REPORT NO. 689

CREATION OF A TEMPORARY REBATE FACILITY FOR TALL OIL FATTY ACIDS ("TOFA"), CLASSIFIABLE UNDER TARIFF SUBHEADING 3823.13

The International Trade Administration Commission of South Africa herewith presents **Report No. 689: Creation of a temporary rebate facility for Tall Oil Fatty Acids ("TOFA"), classifiable under tariff subheading 3823.13.**

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Dumisani Mbambo

Deputy Chief Commissioner

PRETORIA

...04.../...07.../ **2022**

REPUBLIC OF SOUTH AFRICA

INTERNATIONAL TRADE ADMINISTRATION COMMISSION OF SOUTH AFRICA

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CREATION OF A TEMPORARY REBATE FACILITY FOR TALL OIL FATTY ACIDS ("TOFA"), CLASSIFIABLE UNDER TARIFF SUBHEADING 3823.13

Synopsis

The Commission considered an application by Trade Solutions (Pty) Ltd submitted on behalf of Ferro Coating Resins (Pty) Ltd (hereinafter referred to as "FCR" or the "Applicant"), for the creation of a temporary rebate facility on TOFA, classifiable under tariff subheading 3823.13.

During its deliberations and in arriving at its recommendation, the Commission considered the information at its disposal, including comments received during the investigation period.

Based on information at the Commission's disposal, it found that:

- There are currently no local manufacturers of TOFA in the Southern African Customs Union ("SACU"). Industrial Oleochemical Products ("IOP" or "Speciality Chemicals"), the last local manufacturer, closed its tall oil fractionation plant situated in Durban in 2020.
- The Applicant's production volumes have decreased over the period 2017 to 2020.
- The Applicant's domestic sales of alkyd resins decreased over the four-year period.
- Imports of alkyd resins, mainly originating from Germany, Netherlands and the United Arab Emirates ("UAE") decreased during the period of the investigation while exports increased over the same period.
- The Applicant's total production cost increased, on average, between 2018 and 2020. The production costs are mainly driven by the cost of raw materials.

- TOFA was sourced locally by the Applicant until the closure of IOP's tall oil fractionating plant in 2020.
- FCR's domestic input costs decreased from 2018 to 2020 while imported input cost increased over the same period.
- The Applicant made reciprocal commitments for the proposed tariff amendment, in particular with respect to investment and employment creation.
- The Commission received four (4) pre-publication comments in support of the application.
- Further comment was received from Industrial Oleochemical Products, when the investigation was at an advanced stage.

In light of the foregoing, the Commission decided to recommend that a full duty temporary rebate facility be created for the importation of Tall Oil Fatty Acids, classifiable under tariff subheading 3823.13 at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market.

1. APPLICATION AND TARIFF POSITION

1.1. Trade Solutions (Pty) Ltd, on behalf of the Applicant, submitted an application for the creation of a temporary rebate facility for TOFA, classifiable under tariff subheading 3823.13.

1.2. FCR, Ferro Dispersions and Arkem (Pty) Ltd are all entities of Ferro South Africa (Pty) Ltd, which in turn is part of the Bud Group. These companies cover the manufacture of a broad range of polymer solutions for several markets and have more than 60 years' experience operating in South Africa, Sub-Saharan Africa and the Indian Ocean Islands.

1.3. FCR is a manufacturer of resins and additives for the architectural, industrial, construction and adhesives markets. Their product range include alkyds and modified alkyds, acrylics, styrene acrylic emulsions, pure acrylic emulsions, saturated polyesters, polyamides, rheology modifiers and surface modifiers. The products are marketed under the Synolac™, Synocryl™, Crayamid™, Crayvallac™, Gelkyd™ and Super Gelkyd™ trademarks.

1.4. As motivation for the application, the Applicant submitted, *inter alia*, that:

- In 2020 Industrial Oleochemical Products closed its Tall Oil Fractionation plant. Therefore, there is no local manufacturer of TOFA. The only option is to import this vital raw material.
- Ferro Coating Resin ("FCR") cannot substitute TOFA with any other product to manufacture alkyd resins. The company intends to source all required TOFA from non-European Union countries as these provide more competitive pricing. There is currently a 10% general Customs duty on TOFA imported from countries other than those in the European Union ("EU"), the Southern African Development Community ("SADC"), and the European Free Trade Association ("EFTA").
- The existing duty no longer serves to protect any local manufacturers but rather unnecessarily increase the landed cost of this key raw material. The high cost of importing TOFA consequently increases the cost of manufacturing alkyd resins.
- Alkyd resins are a key raw material for the SACU paint and coatings industry.
- FCR remains committed to local manufacturing and investing locally. It further submitted that it remains committed to procuring its raw materials from local manufacturers, where possible. It is for this reason that it opted for a temporary rebate rather than a duty removal.

1.5. The application was published as Notice No. 725 of 2021 in Government Gazette No. 45649 on 17 December 2021, for interested parties to comment.

