ITAC International Trade Administration Commission of South Africa

REPORT NO. 35

AMENDMENT OF THE RATES OF DUTY ON AUTOMOTIVE COMPONENTS AND LIGHT MOTOR VEHICLES AND THE QUALIFYING VALUE OF AUTOMOTIVE EXPORTS UNDER THE MOTOR INDUSTRY DEVELOPMENT PROGRAMME (MIDP) FOR LIGHT MOTOR VEHICLES

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The International Trade Administration Commission of South Africa herewith presents the Report No. 35: *Amendment of the rates of duty on automotive components and light motor vehicles and the qualifying value of automotive and the qualifying value of automotive exports under the Motor Industry Development Programme (MIDP) for light motor vehicles,* with recommendation.

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CHIEF COMMISSIONER

PRETORIA

..12...November 2003

REPUBLIC OF SOUTH AFRICA

INTERNATIONAL TRADE ADMININSTRATION COMMISSION OF SOUTH AFRICA

REPORT NO. 35

AMENDMENT OF THE RATES OF DUTY ON AUTOMOTIVE COMPONENTS AND LIGHT MOTOR VEHICLES AND THE QUALIFYING VALUE OF AUTOMOTIVE EXPORTS UNDER THE MOTOR INDUSTRY DEVELOPMENT PROGRAMME (MIDP) FOR LIGHT MOTOR VEHICLES

Synopsis

The Department of Trade and Industry (DTI) applied for an amendment of one element of the Motor Industry Development Programme (MIDP). Essentially, the application entails a slower phase down of the percentage of the eligible export value that is used as basis for the calculation of the value of Import Rebate Credit Certificates (IRCCs) over a longer period of time.

The DTI also requested the Commission to complete a review of the MIDP in January 2005, during which the recommendations of the Black Barnes report regarding the phase down of the rate of customs duties on light motor vehicles and original equipment components should be considered.

The application and request by the DTI arose from the Black Barnes report that is the result of an investigation commissioned by the DTI in 2001 with the objective of reviewing the MIDP and to make recommendations regarding the extension of the MIDP from 2007 to 2012.

The reason for DTI's application is that the phase down will promote the development of the Southern African Customs Union (SACU) motor industry as it will limit the peak in duties to be paid by the industry, should the existing phase down be maintained. It will also assist the SACU motor industry in meeting the severe competition that the industry will be exposed to in the next few years.

Black and Barnes researched the performance of the SACU motor industry and found that the industry had grown substantially in respect of turnover, manufacturing and exporting of light motor vehicles and automotive components. The research indicated an improvement in the competitiveness of the motor industry, and that the number of vehicle models manufactured in the SACU had been rationalized. Vehicle price increases had lagged the Consumer Price Index for a large period since the inception of the MIDP. It was found that employment levels had remained stable, but that the local content levels in light motor vehicles had decreased, which is ascribed mainly to the deterioration in the exchange rate. The increase in imports of light motor vehicles was in line with expectations, given the decrease in the rate of duty on light motor vehicles and the liberalization of the motor industry. A further measurement of the performance of the motor industry entailed comparing the motor industry's performance against that of the manufacturing sector in general. The motor industry outperformed the manufacturing sector with regard to sales, production and value added. The motor industry's performance regarding capital invested and gross salaries improved markedly during 2000 and 2001. Labour productivity in the motor industry exceeded that of the manufacturing sector by far, but the same is not evident with regard to capital productivity.

The Black Barnes report addressed major challenges that the SACU motor industry is expected to face in the next few years. These relate mainly to the low level of local content in SACU manufactured light motor vehicles, transport and logistics costs and the cost of working capital. The limited domestic market countered the sourcing of large-scale exports of a particular model or automotive component from the SACU. The availability of capacity in the European Union and the expansion of lower cost production capacity in Eastern Europe are expected to slow the expansion of the SACU motor industry. Black and Barnes stated that the global environment has turned against developing economy exporters, which is compounded by the view that developed markets are unlikely to grow over the next few years.

The Black Barnes report recommended that the rates of duty on light motor vehicles and original equipment components be phased down, that the percentage of the eligible export value that is used as a basis for the calculation of the value of IRCCs be phased down and that all the elements of the MIDP again be reviewed by January 2005, against a number of parameters to ascertain whether the MIDP has met its objectives and to consider the policy relating to the MIDP beyond 2012.

