acids classifiable under tariff subheading 2809.20 from free of duty to 10 per cent *ad valorem*, by way of creating an additional 8 digit tariff subheading.

The Commission found that:

- The applicant and Soyo Chemicals (Pty) Ltd are the only two manufacturers of the subject products, being food and technical grade phosphoric acids in the Southern African Customs Union ("SACU"). However, the applicant is the only manufacturer of polyphosphoric acids ("PPA") in the SACU.

- The demand for the subject products is driven mainly by forward linkages with various downstream industries. The various downstream industries use the subject products as intermediate inputs, including, amongst others: the food and beverages industry, metal treatment and water treatment, automotive dyes and pigments, detergent industry, pharmaceutical manufacturing etc. A duty increase on the subject products, which are used as inputs may have a wider adverse impact on these downstream industries.

- Market and trade data analysis revealed that the applicant is facing various challenges, however, the main challenges centre around the export tax imposed by China on its main input, namely, yellow phosphorus, which increased its production cost, as well as the loss of its orthophosphoric acid ("OPA") sales to its major customer. With regard to PPA, information at the Commission's disposal indicated that the applicant has a supply agreement with its major customer.

- Despite experiencing a decline during the period 2014-2016, the applicant's total production volume and capacity utilisation of the subject products increased significantly in 2017. However, the applicant's SACU sales volume declined in 2017, suggesting that the demand for the subject products in SACU remained subdued. The decline in the applicant's sales is informed by the fact that its major customer of OPA completely reduced their sourcing from the applicant in 2017 due to the fact that the applicant's food grade phosphoric acid approval fell away and re-accreditation is required.

- The applicant experienced a price advantage with regard to OPA which is a diluted form of PPA.

- In terms of reciprocal commitments, the applicant committed to increased levels of production and investment. Information at the Commission's disposal indicated that the production process of the applicant is capital-intensive. In terms of employment, information submitted by the applicant indicated that its direct staff compliment will not be increased but retained at current levels.

In light of the foregoing, the Commission recommended that the application for an increase in the general rate of customs duty on phosphoric and polyphosphoric acids classifiable under tariff subheading 2809.20.10 from free of duty to 10 per cent *ad valorem*, be rejected. The reasons are that the applicant is not experiencing import price pressures as it enjoys a price advantage with respect to imported OPA which is a diluted form of PPA and the loss of sales volume to its major OPA customer is due to accreditation issues. Therefore, a duty increase on the subject products which are used as inputs may have a wider adverse impact on the broader food and beverages sector.

THE APPLICATION AND TARIFF POSITION

The International Trade Administration Commission of South Africa ("ITAC" or "the Commission") received an application from XA International Trade Advisors submitted on behalf of Chemical Initiatives (Pty) Ltd, a Subsidiary of AECI Limited ("Chemical Initiatives"), hereon referred to as the applicant, for an increase in the general rate of customs duty on phosphoric and polyphosphoric acids classifiable under tariff subheading 2809.20 from free of duty to 10 per cent *ad valorem*, by way of creating an additional 8 digit tariff subheading.

As reasons for the application, the applicant, among others, submitted that:

a) *"Chemical Initiatives has come increasingly under pressure from imports of the subject products due to increasing raw material costs as a result of the 20% export duty imposed by the Republic of China on yellow phosphorus;*

b) *Chemical Initiatives competes with imports of the subject end products from Chinese manufacturers who are not impacted by the 20% export tax on yellow phosphorus and therefore have lower raw material costs and consequently a significant price advantage over locally produced phosphoric and polyphosphoric acids;*

c) *The duty protection is necessary to make Chemical Initiatives' price more competitive against imports. Without protection of local manufacturers, local production will be lost to imports costing the SACU economy jobs and investments; and*

d) *A 10% duty will assist Chemical Initiatives in cutting back on imports by increasing local production. Chemical Initiatives already has existing capacity and is able to supply the local market."*

The application was published in the Government Gazette No. 41445 on 16 February 2018 for interested parties to comment.

In light of the fact that the South African Revenue Service ("SARS") had already introduced a new 8-digit tariff subheading at the time of publication, the application had to be republished in order to notify interested parties of the alignment to Notice No. 68 of 2018 (List 01/2018) of the Government Gazette No. 41445 with the new 8-digit tariff structure pertaining to tariff subheading 2809.20.10, which forms the basis of this application.