1.6. The current tariff structure of the subject product is as shown in Table 1 below and shows that TOFA is currently classifiable under tariff subheading 3823.13. The subject product currently attracts a 10 per cent *ad valorem* duty from countries under the General and MERCOSUR regions, 8 per cent *ad valorem* duty from countries under the African Continental Free Trade Area ("AfCFTA") region and free of duty under the

European Union/United Kingdom ("EU/UK"), the European Free Trade Association ("EFTA") and the Southern African Development Community ("SADC") regions.

Table 1: Tariff structure of subject product – raw material

Tariff heading	Tariff subheading	Description	Statistical unit	Rate of Duty					
				General	EU/ UK	EFTA	SADC	MERCOSUR	AfCFTA
38.23		Industrial monocarboxylic fatty acids; acid oils from refining; industrial fatty alcohols:							
	3823.1	**Industrial monocarboxylic fatty acids; acid oils from refining:**							
	3823.13	Tall oil fatty acids	kg	10%	free	free	free	10%	8%

Source: SARS

1.7. Table 2 below shows the tariff structure of the final product, alkyd resins which are manufactured by the Applicant. The final product is classifiable under tariff subheading 3907.50. The final product currently attracts a 15 per cent *ad valorem* duty under General, 13.5 per cent *ad valorem* duty under the MERCOSUR region, 12 per cent *ad valorem* duty under the AfCFTA region and free of duty under the EU/UK, the EFTA and the SADC regions.

Table 2: Tariff structure of final manufactured products (Alkyd resins)

Tariff heading	Tariff subheading	Description	Statistical unit	Rate of Duty					
				General	EU/ UK	EFTA	SADC	MERCOSUR	AfCFTA
39.07		Polyacetals, other polyethers and epoxide resins, in primary forms; polycarbonates, alkyd resins, polyallyl esters and other polyesters, in primary forms:							
3907.2		**Other polyethers:**							
	3907.50	Alkyd resins	kg	15%	free	free	free	13.5%	12%

Source: SARS

1.8. The Applicant requested that a 4th Schedule temporary rebate be created, which provides for rebate of the full customs duty on TOFA, with the rebate description, which was provided by the South African Revenue Service ("SARS"), as shown in Table 3 below:

Table 3: Rebate description

Rebate Item	Tariff subheading	Description	Extent of Rebate
XXX.XX	3823.13	Tall Oil Fatty Acids classifiable in tariff subheading 3823.13, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market.	Full duty

Source: SARS

2. DISCUSSION

2.1. The global chemical industry forms an integral component of industrialised economies. It is a unique industry within manufacturing and the broader economy, with a value chain that starts from upstream primary industries to downstream consumer products. Along the value chain, outputs feed into many sectors and may comprise building blocks, intermediaries, inputs into end products, and end products themselves.

2.2. Globally, the chemical sector comprises of two distinct value chains. Upstream of the value chain, processes revolve around the formation of more complex chemical compounds or molecules, and large firms and large capital investments are prevalent. Activities downstream of the value chain show a greater level of chemical product conversion and formulation processes, and these generally lend themselves to small and medium-sized firms and smaller capital needs.

2.3. The following sub-sectors are usually associated with upstream activities: liquid fuels and associated products, commodity organic chemicals, primary polymers and rubbers, commodity inorganic chemicals, and fine chemicals. Downstream sub-sectors include: pure functional and formulated speciality chemicals, bulk-formulated chemicals, pharmaceuticals, consumer-formulated chemicals (cosmetics), as well as plastic and rubber products.

2.4. According to the Tall Oil Fatty Acid Global Market Report (2021), the global TOFA market is expected to grow from US$802.58 million in 2020 to US$821.50 million in 2021 at a compound annual growth rate ("CAGR") of 2.36%. The growth is mainly due to the rising demand of TOFA from the soaps and detergent sectors as well as the cosmetics industry. The market is expected to reach US$1,066.52 million by 2025 at a CAGR of 6.74%.

2.5. Major players in the global TOFA market include entities such as Kraton Corporation, Forchem, Harima Chemicals, Georgia Pacific, Eastman, Lascaray, Chemical Associates, and Univar Solutions.

2.6. The South African chemicals sector is notable for its multiple and interlinked value chains, making it complex and highly diversified. South Africa accounts for approximately 0.5 per cent of the global chemical production capacity, and petrochemicals comprise about 55 per cent of all chemicals produced locally. There are significant linkages between the chemicals sector and the manufacturing sector as a whole – approximately 63 per cent by value of all chemical industry outputs were used outside of the industry in 2013[1].

2.7. Across a range of indicators, the chemical industry has outperformed broader manufacturing in the last decade. In 2016, the chemicals sector constituted 3.1 per cent of South Africa's Gross Domestic Product ("GDP"). Although manufacturing as a whole has declined as a proportion of South Africa's GDP over the past two decades, within manufacturing the share held by chemicals has increased, and the chemicals sector has largely recovered from the 2009 crisis. However, in real terms, South African chemicals production was sluggish over the decade from 2005 to 2015[2].

2.8. The global market share of South African chemical producers has likewise not significantly improved over the same period. Given that the limited size of the South African and regional markets make significant economies of scale hard to achieve, there is good reason to focus on regional integration that can support increasing global exports.