The MIDP is an integrated programme consisting of different elements. In the light of this, the Commission concluded that an amendment of only one element of the MIDP is not appropriate and that an further phasing down of the rates of customs duties for 2008 and 2009 on light motor vehicles and original equipment components is also justified as it will facilitate an improvement of the international competitiveness of the SACU motor industry.

Regarding the recommendation that the MIDP should be reviewed by January 2005, the Commission concluded that a review in 2007 would be more fruitful. In this regard the Commission took into account that the recommendations in this report are intended to create certainty until 2009; that review in 2007 will give sufficient time to determine the position after 2009; that limited time has elapsed between the implementation of the annual amendments to the existing MIDP resulting from the midterm review of the MIDP and the review by Black and Barnes; that the time between the Black Barnes report, the recommendations of this report and the review requested by the DTI is also very limited; and that a review in 2007 will benefit from the fact that the impact of the amendments recommended in this report in respect of 2004 and 2005 will be more visible in 2007 than 2005. The same is true regarding the performance of the industry and the challenges that the industry will face in the period after 2009.

The Commission therefore recommended that the percentage of the eligible export value that is used as a basis for the calculation of the value of Import Rebate Credit Certificates (IRCCs) be phased down by 4 percentage points per annum from 2004 to 70 per cent in 2009 and that the rates of duty on light motor vehicles and original equipment components be phased down on 1 January 2008 to 29 and 24 per cent *ad valorem* respectively and on 1 January 2009 to 28 and 23 per cent *ad valorem* respectively.

Introduction

1 The Department of Trade and Industry (DTI) applied for an amendment of one element of the Motor Industry Development Programme (MIDP) for light motor vehicles[1]. Essentially, the application entails a slower phase down of the percentage of the eligible export value that is used as a basis for the calculation of the value of Import Rebate Credit Certificates (IRCCs) (i.e. the qualifying value of automotive exports) over a longer period of time.

2. The DTI also requested the Commission to review the MIDP by January 2005 with a view of extending the MIDP from 2007 to 2012.

3. The application and request by the DTI arose from the Black Barnes report[2] that is the result of an investigation commissioned by the DTI in 2001 with the objective of reviewing the MIDP and to make recommendations regarding the extension of the MIDP for light motor vehicles from 2007 to 2012.[3]

4. Different arguments are stated in the Black Barnes report in support of the phase down as applied for by the DTI. In summary, the reason is that the phase down will promote the development of the Southern African Customs Union (SACU) motor industry as it will:

Limit the peak in duties to be paid by the industry, should the existing phase down be maintained; and

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[1] Light motor vehicles include cars, minibuses and light goods vehicles, classifiable under tariff subheadings 8701.20.10, 8702.10.80, 8702.90.10, 8703.21.90, 8703.22.90, 8703.23.90, 8703.24.90, 8703.31.90, 8703.32.90, 8703.33.90, 8703.90.90, 8704.21.80, 8704.31.80 and 8706.00.10 of Schedule No. 1 to the Customs and Excise Act, 1964.

[2] The investigation was undertaken by Prof. Justin Barnes, School of Development Studies, University of Natal and Prof. Anthony Black, School of Economics, University of Cape Town and the full name of the report is: *Motor Industry Development Programme, REVIEW REPORT,* May 2003. The report will be made available by the DTI on request.

[3] The existing MIDP covers the period 1995 to 2007 and is the result of the acceptance of the recommendations contained in Board on Tariffs and Trade Report 3625: *Revised customs dispensation for the motor industry,* August 1995 and Board on Tariffs and Trade Report 4045: *Midterm review and extension of the Motor Industry Development Programme for light motor vehicles,* May 2000.

Assist the SACU motor industry in meeting the severe competition that the industry will be exposed to in the next few years.