The tariff structure pertaining to tariff subheading 2809.20 was amended by SARS by way of introducing two new 8-digit tariff subheadings, namely: 2809.20.10 and 2809.20.90, with effect from 1 January 2018.

The new 8-digit tariff subheadings separate orthophosphoric acid ("OPA") and polyphosphoric acid ("PPA") from fertilizer grade phosphoric acid used for agricultural purposes, which is now classified under tariff subheading 2809.20.90. The applicant submitted that it does not manufacture fertiliser grade phosphoric acid; however, this product is manufactured domestically by Foskor (Pty) Ltd. The applicant's request for a duty increase is therefore on the food and technical grades phosphoric acids.

The current tariff structure for OPA and PPA is given in Table 1 below:

Table 1: Tariff position for the subject products

CHAPTER 28 INORGANIC CHEMICALS; ORGANIC OR INORGANIC COMPOUNDS OF PRECIOUS METALS, OF RARE-EARTH METALS, OF RADIOACTIVE ELEMENTS OR OF ISOTOPES								
Tariff headi	Tariff sub-heading	Description	Statistical Unit	Rate of Duty				
				General	EU	EFT	SADC	MERCOSUR
28.09		Diphosphorus Pentaoxide; Phosphoric Acid; Polyphosphoric Acids, Whether Or Not Chemically Defined:						
	2809.20.10	- Of a phosphorous content of 78 per cent or more	Kg	Free	Free	Free	Free	Free
	2809.20.90	- Other	Kg	Free	Free	Free	Free	Free

Source: SARS

The applicable WTO Bound rate for the subject products is 10 per cent *ad valorem*.

DISCUSSION

The applicant is a manufacturer and supplier of specialty chemicals, raw materials and related services. Its products are used as intermediate inputs in the manufacturing and mining sectors.

The applicant has three manufacturing plants, with the only plant that manufactures the subject products, being OPA and PPA, situated in Chamdor near Krugersdorp.

The subject products are intermediate products that are manufactured from yellow phosphorous, which is not manufactured in the SACU but imported mainly from China and Vietnam. Phosphoric acid is an inorganic mineral acid also known as OPA with the most common commercial concentrations being 75% to

85%. On the other hand, PPA is a highly concentrated form of OPA with 114% to 117% concentration levels.

According to information at the Commission's disposal, the applicant and Soyo Chemicals (Pty) Ltd are the only two manufacturers of food and technical grade OPA in SACU. However, the applicant is the only manufacturer of PPA in the SACU. Foskor (Pty) Ltd is the only local manufacturer of fertilizer grade Phosphoric acid.

The applicant's production capacity utilisation is dependent mostly on local demand. Production capacity utilisation has been on a downward trend, declining substantially in 2016. However, capacity utilisation improved in 2017. The applicant submitted that it has sufficient capacity to fully supply the local market, should maximum capacity be utilised.

While the applicant's total production volume of the subject products experienced a downward trend over the period 2014-2016, total production volumes recovered significantly in 2017.

Despite total production volumes increasing in 2017, the applicant's SACU sales volume continued on a downward trend, suggesting that the demand for the subject products in SACU remains subdued. The decline in the applicant's sales volume can partly be explained by the loss of sales from its major customer of OPA. The applicant's total sales comprises of its production volume and own imports of the subject products.

For the period 2014-2017, SARS import statistics pertaining to the subject products included other products (such as fertilizer grade phosphoric acids), which did not form part of this investigation, and as such; import statistics could not be analysed. However, during the same period, the applicant's import volumes of the subject products declined significantly. Similarly, import volumes by the rest of the SACU countries (i.e. Botswana, Lesotho, Namibia and Eswatini) declined during 2014-2017.

The applicant's total investment increased considerably over the period 2014-2017, driven mainly by capital expenditure on upgrading machinery and equipment in the form of acid floor repairs and a further investment in upgrading machinery in 2018.

The applicant's net profit was positive for the period 2014-2016 with regard to PPA. In contrast, the applicant's cost structure shows that it has not been able to manufacture OPA at a profitable level.

Reciprocal commitments made by the applicant for the proposed tariff relief were provided, particularly with respect to increased levels of investment, total production volume and the expansion of its product lines. However, in terms of reciprocal commitments made with regard to employment, information at the Commission's disposal indicated that the applicant's direct staff compliment will not be increased but retained at current levels.