2.9. According to information at the Commission's disposal, South Africa has, over the years, developed the largest chemical industry in Africa, with companies and manufacturing capacity across the entire value chain, and some authentic global players. This is a critical industrial asset that must be supported and maintained if the country is to avoid further de-industrialization and build economic growth momentum.

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[1] The Department of Trade, Industry and Competition (**the dtic**), 2018. *Industrial Policy Action Plan, 2018/19-2020/21*. p.152.
[2] The Department of Trade, Industry and Competition (**the dtic**), 2018. *Industrial Policy Action Plan, 2018/19-2020/21*. p.152.

2.10. Information submitted by the Applicant indicated that there are no local manufacturers in the SACU of the TOFA concerned. The last local manufacturer, Industrial Oleochemical Products ("IOP' or "Speciality Chemicals"), a division of AECI, closed its tall oil fractionation plant in 2020.

2.11. TOFA is mainly used as a raw material in the chemicals industry. Furthermore, alkyd resins are chemical compounds manufactured from TOFA; hence these products reside under the chemicals industry.

2.12. In 2017, **the dtic** developed a National Chemicals Strategy[3] in response to the challenges and complexities faced by the chemicals industry. The strategy aims to serve as a platform to translate key strategic challenges facing the sector into goals and key action programmes that will achieve sustainable growth and increase employment and investment across the sector. The 2018/19 – 2020/21 Industrial Policy Action Plan ("*IPAP*") expresses the implementation of this strategy.

2.13. IPAP recognizes that to develop an advanced manufacturing sector, the economy will need adequate supplies of a full range of chemicals. The Government has committed to establish a platform to advance chemical sector growth through practical, industry-specific initiatives aimed at high-impact industrialization and the creation of opportunities for possible import substitution.

2.14. Domestic chemical firms face challenges on multiple levels, which contribute significantly to the substantial negative trade balance of the sector.

2.15. Over the period of investigation, Applicant's production volumes have decreased. Initially, production volumes decreased in 2018, followed by a further decrease in 2019, and thereafter recovering slightly in 2020.

2.16. The Applicant's domestic sales of alkyd resins decreased significantly over the period under investigation.

2.17. On average, imports of alkyd resins decreased by 13 per cent during the period of investigation. Although imports increased by 26.9 per cent in 2018, this was followed

[3] National Chemicals Strategy: Department of Trade and Industry, 2017

by a decrease of 8.4 per cent and 57.5 per cent in 2019 and 2020, respectively.

2.18. During the period of the investigation, the majority of imported alkyd resins originated from the United Arab Emirates ("UAE"). In terms of economic regions, most of the SACU alkyd resins requirements are being imported from the European Union ("EU"). Imports originating from Germany, Netherlands and the UAE accounted for approximately 69.1 per cent of total alkyd resins imports in 2020.

2.19. Information at the Commission's disposal indicated that the Applicant's production costs increased in 2019 followed by another increase in 2020.

2.20. Information submitted by the Applicant indicated that its costs are mainly driven by the cost of raw material such as TOFA. TOFA was sourced locally by the Applicant until the closure of IOP's tall oil fractionating plant in 2020.

2.21. According to information at the Commission's disposal, FCR's domestic input costs decreased from 2018 to 2020 while imported input cost increased over the same period.

2.22. The Applicant made reciprocal commitments for the proposed tariff amendment, in particular with respect to investment and employment creation.

2.23. During the preliminary stage, the Commission received four (4) pre-publication comments in support of the application.

2.24. Further comment was received from Industrial Oleochemical Products, at an advanced stage of the investigation.

3 FINDINGS

3.1 During its deliberations and in arriving at its recommendation, the Commission considered the information at its disposal, including comments received during the investigation period.

3.2 Based on information at the Commission's disposal, it found that:

- There are currently no local manufacturers of TOFA in SACU. Industrial Oleochemical Products, the last local manufacturer, closed its tall oil fractionation plant situated in Durban in 2020.

- The Applicant's production volumes have decreased over the period 2017 to 2020.

- The Applicant's domestic sales of alkyd resins decreased over the four-year period.

- Imports of alkyd resins, mainly originating from Germany, Netherlands and the UAE decreased during the period of the investigation while exports increased over the same period.

- The Applicant's total production cost increased, on average, between 2018 and 2020. The production costs are mainly driven by the cost of raw materials.

- TOFA was sourced locally by the Applicant until the closure of IOP's tall oil fractionating plant in 2020.

- FCR's domestic input costs decreased from 2018 to 2020 while imported input cost increased over the same period.

- The Applicant made reciprocal commitments for the proposed tariff amendment, in particular with respect to investment and employment creation.

- The Commission received four (4) pre-publication comments in support of the application and a comment from Industrial Oleochemical Products, during the advanced stage of the investigation.

4 RECOMMENDATION

4.1 In light of the foregoing, the Commission decided to recommend that a full duty temporary rebate facility be created for the importation of Tall Oil Fatty Acids, classifiable under tariff subheading 3823.13 at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market.