5. The phase down of the percentage of the eligible export value (qualifying value) that is the basis on which the values of IRCCs are calculated, as applied for by the DTI, and the existing phase down are set out in Table 1 below:

Table 1: Existing and applied for phase down of the percentage of the eligible export value

Year	Existing phase down of eligible export value	Phase down as applied for by DTI
1 January 2004	88	90
1 January 2005	82	86
1 January 2006	76	82
1 January 2007	70	78
1 January 2008	70	74
1 January 2009	70	70

6. The DTI also requested the Commission to complete a review of the MIDP by January 2005, during which the recommendations of the Black Barnes report regarding the phase down of the rate of customs duties on light motor vehicles and original equipment components[4] should be considered. The existing rates of customs duty and the rates recommended in the Black Barnes report are set out in Tables 2 and 3 below.

Table 2: The existing phase down in the rate of customs duties on light motor vehicles from 2003 to 2007 and the rates recommended in the Black Barnes report from 2008 to 2012

Year	Rate of duty on light motor vehicles percentage *ad valorem*
1 January 2003	38
1 January 2004	36
1 January 2005	34
1 January 2006	32

[4] Original equipment components are components that are fitted to motor vehicles during the assembly process. Original equipment components are classifiable under Chapter 98 of Schedule 1 to the Customs and Excise Act.

1 January 2008	29
1 January 2009	28
1 January 2010	27
1 January 2011	26
1 January 2012	25

Table 3: The existing phase down in the rate of customs duties on original equipment components from 2003 to 2007 and the rates recommended in the Black Barnes report from 2008 to 2012

Year	Rate of duty on light motor vehicles percentage *ad valorem*
1 January 2003	38
1 January 2004	36
1 January 2005	34
1 January 2006	32
1 January 2007	30
1 January 2008	29
1 January 2009	28
1 January 2010	27
1 January 2011	26
1 January 2012	25

The Black Barnes report

7. The DTI commissioned Black and Barnes in 2001 review and make recommendations for an extension of the MIDP to 2012. The review entailed that the motor industry's performance and potential future development be analysed and that the future policy relating to the MIDP beyond 2007 be formulated.

8. The research process followed by Black Barnes consisted of secondary research of data, research reports and presentations relating to the development, performance and future of the SACU motor industry specifically as well as the global automotive industry that were obtained from a variety of sources, internet based research of the automotive policies of a select number of countries and consultation with various stakeholders.

9. The Black Barnes report consists of eight sections, including the introduction. The seven remaining sections deal with the research process followed, macro economic performance indicators, automotive policies in selected economies, automotive component fieldwork findings, light motor vehicle manufacturers (OEM) fieldwork findings, policy recommendations and a summary of the final MIDP policy parameters.

10. With regard to the performance of the SACU motor industry, Black and Barnes found that the industry had grown substantially in respect of turnover, manufacturing and exporting of light motor vehicles and automotive components. The research indicated an improvement in the competitiveness of the motor industry, and that the number of vehicle models produced in the SACU had been rationalized. Vehicle price increases had lagged the Consumer Price Index for a large period since the inception of the MIDP. It was found that employment levels had remained stable, but that the local content levels in light motor vehicles had decreased, which is ascribed mainly to the deterioration in the exchange rate. The increase in imports of light motor vehicles was in line with expectations, given the decrease in the rate of duty on light motor vehicles and the liberalization of the motor industry. A further measurement of the performance of the motor industry entailed comparing the motor industry's performance against that of the manufacturing sector in general. The motor industry outperformed the manufacturing sector with regard to sales, production and value added. The motor industry's performance regarding capital invested and gross salaries improved markedly during 2000 and 2001. Labour productivity in the motor industry exceeded that of the manufacturing sector by far, but the same is not evident with regard to capital productivity.

11 The Black Barnes report addressed major challenges that the SACU motor industry is expected to face in the next few years. Although the motor industry was improving its competitiveness from an ex-works point of view, the low level of local content, the transport and logistics costs as well as the cost of working capital, impacted negatively on the landed price of their products in their export destinations. In addition, international firms were perceived to be reluctant to source large-scale exports of a particular model or automotive component from the SACU, given the limited domestic market. International sister plants were found to be strategically better placed for large scale contracts as they can offer parent companies substantial volumes in their domestic and the international markets The availability of capacity in the European Union and the expansion of lower cost production capacity in Eastern Europe is expected to slow the expansion of the SACU motor industry. Competition from the sister companies for contracts is expected to intensify. Black and Barnes state that the global environment has turned against developing economy exporters, which is compounded by the view that developed markets are unlikely to grow over the next few years.