Comments in support of the application were received from; *inter alia*, Adelaide Ruiters Mining and Exploration (Pty) Ltd; Foskor (Pty) Ltd, Soyo Chemicals (Pty) Ltd; Omnia, a subsidiary of Omnia Holdings Limited; and the Government of Botswana. The support for the application was mainly centred around the fact that the 10 per cent duty increase on the subject products will open up the South African market for local production of food grade phosphoric acid and further assist local manufacturers of phosphoric acid to compete with the imported subject products, therefore eliminating the need to import phosphoric acid.

Comments objecting to the application were received from Conco Limited t/a Coca-Cola Swaziland ("Conco Ltd"); Grain SA, Animal Feed Manufacturers Association ("AFMA") and Clariant Sasol. The objections to the application were centred mainly around the cost raising effect of the duty on the downstream industries that use the subject products as inputs. In particular, a 10 per cent increase in duty will have a significant impact on the local food and beverages industry, as well as various downstream manufacturing and mining industries, as this will in effect raise their production costs.

In a counter response to certain objections raised by interested parties, the applicant submitted that it has the capability to meet product specifications needed by Clariant Sasol and these quality measures are already written into the contract with Clariant Sasol. The applicant submitted that the quality of the OPA and PPA manufactured by the applicant is on par with that of imports.

The applicant further submitted that it is the only remaining active or operational SACU manufacturer of food and technical grade OPA and PPA and its products are vital for downstream manufacturers in different SACU industries. The applicant is of the opinion that it is critical that the current threat posed to it by low priced imports of the subject products be dealt with, and that an increased import duty is necessary in order to retain local production and assist the company to be internationally competitive. The applicant submitted that there would be a greater loss to the SACU economy should the only active manufacturer of the subject products in the SACU market cease to exist because of the injury caused by imports.

FINDINGS

The Commission found that:

- The applicant and Soyo Chemicals (Pty) Ltd are the only two manufacturers of the subject products, being food and technical grade phosphoric acids in the Southern African Customs Union ("SACU"). However, the applicant is the only manufacturer of polyphosphoric acids ("PPA") in the SACU.

- The demand for the subject products is driven mainly by forward linkages with various downstream industries. The various downstream industries use the subject products as intermediate inputs, including, amongst others: the food and beverages industry, metal treatment and water treatment, automotive dyes and pigments, detergent industry, pharmaceutical manufacturing etc. A duty increase on the subject products, which are used as inputs may have a wider adverse impact on these downstream industries.

- Market and trade data analysis revealed that the applicant is facing various challenges, however, the main challenges centre around the export tax imposed by China on its main input, namely, yellow phosphorus, which increased its production cost, as well as the loss of its orthophosphoric acid ("OPA") sales to its major customer. With regard to PPA, information at the Commission's disposal indicated that the applicant has a supply agreement with its major customer.

- Despite experiencing a decline during the period 2014-2016, the applicant's total production volume and capacity utilisation of the subject products increased significantly in 2017. However, the applicant's SACU sales volume declined in 2017, suggesting that the demand for the subject products in SACU remained subdued. The decline in the applicant's sales is informed by the fact that its major customer of OPA completely reduced their sourcing from the applicant in 2017 due to the fact that the applicant's food grade phosphoric acid approval fell away and re-accreditation is required.

- The applicant experienced a price advantage with regard to OPA which is a diluted form of PPA, which indicates that the applicant is not experiencing import price pressures.

- In terms of reciprocal commitments, the applicant committed to increased levels of production and investment. Information at the Commission's disposal indicated that the production process of the applicant is capital-intensive. In terms of employment, information submitted by the application indicated that its direct staff compliment will not be increased but retained at current levels.

RECOMMENDATION

In light of the foregoing, the Commission recommended that the application for an increase in the general rate of customs duty on phosphoric and polyphosphoric acids classifiable under tariff subheading 2809.20.10 from free of duty to 10 per cent *ad valorem*, be rejected. The reasons are that the applicant is not experiencing import price pressures as it enjoys a price advantage with respect imported OPA which is a diluted form of PPA and the loss of sales volume to its major OPA customer is due to accreditation issues. Therefore, a duty increase on the subject products which are used as inputs may have a wider adverse impact on the broader food and beverages sector.