12 The inherent challenge that the motor industry faces in terms of the structure of the MIDP, relates to the reduction in the rates of duty and the phasing down of the percentage of the eligible export value used to calculate the value of IRCCs. In addition, to date integration of components that are manufactured into SACU light motor vehicles has been very low and needs to improve to lower the cost base of motor vehicle assembly. The rapid growth of light motor vehicle exports is not expected to continue. Black and Barnes expect that an undesirable peak in duties paid in terms of the MIDP will occur by 2005, despite the number of import credits that are being generated by way of the Productive Asset Allowance and the number of unused IRCCs that are in the system.

13 The Black Barnes report contains the following recommendations:

That the rates of duty on light motor vehicles and original equipment components be phased down as set out in Tables 2 and 3 above.

That the percentage of the eligible export value that is used as basis for the calculation of the value of IRCCs be phased down as set out in Table 1 above.

(c) That the MIDP, including all its elements again be reviewed between 2005 and 2007 against a number of parameters to ascertain whether the MIDP has met its objectives and to consider the policy relating to the MIDP beyond 2012.

Consideration

14 The Commission considered the application in the light of the Black Barnes report. The Commission concluded that the phase down of the percentage of the eligible export value that is used for calculating the value of IRCCs, as applied for by the DTI, is justified. This conclusion was reached as the phase down as applied for from 2004 to 2009 will promote the development of the SACU motor industry as it will:

limit the peak of the customs duties to be paid by the SACU motor industry should the existing phase down be maintained; and

assist the motor industry in meeting the severe competition that the industry is expected to experience in the next few years.

15 The MIDP is an integrated programme consisting of different elements. In the light of this, the Commission concluded that an amendment of only the abovementioned element of the MIDP is not appropriate and that an amendment of the rates of customs duties for 2008 and 2009 on light motor vehicles and

original equipment components is also justified as it will facilitate an improvement of the international competitiveness of the SACU motor industry.

16. The Commission noted that the Black Barnes report recommended a phasing down of the rates of duty on light motor vehicles and original equipment components for the period after 2007. As the DTI application relates to the years 2008 and 2009, the Commission concluded that it is also necessary to determine the rates of duty on light motor vehicles and original equipment components for the same period. The Commission concluded that the phase down as recommended in the Black Barnes report for the years 2008 and 2009 is justified.

17. Regarding the recommendation that the MIDP should be reviewed by January 2005, the Commission concluded that a review in 2007 would be more fruitful. In this regard the Commission took the following into account:

    the recommendations in this report are intended to create certainty until 2009;

    a review in 2007 will give sufficient time to determine the position after 2009;

    the limited time that has elapsed between the implementation of the annual amendments to the existing MIDP as from 2000 resulting from the midterm review of the MIDP and the review by Black and Barnes;

    the limited time between the Black Barnes report, the recommendations of this report and the review requested by the DTI by January 2005;

    a review in 2007 will benefit from the fact that the impact of the amendments recommended in this report in respect of 2004 and 2005 will be more visible in 2007 than 2005 and the same is true regarding the performance of the industry and the challenges that the industry will face in the period after 2009.

Recommendation

18. The Commission therefore recommends that:

(a) The rate of duty of light motor vehicles classifiable under tariff subheadings Nos. 8701.20.10, 8702.10.80, 8702.90.10, 8703.21.90, 8703.22.90, 8703.23.90, 8703.24.90, 8703.31.90, 8703.32.90, 8703.33.90, 8703.90.90, 8704.21.80, 8704.31.80 and 8706.00.10 of Schedule No. 1 to the Customs and Excise Act, 1964, be reduced to 29 per cent *ad valorem* as from 1 January 2008 and to 28 per cent *ad valorem* on 1 January 2009;

(b) The rates of duty on all original equipment components falling under Chapter 98 be reduced to 24 per cent *ad valorem* as from 1 January 2008 and to 23 per cent *ad valorem* as from 1 January 2009; and

(c) That the percentage as stated in Note 16(v) to rebate item 317.04 be amended to:

Date of implementation	Phase down of the percentage of the eligible export value
1 January 2004	90
1 January 2005	86
1 January 2006	82
1 January 2007	78
1 January 2008	74
1 January 2009	70

[T5/2/17/3/1(16/2003)]